# Management's Discussion and Analysis of Financial Condition and Results of Operations
# For the three months ended March 31, 2017

(Expressed in Canadian Dollars, except where indicated)

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## 1. INTRODUCTION

This Management's Discussion and Analysis ("**MD&A**") of Prophecy Development Corp. and its subsidiaries ("**Prophecy**", or the "**Company**") was prepared by management as at May 15, 2017 and was reviewed, approved, and authorized for issue by the Company's Audit Committee. The following discussion of performance, financial condition and future prospects should be read in conjunction with the unaudited condensed interim consolidated financial statements of the Company and notes thereto for the three months ended March 31, 2017 prepared in accordance with International Financial Reporting Standards ("**IFRS**"), applicable to the preparation of interim financial statements, including International Accounting Standard ("**IAS**") 34 Interim Financial Reporting, as issued by the International Accounting Standards Board. This MD&A should be read also in conjunction with both the audited annual consolidated financial statements for the year ended December 31, 2016 (prepared in accordance with IFRS) ("**Annual Financial Statements**") and the related annual MD&A ("**Annual MD&A**") dated March 29, 2017, and the 2016 Annual Information Form ("**AIF**"), all of which are available under the Company's SEDAR profile at www.sedar.com.

The information provided herein supplements but does not form part of the financial statements. Financial information is expressed in Canadian dollars, unless stated otherwise. Readers are cautioned that this MD&A contains "forward-looking statements" and that actual events may vary from management's expectations. Readers are encouraged to read the cautionary note contained herein regarding such forward-looking statements. Information on risks associated with investing in the Company's securities as well as information about mineral resources and reserves under National Instrument 43-101 are contained in the Company's most recently filed AIF which is available on the Company's website at www.prophecydev.com or on SEDAR at www.sedar.com.

### Description of Business

Prophecy is a company amalgamated under the laws of the Province of British Columbia, Canada. The Company's Common shares (the "**Shares**") are listed for trading on the Toronto Stock Exchange (the "**TSX**") under the symbol "PCY" and the Frankfurt Stock Exchange under the symbol "1P2N".

The principal business of the Company is the acquisition, exploration and development of mineral, mining and energy projects in Bolivia, Mongolia, and Canada. The Company owns a 100% interest in the following significant coal projects in Mongolia: the Ulaan Ovoo coal property, the Khavtgai Uul and Chandgana Tal coal deposits (together, the "**Chandgana Coal Properties**"), and the Pulacayo Paca silver-lead-zinc property (the "**Pulacayo Project**") in Bolivia. The Company is focusing on building a successful and profitable intermediate development company. The Company's strategy is to actively pursue growth opportunities by securing financing, further improving operational efficiencies and reducing costs, delivering value through marketing coal and mineral concentrates and marketing power from the Chandgana power plant. The joint venture interest in the Pulacayo Project is the most significant project acquisition in the Company's history and the Company intends to explore and develop this silver district to its full potential.

### General Corporate Information:

At March 31, 2017 and May 15, 2017, Prophecy had: (i) 5,226,339 and 5,329,589 Shares issued and outstanding, respectively; (ii) 542,127 stock options for Shares outstanding, and (iii) 1,398,059 and 1,501,309 warrants for Shares outstanding, respectively.

**Investor and Contact Information**

All financial reports, news releases and corporate information can be accessed on our website at www.prophecydev.com
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**Directors and Officers**

As at the date of this MD&A, Prophecy's directors and officers were as follows:

| **Directors** | **Officers** |
|---|---|
| John Lee, Executive Chairman | John Lee, Interim Chief Executive Officer |
| Harald Batista | Irina Plavutska, Chief Financial Officer |
| Greg Hall | Tony Wong, Corporate Secretary |
| Masa Igata | Bekzod Kasimov, Vice-President, Operations |
| | |
| ***Audit Committee*** | ***Corporate Governance and Compensation Committee*** |
| Greg Hall (Chair) | Greg Hall (Chair) |
| Harald Batista | Harald Batista |
| Masa Igata | Masa Igata |

**Qualified Persons**

Mr. Christopher Kravits, LPG, CPG, is a qualified person as defined under National Instrument 43-101 *Standards of Disclosure for Mineral Projects* ("**NI 43-101**"). Mr. Kravits serves as the Company's general mining manager and qualified person. He is not considered independent of Prophecy given the large extent that his professional time is dedicated solely to Prophecy. Mr. Kravits has reviewed and approved the technical and scientific disclosure regarding the mineral properties of Prophecy contained in this MD&A.

## 2. CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

*This document contains forward-looking statements within the meaning of applicable Canadian securities legislation concerning anticipated developments in the Company's continuing and future operations in Mongolia, Bolivia and Canada, the adequacy of the Company's financial resources and financial projections. Such forward-looking statements include but are not limited to statements regarding the permitting, feasibility, plans for development and production of Prophecy's Chandgana power plant, including finalizing of any power purchase agreement; the likelihood of securing project financing; estimated future coal production at the Ulaan Ovoo coal property and the Chandgana Coal Properties; development of the Pulacayo Project and other information concerning possible or assumed future results of operations of Prophecy. See in particular, the sections Select Financial and Operational Data and 2017 Outlook descriptions under Part 4 – Property Summary.*

*Forward-looking statements in this document are frequently identified by words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", "potentially" or similar expressions, or statements that events, conditions or results "will", "may", "would", "could", "should" occur or are "to be" achieved, and statements related to matters which are not historical facts. Information concerning management's expectations regarding Prophecy's future growth, results of operations, performance, business prospects and opportunities may also be deemed to be forward-looking statements, as such information constitutes predictions based on certain factors, estimates and assumptions subject to significant business, economic, competitive and other uncertainties and contingencies, and involve known and unknown risks which may cause the actual results, performance, or achievements to be different from future results, performance, or achievements contained in such forward-looking statements made by Prophecy.*

*In making the forward-looking statements in this MD&A, Prophecy has made several assumptions that it believes are appropriate, including, but not limited to assumptions that: all required third party contractual, regulatory and governmental approvals will be obtained for the development, construction and production of Prophecy's properties and the Chandgana power plant; there being no significant disruptions affecting operations, whether due to labour disruptions or other causes; currency exchange rates being approximately consistent with current levels; certain price assumptions for coal, silver and other metals, prices for and availability of fuel, parts and equipment and other key supplies remain consistent with current levels; production forecasts meeting expectations; the accuracy of Prophecy's current mineral resource estimates; labour and materials costs increasing on a basis consistent with Prophecy's current expectations; and any additional required financing will be available on reasonable terms; market developments and trends in global supply and demand for coal, energy, silver and other metals meeting expectations. Prophecy cannot assure you that any of these assumptions will prove to be correct.*

*Numerous factors could cause Prophecy's actual results to differ materially from those expressed or implied in the forward-looking statements including the following risks and uncertainties, which are discussed in greater detail under the heading "Risks and Uncertainties" in this MD&A: Prophecy's history of net losses and lack of foreseeable positive cash flow; exploration, development and production risks, including risks related to the development of Prophecy's Ulaan Ovoo coal property and Pulacayo Project; Prophecy not having a history of profitable mineral production; commencing mine development without a feasibility study; the uncertainty of mineral resource and mineral reserve estimates; the capital and operating costs required to bring Prophecy's projects into production and the resulting economic returns from its projects; foreign operations and political conditions, including the legal and political risks of operating in Mongolia and Bolivia which are developing countries and being subject to their local laws; the availability and timeliness of various government approvals, permits and licences; the feasibility, funding and development of the Chandgana power plant and Pulacayo Project; protecting title to Prophecy's mineral properties; environmental risks; the competitive nature of the mining business; lack of infrastructure; Prophecy's reliance on key personnel; uninsured risks; commodity price fluctuations; reliance on contractors; Prophecy's need for substantial additional funding and the risk of not securing such funding on reasonable terms or at all; foreign exchange risk; anti-corruption legislation; recent global financial conditions; the payment of dividends; the inability of insurance to cover all potential risks associated with mining operations and conflicts of interest.*

*In light of the risks and uncertainties inherent in all forward-looking statements, the inclusion or incorporation by reference of forward-looking statements in this MD&A should not be considered as a representation by Prophecy or any other person that Prophecy's objectives or plans will be achieved.*

*These factors should be considered carefully and readers should not place undue reliance on Prophecy's forward-looking statements. The Company believes that the expectations reflected in the forward-looking statements contained in this MD&A and the documents incorporated by reference herein are reasonable, but no assurance can be given that these expectations will prove to be correct. In addition, although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. Prophecy undertakes no obligation to publicly update any future revisions to forward-looking statements to reflect events or circumstances after the date of this MD&A or to reflect the occurrence of unanticipated events, except as expressly required by law.*

## 3. FIRST QUARTER HIGHLIGHTS AND SIGNIFICANT EVENTS

- On January 13, 2017, the Company closed a non-brokered private placement involving the issuance of 49,999 units at a price of $3.00 per unit as previously announced on January 9, 2017. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of $4.00 per Share for a period of five years from the date of issuance.

- On January 13, 2017, The Company announced that pursuant to the terms of its 2016 Share-Based Compensation Plan it has granted in aggregate, 39,000 bonus Shares at a value of $4.88 per bonus Share and 91,000 incentive stock options to various directors, officers and consultants of the Company. The options are exercisable at a price of $4.88 per Share for a term of five years expiring on January 12, 2022 and vest at 12.5% per quarter for the first two years following the date of grant.

- On January 13, 2017, the Company and Linx Partners Ltd. ("**Linx**") a company controlled by Mr. John Lee, Executive Chairman of Prophecy, entered into a Debt Settlement Agreement to settle most of the outstanding balance owing by the Company to Linx under the revolving credit facility agreement dated March 12, 2015, as amended (the "**Credit Facility**"), by issuing 300,000 Shares to Mr. Lee, in satisfaction of $900,000 of indebtedness owing by the Company under the Credit Facility. The Company also announced that for nominal consideration of $1, Linx has agreed to accrue and postpone the repayment of any principal, interest and fees due under the Credit Facility until the earlier of October 1, 2017, or such time as the Company is in a reasonable financial position to repay all or a portion of the amounts owing.

- On February 10, 2017, the Company acquired the remaining 20% title interest held by Randsburg International Gold Corp. ("**Randsburg**") in the patented claims that comprise the Titan vanadium-titanium-iron project in Ontario, Canada by issuing to parties designated by Randsburg 20,000 Prophecy Common shares.

- On March 14, 2017, the Company announced a non-brokered private placement involving the issuance of 100,000 units at a price of $4.00 per unit. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of $5.00 per Share for a period of five years from the date of issuance.

*Subsequent to period end*

- On April 12, 2017, the Company closed a non-brokered private placement involving the issuance of 103,250 units at a price of $4.00 per unit as previously announced on March 14, 2017. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of $5.00 per Share for a period of five years from the date of issuance.

- On May 8, 2017, the Company entered into a binding letter agreement (the "**Letter Agreement**") with arm's-length, private parties (the **"Lessor"**) to acquire through lease, the Gibellini vanadium project in Nevada, USA (the **"Gibellini Project"**). Under the Letter Agreement, Prophecy will lease the Gibellini mining claims which constitute the Gibellini Project by paying to the Lessor, annual advance royalty payments which will be tied, based on an agreed formula (not to exceed US$120,000 per year), to the average vanadium pentoxide price of the prior year. Upon commencement of production, Prophecy intends to maintain its acquisition through lease of the Gibellini mining claims by paying to the Lessor, a 2.5% net smelter return (**"NSR"**) until a total of US$3 million is paid. Thereafter, the NSR will be reduced to 2% over the remaining life of the mine (and referred to thereafter, as "production royalty payments"). All advance royalty payments made, will be deducted as credits against future production royalty payments. The lease will be for a term of 10 years, which can be extended for an additional 10 years at Prophecy's option. The proposed transaction is subject to Prophecy being satisfied with the results of its due diligence inquiries into the Gibellini Project. The parties have agreed to replace the Letter Agreement by entering into a more comprehensive definitive agreement by May 17, 2017. The Letter Agreement includes a commitment by the Lessor to not solicit, pursue or negotiate alternative offers with other parties for the Gibellini Project. Upon completion of the proposed transaction, Prophecy will evaluate the Gibellini Project economics in relation to prevailing vanadium metal prices prior to making any project development plans. At the appropriate time, joint venture partners may be sought to develop the Gibellini Project.

For further information please view the Company's 2017 news releases under the Company's SEDAR profile at www.sedar.com.

## 4. PROPERTY SUMMARY

### Highlights on Pulacayo Project

Please refer to the relevant section of the Annual MD&A for this information.

***Select Financial and Operational Data***

Q1 2017

On acquisition of the Pulacayo project, the Company implemented its fast-track development schedule of the project. The Company intends to develop the Pulacayo Project which includes assessing the mineral resource potential, mine re-opening and construction of a processing facility on site. Exploration will continue including the exploration to prove the planned stopes, completing the exploration plan to assess the mineral resource potential and tailings, continue with securing approval of the exploration permit, and the required exploration to maintain the concessions.

During the three months ending March 31, 2017, the Company continued completing final preparations for underground mining including detailed mine plans, staffing, and securing equipment at Pulacayo. During the quarter, the Company incurred total costs of $198,258 (same period 2016 – $174,395) for the Pulacayo project including $77,955 (same period 2016 – $71,233) for geological and engineering consulting, and $120,303 (same period 2016 – $103,162) for personnel, legal and general and administrative expenses.

*2017 Outlook*

The Company plans to continue exploration of the additional vein system (the "AVS") to assess whether drilling is warranted. The Company believes the results from the latest Pulacayo Chip Sampling Program announced on December 23, 2016 are encouraging given the AVS is located in the shallow part of the deposit; it exhibits strong zinc and lead anomalies and represents a priority area for further exploration which could potentially add resources to the Pulacayo project. The Company continues to study optimal mining production and processing scenarios, and intends to announce a production decision at the conclusion of its study in conjunction with a financing plan, should a positive production decision be reached in the near future. A positive production decision would not be based on a feasibility study of mineral reserves demonstrating economic and technical viability so would carry increased uncertainty and the risk of failure as to the mining method and profitability.

**Highlights on Ulaan Ovoo Coal Property**

Please refer to the relevant section of the Annual MD&A for this information.

***Select Financial and Operational Data***

Q1 2017

During the first quarter of 2017, the Company continued to maintain the Ulaan Ovoo operations on standby. During the quarter the Company sold 17,335 tonnes (Q1 2016 – 760 tonnes) of coal to local customers from existing stockpiles with total sales revenue of approximately $364,600 (Q1 2016 - $24,090). Sales revenue has been recorded against costs incurred at the mine, classified as costs in excess of recovered coal of $163,948 on the consolidated statement of operations and comprehensive loss. As of March 31, 2017, the coal stockpile balance was approximately 61,050 tonnes (March 31, 2016 – 80,800).

*2017 Outlook*

With the increase in the benchmark thermal coal price during late 2016, the Company began surveying existing and prospective customers with a view to possibly restarting Ulaan Ovoo in 2017. Mining operations at Ulaan Ovoo may be restarted in short order since pit dewatering requires less than a month and other work needed to restart mining can be completed at the same time. The Company believes contract mining is a viable option for more efficient operation of the mine since a contract mining firm would be responsible for labor agreements, equipment maintenance and other key responsibilities and functions.

The Company continues its efforts to maximize value including evaluation of operating alternatives (e.g. contract mining, electrification, conveyance vs. haul), infrastructure improvement, management changes, higher margin markets and other markets for Ulaan Ovoo coal, methods to upgrade coal quality and pursuit of financial arrangements including strategic partner or joint venture arrangements or the sale of a portion or the entire project. One of these efforts is to penetrate the urban residential market in Mongolia (total estimated consumption of approximately 700 - 900 thousand tonnes a year in the cities of Ulaanbaatar, Erdenet, and Darkhan) and further increase coal sales to Russia. Pursuit of the river diversion will also continue. Completion of the diversion will both ensure that the Company retains the licenses and decrease the pumping requirement.

Prophecy will continue to pursue government support to open the Zelter border crossing, pave the 136 km Shamaar-Tushig road, as well as to upgrade the 35kV power line from Tsagaannuur soum to Tushig soum and so bring power to Ulaan Ovoo.

At the current stage, the Company is unable to determine when conditions will improve and if so, be sustainable such that the full potential value of the coal resource will be realized. Some of these conditions include when, if at all, greater access to Russian or other export coal markets will be realized and the time and degree desired project changes and operational modifications will improve profitability.

**Highlights on the Chandgana Coal Properties**

Please refer to the relevant section of the Annual MD&A for this information.

***Select Financial and Operational Data***

Q1 2017

During the first quarter of 2017, the Company incurred total general and administrative costs of $16,644 (same period 2016 – $50,304) for the Chandgana Tal and Khavtgai Uul properties (including the power plant project).

*2017 Outlook*

The activities planned during 2017 for the Khavtgai Uul license include normal license maintenance work and start of work to convert the license to a mining license. The exploration and report work to convert the license to a mining license is expected to be completed by the end 2017, then submitted for review by the Mineral Resources Professional Council January 2018 with a conclusion of acceptance expected by April 2018. For the Chandgana Tal project, the Company will assess the local market for coal to determine the need for mining during the 2017 - 2018 heating season. The Company intends to discuss the need to update the detailed environmental impact assessment ("**DEIA**") and mining feasibility study with the relevant ministries.

**Chandgana Power Plant Project**

During the first quarter of 2017, the Company continues to cooperate with government agencies and investors in furthering the Chandgana Power Plant Project.

*2017 Outlook*

For 2017, the Company intends to continue with its 2016 activities and consider other activities that could promote the project. Prophecy intends to continue discussions with large-scale, Asian strategic power producers who have expressed interest in investing in the Chandgana Power Plant. With a new, stable government in place for the next four years and the government's mandate to attract foreign investment and Prophecy's continued commitment to the project, the Company is optimistic that material progress can be made during 2017.

The major reasons completion of the Chandgana power plant project would be beneficial to Mongolia include the current and projected electrical power demand exceeding capacity, current importation of approximately 20% of its electric power from Russia and China and the virtues of the project. The virtues are that the Company is proposing to build a new, modern power plant to provide a stable power supply to Mongolia, with 100% private funding and with no up-front payment or subsidies from the Mongolia government, a fixed, long-term tariff that is lower than those of foreign imported electrical power that would ease Mongolia's budget, the creation of employment and assisting in establishing Mongolia's energy independence. The Chandgana power plant and Chandgana coal mine would be expected to employ over 600 full-time skilled local staff, cause the start of many new support businesses, and revitalize Khentii province.

The Company believes its mine-mouth power plant located far from Ulaanbaatar (as opposed to having a power plant located in or near the city) is not only the solution to Mongolia's power shortage, but eliminates costly coal and ash transportation, preserves the capital city's limited water resources and reduces the severe air pollution in the city. In addition to working with the Mongolia government and its people to fulfill the growing domestic energy demand, the Company with its experienced partners, looks forward to these future steps to expand the Chandgana power plant in order to transform Mongolia, into a net exporter of electricity to its neighboring countries.

Prophecy continues to actively consider project financing options which include either debt, equity or a combination thereof in addition to joint ventures with international power project developers. Otherwise regular land use right maintenance work will continue.

(Expressed in Canadian Dollars, except where indicated)

The Company also plans to hold discussions with the relevant ministries concerning renewal of the DEIA and power plant construction license during 2017.

## 5. SUMMARY OF QUARTERLY RESULTS

The following table summarizes selected consolidated financial information for the eight most recently completed quarters:

| | | 2017 Q1 | | 2016 Q4 | | 2016 Q3 | | 2016 Q2 |
|---|---|---|---|---|---|---|---|---|
| Operating expense | $ | (282,923) | $ | (473,114) | $ | (307,343) | $ | (248,333) |
| Net loss | | (30,009) | | (1,089,282) | | (651,212) | | (140,392) |
| Net loss per share, basic and diluted | $ | (0.01) | $ | (0.23) | $ | (0.14) | $ | (0.04) |
| Comprehensive loss | | (30,009) | | (1,089,282) | | (651,212) | | (140,392) |
| Comprehensive loss per share, basic and diluted | $ | (0.01) | $ | (0.23) | $ | (0.14) | $ | (0.04) |

| | | 2016 Q1 | | 2015 Q4 | | 2015 Q3 | | 2015 Q2 |
|---|---|---|---|---|---|---|---|---|
| Operating expense | $ | (305,697) | $ | (540,153) | $ | (481,915) | $ | (805,826) |
| Net loss | | (126,419) | | (3,884,097) | | (831,656) | | (1,112,025) |
| Net loss per share, basic and diluted | $ | (0.04) | $ | (1.15) | $ | (0.26) | $ | (0.36) |
| Comprehensive loss | | (126,419) | | (3,884,097) | | (831,656) | | (1,112,025) |
| Comprehensive loss per share, basic and diluted | $ | (0.04) | $ | (1.15) | $ | (0.26) | $ | (0.36) |

## 6. DISCUSSION OF OPERATIONS

The reader is encouraged to refer to Note 6 of the Company's Annual Financial Statements for the year ended December 31, 2016 for Prophecy's IFRS accounting policies. For discussion on each project, the reader is encouraged to refer to the "Business Overview" section of this MD&A.

*Three Months Ended March 31, 2017 and 2016 (Q1 2017 and Q1 2016)*

Results of operations are summarized as follows:

| **Operating Expenses** | | **Three Months Ended March 31, 2017** | | **2016** |
|---|---|---|---|---|
| Advertising and promotion | $ | 12,429 | $ | 23,438 |
| Consulting and management fees | | 36,430 | | 49,132 |
| General and administrative expenses | | 153,221 | | 204,710 |
| Professional fees | | 14,843 | | - |
| Share-based payments | | 42,579 | | 20,898 |
| Travel and accommodation | | 23,421 | | 7,519 |
| | $ | 282,923 | $ | 305,697 |

The Company had an operating loss of $282,923 for the Q1 2017, which compares with an operating loss of $305,697 for the Q1 2016.

Of note are the following items:

- Advertising and promotion expenses decreased by $11,009;
- Consulting and management fees decreased by $12,702;
- General and administrative expenses decreased by $51,488 due primarily to decreased office expenses and insurance cost;
- Professional fees increased by $14,843 due to increase in legal fees related to the acquisition of Titan and financing;

(Expressed in Canadian Dollars, except where indicated)

- Travel and accommodation expenses increased by $15,902; and
- Non-cash share-based payments increased by $21,681 due to a larger number of outstanding options vesting during the 2017 period compared to the 2016 period.

For Q1 2017, the Company's "Other Items" amounted to an income of $252,914 compared to an income of $179,278 for Q1 2016.

| **Other Items** | | **Three Months Ended March 31,** | | |
|---|---|---|---|---|
| | | **2017** | | **2016** |
| Costs/(income) in excess of recovered coal | $ | (163,948) | $ | 31,437 |
| Finance cost | | 91 | | 307,353 |
| Foreign exchange loss/(gain) | | (215,956) | | (538,125) |
| Loss/(gain) on sale of available-for-sale investments | | 22,810 | | (59,698) |
| Interest expense | | 7,889 | | 79,755 |
| Impairment of mineral property | | 96,200 | | - |
| | $ | (252,914) | $ | (179,278) |

The increase by $73,636 is the net result of changes to a number of other items. Of note are the following items:

- Costs in excess of recovered coal reduced by $195,385 due to the fact that during Q1 2017, the Company sold 17,335 tonnes of coal with total sales revenue of approximately $364,600 which has been recorded against costs incurred at the mine;
- Finance cost decreased by $307,262 due to much less funds borrowed under the Credit Facility;
- Foreign exchange gain of $215,956 was due to fluctuations in the value of the Canadian dollar compared to the Mongolian tugrik, Bolivian boliviano, and the United States dollar;
- During Q1 2017, the Company disposed of 2,2 million Lorraine Copper Corp. shares for proceeds of $153,190 and a realized loss of $22,810;
- Decrease in interest expense by $71,866 was due to lower interest charges related to the Credit Facility;
- In Q1 2017, the Company acquired the remaining 20% title interest in the Titan project, which value was impaired at December 31, 2014 due to market conditions. As there were no benchmark or market changes from January 1, 2015 to March 31, 2017, the impaired value of $nil for Titan property remains unchanged. Therefore, the Company recorded an impairment loss of $96,200 on the acquisition of the remaining title interest in Titan.

## 7. LIQUIDITY AND CAPITAL RESOURCES

As an exploration and development company, Prophecy has no regular cash in-flow from operations, and the level of operations is principally a function of availability of capital resources. The Company's capital resources are largely determined by the strength of the junior resource markets and by the status of the Company's projects in relation to these markets, and its ability to compete for investor support of its projects. To date, the principal sources of funding have been equity and debt financing. Many factors influence the Company's ability to raise funds, and there is no assurance that the Company will be successful in obtaining adequate financing and at favourable terms for these or other purposes including general working capital purposes.

### Liquidity

At March 31, 2017, the Company had cash of $52,087 representing an increase of $30,439 from $21,648 held at December 31, 2016. The Company's working capital deficit at March 31, 2017 was 2 million compared to working capital deficit of $3.2 million as at December 31, 2016. The Company's working capital deficit decreased since the year ended December 31, 2016 primarily as a result of the decrease in credit facilities.

(Expressed in Canadian Dollars, except where indicated)

### Cash Flow Highlights

| | | Three Months Ended March 31, 2017 | | 2016 |
|---|---|---|---|---|
| Cash provided by (used in) operating activities | $ | 13,542 | $ | 37,153 |
| Cash provided by (used in) investing activities | | (171,607) | | (296,013) |
| Cash provided by (used in) financing activities | | 188,504 | | 277,977 |
| Increase in cash for period | | 30,439 | | 19,117 |
| Cash balance, beginning of period | | 21,648 | | 33,542 |
| Cash balance, end of period | $ | 52,087 | $ | 52,659 |

***Operating activities:*** Cash provided by operating activities during Q1 2017 was $13,542 compared to cash provided of $37,153 during Q1 2016. The Company will require financing in the near term to fund operations.

***Investing activities*****:** During Q1 2017, cash used in investing activities totalled $171,607 compared to $296,013 cash used during Q1 2016. The Company spent $324,797 (Q1 2016 - $390,211) on capital additions and received $153,190 (Q1 2016 – $59,698) from sale of available-for-sale investments.

***Financing activities*****:** A total of $188,504 was provided by financing activities during Q1 2017 compared to $277,977 cash provided during Q1 2016. The Company drew $1,819 (Q1 2016 - $147,068) from the Credit Facility and received net proceeds of $186,685 (Q1 2016 - $186,000) from issuing Shares in private placements.

### Capital Resources

The Company's major commitments over the next 12 months are repayment of trade and other payables. Given the number of obligations and project tasks the Company has in progress, the current cash balance is inadequate to fund operations. Management believes the Company is able to raise capital by means of equity or debt financing, or through other avenues available to mining companies. Management explores all possible avenues to determine the best course of action to acquire the required funds to meet obligations and to fund operations. Management is aware that market conditions, driven primarily by metal prices, may limit the Company's ability to raise additional funds. The Company is also required to maintain a number of financial covenants as part of its Credit Facility, which may limit the Company's ability to access future funding. These factors, and others, are considered when shaping the Company's capital management strategy.

The consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Company's ability to continue as a going concern is dependent upon the continued support from its shareholders, the discovery of economically recoverable reserves, and the ability of the Company to obtain the financing necessary to complete development and achieve profitable operations in the future. The outcome of these matters cannot be predicted at this time.

### Contractual Commitments

Prophecy's commitments related to mineral properties are disclosed in Note 14 to the Annual Financial Statements. Prophecy's other commitments are disclosed in Note 26 to the Annual Financial Statements.

### Capital Risk Management

Prophecy considers its capital structure to consist of share capital, share 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 exploration and development of its projects and to pursue and support growth opportunities. The Board of Directors does not establish quantitative returns on capital criteria for management. The overall objectives for managing capital remained unchanged in 2016 from the prior comparative period.

Management is aware that market conditions, driven primarily by metal prices, may limit the Company's ability to raise additional funds. The Company is also required to maintain a number of financial covenants as part of its Credit Facility, which may limit the Company's ability to access future funding. These factors, and others, are considered when shaping the Company's capital management strategy.

## 8. CONTINGENCIES

The Company accrues for liabilities when they are probable and the amount payable can be reasonably estimated.

### ASC Tax Claim

Pursuant to the terms of the acquisition agreement, Prophecy agreed to assume all liabilities of the Apogee Subsidiaries, including legal and tax liabilities associated with the Pulacayo Project. During Apogee's financial year ended June 30, 2014, it received notice from the Servicio de Impuestos Nacionales, the national tax authority in Bolivia, alleging that ASC Bolivia LDC Sucursal Bolivia, the Company's wholly-owned subsidiary, owed approximately Bs42,000,000 ($7,003,572) in taxes, interest and penalties relating to a historical tax liability in an amount originally assessed at approximately $760,000 in 2004, prior to Apogee acquiring the subsidiary in 2011. Apogee disputed the assessment and disclosed to the Company that it believed the notice was improperly issued. The Company continued to dispute the assessment and hired local legal counsel to pursue an appeal of the tax authority's assessment on both substantive and procedural grounds.

On May 26, 2015, the Company received a positive Resolution issued by the Bolivian Constitutional Court that among other things, declared null and void the previous Resolution of the Bolivian Supreme Court issued in 2011 (that imposed the tax liability on ASC Bolivia LDC Sucursal Bolivia) and sent the matter back to the Supreme Court to consider and issue a new Resolution. The Company plans to continue to vigorously defend its position and make submissions to the Supreme Court during the new hearing.

### Red Hill Tax Claim

During the year ended December 31, 2014, Red Hill was issued a letter from the Sukhbaatar District Tax Division notifying it of the results of the Sukhbaatar District Tax Division's VAT inspection of Red Hill's 2009-2013 tax imposition and payments that resulted in validating VAT credit of only MNT235,718,533 from Red Hill's claimed VAT credit of MNT2,654,175,507. Red Hill disagreed with the Sukhbaatar District Tax Division's findings as the tax assessment appeared to the Company to be unfounded. The Company disputed the Sukhbaatar District Tax Division's assessment and submitted a complaint to the Capital City Tax Tribunal. On March 24, 2015, the Capital City Tax Tribunal resolved to refer the matter back to the Sukhbaatar District Tax Division for revision and separation of the action between confirmation of Red Hill's VAT credit, and the imposition of the penalty/deduction for the tax assessment. The Sukhbaatar District Tax Division appealed the Capital City Tax Tribunal's resolution to the General Tax Tribunal office, but was denied on June 4, 2015 on procedural grounds. As a result, the Sukhbaatar District Tax Division implemented the Capital City Tax Tribunal's resolution on June 25, 2015, finding: (1) with respect to confirmation of Red Hill's VAT credit, that after inspection the amount was to be MNT235,718,533; and (2) with respect to the imposition of the penalty/deduction for the tax assessment, that no penalty was to be issued but that Red Hill's loss to be depreciated and reported to be MNT1,396,668,549 in 2010 and MNT4,462,083,700 in 2011. The Company continues to dispute the Sukhbaatar District Tax Division's assessment and delivered a complaint to Capital City Tax Tribunal on July 24, 2015. Due to the uncertainty of realizing the VAT balance, the Company recorded an impairment charge for the full VAT balance in the prior year (see Note 10 to Annual Financial Statements).

## 9. RELATED PARTY DISCLOSURES

Prophecy had related party transactions with the following companies, related by way of directors and key management personnel:

- Linx Partners Ltd., a private company controlled by John Lee, Director, CEO and Executive Chairman of Prophecy, provides management and consulting services to the Company.

(Expressed in Canadian Dollars, except where indicated)

- MaKevCo Consulting Inc., a private company 50% owned by Greg Hall, Director of Prophecy, provides consulting services to the Company.
- Sophir Asia Ltd., a private company controlled by Masa Igata, Director of Prophecy, provides consulting services to the Company.

A summary of amounts paid or accrued to related parties is as follows:

| | | Three Months Ended March 31, | |
|---|---|---|---|
| **Related parties** | | **2017** | **2016** |
| Directors and officers | $ | 52,250 $ | 87,750 |
| Linx Partners Ltd. | | 52,500 | 52,500 |
| MaKevCo Consulting Inc. | | 6,200 | 3,800 |
| Sophir Asia Ltd. | | 3,500 | 3,500 |
| | $ | 114,450 $ | 147,550 |

A summary of the transactions by nature among the related parties is as follows:

| | | Three Months Ended March 31, | |
|---|---|---|---|
| **Related parties** | | **2017** | **2016** |
| Consulting and management fees | $ | 30,900 $ | 28,500 |
| Directors' fees | | 10,800 | 10,800 |
| Mineral properties | | 39,000 | 39,000 |
| Salaries and benefits | | 33,750 | 69,250 |
| | $ | 114,450 $ | 147,550 |

On January 13, 2016, the Company's directors and executive management agreed to temporarily:

- reduce directors fees by 50% and defer payment of such reduced directors fees until such time as the Company's cash flow situation permits it to pay such reduced directors fees, and/or to fully or partially restore their directors fees to their original levels;
- reduce the CEO's consulting fees by 50% and defer payment of such reduced consulting fees until such time as the Company's cash flow situation permits it to pay such reduced consulting fees, and/or to fully or partially restore the CEO's consulting fees to their original level;
- reduce other executive officers' salaries by 17% – 50% until such time as the Company's cash flow situation permits it to fully or partially restore their salaries to their original levels.

During Q1 2017, the Company issued 300,000 Shares to Linx in satisfaction of $900,000 worth of indebtedness owing by the Company under the Credit Facility. Linx also agreed for the nominal consideration of $1, to accrue and postpone the repayment of any principal, interest and fees due until the earlier of October 1, 2017, or such time as the Company is in a reasonable financial position to repay all or a portion of the amounts owing. See Note 16 to the Annual Financial Statements for more information regarding the Credit Facility with Linx.

As at the date of this MD&A, Mr. Lee beneficially owns and exercises control over an aggregate of 1,026,453 shares representing an interest of approximately 19.26% of the Company's currently issued and outstanding shares, and 34.35% of the Company's shares on a fully diluted basis assuming exercise of all of the Company's outstanding share purchase options and warrants. The securities were acquired or disposed of by Mr. Lee for investment purposes only, and not for purposes of exercising control or direction over the Company. Generally, Mr. Lee intends to evaluate his investment in the Company and to increase or decrease his shareholdings as circumstances require, depending on market conditions and other factors, through market transactions, private agreements or otherwise.

As at March 31, 2017, amounts due to related parties totaled of $218,446 (December 31, 2016 – $366,269) and was comprised of $218,446 deferred amounts due to directors, CEO and officers (December 31, 2016 - $180,829), $Nil bonus payable (December 31, 2016 - $185,440).

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

(Expressed in Canadian Dollars, except where indicated)

| | | Three Months Ended March 31, | | |
|---|---|---|---|---|
| **Key Management Personnel** | | **2017** | | **2016** |
| Salaries and short term benefits | $ | 34,367 | $ | 69,250 |
| Share-based payments | | 26,324 | | 29,181 |
| | $ | 60,691 | $ | 98,431 |

## 10. CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's consolidated financial statements are prepared in accordance with IFRS as issued by the IASB. The Company followed the same accounting policies and methods of computation in the Annual Financial Statements for the three months ended March 31, 2017. The significant accounting policies applied and recent accounting pronouncements are described in Notes 4 and 6 to the Annual Financial Statements.

In preparing the condensed consolidated interim financial statements in accordance with IFRS, management is required 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 the financial statements, and the reported amounts of revenues and expenses during the reporting period. Areas requiring the use of estimates include the rates of amortization for property and equipment, the useful life and recoverability of long-lived assets, the recoverability of accounts receivable, determination of environmental obligation provision for closure and reclamation, accounts payable and accrued liabilities, the assumptions used in the determination of the fair value of financial instruments and share-based payments, and the determination of the recoverability of deferred income tax assets bases its estimates and assumptions on current and various other factors that it believes to be reasonable under the circumstances. Management believes the estimates are reasonable; however, actual results could differ from those estimates and could impact future results of operations and cash flows.

Readers are encouraged to read the significant judgements, estimates and assumptions as described in Note 5 to the Annual Financial Statements.

## 11. ACCOUNTING CHANGES AND RECENT ACCOUNTING PRONOUNCEMENTS

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective. The Company has not early adopted any of these standards and is currently evaluating the impact, if any, that these standards might have on its financial statements.

## 12. FINANCIAL INSTRUMENTS AND RELATED RISKS

The Board of Directors, through the Audit Committee is responsible for identifying the principal risks of the Company and ensuring that risk management systems are implemented. Prophecy 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 reviews Prophecy's policies on an ongoing basis.

### Financial Instruments

A description of financial instruments is included in Note 21 to the Annual Financial Statements. There were no changes to the method of fair value measurement of financial assets and financial liabilities during the period.

### Related Risks

(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 March 31, 2017, the Company had a cash balance of $52,087 (December 31, 2016 – $21,648) in order to meet short-term business requirements.

At March 31, 2017, the Company had accounts payable and accrued liabilities of $2,305,874 (December 31, 2016 - $2,658,018), which have contractual maturities of 90 days or less and a line of credit payments of $181,359 (December 31, 2016 - $1,071,560). The Company is seeking financing in order to be in a position to satisfy its current liabilities.

Additional sources of funding, which may not be available on favourable terms, if at all, include: share equity and debt financings; coal sales from stockpiled inventory; equity, debt or property level joint ventures with power project and coal property developers; and sale of interests in existing assets.

(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 with cash and cash equivalents and receivables, net of allowances. The significant concentration of credit risk is situated in Mongolia. The carrying amount of assets included on the statements of financial position represents the maximum credit exposure.

(c) Market risk

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

(i) Interest rate risk

Interest rate 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. During the three months ended March 31, 2017, the Company drew down $1,819 on its Credit Facility with an outstanding balance of $181,359 as at March 31, 2017. Due to the short-term nature of these financial instruments, and that the Company's Credit Facility bears interest at a fixed rate, fluctuations in market rates do not have a significant impact on the fair values or future cash flows of the financial instruments as of March 31, 2017. 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 has exploration and development projects in Mongolia and Bolivia 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, Mongolian tugrik, and Bolivian boliviano into its functional and reporting currency, the Canadian dollar.

Based on the above, net exposures as at March 31, 2017, with other variables unchanged, a 10% (December 31, 2016 – 10%) strengthening (weakening) of the Canadian dollar against the Mongolian tugrik would impact net loss with other variables unchanged by $36,000. A 10% strengthening (weakening) of the Canadian dollar against the Bolivian boliviano would impact net loss with other variables unchanged by $704,300. A 10% strengthening (weakening) of the US dollar against the Canadian dollar would impact net loss with other variables unchanged by $72,000. The Company currently does not use any foreign exchange contracts to hedge this currency risk.

(iii) Commodity and equity price risk

Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. Commodity prices fluctuate on a daily basis and are affected by numerous factors beyond the Company's control. The supply and demand for these commodities, the level of interest rates, the rate of inflation, investment decisions by large holders of commodities including governmental reserves and stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns and monetary systems and political developments. The Company closely monitors commodity prices, individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company. Fluctuations in value may be significant.

## 13. RISKS AND UNCERTAINTIES

Readers should carefully consider the risks and uncertainties described in the Company's most recently filed AIF "Risk Factors" page 89 which is available under the Company's SEDAR profile at www.sedar.com. Additional risks not currently known to the Company, or that the Company currently deems immaterial, may also impair the Company's operations. If any of the foregoing risks actually occur, the Company's business, financial condition and operating results could be adversely affected.

## 14. DISCLOSURE CONTROLS AND PROCEDURES

### Design of Internal Controls over Financial Reporting

The Company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The Company's internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions, acquisition and disposition of assets and liabilities;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with the authorization of management and directors of Prophecy; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets, and incurrence of liabilities, that could have a material effect on the financial statements.

The Company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting using the criteria set forth in the *Internal Control – Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of March 31, 2017.

### Changes in internal control over financial reporting

There have been no changes in the Company's internal control over financial reporting during the three months ended March 31, 2017, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### Limitations of controls and procedures

The Company's management, including the Chief Executive Officer and the Chief Financial Officer, believe that any disclosure controls and procedures or internal controls over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgements in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

## 15. DISCLOSURE OF OUTSTANDING SHARE DATA

As at the date of this MD&A, the Company had a total of:

- 5,329,589 Shares outstanding with recorded value of $158,319,637;
- 542,127 stock options outstanding with a weighted average exercise price of $6.19 and exercisable to purchase one Share at prices ranging from $2.00 to $28.00 and which expire between June 2017 and January 2022; and
- 1,501,309 warrants outstanding with a weighted average exercise price of $4.61 and exercisable to purchase one Share at prices ranging from $4.00 to $7.00 and which expire between June 2017 and April 2022.

## 16. OFF-BALANCE SHEET ARRANGEMENTS

During the three months ended March 31, 2017, Prophecy was not a party to any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations, financial condition, revenues or expenses, liquidity, capital expenditures or capital resources of Prophecy.

Prophecy Development Corp.

# Condensed Interim Consolidated Financial Statements
# For the three months ended March 31, 2017 and 2016

(Expressed in Canadian Dollars)

**Unaudited – Prepared by Management**

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## NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited condensed interim consolidated financial statements have been prepared by management and approved by the Audit Committee. The Company’s independent auditors have not performed a review of these condensed interim consolidated financial statements in accordance with the standards established for a review of interim financial statements by an entity’s auditors.

**PROPHECY DEVELOPMENT CORP.**
**Condensed Interim Consolidated Statements of Financial Position**
(Expressed in Canadian Dollars) (Unaudited)

| As at | Notes | | March 31, 2017 | | December 31, 2016 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Current assets** | | | | | |
| Cash | 4 | $ | 52,087 | $ | 21,648 |
| Receivables | | | 233,644 | | 91,565 |
| Prepaid expenses | | | 185,508 | | 200,526 |
| Available-for-sale investments | 5 | | - | | 176,000 |
| | | | 471,239 | | 489,739 |
| **Non-current assets** | | | | | |
| Reclamation deposits | | | 21,055 | | 21,055 |
| Property and equipment | 6 | | 812,179 | | 917,607 |
| Mineral properties | 7 | | 26,614,610 | | 26,399,708 |
| | | $ | 27,919,083 | $ | 27,828,109 |
| **Liabilities and Equity** | | | | | |
| **Current liabilities** | | | | | |
| Accounts payable and accrued liabilities | 8 | $ | 2,305,874 | $ | 2,658,018 |
| Credit facilities | 9 | | 181,359 | | 1,071,560 |
| | | | 2,487,233 | | 3,729,578 |
| **Non-current liabilities** | | | | | |
| Provision for closure and reclamation | | | 242,347 | | 242,347 |
| Tax provision | 16 | | 7,003,572 | | 7,060,691 |
| | | | 9,733,152 | | 11,032,616 |
| **Equity** | | | | | |
| Share capital | 10 | | 157,907,917 | | 156,529,025 |
| Reserves | | | 21,523,688 | | 21,482,133 |
| Deficit | | | (161,245,674) | | (161,215,665) |
| | | | 18,185,931 | | 16,795,493 |
| | | $ | 27,919,083 | $ | 27,828,109 |

Approved on behalf of the Board:

***"John Lee"*** — John Lee, Director

***"Greg Hall"*** — Greg Hall, Director

**Nature of operations and going concern** (Note 1)
**Contingencies** (Note 16)

See accompanying notes to the consolidated financial statements.

**PROPHECY DEVELOPMENT CORP.**
**Condensed Interim Consolidated Statements of Operations and Comprehensive Loss**
(Expressed in Canadian Dollars) (Unaudited)

| | Notes | Three Months Ended March 31, 2017 | 2016 |
|---|---|---|---|
| **General and Administrative Expenses** | | | |
| Advertising and promotion | | $ 12,429 | $ 23,438 |
| Consulting and management fees | | 36,430 | 49,132 |
| Depreciation and accretion | | 2,389 | 18,572 |
| Director fees | | 10,800 | 10,800 |
| Insurance | | 13,098 | 13,345 |
| Office and administration | | 27,886 | 48,121 |
| Professional fees | | 14,843 | - |
| Salaries and benefits | | 42,582 | 77,000 |
| Share-based payments | 10 | 42,579 | 20,898 |
| Stock exchange and shareholder services | | 56,466 | 36,872 |
| Travel and accommodation | | 23,421 | 7,519 |
| | | (282,923) | (305,697) |
| **Other Items** | | | |
| Income/(costs) in excess of recovered coal | | 163,948 | (31,437) |
| Finance cost | 9 | (91) | (307,353) |
| Foreign exchange (loss)/gain | | 215,956 | 538,125 |
| (Loss)/gain on sale of available-for-sale investment | 5 | (22,810) | 59,698 |
| Interest expense | 9 | (7,889) | (79,755) |
| Impairment of mineral property | 7 | (96,200) | - |
| | | 252,914 | 179,278 |
| **Net Loss for Period** | | (30,009) | (126,419) |
| **Comprehensive Loss for Period** | | $ (30,009) | (126,419) |
| **Loss Per Common Share,** basic and diluted | | $ (0.01) | $ (0.04) |
| **Weighted Average Number of Common Shares Outstanding** | | 5,107,085 | 3,527,012 |

See accompanying notes to the consolidated financial statements.

**PROPHECY DEVELOPMENT CORP.**
**Condensed Interim Consolidated Statements of Changes in Equity**
(Expressed in Canadian Dollars, except number of shares) (Unaudited)

| | Numbers of shares | | Share Capital | | Reserves | | Deficit | | Total |
|---|---|---|---|---|---|---|---|---|---|
| **December 31, 2015** | 3,427,474 | $ | 153,281,631 | $ | 21,205,698 | $ | (159,208,360) | $ | 15,278,969 |
| Private placements, net of share issue costs | 80,000 | | 175,817 | | 10,183 | | | | 186,000 |
| Debt Settlement | 148,237 | | 364,462 | | - | | - | | 364,462 |
| Share-based payments | - | | - | | 33,539 | | - | | 33,539 |
| Loss for the period | - | | - | | - | | (126,419) | | (126,419) |
| **March 31, 2016** | 3,655,711 | $ | 153,821,910 | $ | 21,249,420 | $ | (159,334,779) | $ | 15,736,551 |
| **December 31, 2016** | 4,807,653 | | 156,529,025 | | 21,482,133 | | (161,215,665) | | 16,795,493 |
| Shares issued for mineral properties | 20,000 | | 96,200 | | - | | - | | 96,200 |
| Private placements, net of share issue costs | 49,999 | | 142,000 | | - | | - | | 142,000 |
| Debt Settlement | 300,000 | | 900,000 | | - | | - | | 900,000 |
| Share bonus to personnel | 39,000 | | 190,320 | | - | | - | | 190,320 |
| Exercise of stock options | 9,687 | | 50,372 | | (5,687) | | - | | 44,685 |
| Share-based payments | - | | - | | 47,242 | | - | | 47,242 |
| Loss for the period | - | | - | | - | | (30,009) | | (30,009) |
| **March 31, 2017** | 5,226,339 | $ | 157,907,917 | $ | 21,523,688 | $ | (161,245,674) | $ | 18,185,931 |

See accompanying notes to the consolidated financial statements

**PROPHECY DEVELOPMENT CORP.**
**Condensed Interim Consolidated Statements of Cash Flows**
(Expressed in Canadian Dollars) (Unaudited)

| | Three Months Ended March 31, 2017 | 2016 |
|---|---|---|
| **Operating Activities** | | |
| Net loss for period | $ (30,009) | $ (126,419) |
| Adjustments to reconcile net loss to net cash flows: | | |
| Depreciation and accretion | 105,428 | 109,274 |
| Share-based payments | 42,579 | 20,898 |
| (Gain)/loss on sale of available-for-sale investment | 22,810 | (59,698) |
| Finance cost | 91 | 307,353 |
| Interest costs | 7,889 | 79,755 |
| Impairment of mineral property | 96,200 | - |
| | 244,988 | 331,163 |
| Working capital adjustments | | |
| Receivables | (142,079) | 101,589 |
| Prepaid expenses and reclamation deposits | 15,018 | 58,395 |
| Accounts payable and accrued liabilities and tax provision | (104,385) | (453,994) |
| | (231,446) | (294,010) |
| **Cash Used in Operating Activities** | 13,542 | 37,153 |
| **Investing Activities** | | |
| Cash received from GIC redemption | - | 34,500 |
| Property and equipment expenditures | - | (130,302) |
| Mineral property expenditures | (324,797) | (259,909) |
| Proceeds from sale of available-for-sale investment | 153,190 | 59,698 |
| **Cash Provided by (Used in) Investing Activities** | (171,607) | (296,013) |
| **Financing Activities** | | |
| Credit facilities paid | - | (45,143) |
| Funds borrowed under credit facility | 1,819 | 147,068 |
| Interest paid | - | (9,948) |
| Proceeds from share issuance, net of share issue costs | 186,685 | 186,000 |
| **Cash Provided by Financing Activities** | 188,504 | 277,977 |
| Net Increase in cash | 30,439 | 19,117 |
| Cash - beginning of period | 21,648 | 33,542 |
| Cash - end of period | $ 52,087 | $ 52,659 |

**Supplemental cash flow information** (Note 15)

See accompanying notes to the consolidated financial statements.

## 1. NATURE OF OPERATIONS AND GOING CONCERN

Prophecy Development Corp. ("**Prophecy**" or the "**Company**") is incorporated under the laws of the province of British Columbia, Canada and is engaged in exploring and developing mining properties and energy projects in Bolivia, Mongolia, and Canada. The Company's principal assets are its 100% interest in mining licenses in the Ulaan Ovoo property and Chandgana properties in Mongolia and in the Pulacayo Project in Bolivia.

The Company maintains its registered and records office at #1610 – 409 Granville Street, Vancouver, B.C., Canada, V6C 1T2.

These unaudited condensed interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. The Company incurred a net loss of $30,009 during the three months ended March 31, 2017 and as of that date the Company's deficit was $161.2 million.

The business of mineral exploration involves a high degree of risk and there can be no assurance that the Company's current operations, including exploration programs, will result in profitable mining operations. The recoverability of the carrying value of mineral properties, and property and equipment interests and the Company's continued on going existence is dependent upon the preservation of its interest in the underlying properties, the discovery of economically recoverable reserves, the achievement of profitable operations, the ability of the Company to raise additional sources of funding, and/or, alternatively, upon the Company's ability to dispose of some or all of its interests on an advantageous basis. Additionally, the current capital markets and general economic conditions are significant obstacles to raising the required funds. These conditions may cast significant doubt upon the Company's ability to continue as a going concern.

The Company is actively seeking additional sources of funding, which may not be available at favourable terms, if at all. They include: equity and debt financings; coal sales; equity, debt or property level joint ventures with power project and coal property developers; and sales of interests in existing assets. Because of the Company's need to conserve cash, all discretionary spending and exploration spending has been placed on hold.

In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period. Management is aware, in making its assessment, of uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern that these uncertainties are material and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business. Accordingly, they do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore to realize its assets and discharge its liabilities and commitments in other than the normal course of business and at amounts different from those in the accompanying financial statements. These adjustments could be material.

## 2. BASIS OF PRESENTATION

(a) Statement of compliance

These unaudited condensed interim consolidated financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting. They do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Company's annual financial statements as at and for the year ended December 31, 2016. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Company's financial position and performance since the last annual consolidated financial statements as at and for the year ended December 31, 2016 ("**Annual Financial Statements**").

These unaudited condensed interim consolidated financial statements were approved and authorized for issue by the Audit Committee on May 9, 2017.

(b) Significant accounting policies

These interim financial statements follow the same accounting policies and methods of application as the Annual Financial Statements. Accordingly, they should be read in conjunction with the Annual Financial Statements.

(c) Use of judgments and estimates

In preparing these interim financial statements, management makes judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates. The significant judgements made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the Annual Financial Statements.

(d) Changes in accounting standards

There were no previously undisclosed significant accounting pronouncements issued during the three months ended March 31, 2017.

## 3. SEGMENTED INFORMATION

The Company operates in one operating segment, being the acquisition, exploration and development of mineral properties. Geographic segmentation of Prophecy's assets is as follows:

(Expressed in Canadian Dollars) (Unaudited)

## 3. SEGMENTED INFORMATION (cont'd…)

| | March 31, 2017 | | | |
|---|---|---|---|---|
| | Canada | Mongolia | Bolivia | Total |
| Reclamation deposits | $ - | $ 21,055 | $ - | $ 21,055 |
| Property and equipment | 21,609 | 268,454 | 522,116 | 812,179 |
| Mineral properties | - | 14,435,409 | 12,179,201 | 26,614,610 |
| | $ 21,609 | $ 14,724,918 | $ 12,701,317 | $ 27,447,844 |

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Canada | Mongolia | Bolivia | Total |
| Reclamation deposits | $ - | $ 21,055 | $ - | $ 21,055 |
| Property and equipment | 22,816 | 329,912 | 564,879 | 917,607 |
| Mineral properties | - | 14,418,765 | 11,980,943 | 26,399,708 |
| | $ 22,816 | $ 14,769,732 | $ 12,545,822 | $ 27,338,370 |

## 4. CASH

Cash of Prophecy is comprised of bank balances.

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| Cash | $ 52,087 | $ 21,648 |

## 5. AVAILABLE-FOR-SALE INVESTMENTS

On September 22, 2016, the Company sold its 60% interest in the Okeover copper-molybdenum project located in British Columbia to Lorraine Copper Corp. ("**Lorraine**"). Under the terms of the agreement, Lorraine issued 2,200,000 common shares of Lorraine (valued at $0.08/share) to Prophecy and assumed Prophecy's $19,079 payment obligation to Eastfield Resources Ltd. under such parties' existing joint venture agreement. The Lorraine shares are subject to a hold period of four months plus one day. The 2,200,000 common shares of Lorraine represented approximately 9.6% of the issued and outstanding common shares of Lorraine at the acquisition date. The investment in Lorraine of $176,000 is classified as available-for-sale and is measured at fair value with changes in fair value recognized in other comprehensive income.

During the three months ended March 31, 2017, the Company disposed of 2,200,000 Lorraine shares for proceeds of $153,190 and a realized loss of $22,810.

As at March 31, 2017, the Company does not have available-for-sale investments.

(Expressed in Canadian Dollars) (Unaudited)

## 6. PROPERTY AND EQUIPMENT

| | Computer Equipment | Furniture & Equipment | Vehicles | Computer Software | Leasehold Improvements | Mining Equipment | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| Balance, December 31, 2015 | $ 161,959 | $ 388,933 | $ 459,229 | $ 197,813 | $ 172,818 | $ 1,574,098 | $ 2,954,850 |
| Additions | - | - | - | - | - | - | - |
| Disposals | (61,738) | (109,720) | (5,375) | - | (172,818) | (39,353) | (389,004) |
| Balance, December 31, 2016 | $ 100,221 | $ 279,213 | $ 453,854 | $ 197,813 | $ - | $ 1,534,745 | $ 2,565,846 |
| **Accumulated depreciation** | | | | | | | |
| Balance, December 31, 2015 | $ 135,912 | $ 230,867 | $ 330,345 | $ 197,813 | $ 135,086 | $ 617,344 | $ 1,647,367 |
| Depreciation for year | 12,053 | 29,443 | 26,129 | - | - | 242,572 | 310,197 |
| Disposals | (53,065) | (78,671) | (16,558) | - | (135,086) | (25,945) | (309,325) |
| Balance, December 31, 2016 | $ 94,900 | $ 181,639 | $ 339,916 | $ 197,813 | $ - | $ 833,971 | $ 1,648,239 |
| **Carrying amount** | | | | | | | |
| At December 31, 2015 | $ 26,047 | $ 158,066 | $ 128,884 | $ - | $ 37,732 | $ 956,754 | $ 1,307,483 |
| At December 31, 2016 | $ 5,321 | $ 97,574 | $ 113,938 | $ - | $ - | $ 700,774 | $ 917,607 |

| | Computer Equipment | Furniture & Equipment | Vehicles | Computer Software | Leasehold Improvements | Mining Equipment | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| Balance, December 31, 2016 | $ 100,221 | $ 279,213 | $ 453,854 | $ 197,813 | $ - | $ 1,534,745 | $ 2,565,846 |
| Additions/Disposals | - | - | - | - | - | - | - |
| Balance, March 31, 2017 | $ 100,221 | $ 279,213 | $ 453,854 | $ 197,813 | $ - | $ 1,534,745 | $ 2,565,846 |
| **Accumulated depreciation** | | | | | - | | |
| Balance, December 31, 2016 | $ 94,900 | $ 181,639 | $ 339,916 | $ 197,813 | $ - | $ 833,971 | $ 1,648,239 |
| Depreciation for period | 787 | 25,728 | 6,533 | - | - | 72,380 | 105,428 |
| Balance, March 31, 2017 | $ 95,687 | $ 207,367 | $ 346,449 | $ 197,813 | $ - | $ 906,351 | $ 1,753,667 |
| **Carrying amount** | | | | | | | |
| At December 31, 2016 | $ 5,321 | $ 97,574 | $ 113,938 | $ - | $ - | $ 700,774 | $ 917,607 |
| At March 31, 2017 | $ 4,534 | $ 71,846 | $ 107,405 | $ - | $ - | $ 628,394 | $ 812,179 |

(Expressed in Canadian Dollars) (Unaudited)

## 7. MINERAL PROPERTIES

| | Chandgana Tal | Khavtgai Uul | Pulacayo | Total |
|---|---|---|---|---|
| **Balance, December 31, 2015** | $ 11,040,916 | $ 3,139,891 | $ 11,115,403 | $ 25,296,210 |
| *Additions:* | | | | |
| Deferred exploration costs: | | | | |
| Licenses, power plant application | 93,505 | 89,184 | 4,970 | 187,659 |
| Geological core and consulting | 48,533 | - | 146,051 | 194,584 |
| Personnel, camp and general | 3,368 | 3,368 | 714,519 | 721,255 |
| | 145,406 | 92,552 | 865,540 | 1,103,498 |
| **Balance, December 31, 2016** | $ 11,186,322 | $ 3,232,443 | $ 11,980,943 | $ 26,399,708 |
| *Additions:* | | | | |
| Acquisition cost | $ - | $ - | $ - | $ - |
| Deferred exploration costs: | | | | |
| Licenses, power plant application | 9,599 | 2,449 | - | 12,048 |
| Geological core and consulting | 2,204 | - | 77,955 | 80,159 |
| Personnel, camp and general | 1,196 | 1,196 | 120,303 | 122,695 |
| | 12,999 | 3,645 | 198,258 | 214,902 |
| **Balance, March 31, 2017** | $ 11,199,321 | $ 3,236,088 | $ 12,179,201 | $ 26,614,610 |

Titan Property, Ontario, Canada

The Company has a 100% interest in the Titan property, a vanadium-titanium-iron project located in Ontario, Canada.

In January 2010, the Company entered into an option agreement with Randsburg International Gold Corp. (“**Randsburg**”) whereby Prophecy Resource Corp. had the right to acquire an 80% interest in the Titan property by paying Randsburg an aggregate of $500,000 (paid), and by 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 or 400,000 shares of the Company.

At December 31, 2014, due to market conditions, the Company impaired the value of the property to $nil. On February 10, 2017, the Company acquired the remaining 20% title interest of Randsburg in the Titan project by issuing to Randsburg 20,000 Prophecy Shares at a value of $4.81. As there were no benchmark or market changes from January 1, 2015 to March 31, 2017, the impaired value of $nil for Titan property remains unchanged. Therefore, the Company recorded an impairment loss of $96,200 on the acquisition of the remaining title interest in Titan which was reflected on the consolidated statement of operations and comprehensive loss.

(Expressed in Canadian Dollars) (Unaudited)

## 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities of the Company consist of amounts outstanding for trade and other purchases relating to development and exploration, along with administrative activities. The usual credit period taken for trade purchases is between 30 to 90 days.

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| Trade accounts payable | $ 2,021,184 | $ 2,224,134 |
| Accrued liabilities | 284,690 | 433,884 |
| | $ 2,305,874 | $ 2,658,018 |

## 9. CREDIT FACILITES

In order to meet interim working capital requirements to fund the Company's business operations and financial commitments, the Company arranged a revolving credit facility with Linx Partners Ltd. ("**Linx**"), a private company wholly-owned and controlled by John Lee, Director, CEO and Executive Chairman of the Company by entering into an agreement dated March 12, 2015 (the "**Credit Facility**").

The Credit Facility had a maximum principal amount available for advance of $1.5 million, a two year term (formerly one year, but amended on May 5, 2015 and approved by the TSX) with an option to extend it for any number of subsequent one-year terms and bears an interest at a rate of 1.5% per month with unpaid amounts accruing interest on the same terms.

On February 24, 2016, the Company entered into an agreement (the "**Second Amendment**") to increase and amend the Credit Facility. The previous maximum principal amount of $1.5 million has been increased with the Second Amendment to $2.5 million. A 5% "drawdown" fee will be applicable to amounts advanced over and above the original and outstanding $1.5 million advanced under the Credit Facility, at the time of advance. In consideration of a bonus of $300,000 (the "**Bonus**"), Linx has agreed to postpone any repayments due under the Credit Facility, until the earlier of October 1, 2016, or such time as the Company is in a reasonable financial position to repay all or a portion of the amounts owing, and remove the requirement for the Company to pay any 20% penalties as a result of any future failure to repay any amounts when due under the terms of the Credit Facility.

Including the interest on the Bonus and "drawdown" fee, which also bears an interest at a rate of 1.5% per month with unpaid amounts accruing interest on the same terms, the Credit Facility, carries an effective annual interest rate of 36.3%. The "drawdown" fee, Bonus and all interest payable will be accrued and added to the maximum principal amount as they are incurred.

On March 30, 2016, the Company entered into a Debt Settlement Agreement with Linx and Mr. Lee pursuant to which, the Company agreed, subject to TSX and shareholder approval, which was obtained at the Annual General Meeting on June 2, 2016 to issue 750,000 units to Mr. Lee, in satisfaction of $1,500,000 of indebtedness owed by the Company to Linx under the Credit Facility. Each unit consists of one Common share and one share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of $4.00 per Share for a period of five years from the date of issuance.

## 9. CREDIT FACILITES (cont'd…)

On October 28, 2016, the Company paid $35,000 toward the Credit Facility. As at December 31, 2016, the outstanding balance of the Credit Facility was $1,071,560 including interest payable of $448,388. For the year ended December 31, 2016, the Company recorded an interest expense of $258,640 and finance cost of $317,056 which included the Bonus of $300,000 and draw-down fees of $17,056.

On January 12, 2017, the Company issued 300,000 Shares to Linx in satisfaction of $900,000 of indebtedness owing by the Company under the Credit Facility. Linx also has agreed for a nominal consideration of $1, to accrue and postpone the repayment of any principal, interest and fees due until the earlier of October 1, 2017, or such time as the Company is in a reasonable financial position to repay all or a portion of the amounts owing

As at March 31, 2017, the outstanding balance of the Credit Facility was $181,359 including interest payable of $7,889. For the three months ended March 31, 2017, the Company recorded an interest expense of $7,889 and finance cost of $91.

## 10. SHARE CAPITAL

(a) Authorized

The authorized share capital consists of an unlimited number of common shares without par value (the "**Shares**"). There are no authorized preferred shares. At March 31, 2017, the Company had 5,226,339 (March 31, 2016 – 3,655,711) common shares issued and outstanding.

(b) Equity issuances

On January 12, 2017, The Company, pursuant to the terms of its 2016 Share-Based Compensation Plan, issued 39,000 Shares valued at $4.88 per Share as a bonus to its directors, officers and consultants.

On January 12, 2017, the Company issued 300,000 Shares to Mr. Lee pursuant a Debt Settlement Agreement with Linx to settle $900,000 of the outstanding balance owing by the Company to Linx under the Credit Facility.

On January 13, 2017, the Company closed a non-brokered private placement involving the issuance of 49,999 units (at a price of $3.00 per unit). Each unit consists of one Share and one share purchase warrant. Each Share purchase warrant entitles the holder to acquire an additional Share at a price of $4.00 per Share for a period of five years from the date of issuance. The Company paid in cash, finder's fees totaling $7,997.

On February 10, 2017, the Company acquired the remaining 20% title interest of Randsburg in the patented claims that comprise the Titan project by issuing to Randsburg 20,000 Shares at a value of $4.81.

During three months ended March 31, 2017, the Company issued 9,687 Shares on the exercise of options for total proceeds of $44,685.

(Expressed in Canadian Dollars) (Unaudited)

## 10. SHARE CAPITAL (cont'd…)

(c) Equity-based compensation plans

The following is a summary of the changes in Prophecy's stock options from December 31, 2015 to March 31, 2017:

| | Number of Options | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2015 | 343,742 | $10.00 |
| Granted | 160,000 | $2.00 |
| Expired | (1,000) | $28.00 |
| Forfeited | (37,928) | $21.85 |
| Cancelled | (4,000) | $6.05 |
| Outstanding, December 31, 2016 | 460,814 | $6.42 |
| Granted | 91,000 | $4.88 |
| Exercised | (9,687) | $4.61 |
| Outstanding, March 31, 2017 | 542,127 | $6.19 |

As of March 31, 2017, the following Prophecy Share purchase options were outstanding:

| Exercise Price | Expiry Date | Options Outstanding March 31, 2017 | Options Outstanding December 31, 2016 | Exercisable March 31, 2017 | Unvested March 31, 2017 |
|---|---|---|---|---|---|
| $2.00 | June 2, 2021 | 158,750 | 160,000 | 59,531 | 99,219 |
| $4.88 | January 12, 2022 | 91,000 | - | 91,000 | - |
| $5.00 | June 22, 2020 | 32,800 | 32,800 | 26,240 | 6,560 |
| $5.00 | April 7, 2020 | 82,063 | 90,500 | 80,012 | 2,051 |
| $6.50 | May 1, 2019 | 54,750 | 54,750 | 54,750 | - |
| $10.00 | February 3, 2019 | 5,000 | 5,000 | 5,000 | - |
| $10.50 | January 27, 2019 | 51,500 | 51,500 | 51,500 | - |
| $12.00 | August 16, 2018 | 32,472 | 32,472 | 32,472 | - |
| $13.00 | July 22, 2018 | 2,500 | 2,500 | 2,500 | - |
| $18.00 | August 16, 2017 | 1,500 | 1,500 | 1,500 | - |
| $18.00 | September 24, 2017 | 3,750 | 3,750 | 3,750 | - |
| $18.00 | August 22, 2017 | 17,242 | 17,242 | 17,242 | - |
| $25.00 | June 1, 2017 | 100 | 100 | 100 | - |
| $28.00 | June 18, 2017 | 8,700 | 8,700 | 8,700 | - |
| | | 542,127 | 460,814 | 434,297 | 107,830 |

The three months ended March 31, 2017, included $42,579 (Q1 2016 - $20,898) in share based payment costs related to stock options expensed as general and administrative expenses and $4,663 (Q1 2016 – 12,641) capitalized to mineral properties.

(Expressed in Canadian Dollars) (Unaudited)

## 10. SHARE CAPITAL (cont'd…)

(d) Share purchase warrants

The following is a summary of the changes in Prophecy's share purchase warrants from December 31, 2015 to March 31, 2017 (see Note 10(b)):

| | Number of Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2015 | 436,504 | $6.00 |
| Issued | 936,967 | $4.04 |
| Expired | (25,411) | $10.00 |
| Outstanding, December 31, 2016 | 1,348,060 | $4.68 |
| Issued | 49,999 | $4.00 |
| Outstanding, March 31, 2017 | 1,398,059 | $4.66 |

As of March 31, 2016, the following Prophecy share purchase warrants were outstanding:

| Exercise price | Number of Warrants At March 31, 2017 | At December 31, | Expiry date |
|---|---|---|---|
| $7.00 | 111,200 | 111,200 | September 30, 2020 |
| $7.00 | 62,500 | 62,500 | November 13, 2020 |
| $7.00 | 2,625 | 2,625 | November 13, 2017 |
| $6.00 | 114,768 | 114,768 | June 24, 2017 |
| $5.00 | 120,000 | 120,000 | May 22, 2020 |
| $4.40 | 101,367 | 101,367 | August 29, 2021 |
| $4.00 | 80,000 | 80,000 | January 25, 2021 |
| $4.00 | 5,600 | 5,600 | January 25, 2018 |
| $4.00 | 750,000 | 750,000 | June 2, 2021 |
| $4.00 | 49,999 | - | January 13, 2022 |
| | 1,398,059 | 1,348,060 | |

## 11. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

The fair values of financial assets and financial liabilities approximate their carrying amounts in the condensed interim consolidated balance sheet. The Company does not offset financial assets with financial liabilities. There were no changes to the method of fair value measurement during the period.

(Expressed in Canadian Dollars) (Unaudited)

## 11. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS (cont'd…)

The Company's financial assets and financial liabilities are categorized as follows:

| | March 31, 2017 | | December 31, 2016 | |
|---|---|---|---|---|
| Fair value through profit or loss | | | | |
| Cash | $ | 52,087 | $ | 21,648 |
| Available-for-sale | | | | |
| Available-for-sale investment | | - | | 176,000 |
| Loans and receivables | | | | |
| Receivables | | 233,644 | | 91,565 |
| | $ | 285,731 | $ | 289,213 |
| Other financial liabilities | | | | |
| Accounts payable and accrued liabilities | $ | 2,305,874 | $ | 2,658,018 |
| Credit facilities | | 181,359 | | 1,071,560 |
| | $ | 2,487,233 | $ | 3,729,578 |

## 12. FINANCIAL RISK MANAGEMENT DISCLOSURES

(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 March 31, 2017, the Company had a cash balance of $52,087 (December 31, 2016 – $21,648) in order to meet short-term business requirements.

At March 31, 2017, the Company had accounts payable and accrued liabilities of $2,305,874 (December 31, 2016 - $2,658,018), which have contractual maturities of 90 days or less and a line of credit payments of $181,359 (December 31, 2016 - $1,071,560). The Company is seeking financing in order to be in a position to satisfy its current liabilities. Additional sources of funding, which may not be available on favourable terms, if at all, include: share equity and debt financings; equity, debt or property level joint ventures with power project and coal property developers. In the event that the Company is not able to obtain adequate additional funding to continue as a going concern, material adjustment would be required to both the carrying value and classification of assets and liabilities on the statement of financial position (Note 1).

(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 and receivables, net of allowances. The significant concentration of credit risk is situated in Mongolia. The carrying amount of assets included on the statements of financial position represents the maximum credit exposure.

## 12. FINANCIAL RISK MANAGEMENT DISCLOSURES (cont'd…)

(c) Market risk

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

(i) Interest rate risk

Interest rate 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. During the three months ended March 31, 2017, the Company drew down $1,819 on its Credit Facility with an outstanding balance of $181,359 as at March 31, 2017. Due to the short-term nature of these financial instruments, and that the Company's Credit Facility bears interest at a fixed rate, fluctuations in market rates do not have a significant impact on the fair values or future cash flows of the financial instruments as of March 31, 2017. 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 has exploration and development projects in Mongolia and Bolivia 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, Mongolian tugrik, and Bolivian boliviano into its functional and reporting currency, the Canadian dollar.

Based on the above, net exposures as at March 31, 2017, with other variables unchanged, a 10% (December 31, 2016 – 10%) strengthening (weakening) of the Canadian dollar against the Mongolian tugrik would impact net loss with other variables unchanged by $36,000. A 10% strengthening (weakening) of the Canadian dollar against the Bolivian boliviano would impact net loss with other variables unchanged by $704,300. A 10% strengthening (weakening) of the US dollar against the Canadian dollar would impact net loss with other variables unchanged by $72,000. The Company currently does not use any foreign exchange contracts to hedge this currency risk.

(iii) Commodity and equity price risk

Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. Commodity prices fluctuate on a daily basis and are affected by numerous factors beyond the Company's control. The supply and demand for these commodities, the level of interest rates, the rate of inflation, investment decisions by large holders of commodities including governmental reserves and stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns and monetary systems and political developments. The Company closely monitors commodity prices, individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company. Fluctuations in value may be significant.

(Expressed in Canadian Dollars) (Unaudited)

## 13. RELATED PARTY DISCLOSURES

Prophecy had related party transactions with the following companies, related by way of directors and key management personnel:

- Linx Partners Ltd., a private company controlled by John Lee, Director, CEO and Executive Chairman of Prophecy, provides management and consulting services to the Company.

- MaKevCo Consulting Inc., a private company 50% owned by Greg Hall, Director of Prophecy, provides consulting services to the Company.

- Sophir Asia Ltd., a private company controlled by Masa Igata, Director of Prophecy, provides consulting services to the Company

The amounts due to related parties are non-interest bearing and are due upon demand. See Note 9 for information regarding the Company's credit facility with Linx Partners Ltd.

A summary of amounts paid or accrued to related parties is as follows:

| | | Three Months Ended March 31, | | |
|---|---|---|---|---|
| Related parties | | 2017 | | 2016 |
| Directors and officers | $ | 52,250 | $ | 87,750 |
| Linx Partners Ltd. | | 52,500 | | 52,500 |
| MaKevCo Consulting Inc. | | 6,200 | | 3,800 |
| Sophir Asia Ltd. | | 3,500 | | 3,500 |
| | $ | 114,450 | $ | 147,550 |

A summary of the transactions by nature among the related parties is as follows:

| | | Three Months Ended March 31, | | |
|---|---|---|---|---|
| Related parties | | 2017 | | 2016 |
| Consulting and management fees | $ | 30,900 | $ | 28,500 |
| Directors' fees | | 10,800 | | 10,800 |
| Mineral properties | | 39,000 | | 39,000 |
| Salaries and benefits | | 33,750 | | 69,250 |
| | $ | 114,450 | $ | 147,550 |

On January 13, 2016, the Company's directors and executive management agreed to temporarily:

- reduce directors fees by 50% and defer payment of such reduced directors fees until such time as the Company's cash flow situation permits it to pay such reduced directors fees, and/or to fully or partially restore their directors fees to their original levels;
- reduce the CEO's consulting fees by 50% and defer payment of such reduced consulting fees until such time as the Company's cash flow situation permits it to pay such reduced consulting fees, and/or to fully or partially restore the CEO's consulting fees to their original level;
- reduce other executive officers' salaries by 17% – 50% until such time as the Company's cash flow situation permits it to fully or partially restore their salaries to their original levels.

(Expressed in Canadian Dollars) (Unaudited)

## 13. RELATED PARTY DISCLOSURES (cont'd…)

As at March 31, 2017, amounts due to related parties totaled of $218,446 (December 31, 2016 – $366,269) and was comprised of $218,446 of deferred amounts due to directors, CEO and officers (December 31, 2016 - $180,829), $Nil bonus payable (December 31, 2016 - $185,440).

## 14. KEY MANAGEMENT PERSONNEL COMPENSATION

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

| Key Management Personnel | Three Months Ended March 31, 2017 | 2016 |
|---|---|---|
| Salaries and short term benefits | $ 34,367 | $ 69,250 |
| Share-based payments | 26,324 | 29,181 |
| | $ 60,691 | $ 98,431 |

## 15. SUPPLEMENTAL CASH FLOW INFORMATION

| | Three Months Ended March 31, 2017 | 2016 |
|---|---|---|
| Supplementary information | | |
| Non-Cash Financing and Investing Activities | | |
| Share issued as debt settlement | $ 900,000 | $ - |
| Shares issued for mineral properties | $ 96,200 | $ - |
| Share bonus to personnel | $ 190,320 | $ 364,462 |
| Capitalized interest | $ - | $ 9,948 |
| Property & equipment expenditures included in accounts payable | $ 1,749,571 | $ 1,620,573 |
| Mineral property expenditures included in accounts payable | $ 1,162,057 | $ 592,736 |
| Share-based payments capitalized in mineral properties | $ 4,663 | $ 12,641 |

## 16. CONTINGENCIES

ASC tax claim

Pursuant to the terms of the Agreement, Prophecy agreed to assume all liabilities of the Apogee Subsidiaries, including legal and tax liabilities associated with the Pulacayo Project. During Apogee's financial year ended June 30, 2014, it received notice from the Servicio de Impuestos Nacionales, the national tax authority in Bolivia, that ASC Bolivia LDC Sucursal Bolivia, the Company's wholly-owned subsidiary, owed approximately Bs42,000,000 ($7,003,572) in taxes, interest and penalties relating to a historical tax liability in an amount originally assessed at approximately $760,000 in 2004, prior to Apogee acquiring the subsidiary in 2011. Apogee disputed the assessment and disclosed to the Company that it believed the notice was improperly issued. The Company continued to dispute the assessment and hired local legal counsel to pursue an appeal of the tax authority's assessment on both substantive and procedural grounds.

**16. CONTINGENCIES** (cont'd…)

ASC tax claim (cont'd…)

On May 26, 2015, the Company received a positive Resolution issued by the Bolivian Constitutional Court that among other things, declared null and void the previous Resolution of the Bolivian Supreme Court issued in 2011 (that imposed the tax liability on ASC Bolivia LDC Sucursal Bolivia) and sent the matter back to the Supreme Court to consider and issue a new Resolution. The Company plans to continue to vigorously defend its position and make submissions to the Supreme Court during the new hearing. Based on these developments, the tax claim amount of $7,003,572 was classified as non-current liabilities.

Red Hill tax claim

During the year ended December 31, 2014, Red Hill was issued a letter from the Sukhbaatar District Tax Division notifying it of the results of the Sukhbaatar District Tax Division's VAT inspection of Red Hill's 2009-2013 tax imposition and payments that resulted in validating VAT credits of only MNT235,718,533 from Red Hill's claimed VAT credit of MNT2,654,175,507. Red Hill disagreed with the Sukhbaatar District Tax Division's findings as the tax assessment appeared to the Company to be unfounded. The Company disputed the Sukhbaatar District Tax Division's assessment and submitted a complaint to the Capital City Tax Tribunal. On March 24, 2015, the Capital City Tax Tribunal resolved to refer the matter back to the Sukhbaatar District Tax Division for revision and separation of the action between confirmation of Red Hill's VAT credit, and the imposition of the penalty/deduction for the tax assessment.

The Sukhbaatar District Tax Division appealed the Capital City Tax Tribunal's resolution to the General Tax Tribunal office, but was denied on June 4, 2015 on procedural grounds. As a result, the Sukhbaatar District Tax Division implemented the Capital City Tax Tribunal's resolution on June 25, 2015, finding: (1) with respect to confirmation of Red Hill's VAT credit, that after inspection the amount was to be MNT235,718,533; and (2) with respect to the imposition of the penalty/deduction for the tax assessment, that no penalty was to be issued but that Red Hill's loss to be depreciated and reported to be MNT1,396,668,549 in 2010 and MNT4,462,083,700 in 2011. The Company continues to dispute the Sukhbaatar District Tax Division's assessment and delivered a complaint to Capital City Tax Tribunal on July 24, 2015. Due to the uncertainty of realizing the VAT balance, the Company has recorded an impairment charge for the full VAT balance in the year ended December 31, 2015. As there were no changes from January 1 to March 31, 2017, the impaired value of $Nil for the VAT receivable remains unchanged.

**17. EVENTS AFTER THE REPORTING DATE**

- On April 12, 2017, the Company closed a non-brokered private placement involving the issuance of 103,250 units at a price of $4.00 per unit. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of $5.00 per Share for a period of five years from the date of issuance.

- On May 8, 2017, the Company entered into a binding letter agreement (the "**Letter Agreement**") with arm's-length, private parties (the **"Lessor"**) to acquire through lease, the Gibellini vanadium project in Nevada, USA (the **"Gibellini Project"**). Under the Letter Agreement, Prophecy will lease the Gibellini mining claims which constitute the Gibellini Project by paying to the Lessor, annual advance royalty payments which will be tied, based on an agreed formula (not to exceed US$120,000 per year), to the average vanadium pentoxide price of the prior year.

## 17. EVENTS AFTER THE REPORTING DATE (cont'd…)

Upon commencement of production, Prophecy intends to maintain its acquisition through lease of the Gibellini mining claims by paying to the Lessor, a 2.5% net smelter return (**"NSR"**) until a total of US$3 million is paid. Thereafter, the NSR will be reduced to 2% over the remaining life of the mine (and referred to thereafter, as "production royalty payments"). All advance royalty payments made, will be deducted as credits against future production royalty payments. The lease will be for a term of 10 years, which can be extended for an additional 10 years at Prophecy's option. The parties have agreed to replace the Letter Agreement by entering into a more comprehensive definitive agreement by May 17, 2017.