Prophecy Coal Corp.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## For the three months ended March 31, 2014
## (Expressed in Canadian Dollars)

This Management's Discussion and Analysis ("**MD&A**") of Prophecy Coal Corp. and its subsidiaries ("**Prophecy Coal**", or the "**Company**") provides analysis of the Company's financial results for the three months ended March 31, 2014. The following information should be read in conjunction with the accompanying March 31, 2014 unaudited condensed interim consolidated financial statements and the notes to those financial statements, 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, 2013 (prepared in accordance with IFRS) ("**Audited Consolidated Financial Statements**") and the related annual MD&A, all of which are available on the SEDAR website at www.SEDAR.com.

Financial information is expressed in Canadian dollars, unless stated otherwise. This MD&A is current as of May 14, 2014, and was reviewed, approved, and authorized for issue by the Company's Board of Directors.

**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, 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 Coal'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 mineral property and the Chandgana coal mineral properties; and other information concerning possible or assumed future results of operations of Prophecy Coal. See in particular, the section Select Financial and Operational Data under Part 3 – Business Overview and 2014 Outlook descriptions.*

*Forward-looking statements in this document are frequently identified by words such as "expects", "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 Coal'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 Coal.*

*In making the forward-looking statements in this MD&A, Prophecy Coal 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 Coal'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, 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 Coal's current mineral resource estimates; labour and materials costs increasing on a basis consistent with Prophecy Coal's current expectations; and any additional required financing will be available on reasonable terms. Prophecy Coal cannot assure you that any of these assumptions will prove to be correct.*

*Numerous factors could cause Prophecy Coal'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 Coal's history of net losses and lack of foreseeable cash flow; exploration, development and production risks, including risks related to the development of Prophecy Coal's Ulaan Ovoo coal property; Prophecy Coal not having a history of profitable mineral production; commencing mine development production without a feasibility study; the uncertainty of mineral resource and mineral reserve estimates; the capital and operating costs required to bring Prophecy Coal'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, which is a developing country and being subject to its local laws; the availability and timeliness of various government approvals and licences; the feasibility, funding and development of the Chandgana Power Plant; protecting title to Prophecy Coal's mineral properties; environmental risks; the competitive nature of the mining business; lack of infrastructure; Prophecy Coal's reliance on key personnel; uninsured risks; commodity price fluctuations; reliance on contractors; Prophecy Coal'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; 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 Coal or any other person that Prophecy Coal's objectives or plans will be achieved.*

*These factors should be considered carefully and readers should not place undue reliance on Prophecy Coal's forward-looking statements. Prophecy Coal 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 Prophecy Coal 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 Coal 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.*

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(Expressed in Canadian Dollars)

## 1. INTRODUCTION

Prophecy Coal Corp. is a company incorporated under the laws of the province of British Columbia, Canada. Its focus is on the acquisition, exploration and development of coal properties and the development of its Chandgana Power Plant project in Mongolia.

Prophecy Coal is a reporting issuer in the provinces of British Columbia, Alberta, and Ontario. The Company's common shares (the "**Shares**" or "**Prophecy Coal Shares**") are listed for trading on the Toronto Stock Exchange ("**TSX**" or the "**Exchange**") under the symbol "PCY".

### *General Corporate Information*

At March 31, 2014 and May 14, 2014, Prophecy Coal had: (i) 249,387,569 common shares issued and outstanding; (ii) 22,053,750 and 28,963,750 share options for common shares outstanding, respectively; and (iii) 13,225,583 warrants for common shares outstanding.

**Share Information**
Common shares of Prophecy Coal are listed for trading on: (i) the TSX under the symbol "PCY", (ii) the OTC-QX under the symbol "PRPCF", and (iii) on the Frankfurt Stock Exchange under the symbol "1P2".

**Investor Information**
All financial reports, news releases and corporate information can be accessed on our web site at www.prophecycoal.com

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### *Directors and Officers*

As at the date of this MD&A, Prophecy Coal'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 |
| Chuluunbaatar Baz | Tony Wong, Corporate Secretary |
| Greg Hall | |
| Masa Igata | |
| ***Audit Committee*** | ***Corporate Governance and Compensation Committee*** |
| Greg Hall (Chair) | Greg Hall (Chair) |
| Harald Batista | Harald Batista |
| Masa Igata | Masa Igata |

### *Qualified Person*

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 is not considered independent of Prophecy Coal given the large extent that his professional time is dedicated solely to Prophecy Coal. Mr. Kravits has reviewed and approved the technical and scientific disclosure regarding the mineral properties of Prophecy Coal contained in this MD&A.

## 2. FIRST QUARTER HIGHLIGHTS

- On January 7, 2014, the Company issued a second tranche of 1,013,750 shares related to its 2012 share bonus to certain employees, directors, officers, and consultants of the Company;
- On February 3, 2014, the Company appointed Tony Wong as General Counsel and Corporate Secretary. Mr. Wong replaced Pat Purdy as Prophecy Coal's Corporate Secretary;
- In January and February 2014, the Company granted 250,000, 5,550,000, and 500,000 share purchase options to directors, officers, employees, and consultants of the Company at exercise prices of $0.08, $0.105, and $0.10 per share respectively. All of these options are exercisable for a period of five years and vest at 12.5% per quarter following the date of grant;
- On February 27, 2014, the Company announced the death of Company director Michael J. Deats;
- On January 23, 2014, 1,056,800 share purchase options exercisable at $0.28 per share expired;
- In January and February 2014, 14,755,000 Prophecy Coal share purchase options with exercise prices of $0.25 and $0.28 and expiring between October 29, 2014 and June 18, 2016 were voluntarily surrendered and cancelled;
- During the quarter, 1,523,881 of Wellgreen Platinum Ltd.'s ("**Wellgreen Platinum**") reserved common shares held in-trust were released back to the Company; and
- During the quarter, the Company sold its remaining 3,327,261 un-reserved common shares of Wellgreen Platinum in addition to 1,523,881 common shares released from trust for net proceeds of $4,203,638.

*Subsequent to quarter end*

- On April 3, 2014, the Company filed on SEDAR a revised National Instrument 43-101 compliant technical report on its Chandgana Tal coal mining licenses in central Mongolia with a reissue date of February 2014, titled "Technical Report, Coal Resources and Preliminary Economic Assessment, Coal Mine Component, Chandgana Tal Coal Project" (the "**PEA**"). The PEA replaces the technical report on the Chandgana Tal Coal Project previously filed by the Company on SEDAR on November 30, 2012 (the "**Previous Report**"). See discussion below under Highlights on the Chandgana Coal Properties; and
- On May 1, 2014, the Company granted 7,135,000 incentive share purchase options to various directors, officers, employees and consultants of the Company. The options are exercisable at a price of $0.065 per common share for a term of five years expiring on May 1, 2019 and vest at 12.5% per quarter two years following the date of grant. 3,575,000 of these options are subject to the approval of the TSX and a portion thereof, is also subject to shareholder approval at the Company's next annual general meeting.

## 3. BUSINESS OVERVIEW

### Mineral Properties

As of March 31, 2014, Prophecy Coal's primary mineral properties included: Ulaan Ovoo coal property (Operating mine, Mongolia), the Khavtgai Uul and Chandgana Tal coal deposits (Mongolia), collectively known as the "Chandgana Coal Properties". The other properties of Prophecy Coal include the Okeover copper-molybdenum project (British Columbia, Canada), Kanichee property (Ontario, Canada), and the Titan iron-titanium project (Ontario, Canada).

***Highlights on Ulaan Ovoo***

The estimated resources, reserves, coal quality, and other mine characteristics of the Ulaan Ovoo coal property (100% interest) were estimated by independent consultancies. The Behre Dolbear & Company (USA), Inc. report ("**Scoping Study Ulaan-Ovoo Coal Deposit**") dated October 2006 was prepared by independent Qualified

Person Mr. Gardar G. Dahl, Jr, P. Geo, a senior associate of Behre Dolbear & Company (USA), Inc. (the "**Behre Dolbear Report**"). The Wardrop report ("**Ulaan Ovoo Pre-Feasibility Study**") dated December 10, 2010 was prepared by John Sampson, B.Sc. (Hons) and Brian Saul P. Eng. who are independent Qualified Persons under NI 43-101. Both reports are available on www.SEDAR.com.

Coal resource detail of the Ulaan Ovoo property

| Coal Resources (million tonnes) | | |
|---|---|---|
| Measured | Indicated | Total |
| 174.5 | 34.3 | 208.8 |

*Resources are from the 2006 Behre Dolbear NI 43-101 report.*

Coal reserve detail of the starter pit area of the Ulaan Ovoo property

| Coal Reserves (million tonnes) | | | Mining Period (years) | Strip Ratio (Bcm/t) | Coal Quality (arb) | | | |
|---|---|---|---|---|---|---|---|---|
| Proven | Probable | Total | | | Total Moisture (wt %) | Ash (wt %) | Gross Calorific Value (kcal/kg) | Total Sulfur (wt %) |
| 20.7 | 0 | 20.7 | 10.7 | 1.8:1 | 21.7 | 11.3 | 5,040 | Not det |

*Reserves, mining period, coal quality, and strip ratio are from the December 2010 Wardrop pre-feasibility report. This study was prepared for a starter pit and only considered a portion of the resource area north of the Zelter River. Coal reserves and qualities given in the above table are stated on a Run-of-Mine (ROM) basis and take into account mining loss and rock dilution at coal/rock interfaces. Strip ratio is the operating strip ratio. Proven reserves are of Low Ash (high grade) coal.*

**Select Financial and Operational Data**

On December 31, 2012, the Company recorded a non-cash impairment write down of $47 million on the Ulaan Ovoo property, which was reflected on the consolidated statement of operations and comprehensive loss. The impairment charge reduced previously capitalized deferred exploration costs within property and equipment, to a balance of $2 million. As there were no benchmark or market changes as of March 31, 2014 the impaired value for Ulaan Ovoo within property and equipment, remained unchanged at a balance of $2 million. Costs in excess of the impaired value for the quarter ended March 31, 2014 totalled $2.2 million (March 31, 2013 - $2 million) which are reflected on the consolidated statement of operations and comprehensive loss.

During the first quarter of 2014, the Company produced approximately 77,500 tonnes (March 31, 2013 - nil) of coal, all of which had a gross calorific value ("**GCV**") greater than 5,000 kcal/kg. As of March 31, 2014, the coal stockpile balance was approximately 154,000 tonnes (December 31, 2013 - 119,900) with a value of approximately $2.56 million (December 31, 2013 - $1.76 million).

During the quarter, the Company sold approximately 43,000 tonnes (March 31, 2013 - 40,000 tonnes) of coal with total sales revenue of approximately $1.24 million (March 31, 2013 - $0.85 million). Sales volume is generally lower in the first quarter of each year due to the seasonal holidays of Mongolian Tsagaan Sar and Chinese New Year, which result in a general decrease in the level of economic activity. Approximately 70% of sales during the quarter consisted of coal with GCV greater than 5,000 kcal/kg consistent with the Company's efforts to drive higher margin sales. As the Company is in the pre-commercial production stages, proceeds from the sale of coal are not recorded as revenue but are rather offset against capitalized deferred exploration costs.

During the quarter, the Company purchased approximately $0.5 million in mining equipment which included an excavator, a loader, and coal drying and crushing equipment to facilitate consistently producing coal with GCV greater than 5,000 kcal/kg.

The Company continued its dedication to satisfying its existing local customer base while simultaneously trying to increase domestic sales to industrial customers while actively managing existing and new business relationships in its neighbouring Russian regions. Inquiries regarding Ulaan Ovoo coal purchases from the state Republic of Buryatia, Russia continued and discussions with Mongolian local and national governments, related to re-opening the Zeltura border crossing in order to facilitate coal exports to Russia also continued.

During the end of 2013 and the first quarter of 2014, management visited a number of potential industrial customers in the Republic of Buryatia, Russia to discuss their coal purchase needs and drafted proposals with the goal of establishing continuous coal shipments to Russia during 2014. The Company is currently negotiating coal offtake agreements with these potential industrial customers in the Republic of Buryatia, Russia. On February 10, 2014, the Company sold and successfully delivered a coal shipment from Sukhbaatar rail station to a Russian customer. The coal quality was approximately 5,300kcal/kg of GCV, 0.5% sulphur, and 5% ash.

***2014 Outlook***

Since resuming operations at Ulan Ovoo, management primarily works towards improving mining practices in the areas of safety, cost containment and coal quality improvement. With these mandates and since near surface oxidized coal was removed in 2011 and 2012, the Company has been able to consistently mine higher grade thermal coal with GCV greater than 5,000 kcal/kg, as evidenced with quarter one production figures. With consistent, effective and efficient mining practices, management expects that approximately ninety percent of the coal mined at Ulan Ovoo will be greater than 5,000 kcal/kg in 2014 as was projected in the Wardrop Pre-Feasibility Study. As such the Company is transitioning to supplying to a market for coal of GCV greater than 5,000 kcal/kg which realizes premium pricing, both in the Company's domestic and neighbouring market, Russia.

The Company has only commenced penetrating the premium thermal coal market in these regions and believes there is potential to expand sales with minimal competition in northern Mongolia and its neighboring Russian region, where higher margins can be obtained. The Company has invested in various mining equipment including a coal screener and coal drying equipment in order to enable the provision of specific coal sizes and to support maintaining lower moisture levels in order to consistently produce coal with GCV greater than 5,000 kcal/kg. As such the Company is focusing its efforts on controlling its mining practices and its marketing efforts to primarily become a provider of coal with GCV greater than 5,000 kcal/kg and to capture greater market share where premium prices can be obtained. Lower grades of coal will be used to produce briquettes and sold in the briquette market for higher prices accordingly.

In addition, the Company has officially submitted a feasibility study for upgrading the road from the Ulaan Ovoo mine to the Zeltura border to the Mongolian Ministry of Road and Transportation. Given that the mine is approximately 17km from the Zeltura border (as opposed to approximately 120km from the mine to Sukhbaatar), the re-opening of the Zeltura border crossing would reduce transportation costs and potentially further support increased coal sales to Russia. If accepted by the Ministry of Road and Transportation, road upgrades can begin which are estimated to take approximately four months, based on preliminary tenders received. Concurrently, the Company is working with the Ministry of Finance and Mongolian Customs Office on creating a customs clearing zone at the Ulaan Ovoo mine site for Russian exports that would go through Zeltura. While the Company is pleased with the overall progress and appreciates the support from the Mongolian and Russian authorities, it cannot offer any certainty or a definitive time frame to start transporting coal to Russia through Zeltura.

The Company continues to evaluate operating alternatives (e.g. electrification, conveyance vs. haul), infrastructure improvement, and further management changes in addition to new uses for Ulaan Ovoo coal, methods to upgrade its quality and pursue financial arrangements including strategic partner or joint venture arrangements or the sale of a portion or the entire project. Though management believes the domestic and export thermal coal market appears to be improving and is profitable, the Company is unable to determine whether improvement will materialize and if so, be sustainable, and when, if at all, access to Russian coal markets will be opened, nor the extent of project changes and operational modifications required and the potential value of the coal resources.

***Highlights on the Chandgana Coal Properties***

The Chandgana properties consist of the Chandgana Tal ("**Tal**") and Khavtgai Uul ("**Khavtgai**") (formerly named Chandgana Khavtgai) (100% interest) properties which are within nine kilometres of each other in the Nyalga Coal Basin in east central Mongolia which is approximately 280 kilometres east of Ulaanbaatar.

A NI 43-101 technical report ("**Technical Report on the Coal Resources of the Chandgana Tal Coal Project Khentii Aimag, Mongolia**") dated September 11, 2007 was prepared by independent Qualified Person Mr. Gardar G. Dahl, Jr, P. Geo, a senior associate of Behre Dolbear & Company (USA), Inc. (the "**Behre Dolbear**

**Report**"). Prophecy Coal engaged Leighton Asia LLC to prepare a scoping level mine study for the Tal property which was completed during December 2011. Later the PEA was prepared by John T. Boyd Co. and received in November 2012 for the Tal licenses. A subsequent amendment to the PEA was reissued in February of 2014 with the following revisions:

- The previous report was prepared on a before tax basis. The change to an after-tax basis in the amended PEA decreased the base financial results including reducing the IRR from 36% to 28%, increased the payback period from 4 to 5.3 years, and decreased the NPV from US $70.5 million to US $47.8 million at a 10% discount rate.

- The previous report was also prepared without depreciation. The inclusion of depreciation as determined for income tax purposes effected an approximate US $5 million per year positive adjustment to after tax cash flow. The Mongolian income tax is a two tiered rate that makes for an approximate US $3 million decrease in net cash flow.

- Net annual cash flow decreased slightly in the amended PEA due to an increase in total indirect costs from US $1.24 to US $1.60 per tonne to account for additional water usage fees determined and applied by the Mongolian government after the previous report was prepared.

- The final revised direct cost of materials and supplies also decreased resulting in a net decrease in total direct costs from US $6.56 to US $6.30 per tonne.

- The amended PEA has also been updated to reflect that the US $17.70 per tonne mine gate price has been determined in reliance on the terms of the Coal Supply Agreement.

The resulting financial evaluation in the amended PEA indicates that the project is potentially economically viable given the coal price assumption of US $17.70 per tonne sold at the mine gate directly to the power plant. The coal price is fully indexed and will rise according to rising input costs such as fuel, labor, and parts. Therefore the coal project is expected to provide stable return throughout the life of mine. Furthermore, the mineral resource estimate covers only the Chandgana Tal mining licenses. There is potential to scale up the Chandgana power plant project and source additional coal supply from Chandgana Coal's nearby Khavtgai Uul coal deposit. Please refer to the news release dated April 3, 2014 or the updated PEA as filed on www.SEDAR.com on April 3, 2014 for additional details.

An updated NI 43-101 technical report on the Khavtgai property ("**Updated Technical Report on the Coal Resources of the Chandgana Khavtgai Coal Resource Area, Khentii Aimag, Mongolia**") dated September 28, 2010 was completed by Christopher Kravits, LPG, CPG of Kravits Geological Services LLC (the "**Khavtgai Report**"). The Khavtgai Report updates the previous independent technical report on the Khavtgai property prepared by Mr. Kravits dated January 9, 2008. All the reports are filed on www.SEDAR.com. The resource and mining characteristics of the Chandgana Coal Properties are summarized in the following table:

Coal resource details of the Chandgana Properties

| Property | Coal Resources (million tonnes) | | | Life of Mine (years) | Strip Ratio (Bcm/t) | Coal Quality (arb) | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Measured | Indicated | Total | | | Total Moisture (wt %) | Ash (wt %) | Gross Calorific Value (kcal/kg) | Total Sulfur (wt %) |
| Khavtgai | 509.3 | 538.8 | 1,048.1 | Not det | 2.2:1 | 36.5 | 10.1 | 3,636 | 0.6 |
| Tal | 124.4 | 0.0 | 124.4 | 30 | 0.7:1 | 40.9 | 10.8 | 3,306 | 0.6 |
| Total/Weighted Avg | 633.7 | 538.8 | 1,172.5 | | 2.0:1 | 37.0 | 10.2 | 3,601 | 0.6 |

*Coal quality is for the in-place coal. Strip ratio is the point strip ratio for Khavtgai and operating strip ratio for Tal.*

The Khavtgai coal resource area contains a significant coal resource. The coal seams are thick and the strip ratio is low such that surface mining methods appear best suited to recover the coal. The coal is of moderate grade and low rank and appears suitable for use as a thermal coal but the large size of the resource and moderate grade suggest the resource may also be suitable for use as a conversion feedstock.

During the first quarter 2014, the Company incurred total costs of $156,237 (March 31, 2013 - $1.35 million) for the Chandgana Tal property (including power plant application costs) and $21,269 (March 31, 2013 - $271,821) for the Chandgana Khavtgai property.

***2014 Outlook***

For the Tal property, the Company is preparing to register the reserve estimate and have more studies prepared. This work is needed to maintain the licenses and eventually obtain permission to mine at the rate of 3.6 million tonnes per year.

Work on the Khavtgai license will include drilling, hydrologic and geotechnical studies, and other work. This work is needed to convert the license to a mining license such that the Company may retain exploration and mining rights to the license.

***Chandgana Power Plant Project, Mongolia***

The Chandgana Power Plant Project area is next to the Baganuur - Undurkhaan paved road and within 150 kilometres of the Central Mongolian Railroad. The paved road and the railroad can facilitate the transportation of construction equipment, power plant components and mining equipment. The Power Plant Project is within 150 kilometres of the Bagaanuur interconnect to the central electricity transmission grid and 50 kilometres to the Undurhaan interconnect to the eastern electricity transmission grid.

On November 15, 2010, Prophecy Coal reported that the Detailed Environmental Impact Assessment ("**DEIA**") pertaining to the construction of the Power Plant Project was approved by the Mongolian Ministry of Nature and the Environment. The DEIA was prepared by an independent Mongolian environmental consulting firm which considered social and labour issues, climate and environmental circumstances specific to the proposed power plant. According to the study, there are no major impediments to the Power Plant Project. On November 15, 2011, Prophecy Coal's wholly-owned Mongolian subsidiary East Energy Development LLC (now renamed as Prophecy Power Generation LLC),("**Prophecy Power**") received a license certificate from the Mongolian Energy Regulatory Authority (the "**ERA**") to construct a 600 MW (150 MW x 4) power plant at Chandgana. An English translation of the license was filed on SEDAR at www.SEDAR.com on December 14, 2011.

During late 2011 and early 2012 Prophecy Power received requests to be considered for the construction of the power plant from Asian Engineering, Procurement and Construction (EPC) firms. Prophecy Power shortlisted the field during June 2012 to three Chinese EPC firms. The Company then issued the technical specification requirements in July 2012 and received three final tenders in September 2012. Evaluation of the final tenders indicated that the Chandgana Power Plant project construction costs are within the estimated capital budget of the project.

On May 28, 2012, Prophecy Coal reported that it entered into a Cooperation Covenant (the "**Covenant**") with the ERA to bring the 600 MW Chandgana Power Project online by 2016. The ERA is the agency which implements governmental policy in the power and energy sector of Mongolia. The Covenant provides for the coventees to support the construction and operation of the Chandgana 600 MW mine-mouth power plant and its ability to supply the electricity to the central and eastern power grids of Mongolia by 2016. The Covenant also addresses the basic rights and obligations of Prophecy Coal, as the seller and the National Electricity Transmission Grid Company of Mongolia ("**NETGCO"**) as the purchaser of the electrical energy.

On August 7, 2012 Prophecy Coal reported that since East Energy Development LLC (now Prophecy Power Generation LLC) obtained the construction licence in November, 2011, Prophecy Coal has been in on-going discussions with the Mongolian government to finalize a Power Purchase Agreement ("**PPA**"). The proposed PPA details the terms under which Prophecy Power would supply power to NETGCO and once executed will enable Prophecy Coal to seek project financing and begin construction. Prophecy Coal has also had numerous discussions with the Ministry of Natural Resources and Energy (now Ministry of Energy) to discuss technical and commercial issues. Prophecy Power formally submitted its PPA proposal to NETGCO on September 6, 2012 the highlights of which include:

- A designated commercial operations date of the proposed power plant to be determined dependant on signing required agreements, obtaining appropriate approvals and permits, and closure of the power plant projects financing, which are in the process of being obtained;

- A long term power off-take contract to ensure 24/7, uninterrupted dispatch power supply to the Mongolian grid; and

- Capacity and energy charge components in the tariff to cover fixed and variable costs respectively.

Prophecy Power has also been in discussions with several private Mongolian companies regarding entering into bilateral power purchase agreements for mining projects (copper, molybdenum and iron ore) and an industrial development complex (cement manufacture and smelter) in Mongolia.

On September 3, 2012, Prophecy Power submitted a Tariff Application to the Energy Regulatory Commission ("ERC"). Prophecy Power received official notice outlining the terms of the tariff agreement on May 17, 2013. The tariff includes:

- An initial tariff for the first year of the Power Project plant operation; and

- A weighted average tariff for the remaining 24 years of power plant operation.

The tariff numbers are in-line with PPG's final proposal submission to the Working Group on February 2013.

On March 5, 2013, the Company announced that Prophecy Power has been granted 532.4 hectares of land to be used for siting the Company's proposed Chandgana power plant (the "**Land Use Rights**"). With the Land Use Rights in place, Prophecy Power has entered into a contract with Erchim Concern LLC to bring 4MW of temporary power to the Chandgana Power Plant site from a local 35kV power line. Separately, Prophecy Power has issued tenders for the construction of 250 housing units along with a water supply to the Chandgana power plant site.

On June 5, 2013 PPG and Chandgana Coal executed a Coal Supply Agreement (CSA). The CSA calls for Chandgana Coal LLC, another Prophecy Coal wholly-owned Mongolian subsidiary, to supply 3.6 million tonnes of coal per year to Prophecy Power for 25 years. The initial coal price is US $17.70 per tonne which is competitive with Mongolian domestic thermal coal prices and is subject to annual price adjustments through indexing using the US Consumer Price Index, Mongolian Wage Index and Mongolian Diesel Price Index. The coal is to be mined from Chandgana Coal's Chandgana Tal mining licenses located two kilometres to the south of the proposed power plant location.

Prophecy Power entered into a Memorandum of Cooperation with Murum Soum where the power plant will be located wherein both parties will support each other in areas of mutual concern such as infrastructure, cultural issues, social issues, education, and health issues. As a result, a scholarship program was initiated during 2012 and continues for those interested in obtaining a university degree. Also, Prophecy Coal continues to supports certain cultural and social events.

In July 2013, the Company applied for a concession with the Ministry of Economic Development (MOED) for the power project. After extensive document submissions and discussions, the Mongolian Cabinet approved the Chandgana Power Plant project as a concession project in January 2014. Subject to negotiations, a concession project may be entitled to stable tax rates, favorable VAT and customs duties, as well as other forms of government subsidies, endorsement and support; all of which can enhance bankability and lead to better financing options for the project. While the Company is pleased with the overall progress and appreciated support from various Mongolian authorities, it cannot offer certainty or a definitive time frame to conclude the Concession Agreement with MOED, or the Power Purchase Agreement with the Ministry of Energy.

### *2014 Outlook*

The Company actively pursues the remaining agreements, approvals and permits required to proceed with the development of the Chandgana Power Plant Project. Prophecy Coal also continues to actively consider the project financing options which include either debt, equity or a combination thereof in addition to joint ventures with international power project developers.

***Titan Property, Ontario, Canada***

Prophecy Coal has an 80% interest in the Titan iron-titanium property ("**Titan**") located in Ontario province, Canada. Prophecy Coal has done much exploration work including 22 kilometres of line cutting covering over 2.7 square kilometres in 100 metre intervals that extended the current surveyed grid west and southwest of the Titan property. A ground magnetometer survey was completed during the summer of 2010, the results of which expanded the extent of the magnetic anomaly associated with the Titan deposit. This work successfully demonstrated that exploration is warranted outside the previously known limits. The assessment work completed 2011 was approved. No assessment work was completed during 2013. During the quarter ended March 31, 2014, the Company spent $2,549 for land taxes.

***2014 Outlook***

The Company will maintain its interest in Titan and the required license maintenance work will be completed. Further exploration is planned for 2014 including GPS of the claim posts. The Company will continue monitoring commodity prices to consider the timing of possible development.

***Kanichee Property, Ontario, Canada***

Prophecy Coal holds a 100% interest in the surface rights of the Kanichee property ("**Kanichee**") located in Streathy Township, 375 km north of Toronto, Ontario, Canada. Kanichee consists of 15 mineral claims covering 583 acres that include surface and underground mine workings. The property includes copper and nickel mineralization associated with two dykes. No assessment work is currently planned as of the date of this report. No claim work is required to maintain title to the properties since they are surface rights.

***2014 Outlook***

The Company will maintain its interest in Kanichee. The required 2014 taxes were paid and the required license maintenance work will be completed in 2014.

***Okeover Property, British Columbia, Canada***

The 60% interest in Okeover, a copper-molybdenum project in south-western British Columbia, Canada, 25 kilometres north of Powell River and 145 kilometres northwest of Vancouver, was acquired through the amalgamation between Red Hill and Prophecy Coal Holdings Inc. in April 2010. Prior exploration work suggested mineralization exists east, west and south of the known mineralized body. Work costing $56,488 was completed during the year ended December 31, 2013 to assess the mineralization. This work included 13.3 line kilometers of surveying and flagging to extend the grid of which 9.4 km the vegetation was cut and the soil sampled with a total 178 soil and 29 rock samples. Significant copper and molybdenum mineralization was found and zones of high IP chargeability. The results are being reviewed as of the first quarter 2014.

***2014 Outlook***

The Company will maintain its interest in Okeover. The planned exploration includes four kilometers of grid lines to be cut and sampled and diamond drilling. The required license maintenance work will be completed and the Company will continue monitoring commodity prices to consider the timing of possible development.

(Expressed in Canadian Dollars)

## 4. SUMMARY OF QUARTERLY RESULTS

| | 2014 | 2013 Dec-31 | 2013 Sep-30 | 2013 Jun-30 |
|---|---|---|---|---|
| Operating expense | $ (622,005) | $ 225,160 | $ (2,731,414) | $ (793,281) |
| **Loss Before Other Items and Deferred Income Tax** | (622,005) | 225,160 | (2,731,414) | (793,281) |
| Other items | 422,796 | (11,997,195) | (2,568,853) | (2,771,104) |
| **Loss Before Deferred Income Tax** | (199,209) | (11,772,035) | (5,300,267) | (3,564,385) |
| Deferred income tax recovery | - | 953,100 | - | - |
| **Net Income (Loss) for Quarter** | (199,209) | (10,818,935) | (5,300,267) | (3,564,385) |
| Fair value gain (loss) on available-for-sale investments | - | - | (202,149) | (333,639) |
| **Comprehensive Income (Loss) for Quarter** | (199,209) | (10,818,935) | (5,502,416) | (3,898,023) |
| **Share Information** | | | | |
| Net Loss per share, basic and diluted | $ (0.00) | $ (0.04) | $ (0.02) | $ (0.02) |
| Comprehensive Loss per share, basic and diluted | (0.00) | (0.04) | (0.02) | (0.02) |
| Average number of common shares outstanding for quarter, basic and diluted | 249,319,226 | 248,148,215 | 243,176,495 | 236,490,184 |

| | 2013 Mar-31 | 2012 Dec-31 | 2012 Sep-30 | 2012 Jun-30 |
|---|---|---|---|---|
| Operating expense | $ (794,913) | $ (1,069,354) | $ (2,970,363) | $ (2,474,327) |
| **Loss Before Other Items and Deferred Income Tax** | (794,913) | (1,069,354) | (2,970,363) | (2,474,327) |
| Other items | (2,817,654) | (46,585,365) | (2,328,747) | 1,439,189 |
| **Loss Before Deferred Income Tax** | (3,612,567) | (47,654,718) | (5,299,110) | (1,035,138) |
| Deferred income tax recovery | - | (1,569,024) | 160,247 | (68,176) |
| **Net Loss for Quarter** | (3,612,567) | (49,223,742) | (5,138,863) | (1,103,314) |
| Fair value gain (loss) on available-for-sale investments | 781,484 | 2,476,797 | 688,744 | (2,114,759) |
| **Comprehensive Income (Loss) for Quarter** | (2,831,082) | (46,746,945) | (4,450,119) | (3,218,073) |
| **Net Income (Loss) for Quarter Attributable to:** | | | | |
| Owners of the Company | (3,612,567) | (48,831,202) | (3,242,577) | (289,024) |
| Non-controlling interest | - | (879,254) | (1,409,573) | (814,290) |
| | (3,612,567) | (49,710,456) | (4,652,150) | (1,103,314) |
| **Comprehensive Loss for Quarter Attributable to:** | | | | |
| Owners of the Company | (2,831,082) | (44,266,921) | (2,961,989) | (4,638,569) |
| Non-controlling interest | - | (804,911) | (1,647,892) | (94,856) |
| | $ (2,831,082) | $ (45,071,832) | $ (4,609,880) | $ (4,733,425) |
| **Share Information** | | | | |
| Net Loss per share, basic and diluted attributable to: | | | | |
| Owners of the Company | $ (0.02) | $ (0.22) | $ (0.01) | $ (0.00) |
| Non-controlling interest | (0.00) | (0.00) | (0.01) | (0.00) |
| Comprehensive Loss per share, basic and diluted attributable to: | | | | |
| Owners of the Company | - 0.01 | (0.21) | (0.01) | (0.02) |
| Non-controlling interest | $ (0.00) | $ (0.00) | $ (0.01) | $ (0.00) |
| Average number of common shares outstanding for quarter, basic and diluted | 229,547,023 | 228,379,503 | 227,407,328 | 225,071,203 |

*Prior to December 1, 2012, Wellgreen Platinum's results of operations were consolidated into the statement of operations and comprehensive loss. Thereafter the proportional share of Wellgreen Platinum's net loss was reflected in the Share of Loss of an Associate line item on the statements of operations and comprehensive loss (Note 13 to the Annual Financial Statements).*

The Company's quarterly general and administrative expenses remain relatively stable. Factors causing significant changes between the most recently completed eight quarters have primarily been items such as share-based payments expense, consulting and management fees, and advertising and promotion expense.

(Expressed in Canadian Dollars)

## 5. DISCUSSION OF OPERATIONS

Results of operations are summarized as follows:

| Operating Expenses | | Three months ended March 31, 2014 | | 2013 |
|---|---|---|---|---|
| Advertising and promotion | $ | 19,460 | $ | 59,015 |
| Consulting and management fees | | 22,811 | | 28,052 |
| General and administrative expenses | | 265,893 | | 379,239 |
| Professional fees | | 88,739 | | 102,564 |
| Share-based payments | | 192,603 | | 200,152 |
| Travel and accommodation | | 32,499 | | 25,891 |
| | $ | 622,005 | $ | 794,913 |

In the first quarter 2014, the Company's operating expenses decreased by $172,908 compared to operating expenses for the first quarter in 2013. The decrease was primarily due to lower general and administrative expenses as less personnel were on payroll during the first quarter 2014 compared to the first quarter of 2013.

| Other Items | | Three months ended March 31, 2013 | | 2012 |
|---|---|---|---|---|
| Costs in excess of impaired value | | 2,211,781 | | 2,053,103 |
| Foreign exchange (gain) loss | | (275,465) | | (303,259) |
| Gain on sale of available-for-sale investments | | (2,351,906) | | - |
| Interest expense | | - | | 615,094 |
| Interest income | | (7,206) | | (20,097) |
| Share of net loss of associate | | - | | 472,811 |
| | $ | (422,796) | $ | 2,817,652 |

For the first quarter of 2014, the Company's "Other Items" increased by approximately $2.4 million as a result of a gain on sale of available-for-sale investments of $2.35 million.

## 6. LIQUIDITY AND CAPITAL RESOURCES

### Working Capital

At March 31, 2014 Prophecy Coal had approximately $1.9 million comprised of cash and cash equivalents, representing an increase of $1.4 million from the $0.5 million held at December 31, 2013. Working capital amounted to $5.7 million at March 31, 2014 compared to working capital of $6.1 million as at December 31 2013.

As at the date of this report, the Company's working capital is approximately $4.5 million. The Company has sufficient capital to fund its mining and exploration activities and to cover its administrative costs for 2014.

During the quarter, the Company generated $4.2 million through the sale of 4.85 million common shares of its available for sale investment in Wellgreen Platinum.

In October 2013, Prophecy Coal's wholly-owned Mongolian subsidiary, Red Hill Mongolia LLC ("**Red Hill**") arranged a line of credit for US $1,500,000 ("**LOC**") with the Trade and Development Bank of Mongolia. The LOC had a 1.5 year term, with the option of extension, and bears interest at 15% per annum and a commitment rate of 2% per annum payable monthly. The funds were used for working capital. The credit facility is collateralized by certain equipment and certain mineral and exploration licences. As at March 31, 2014, Red Hill had drawn down US $1.5 million of the LOC. Pursuant the LOC agreement, Red Hill shall pay a fixed amount of US $125,000 monthly against the principal starting May 2014.

The Company has no capital lease obligations, operating leases (other than office leases) or any other long term obligations.

(Expressed in Canadian Dollars)

**Cash Flow Highlights**

| | | Three months ended March 31, 2014 | | 2013 |
|---|---|---|---|---|
| Cash (used in) provided by operating activities | $ | (1,361,339) | $ | 598,324 |
| Cash (used in) provided by investing activities | | 2,819,324 | | (1,035,146) |
| Cash (used in) provided by financing activities | | (61,598) | | 103,850 |
| Increase (decrease) in cash for period | | 1,396,388 | | (332,973) |
| Cash balance, beginning of period | | 507,996 | | 768,831 |
| Cash balance, end of period | $ | 1,904,384 | $ | 435,858 |

**Operating activities:** Cash used in operating activities was $1.36 million during the first quarter of 2014 compared to cash provided of $0.6 million during the first quarter of 2013. The increased outflows of 1.96 million in the quarter primarily related to an increase in working capital requirements for Ulaan Ovoo's mining activities.

**Investing activities:** Cash generated by investing activities was $2.8 million for the first quarter of 2014, compared to $1 million used in the first quarter of 2013. The Company received $4.2 million from the sale of its common shares of Wellgreen Platinum (March 31, 2013 - $nil). Cash used for property and equipment during the first quarter of 2014 was $1.56 million (March 31, 2013 - $0.5 million) and cash used for mineral property expenditures was $0.12 million (March 31, 2013 - $0.56 million).

**Financing activities:** A total of $0.06 million was used in financing activities for interest payments during the first quarter of 2014 compared to $0.1 million cash received from financial activities during the first quarter of 2013.

**Contractual Commitments**

Prophecy Coal's commitments related to mineral properties are disclosed in Note 15 to the Annual Financial Statements.

**Capital Risk Management**

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

The properties, to which Prophecy Coal currently has an interest in, are predominantly in the exploration and development stage; as such, Prophecy Coal is dependent on external financing to fund its activities. In order to carry out the planned exploration and development and pay for administrative costs, Prophecy Coal will spend its existing working capital and raise additional amounts as needed. There were no changes in managements approach to capital management during the three months ended March 31, 2014. Neither Prophecy Coal nor its subsidiaries are subject to externally imposed capital requirements.

Prophecy Coal's investment policy is to invest its surplus cash in highly liquid short-term interest-bearing investments with maturities of 90 days or less from the original date of acquisition, and Guaranteed Investment Certificates with maturities of 365 days of less, all principally held with major Canadian financial institutions.

The Company expects to have sufficient liquidity and capital resources to be able to continue as a going concern until at least December 31, 2014 based on existing capital resources and estimated cash flows from mining operations.

(Expressed in Canadian Dollars)

## 9. CONTINGENTIES

The Company accrues for contingent liabilities when they are probable and the amount payable can be reasonably estimated. As at March 31, 2014 no contingent amounts have been accrued.

## 10. RELATED PARTY DISCLOSURES

Prophecy Coal 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, Interim CEO and Executive Chairman of Prophecy Coal, provides management and consulting services to the Company.

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

A summary of related party transactions by related party are as follows:

| | | Three Months Ended March 31, | | |
|---|---|---|---|---|
| Related parties | | 2014 | | 2013 |
| Directors and officers | | 84,252 | | 86,956 |
| Linx Partners Ltd. | | 105,003 | | 105,003 |
| MaKevCo Consulting Inc. | | 12,400 | | 21,400 |
| | $ | 201,655 | $ | 213,359 |

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

| | | Three Months Ended March 31, | | |
|---|---|---|---|---|
| Related parties | | 2014 | | 2013 |
| Consulting and management fees | $ | 16,754 | $ | 10,503 |
| Directors' fees | | 36,871 | | 45,752 |
| Mineral properties | | 47,250 | | 73,500 |
| Property and equipment | | 47,250 | | 21,000 |
| Salaries and benefits | | 53,530 | | 62,604 |
| | $ | 201,655 | $ | 213,359 |

As at March 31, 2014, the amount included within accounts payable and accrued liabilities, which was due to related parties totalling $334,620 (December 31, 2013 – $413,278), consisted of amounts owing for directors fees of $59,385 (December 31, 2013 - $129,060), for consulting fees of $54,524 (December 31, 2013 - $84,072), and for management of property, equipment, mineral properties and the power plant project of $220,711 (December 31, 2013 - $200,146).

Transactions between the Company and its subsidiaries are eliminated on consolidation; therefore, they are not disclosed as related party transactions. The amounts due to related parties are non-interest bearing and are due upon demand.

As at March 31, 2014 an estimated amount of $78,364 was due from Wellgreen Platinum, for shared office costs. The Company shared office space, administrative resources and management with Wellgreen Platinum in 2013.

Transactions with related parties have been measured at the fair value of services rendered.

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)

| Key Management Personnel | | Three Months Ended March 31, 2014 | | 2013 |
|---|---|---|---|---|
| Salaries and short term benefits | $ | 85,277 | $ | 74,284 |
| Share-based payments | | 123,694 | | 146,505 |
| | $ | 208,971 | $ | 220,789 |

## 12. CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's consolidated financial statements are prepared in accordance with IFRS as issued by the IASB. Prophecy Coal followed the same accounting policies and methods of computation in the Annual Financial Statements for the three months ended March 31, 2014. The significant accounting policies applied and recent accounting pronouncements are described in Note 6 to the Company's 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. Prophecy Coal 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 Company's Interim Financial Statements.

## 13. FINANCIAL INSTRUMENTS AND RELATED RISKS

Details of the significant accounting policies and methods adopted for financial instruments for each class of financial assets and financial liability are disclosed in Note 6 to the Annual Financial Statements.

The following table sets forth Prophecy Coal's financial assets that are measured at fair value on a recurring basis by level within the fair value hierarchy. As at March 31, 2014, those financial assets and liabilities are classified in their entirety based on the level of input that is significant to the fair value measurement.

| As at March 31, 2014 | | Level 1 | | Level 2 | | Level 3 | | Total |
|---|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | | |
| Cash and cash equivalents | $ | 1,904,384 | $ | - | $ | - | $ | 1,904,384 |
| Restricted cash equivalents | $ | 34,500 | | - | | - | | 34,500 |
| Available-for-sale investments | $ | - | | - | | - | | - |
| | $ | 1,938,884 | $ | - | $ | - | $ | 1,938,884 |

| As at December 31, 2013 | | Level 1 | | Level 2 | | Level 3 | | Total |
|---|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | | |
| Cash and cash equivalents | $ | 507,996 | $ | - | $ | - | $ | 507,996 |
| Restricted cash equivalents | $ | 34,500 | | - | | - | | 34,500 |
| Available-for-sale investments | $ | 2,295,810 | | - | | - | | 2,295,810 |
| | $ | 2,838,306 | $ | - | $ | - | $ | 2,838,306 |

### Related Risks

A description of types of risks that the Company is exposed to and its objectives and policies for managing such risks is included in the Company's MD&A for the year ended December 31, 2013 dated March 28, 2014, which is available on SEDAR at www.SEDAR.com. There have been no changes in the risks, objectives, policies or procedures during the three months ended March 31, 2014.

## 14. RISKS AND UNCERTAINTIES

The operations of the Company are highly speculative due to the high-risk nature of its business in the mining and exploration industries. Readers should carefully consider the risks and uncertainties described in the Company's Annual Information Form for the year ended December 31, 2013 dated March 28, 2014 (the "**AIF**") "Risk Factors" page 44. 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.

## 15. DISCLOSURE CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, are 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. Any system of internal control over financial reporting, no matter how well designed, has inherent limitations. As a result, even those systems determined to be effective can only provide reasonable assurance regarding the preparation of financial statements.

The Company's management has determined that there has been no change in the Company's internal control over financial reporting during the three months ended March 31, 2014, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## 16. DISCLOSURE OF OUTSTANDING SHARE DATA

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

- 249,387,569 common shares outstanding with recorded value of $147,761,213;
- 28,963,750 stock options outstanding with a weighted average exercise price of $0.13. Each option is exercisable to purchase a common share of the Company at prices ranging from $0.065 to $0.67 and which expire between 2014 and 2019; and
- 13,225,583 share purchase warrants outstanding exercisable to purchase one common share of the Company at any time at a price of $0.18 and which expire between April and October 2015.

## 17. OFF-BALANCE SHEET ARRANGEMENTS

During the three months ended March 31, 2014, Prophecy Coal 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 Coal.

Prophecy Coal Corp.

# Condensed Interim Consolidated Financial Statements
# Unaudited
# For the three months ended March 31, 2014
(Expressed in Canadian Dollars)

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

| As at | Notes | | March 31, 2014 | | December 31, 2013 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Current assets** | | | | | |
| Cash and cash equivalents | 5 | $ | 1,904,384 | $ | 507,996 |
| Receivables | | | 3,075,663 | | 2,648,993 |
| Amount due from related party | 11 | | 78,364 | | 78,364 |
| Prepaid expenses | | | 927,493 | | 1,278,914 |
| Inventory | | | 2,564,117 | | 1,758,310 |
| Available-for-sale-investments | 6 | | - | | 2,295,810 |
| | | | 8,550,021 | | 8,568,387 |
| **Non-current assets** | | | | | |
| Restricted cash equivalents | | | 34,500 | | 34,500 |
| Reclamation deposits | | | 27,554 | | 27,554 |
| Property and equipment | 7 | | 10,464,324 | | 10,758,586 |
| Mineral properties | 8 | | 15,255,263 | | 15,053,773 |
| | | $ | 34,331,662 | $ | 34,442,800 |
| **Liabilities and Equity** | | | | | |
| **Current liabilities** | | | | | |
| Accounts payable & accrued liabilities | | $ | 1,717,803 | $ | 1,432,238 |
| Line of credit facility, current portion | 9 | | 1,105,800 | | 1,069,400 |
| | | | 2,823,603 | | 2,501,638 |
| **Non-current liabilities** | | | | | |
| Provision for closure and reclamation | | | 129,552 | | 129,552 |
| Line of credit facility | 9 | | 556,778 | | 631,925 |
| | | | 3,509,933 | | 3,263,115 |
| **Equity** | | | | | |
| Share capital | 10 | | 147,761,213 | | 147,680,113 |
| Reserves | | | 19,949,513 | | 19,790,089 |
| Accumulated other comprehensive gain | | | - | | 399,271 |
| Deficit | | | (136,888,997) | | (136,689,788) |
| | | | 30,821,729 | | 31,179,685 |
| | | $ | 34,331,662 | $ | 34,442,800 |

Approved on behalf of the Board:

***"John Lee"*** — John Lee, Director

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

See accompanying notes to the consolidated financial statements.

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

| | Notes | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|---|
| **General and Administrative Expenses** | | | |
| Advertising and promotion | | $ 19,460 | $ 59,015 |
| Consulting and management fees | | 22,811 | 28,052 |
| Depreciation | | 16,461 | 22,689 |
| Director fees | | 36,871 | 45,753 |
| Insurance | | 37,606 | 51,954 |
| Office and administration | | 44,370 | 11,981 |
| Professional fees | | 88,739 | 102,564 |
| Salaries and benefits | | 81,052 | 200,236 |
| Share-based payments | 10 | 192,603 | 200,152 |
| Stock exchange and shareholder services | | 49,533 | 46,626 |
| Travel and accommodation | | 32,499 | 25,891 |
| **Loss Before Other Items** | | (622,005) | (794,913) |
| **Other Items** | | | |
| Costs in excess of impaired value | 7 | (2,211,781) | (2,053,103) |
| Foreign exchange gain (loss) | | 275,465 | 303,259 |
| Gain on sale of available-for-sale investments | 6 | 2,351,906 | - |
| Interest expense | | - | (615,094) |
| Interest income | | 7,206 | 20,097 |
| Share of net loss of associate | | - | (472,811) |
| **Net Loss for Period** | | (199,209) | (3,612,567) |
| Fair value gain on available-for-sale investments | | - | 785,234 |
| Fair value loss on available-for-sale investments of an associate | | - | (3,750) |
| **Comprehensive Loss for Period** | | $ (199,209) | $ (2,831,082) |
| **Loss Per Common Share,** basic and diluted | | $ (0.00) | $ (0.02) |
| **Weighted Average Number of Common Shares Outstanding** | | 249,319,226 | 229,547,023 |

See accompanying notes to the consolidated financial statements.

**PROPHECY COAL CORP.**
**Condensed Interim Consolidated Statements of Changes in Equity**
(Expressed in Canadian Dollars) (Unaudited)

| | Numbers of shares | Share Capital | Reserves | Accumulated Other Comprehensive Gain (Loss) | Deficit | Total |
|---|---|---|---|---|---|---|
| **Balance, December 31, 2012** | 228,400,956 | $ 145,796,591 | $ 18,577,859 | $ - | $ (113,393,634) | $ 50,980,816 |
| Common shares subscribed | - | 536,560 | - | - | - | 536,560 |
| Private placement, share issue costs | - | (82,709) | - | - | - | (82,709) |
| Shares issued as financing fees | 2,000,000 | 280,000 | - | - | - | 280,000 |
| Share-based payments | - | - | 234,669 | - | - | 234,669 |
| Share bonuses to personnel | - | - | 6,756 | - | - | 6,756 |
| Loss for the period | - | - | - | - | (3,612,567) | (3,612,567) |
| Unrealized gain (loss) on available for-sale investments | - | - | - | 785,234 | - | 785,234 |
| Fair value loss on available-for-sale-investments of an associate | - | - | - | (3,750) | - | (3,750) |
| **Balance, March 31, 2013** | 230,400,956 | 146,530,443 | 18,819,284 | 781,484 | (117,006,199) | 49,125,012 |
| | | | | | | |
| **Balance, December 31, 2013** | 248,373,819 | 147,680,113 | 19,790,089 | 399,271 | (136,689,788) | 31,179,685 |
| Share-based payments | - | - | 159,424 | - | - | 159,424 |
| Share bonuses to personnel | 1,013,750 | 81,100 | - | - | - | 81,100 |
| Loss for the period | - | - | - | - | (199,209) | (199,209) |
| Sale of available-for-sale-investments | - | - | - | (399,271) | - | (399,271) |
| **Balance, March 31, 2014** | 249,387,569 | $ 147,761,213 | $ 19,949,513 | $ - | $ (136,888,997) | $ 30,821,729 |

See accompanying notes to the consolidated financial statements.

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

| | Three Months Ended March 31 2014 | 2013 |
|---|---|---|
| **Operating Activities** | | |
| Net loss for the year | $ (199,209) | $ (3,612,567) |
| Adjustments to reconcile net loss to net cash flows: | | |
| Depreciation and accretion | 16,461 | 22,689 |
| Share-based payments | 192,603 | 200,152 |
| Share of loss of an associate | - | 472,811 |
| Costs in excess of impaired value | 2,211,781 | 2,053,103 |
| Gain on sale of available-for-sale investments | (2,351,906) | - |
| Interest costs | - | 615,094 |
| Interest income | (7,206) | (20,097) |
| | (137,476) | (268,815) |
| Working capital adjustments | | |
| Receivables | 509,257 | (368,773) |
| Prepaid expenses | 351,421 | (61,925) |
| Increase in inventory | (805,807) | 851,337 |
| Accounts payable and accrued liabilities | (1,278,734) | 446,499 |
| | (1,223,863) | 867,138 |
| **Cash Used in Operating Activities** | (1,361,339) | 598,324 |
| **Investing Activities** | | |
| Acquisition of property and equipment | (1,560,064) | (493,226) |
| Mineral property expenditures | 123,737 | (562,017) |
| Interest received from short term investment | - | 20,097 |
| Proceeds from sale of available-for-sale investments | 4,255,651 | - |
| **Cash (Used in) Provided by Investing Activities** | 2,819,324 | (1,035,146) |
| **Financing Activities** | | |
| Interest paid | (61,598) | (350,001) |
| Shares issued, net of share issuance costs | - | 453,851 |
| **Cash (Used in) Provided by Financing Activities** | (61,598) | 103,850 |
| Net (Decrease) Increase in cash and cash equivalents | 1,396,388 | (332,973) |
| Cash and Cash Equivalents - beginning of period | 507,996 | 768,831 |
| Cash and Cash Equivalents - end of period | $ 1,904,384 | $ 435,858 |

Supplemental cash flow information (Note 14)

See accompanying notes to the consolidated financial statements.

## 1. NATURE OF BUSINESS

Prophecy Coal Corp. ("Prophecy Coal" or the "Company") is incorporated under the laws of the province of British Columbia, Canada and maintains its head office at 2nd floor, 342 Water Street, Vancouver, B.C., Canada, V6B 1B6. The Company's focus is on the acquisition, exploration and development of coal properties and the development of its Chandgana Power Plant project in Mongolia. The Company's common shares are listed for trading on the Toronto Stock Exchange ("TSX") under the symbol "PCY".

The Company's continued operations, existence and recoverability of the carrying value of mineral properties, and property and equipment is dependent upon the preservation of its interest in the underlying properties, the discovery of economically recoverable reserves, the achievement of stable and profitable operations at the Ulaan Ovoo property, the ability of the Company to raise additional sources of funding, develop the Chandgana Power Plant project including coal feed, control costs of production, and receive the required market price levels for coal, and/or, alternatively, upon the Company's ability to dispose of some or all of its interests on an advantageous basis.

Based on existing capital resources and estimated cash flows from mining operations, the Board of Directors has determined that the Company will be able to continue as a going concern for the foreseeable future and realize its assets and discharge its liabilities and commitments in the normal course of business, and therefore, these consolidated financial statements have been prepared on a going concern basis and do not reflect any adjustments that may be necessary if the Company is unable to continue as a going concern.

## 2. BASIS OF PREPARATION

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, 2013. 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, 2013.

These unaudited condensed interim consolidated financial statements were approved and authorized for issue by the Audit Committee on May 9, 2014.

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 as at and for the year ended December 31, 2013.

(Expressed in Canadian Dollars) (Unaudited)

## 3. SIGNIFICANT ACCOUNTING POLICIES

Except as described below, the accounting policies applied in these interim financial statements are the same as those applied in the Company's Annual Financial Statements as at and for the year ended December 31, 2013. The following changes in accounting policies are also expected to be reflected in the Company's consolidated financial statements as at and for the year ending December 31, 2014.

Changes in accounting policies

The Company has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 January 2014:

| | |
|---|---|
| IFRS 10, IFRS 12 and IAS 27 (2011) Amendments | Amendments to IFRS 10, IFRS 12 and IAS 27 (2011) – Investment Entities |
| IAS 32 Amendments | Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities |
| IAS 39 Amendments | Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting |
| IFRIC 21 | Levies |

These adoptions did not have a material impact on the Company's unaudited condensed interim consolidated financial statements.

IFRIC 20 - *Stripping Costs in the Production Phase of a Surface Mine* ("IFRS 20")

As at March 31, 2014, the Company is not in the production stage. The Company is currently assessing the impact of adopting IFRIC 20 on its consolidated financial statements.

## 4. SEGMENTED INFORMATION

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

| | March 31, 2014 | | |
|---|---|---|---|
| | Canada | Mongolia | Total |
| Reclamation deposits | $ 6,500 | $ 21,054 | $ 27,554 |
| Property and equipment | 174,318 | 10,290,006 | 10,464,324 |
| Mineral properties | 2,211,460 | 13,043,802 | 15,255,262 |
| | $ 2,392,278 | $ 23,354,862 | $ 25,747,140 |

| | December 31, 2013 | | |
|---|---|---|---|
| | Canada | Mongolia | Total |
| Reclamation deposits | $ 6,500 | $ 21,054 | $ 27,554 |
| Property and equipment | 190,135 | 10,568,451 | 10,758,586 |
| Mineral properties | 2,203,794 | 12,849,979 | 15,053,773 |
| | $ 2,400,429 | $ 23,439,484 | $ 25,839,913 |

## 5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents of Prophecy Coal are comprised of bank balances and short-term money market instruments with original maturities of three months or less. The carrying amounts of cash and cash equivalents approximate fair value. Prophecy Coal's cash and cash equivalents are denominated in the following currencies:

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Denominated in Canadian dollars | $ 1,865,454 | $ 259,411 |
| Denominated in US dollars | 20,498 | 1,777 |
| Denominated in Mongolian tugriks | 18,432 | 246,808 |
| | $ 1,904,384 | $ 507,996 |

## 6. AVAILABLE FOR SALE INVESTMENTS

Available-for-sale investments consisted of investments in common shares of Wellgreen Platinum Ltd. ("Wellgreen Platinum"), and therefore had no fixed maturity date or coupon rate. The fair value of the listed available-for-sale investments were determined directly by reference to published price quotations in an active market.

The Company's activity in it's available-for-sale investment for the three months ended March 31, 2014 and the year ended December 31, 2013 was as follows:

(Expressed in Canadian Dollars) (Unaudited)

## 6. AVAILABLE FOR SALE INVESTMENTS (cont'd...)

| | | March 31, 2014 | | December 31, 2013 |
|---|---|---|---|---|
| Investment in Wellgreen Platinum Ltd. | | | | |
| Opening balance | $ | 2,295,810 | $ | 25,118,910 |
| Deemed disposal loss of associate | | - | | (1,264,472) |
| Share of net loss of associate | | - | | (1,397,252) |
| Acquisitions | | 1,382,789 | | 140,000 |
| Disposals to market | | (3,279,328) | | (625,222) |
| Settlement of debt | | - | | (474,699) |
| Private sale | | - | | (19,596,976) |
| Fair value loss on available-for-sale investments of an associate | | - | | (3,750) |
| Net gain/(loss) transferred to equity | | (399,271) | | 399,271 |
| | $ | - | $ | 2,295,810 |

Pursuant to the plan of arrangement and consolidation in share capital in the acquisition of Wellgreen Platinum shares in June 2011, each option and warrant holder of Prophecy Coal as at June 9, 2011 will, upon the exercise of their Prophecy Coal options and warrants, ("June 9, 2011 Options and Warrants") receive 0.094758 of a Wellgreen Platinum common share, in addition to one common share of Prophecy Coal for each whole option or warrant of Prophecy Coal held and exercised. Any Wellgreen Platinum shares held in-trust, but not delivered, due to the expiry of unexercised June 9, 2011 Options and Warrants, shall be returned to Prophecy Coal.

During the three months ended March 31, 2014, a total of 1,523,881 of Wellgreen Platinum's reserved held in-trust common shares were released back to the Company due to the forfeiture and expiry of June 9, 2011 Options and Warrants. During the three months ended March 31, 2014, the Company sold a total of 4,851,142 Wellgreen Platinum's common shares for net proceeds of $4,203,654 and a realized gain of $2,351,906.

At March 31, 2014 Prophecy Coal held, reserved in-trust, 792,453 (December 31, 2013 – 2,316,634) Wellgreen Platinum common shares contingent upon exercise of these June 9, 2011 Options and Warrants.

(Expressed in Canadian Dollars) (Unaudited)

## 7. PROPERTY AND EQUIPMENT

| | Computer Equipment | Furniture & Equipment | Vehicles | Computer Software | Leasehold Improvements | Ulaan Ovoo Mining Equipment | Ulaan Ovoo Deferred Exploration | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| Balance, December 31, 2012 | $ 176,192 | $ 377,701 | $ 786,946 | $ 196,707 | $ 172,818 | $ 14,459,112 | $ 2,000,000 | $ 18,169,476 |
| Additions/(disposals) | (4,642) | (5,156) | 11,653 | (153) | - | 612,388 | 7,970,277 | 8,584,368 |
| Sale of coal | - | - | - | - | - | - | (3,253,283) | (3,253,283) |
| Equipment rental revenue | - | - | - | - | - | - | (1,338,003) | (1,338,003) |
| Costs in excess of impaired value | - | - | - | - | - | - | (3,378,991) | (3,378,991) |
| Balance, December 31, 2013 | $ 171,550 | $ 372,545 | $ 798,599 | $ 196,554 | $ 172,818 | $ 15,071,500 | $ 2,000,000 | $ 18,783,567 |
| **Accumulated depreciation** | | | | | | | | |
| Balance, December 31, 2012 | 80,515 | 135,451 | 288,488 | 120,433 | 58,145 | 4,557,103 | - | 5,240,135 |
| Depreciation for period | 19,357 | 38,564 | 116,099 | 10,895 | 34,564 | 2,565,366 | 1,032,548 | 3,817,393 |
| Costs in excess of impaired value | - | - | - | - | - | - | (1,032,548) | (1,032,548) |
| Balance, December 31, 2013 | $ 99,872 | $ 174,015 | $ 404,587 | $ 131,328 | $ 92,709 | $ 7,122,469 | $ - | $ 8,024,980 |
| **Carrying amount** | | | | | | | | |
| At December 31, 2012 | $ 95,677 | $ 242,250 | $ 498,458 | $ 76,274 | $ 114,673 | $ 9,902,009 | $ 2,000,000 | $ 12,929,342 |
| At December 31, 2013 | $ 71,678 | $ 198,530 | $ 394,012 | $ 65,226 | $ 80,109 | $ 7,949,031 | $ 2,000,000 | $ 10,758,586 |

| | Computer Equipment | Furniture & Equipment | Vehicles | Computer Software | Leasehold Improvements | Ulaan Ovoo Mining Equipment | Ulaan Ovoo Deferred Exploration | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| Balance, December 31, 2013 | $ 171,550 | $ 372,545 | $ 798,599 | $ 196,554 | $ 172,818 | $ 15,071,500 | $ 2,000,000 | $ 18,783,566 |
| Additions/(disposals) | (5,096) | 672 | (11,291) | (501) | - | 494,855 | 4,679,849 | 5,158,488 |
| Sale of coal | - | - | - | - | - | - | (1,229,902) | (1,229,902) |
| Costs in excess of impaired value | - | - | - | - | - | - | (3,449,947) | (3,449,947) |
| Balance, March 31, 2014 | $ 166,454 | $ 373,217 | $ 787,308 | $ 196,053 | $ 172,818 | $ 15,566,355 | $ 2,000,000 | $ 19,262,206 |
| **Accumulated depreciation** | | | | | | | | |
| Balance, December 31, 2013 | 99,872 | 174,015 | 404,587 | 131,328 | 92,709 | 7,122,469 | - | 8,024,980 |
| Depreciation for period | 4,499 | 8,993 | 374,264 | 1,277 | 8,641 | 375,228 | 1,238,166 | 2,011,068 |
| Costs in excess of impaired value | - | - | - | - | - | - | (1,238,166) | (1,238,166) |
| Balance, March 31, 2014 | $ 104,371 | $ 183,008 | $ 778,851 | $ 132,605 | $ 101,350 | $ 7,497,697 | $ - | $ 8,797,882 |
| **Carrying amount** | | | | | | | | |
| At December 31, 2013 | $ 71,678 | $ 198,530 | $ 394,012 | $ 65,226 | $ 80,109 | $ 7,949,031 | $ 2,000,000 | $ 10,758,586 |
| At March 31, 2014 | $ 62,083 | $ 190,209 | $ 8,458 | $ 63,448 | $ 71,468 | $ 8,068,658 | $ 2,000,000 | $ 10,464,324 |

## 7. PROPERTY AND EQUIPMENT (cont'd...)

### Ulaan Ovoo Property

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

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

In March 2010, Prophecy Coal was granted an option to purchase a 2% NSR on the Ulaan Ovoo property from Dunview Services Ltd., a private British Virgin Islands company, with a cash payment of US $130,000 and issuance of 2,000,000 common shares of Prophecy Coal. In April 2010, Prophecy Coal exercised the option and a total of $1,570,000 was capitalized as acquisition costs of the property.

On November 9, 2010, Prophecy Coal received a mining permit from the Mongolian Ministry of Mineral Resources and Energy (“MMMRE”) for the Ulaan Ovoo coal property. During the year ended December 31, 2010, Prophecy Coal had reached technical feasibility, commenced development, and achieved some pre-commercial production, and accordingly reclassified mineral property costs to Property and Equipment.

Pre-commercial operations for the period from commencement in November 2010 until March 31, 2014, along with project exploration and development costs are capitalized within the category Ulaan Ovoo deferred exploration costs within property and equipment. Coal sales revenue and associated costs to deliver the coal have been recorded against deferred exploration, within property and equipment.

During the quarter ended March 31, 2014, the Company incurred expenditures on the Ulaan Ovoo property, classified as costs in excess of impaired value, amounting to $2,211,781 which is reflected on the consolidated statement of operations and comprehensive loss. As there were no benchmark or market changes from January 1, 2014 to March 31, 2014, the impaired value for Ulaan Ovoo within property and equipment, remains unchanged at a balance of $2,000,000. The ending coal stockpile inventory value at March 31, 2014 was $2.56 million ($1.76 million at December 31, 2013).

(Expressed in Canadian Dollars) (Unaudited)

## 8. MINERAL PROPERTIES

| | Chandgana Tal | Chandgana Khavtgai | Titan | Okeover, others | Total |
|---|---|---|---|---|---|
| **Balance, December 31, 2012** | $ 8,624,130 | $ 2,603,986 | $ 750,628 | $ 1,409,138 | $ 13,387,882 |
| *Additions:* | | | | | |
| Acquisition cost | - | - | - | - | - |
| Deferred exploration costs: | | | | | |
| Licenses, leases, and power plant application | 792,392 | 161,225 | - | 4,853 | 958,470 |
| Geological core, engineering, and consulting | 271,683 | 515 | - | 30,580 | 302,778 |
| Camp and general | 285,967 | 110,081 | - | 8,595 | 404,643 |
| | 1,350,042 | 271,821 | - | 44,028 | 1,665,891 |
| **Balance, December 31, 2013** | $ 9,974,172 | $ 2,875,807 | $ 750,628 | $ 1,453,166 | $ 15,053,773 |
| *Additions:* | | | | | |
| Acquisition cost | - | - | - | - | - |
| Deferred exploration costs: | | | | | |
| Licenses, leases, and power plant application | 80,921 | 17,140 | 1,049 | 1,901 | 101,011 |
| Geological core, engineering, and consulting | 17,064 | - | - | 1,428 | 18,492 |
| Camp and general | 74,570 | 4,129 | 1,500 | 1,788 | 81,987 |
| | 172,555 | 21,269 | 2,549 | 5,117 | 201,490 |
| **Balance, March 31, 2014** | $ 10,146,727 | $ 2,897,076 | $ 753,177 | $ 1,458,283 | $ 15,255,263 |

**8. MINERAL PROPERTIES** (cont'd...)

a) Chandgana Tal Property, Mongolia

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

In March 2011, the Company obtained a mine permit from Ministry of Mineral Resources and Energy for the Chandgana Tal coal project.

b) Chandgana Khavtgai Property, Mongolia

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

c) Titan property, Ontario, Canada

The Company has an 80% 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 the Company 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. The Titan property is subject to a 3% NSR that may be purchased for $20,000.

On June 30, 2011, the Company paid Randsburg the balance of unexpended amount of $114,742 according to the terms of an amended agreement with Randsburg signed on June 30, 2011.

d) Okeover property, British Columbia, Canada

The Company has a 60% interest in the Okeover property, a copper-molybdenum project in the Vancouver Mining Division of southwestern British Columbia, Canada.

A total of $1,246,890 was capitalized as the acquisition costs of Okeover.

## 9. LINE OF CREDIT FACILITY

In October 2013, Prophecy Coal's wholly-owned Mongolian subsidiary, Red Hill Mongolia LLC ("Red Hill") arranged a line of credit for US $1,500,000 ("LOC") with the Trade and Development Bank. The line of credit has a 1.5 year term, with the option of extending it, and bears interest at 15% per annum and a commitment rate of 2% per annum payable monthly. The funds will be used for working capital. The credit facility is collateralized by certain equipment and certain mineral and exploration licences. Pursuant the LOC agreement, Red Hill shall pay a fixed amount of US $125,000 monthly against the principal starting May 2014.

As at March 31, 2014, had drawn down $1,662,578 of the LOC. Accordingly, the Company classified $1,105,800 as current portion of the LOC on its statement of financial position. For the three months ended March 31, 2014, Red Hill recorded an interest expense of $42,993 (capitalized to property and equipment), interest paid of $61,598, and interest payable of $19,160.

## 10. SHARE CAPITAL

(a) Authorized

The authorized share capital consists of an unlimited number of common shares without par value. There are no authorized preferred shares. At March 31, 2014, the Company had 249,387,569 (December 31, 2013 – 248,373,819) common shares issued and outstanding.

(b) Equity issuances

During the three month period ended March 31, 2014, the Company issued a second tranche of 1,013,750 shares related to its 2012 share bonus to certain employees, directors, officers, and consultants of the Company. As at March 31, 2014, the Company recorded $81,100 as share bonus expense to personnel.

(c) Share purchase options

The Company has a rolling share purchase option plan (the "2013 Plan") permitting the reserve for issuance of options exercisable for 20% of the Company's common shares issued and outstanding at the date of grant. The provisions of the 2013 Plan dealing with the expiry date and vesting of options provide an allowable exercise period of options granted under the 2013 Plan, unless otherwise fixed by the Board, of up to ten years from the date the option is granted, subject to any accelerated termination. Options granted under the 2013 Plan vest and become exercisable at 12.5% per quarter over two years, unless determined otherwise by the Board.

The following is a summary of the changes in Prophecy Coal's share purchase options from December 31, 2012 to March 31, 2014:

(Expressed in Canadian Dollars) (Unaudited)

**10. SHARE CAPITAL** (cont'd...)

| | Number of Options | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2012 | 32,485,550 | $0.57 |
| Granted | 4,800,000 | $0.12 |
| Cancelled | (5,720,000) | $0.20 |
| Outstanding, December 31, 2013 | 31,565,550 | $0.26 |
| Granted | 6,300,000 | $0.12 |
| Expired | (1,056,800) | $0.28 |
| Forfeited | (14,755,000) | $0.29 |
| Outstanding, March 31, 2014 | 22,053,750 | $0.17 |
| Options exercisable on March 31, 2014 | 9,076,667 | $0.24 |

As of March 31, 2014, the following Prophecy Coal share purchase options were outstanding:

| March 31, 2014 | | December 31, 2013 | | Expiry | At March 31, 2014 | |
|---|---|---|---|---|---|---|
| Exercise Price | Options Outstanding | Exercise Price | Options Outstanding | Date | Exercisable | Unvested |
| $ 0.10 | 500,000 | $ - | - | February-03-19 | - | 500,000 |
| $ 0.11 | 5,550,000 | $ - | - | January-27-19 | - | 5,550,000 |
| $ 0.08 | 250,000 | $ - | - | January-09-19 | - | 250,000 |
| $ 0.12 | 3,900,000 | $ 0.12 | 3,900,000 | August 15, 2018 | 975,000 | 2,925,000 |
| $ 0.13 | 250,000 | $ 0.13 | 250,000 | July 22, 2018 | 62,500 | 187,500 |
| $ 0.18 | 375,000 | $ 0.18 | 375,000 | September 24, 2017 | 187,500 | 187,500 |
| $ 0.18 | 230,000 | $ 0.18 | 230,000 | August 16, 2017 | 115,000 | 115,000 |
| $ 0.18 | 3,804,167 | $ 0.18 | 3,804,167 | August 22, 2017 | 1,902,084 | 1,902,084 |
| $ 0.25 | 125,000 | $ 0.25 | 975,000 | October 29, 2014 | 125,000 | - |
| $ 0.25 | 10,000 | $ 0.25 | 10,000 | June 1, 2017 | 5,000 | 5,000 |
| $ 0.28 | 2,650,000 | $ 0.28 | 3,050,000 | June 18, 2017 | 1,325,000 | 1,325,000 |
| $ 0.28 | 200,000 | $ 0.38 | 200,000 | November 30, 2014 | 200,000 | - |
| $ 0.28 | - | $ 0.28 | 1,056,800 | January 23, 2014 | - | - |
| $ 0.28 | 131,250 | $ 0.28 | 281,250 | January 29, 2015 | 131,250 | |
| $ 0.40 | 100,000 | $ 0.40 | 100,000 | January 29, 2015 | 100,000 | - |
| $ 0.28 | 175,000 | $ 0.28 | 525,000 | September 21, 2015 | 175,000 | - |
| $ 0.54 | 125,000 | $ 0.54 | 125,000 | September 21, 2015 | 125,000 | - |
| $ 0.28 | 350,000 | $ 0.28 | 350,000 | March 10, 2015 | 350,000 | - |
| $ 0.28 | 175,000 | $ 0.28 | 175,000 | July 17, 2014 | 175,000 | - |
| $ 0.28 | 65,000 | $ 0.28 | 65,000 | September 21, 2014 | 65,000 | - |
| $ 0.28 | 765,000 | $ 0.28 | 1,340,000 | May 10, 2015 | 765,000 | - |
| $ 0.67 | 262,500 | $ 0.67 | 262,500 | May 10, 2015 | 262,500 | - |
| $ 0.28 | 75,000 | $ 0.28 | 75,000 | October 15, 2015 | 75,000 | - |
| $ 0.67 | 100,000 | $ 0.67 | 100,000 | October 15, 2015 | 100,000 | - |
| $ 0.28 | 50,000 | $ 0.28 | 2,050,000 | December 24, 2015 | 50,000 | - |
| $ 0.28 | - | $ 0.28 | 9,000,000 | December 10, 2015 | - | - |
| $ 0.80 | 400,000 | $ 0.80 | 400,000 | April 30, 2015 | 400,000 | - |
| $ 0.28 | 75,000 | $ 0.28 | 75,000 | April 30, 2015 | 75,000 | - |
| $ 0.28 | 100,000 | $ 0.28 | 100,000 | September 23, 2015 | 100,000 | - |
| $ 0.28 | 120,000 | $ 0.28 | 120,000 | January 4, 2016 | 120,000 | - |
| $ 0.28 | 1,040,833 | $ 0.28 | 2,270,833 | December 24, 2015 | 1,040,833 | - |
| $ 0.28 | - | $ 0.28 | 50,000 | January 6, 2016 | - | - |
| $ 0.28 | 100,000 | $ 0.28 | 100,000 | February 14, 2016 | 100,000 | - |
| $ 1.03 | - | $ 1.03 | 150,000 | March 24, 2015 | - | - |
| | 22,053,750 | | 31,565,550 | | 9,106,667 | 12,947,084 |

(Expressed in Canadian Dollars) (Unaudited)

**10. SHARE CAPITAL** (cont'd...)

At March 31, 2014, the Company had 9,106,667 exercisable share purchase options outstanding (December 31, 2013 – 24,199,717).

The fair value of options granted are recorded using the Black Scholes model. Share-based payment expenses resulting from stock options are amortized over the corresponding vesting periods. During the three months ended March 31, 2014, the share-based payment expenses were calculated using the following weighted average assumptions:

| | |
|---|---|
| Dividend yield, % | Nil |
| Expected volatility, % | 85.5 |
| Risk-free interest rate, % | 1.63 |
| Expected life, years | 4.31 |
| Weighted average share price, $ | 0.14 |

Share-based payments are allocated between being either capitalized to property and equipment where related to Ulaan Ovoo, to deferred exploration costs where related to other mineral properties, or expensed as general and administrative expenses where otherwise related to the general operations of the Company. For the three months ended March 31, 2014 and 2013, share-based payments were allocated as follows:

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Consolidated Statement of Operations | | |
| Share based payments | $ 192,603 | $ 200,152 |
| | 192,603 | 200,152 |
| Consolidated Statement of Financial Position | | |
| Ulaan Ovoo exploration | 31,163 | 170,731 |
| Power Plant application | 16,758 | 16,580 |
| | 47,921 | 187,311 |
| Total share-based payments | $ 240,524 | $ 387,463 |

(d) Share purchase warrants

As at March 31, 2014, the outstanding number of the Company's share purchase warrants remains unchanged.

| | Number of Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2012 | 10,339,926 | $0.57 |
| Issued | 9,394,072 | $0.18 |
| Expired | (6,508,415) | $0.80 |
| Outstanding, December 31, 2013 | 13,225,583 | $0.18 |
| Outstanding, March 31, 2014 | 13,225,583 | $0.18 |

(Expressed in Canadian Dollars) (Unaudited)

## 10. SHARE CAPITAL (cont'd...)

| Exercise price | Number of Warrants | | Expiry date |
|---|---|---|---|
| | At March 31, 2014 | At December 31, 2013 | |
| $0.18 | 3,286,929 | 3,286,929 | April 11, 2015 |
| $0.18 | 6,107,143 | 6,107,143 | June 4, 2015 |
| $0.18 | 3,831,511 | 3,831,511 | October 28, 2015 |
| | 13,225,583 | 13,225,583 | |

## 11. RELATED PARTY DISCLOSURES

Prophecy Coal 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, Interim CEO and Executive Chairman of Prophecy Coal, provides management and consulting services to the Company.

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

A summary of related party transactions by related party are as follows:

| | | Three Months Ended March 31, | | |
|---|---|---|---|---|
| Related parties | | 2014 | | 2013 |
| Directors and officers | | 84,252 | | 86,956 |
| Linx Partners Ltd. | | 105,003 | | 105,003 |
| MaKevCo Consulting Inc. | | 12,400 | | 21,400 |
| | $ | 201,655 | $ | 213,359 |

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

| | | Three Months Ended March 31, | | |
|---|---|---|---|---|
| Related parties | | 2014 | | 2013 |
| Consulting and management fees | $ | 16,754 | $ | 10,503 |
| Directors' fees | | 36,871 | | 45,752 |
| Mineral properties | | 47,250 | | 73,500 |
| Property and equipment | | 47,250 | | 21,000 |
| Salaries and benefits | | 53,530 | | 62,604 |
| | $ | 201,655 | $ | 213,359 |

As at March 31, 2014, the amount included within accounts payable and accrued liabilities, which was due to related parties totalling $334,620 (December 31, 2013 – $413,278), consisted of amounts owing for directors fees of $59,385 (December 31, 2013 - $129,060), for consulting fees of $54,524 (December 31, 2013 - $84,072), and for management of property, equipment, mineral properties and the power plant project of $220,711 (December 31, 2013 - $200,146).

(Expressed in Canadian Dollars) (Unaudited)

## 11. RELATED PARTY DISCLOSURES (cont'd...)

Transactions between the Company and its subsidiaries are eliminated on consolidation therefore, they are not disclosed as related party transactions. The amounts due to related parties are non-interest bearing and are due upon demand.

As at March 31, 2014 an estimated amount of $78,364 was due from Wellgreen Platinum, for shared office costs. The Company shared office space, administrative resources and management with Wellgreen Platinum in 2013.

## 12. 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.

| | Three Months Ended March 31, | |
|---|---|---|
| Key Management Personnel | 2014 | 2013 |
| Salaries and short term benefits | $ 85,277 | $ 74,284 |
| Share-based payments | 123,694 | 146,505 |
| | $ 208,971 | $ 220,789 |

## 13. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

### Fair Value

Fair value is the price that would be received to sell and asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Prophecy Coal utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value as follows:

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

Level 2 – inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts and volatility measurements used to value option contracts), or inputs that are derived principally from or corroborated by observable market data or other means; and

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

(Expressed in Canadian Dollars) (Unaudited)

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

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.The following table sets forth Prophecy Coal's financial assets measured at fair value by level within the fair value hierarchy:

| As at March 31, 2014 | | Level 1 | | Level 2 | | Level 3 | | Total |
|---|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | | |
| Cash and cash equivalents | $ | 1,904,384 | $ | - | $ | - | $ | 1,904,384 |
| Restricted cash equivalents | $ | 34,500 | | - | | - | | 34,500 |
| Available-for-sale investments | $ | - | | - | | - | | - |
| | $ | 1,938,884 | $ | - | $ | - | $ | 1,938,884 |

| As at December 31, 2013 | | Level 1 | | Level 2 | | Level 3 | | Total |
|---|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | | |
| Cash and cash equivalents | $ | 507,996 | $ | - | $ | - | $ | 507,996 |
| Restricted cash equivalents | $ | 34,500 | | - | | - | | 34,500 |
| Available-for-sale investments | $ | 2,295,810 | | - | | - | | 2,295,810 |
| | $ | 2,838,306 | $ | - | $ | - | $ | 2,838,306 |

The Company considers that the carrying amount of all its financial assets and financial liabilities measure at amortized cost approximates their fair value. The Company does not offset financial assets with financial liabilities. There were no transfers between Level 1, 2 and 3 for the three months ended March 31, 2014.

**Categories of financial instruments**

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

| | | As at March 31, 2014 | | As at December 31, 2013 |
|---|---|---|---|---|
| Fair value through profit or loss | | | | |
| Cash and cash equivalents | $ | 1,904,384 | $ | 507,996 |
| Restricted cash equivalents | | 34,500 | | 34,500 |
| Loans and receivables | | | | |
| Trade receivable | | 935,927 | | 679,738 |
| Due from related party | | 78,364 | | 78,364 |
| Available-for-sale investments | | - | | 2,295,810 |
| | $ | 2,953,175 | $ | 3,596,408 |
| | | | | |
| Other financial liabilities | | | | |
| Accounts payable and accrued liabilities | $ | 1,717,803 | $ | 1,432,238 |
| Line of credit facility, current portion | | 1,105,800 | | 1,069,400 |
| | $ | 2,823,603 | $ | 2,501,638 |

(Expressed in Canadian Dollars) (Unaudited)

## 14. SUPPLEMENTAL CASH FLOW INFORMATION

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Supplementary information | | |
| Interest paid | $ 61,598 | $ 350,001 |
| Non-Cash Financing and Investing Activities | | |
| Shares issued as financing fees | $ - | $ 280,000 |
| Share bonuses to personnel | $ 81,100 | $ - |
| Capitalized depreciation of fixed assets | $ 756,441 | $ 1,479,639 |
| Property & equipment expenditures included in accounts payable | $ 1,255,830 | $ 350,275 |
| Mineral property expenditures included in accounts payable | $ 308,469 | $ 55,962 |
| Share-based payments capitalized in property and equipment | $ 31,163 | $ 32,313 |
| Share-based payments capitalized in mineral properties | $ 16,758 | $ 8,960 |

## 15. COMMITMENTS

Commitments, not disclosed elsewhere in these Annual Financial Statements, are as follows:

| Office rental commitments | |
|---|---|
| Year | Amount |
| 2014 | $ 63,641 |
| 2015 | 63,641 |
| 2016 | 21,214 |
| | $ 148,496 |

| Line of credit facility re-payment commitments | |
|---|---|
| Year | Amount |
| 2014 | $ 1,105,800 |
| 2015 | 556,778 |
| | $ 1,662,578 |

## 16. CONTINGENCIES

The Company accrues for contingent liabilities when they are probable and the amount payable can be reasonably estimated. As at March 31, 2014 no contingent amounts have been accrued.

## 17. EVENTS AFTER THE REPORTING DATE

On May 1, 2014, the Company granted 7,135,000 incentive share purchase options to various directors, officers, employees and consultants of the Company. The options are exercisable at a price of $0.065 per common share for a term of five years expiring on May 1, 2019 and vest at 12.5% per quarter two years following the date of grant. 3,575,000 of these options are subject to the approval of the TSX and a portion thereof, are also subject to shareholder approval at the Company's next annual general meeting.