



**PROPHECY DEVELOPMENT CORP.  
(FORMERLY PROPHECY COAL CORP.)  
(HEREIN "PROPHECY" OR THE "COMPANY")**

**ANNUAL INFORMATION FORM  
FOR THE FINANCIAL YEAR ENDED DECEMBER 31, 2017**

March 29, 2018

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## 1. GENERAL

### 1.1 Forward-Looking Statements

This Annual Information Form (“AIF”) contains forward-looking statements within the meaning of applicable Canadian securities legislation concerning anticipated developments in the Company’s continuing and future operations, the adequacy of the Company’s financial resources and financial projections.

Forward-looking statements in this document are frequently identified by words such as “expects”, “anticipates”, “intends”, “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 the Company’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.

#### Examples of Forward-Looking Statements in this AIF

Such forward-looking statements include but are not limited to statements regarding the permitting, feasibility, plans for development of the Gibellini Project (as hereinafter defined), development of the Titan Project (as hereinafter defined), development of the Pulacayo Project (as hereinafter defined), development of the Chandgana Power Plant Project (as hereinafter defined), including finalizing of any Power Purchase Agreement; the likelihood of securing project financing; estimated future coal production at the Ulaan Ovoo Property (as hereinafter defined) and the Chandgana Project (as hereinafter defined); and other information concerning possible or assumed future results of operations of Prophecy. See in particular, portions of Section 3.1 – *Three Year History* and Section 4 – *Description of the Business* in this AIF.

#### Material Assumptions

In making the forward-looking statements in this AIF, Prophecy has made several assumptions that it believes are appropriate, including, but not limited to assumptions that: all required third party contractual, regulatory and governmental approvals will be obtained for the development, construction and production of Prophecy’s properties and projects; 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 vanadium, silver, other metals and 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’s current mineral resource estimates; labour and materials costs increasing on a basis consistent with Prophecy’s current expectations; and any additional required financing will be available on reasonable terms, market developments and trends in global supply and demand for vanadium, silver, other metals, coal and energy meeting expectations. Prophecy cannot assure you that any of these assumptions will prove to be correct.

#### Material Risks

Numerous factors could cause Prophecy’s actual results to differ materially from those expressed or implied in the forward-looking statements including the following risks and uncertainties, which are discussed in greater detail under Section 6 – *Risk Factors* in this AIF: the Company’s history of net losses and lack of foreseeable positive cash flow; exploration, development and production risks, including risks related to the development of its properties and projects; Prophecy not having a history of profitable mineral production; commencing mine development without a feasibility study; the uncertainty of mineral resource and mineral reserve estimates; the capital and operating costs required to bring Prophecy’s projects into production and the resulting economic returns from its projects; foreign operations and political conditions, including the legal and political risks of operating in Bolivia and Mongolia, which are developing countries and being

subject to their local laws; the availability and timeliness of various government approvals, permits and licenses; the feasibility, funding and development of the Company's properties and projects; protecting title to the Company's mineral properties; environmental risks; the competitive nature of the mining business; lack of infrastructure; Prophecy's reliance on key personnel; uninsured risks; commodity price fluctuations; reliance on contractors; Prophecy's need for substantial additional funding and the risk of not securing such funding on reasonable terms or at all; foreign exchange risk; anti-corruption legislation; recent global financial conditions; the payment of dividends; the inability of insurance to cover all potential risks associated with mining operations, conflicts of interest, and reliance on information systems with exposure to cyber-security risks.

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 AIF should not be considered as a representation by Prophecy or any other person that Prophecy's objectives or plans will be achieved.

These factors should be considered carefully and readers should not place undue reliance on Prophecy's forward-looking statements. Prophecy believes that the expectations reflected in the forward-looking statements contained in this AIF 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 has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. Prophecy undertakes no obligation to publicly update any future revisions to forward-looking statements to reflect events or circumstances after the date of this AIF or to reflect the occurrence of unanticipated events, except as expressly required by law.

The information in this AIF is for the fiscal year ended December 31, 2017 but is current as of March 29, 2018 unless otherwise stated or clear from the context.

## **1.2 Accounting Principles**

All financial information in this AIF is prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board.

## **1.3 Share Consolidation**

On June 7, 2016, the Company completed a consolidation of its issued and outstanding Common shares on the basis of 100 pre-consolidation Common shares, options and warrants to one (1) post-consolidation Common share, option and warrant (the "**Share Consolidation**"). The exercise price and the number of Common shares issuable under any of the Company's outstanding warrants and stock options have been proportionately adjusted to reflect the Share Consolidation in accordance with their respective terms thereof. No fractional Common shares were issued pursuant to the Share Consolidation, and any fractional Common shares that would otherwise have resulted were rounded down to the nearest whole number.

The Share Consolidation has been presented throughout this report retroactively.

## **1.4 Currency**

Unless otherwise indicated, all references to "dollars" or "\$" are to Canadian dollars and all references to "US dollars" or "USD" are to United States of America dollars. Descriptive statistics for United States dollars to Canadian dollars for the years 2015, 2016, and 2017 are given in Table 1 below.

**Table 1. United States Dollars to the Canadian Dollar**

	Year ended December 31,		
	2017	2016	2015
High	\$1.3743	\$1.4559	\$1.3990
Low	\$1.2128	\$1.2536	\$1.1728
Average	\$1.2986	\$1.3245	\$1.2787
Closing	\$1.2545	\$1.3427	\$1.3840

On March 29, 2018, the Bank of Canada's noon mid-market rate of exchange was USD1.2894 to \$1.00.

### 1.5 Documents Incorporated by Reference

The following documents are incorporated by reference into this AIF:

- (a) Updated Technical Report on the Coal Resources of the Chandgana Khavtgai Coal Resource Area, Khentii Aimag, Mongolia" dated September 28, 2010 prepared in accordance with the CIM Standards that fulfills the disclosure requirements of NI 43-101, prepared by Christopher M. Kravits, CPG, LPG of Kravits Geological Services, LLC (the "**Chandgana Technical Report**"), who was at the effective date and filing date an independent Qualified Person under NI 43-101 but has since become non-independent by virtue of the fact that the Company has become his primary client;
- (b) "Ulaan Ovoo – Pre-Feasibility Study" dated December 10, 2010 prepared in accordance with the CIM Standards that fulfills the disclosure requirements of NI 43-101, prepared by John Sampson, B.Sc. (Hons) and Brian Saul, P. Eng. of Wardrop Engineering Inc. (the "**Ulaan Ovoo PFS**"), who were independent Qualified Persons under NI 43-101 at the effective date and filing date of the report;
- (c) Technical Report Coal Resources and Preliminary Economic Assessment - Coal Mine Component, Chandgana Tal Coal Project, Khentii Province, Mongolia" (the "**Chandgana Tal PEA**") reissued February 2014, prepared in accordance with the CIM Standards that fulfills the disclosure requirements of NI 43-101, filed on SEDAR on April 3, 2014 and prepared by John T. Boyd Co. (USA). The lead Qualified Person for the report is Robert J. Farmer, P. Eng., who was an independent Qualified Person under NI 43-101 at the effective date and filing date of the report;
- (d) Credit Facility Agreement dated March 12, 2015 between the Company and Linx Partners Ltd. ("**Linx**"), a private company wholly-owned and controlled by John Lee, Director, CEO and Executive Chairman of the Company (as amended, the "**Credit Facility**");
- (e) Business Acquisition Report dated March 18, 2015 disclosing the acquisition of the Company's Bolivian and Cayman subsidiaries;
- (f) Shareholder Rights Plan Agreement dated April 29, 2015 between the Company and Computershare Trust Company of Canada;
- (g) Material Change Report dated May 14, 2015 disclosing Red Hill Mongolia LLC's ("**Red Hill**"), the Company's wholly-owned and controlled Mongolian subsidiary, having entered into a Purchase Agreement with an arm's-length party in Mongolia to sell substantially all of its mining and transportation equipment at the Company's Ulaan Ovoo mine for total proceeds of approximately \$2.34 million;

The Company also disclosed the issuance to Mr. Lee, the beneficial owner of Linx, for consenting to the sales of, and waiving its security interest in, the equipment, of the equivalent of 120,000 Share purchase warrants of the Company exercisable at the equivalent of \$5.00 per Share for a period of five years expiring on May 22, 2020;

- (h) Material Change Report dated September 10, 2015 disclosing the announcement of a non-brokered private placement involving the issuance of up to the equivalent of 400,000 units at a price of the equivalent of \$5.00 per unit;
- (i) Material Change Report dated October 2, 2015 disclosing the closing of a first cash tranche of the non-brokered private placement announced on September 10, 2015, which raised gross cash proceeds of \$556,000 through the issuance of the equivalent of 111,200 2015 units of Prophecy. Company management and directors subscribed for the equivalent of 70,000 units of the placement in the first tranche;
- (j) Material Change Report dated November 12, 2015 disclosing the announcement of a non-brokered private placement involving the issuance of up to the equivalent of 250,000 units at a price of the equivalent of \$4.00 per unit;
- (k) Material Change Report dated November 13, 2015 disclosing the closing of a first tranche of the non-brokered private placement announced on November 12, 2015 which raised gross proceeds of \$250,000 through the issuance of the equivalent of 62,500 units of Prophecy. Company management and directors subscribed for the equivalent of 25,000 units of the placement;
- (l) Material Change Report dated December 18, 2015 disclosing the entering into of an Engineering, Procurement and Construction (“EPC”) Agreement, Equity Investment Agreement and Share Purchase Agreement with Shandong Electrical Power Construction No.2 Company (“SEPCO2”) to invest in, and build the Company’s 600 MW Chandgana Power Plant Project in Mongolia;
- (m) Material Change Report dated January 25, 2016 disclosing the closing of a non-brokered private placement involving the issuance of the equivalent of 80,000 units at a price of the equivalent of \$2.50 per unit, and entered into Settlement and Release Agreements with certain officers, employees and consultants to settle various debts owing to them on January 13, 2016 by issuing in aggregate the equivalent of 61,385 Shares (as hereinafter defined) at a deemed price of the equivalent of \$3.00 per Share;
- (n) Material Change Report dated January 29, 2016 disclosing the voluntary delisting of the Shares from the OTCQX® Best Market;
- (o) Material Change Report dated March 4, 2016 disclosing the entering into of an agreement to increase and amend the Credit Facility with Linx, and the entering into of Settlement and Release Agreements with certain directors, officers, employees and consultants to settle various debts owing to them on February 29, 2016 by issuing in aggregate the equivalent of 73,645 Shares at a deemed price of the equivalent of \$2.00 per Share;
- (p) Material Change Report dated March 30, 2016 disclosing the entering into of a Debt Settlement Agreement with Linx pursuant to which, the Company agreed to issue the equivalent of 750,000 units at a deemed price of the equivalent of \$2.00 per unit to Mr. Lee, in satisfaction of \$1,500,000 of indebtedness owed by the Company to Linx under the Credit Facility;
- (q) Material Change Report dated August 8, 2016 disclosing the announcement of a non-brokered private placement involving the issuance of up to 150,000 units at a price of \$3.80 per unit;
- (r) Material Change Report dated August 29, 2016 disclosing the closing of an oversubscribed non-brokered private placement involving the issuance of 202,735 units at a price of \$3.80 per unit;
- (s) Material Change Report dated January 13, 2017 disclosing that Linx entered into a Debt Settlement Agreement to settle most of the outstanding balance owing by the Company to Linx under the Credit Facility, by issuing 300,000 Shares to Mr. Lee, in satisfaction of \$900,000 of indebtedness owing by the Company under the Credit Facility;

The Company also disclosed that for nominal consideration of \$1, Linx has agreed to accrue and postpone the repayment of any principal, interest and fees due under the Credit Facility until the earlier of October 1, 2017, or such time as the Company is in a reasonable financial position to repay all or a portion of the amounts owing;

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

- (t) Material Change Report dated March 14, 2017 disclosing the announcement of a non-brokered private placement involving the issuance of 100,000 units at a price of \$4.00 per unit;
- (u) Material Change Report dated April 12, 2017 disclosing the Company closed an oversubscribed non-brokered private placement previously announced on March 14, 2017, involving the issuance of 103,250 units at a price of \$4.00 per unit for gross proceeds of \$413,000;
- (v) Material Change Report dated August 25, 2017 disclosing the announcement of a non-brokered private placement involving the issuance of up to 888,000 units at a price of \$3.50 per unit;
- (w) Material Change Report dated September 1, 2017 disclosing that the Company's intent to increase the size of the non-brokered private placement previously announced for \$3,108,000 on August 25, 2017, to a maximum of \$5,757,360. The placement as amended, involves, in addition to the issuance of up to 888,000 units, the issuance of up to 900,000 special warrants (the "**Special Warrants**") at a price of \$3.50 per Special Warrant. Each Special Warrant will be exercisable for one unit at no additional cost to the holder provided the Toronto Stock Exchange (the "**TSX**") and shareholder approval for the issuance of the units underlying the Special Warrants is obtained at a general meeting of shareholders to be called within 60 days after the closing of the placement.

The Company granted in aggregate, 167,000 incentive stock options to various directors, officers and consultants of the Company. The options are exercisable at a price of \$3.50 per Share for a term of five years expiring on September 1, 2022 and vest at 12.5% per quarter for the first two years following the date of grant;

- (x) Material Change Report dated September 20, 2017 disclosing the closing of the first tranche of the non-brokered private placement initially announced on August 25, 2017, as amended, raising gross cash proceeds of \$4,539,390 through the issuance of 667,968 units and 716,013 Special Warrants (including 87,013 Special Warrants issued as finder's fees);
- (y) Material Change Report dated October 16, 2017 disclosing the closing of the second and final tranche of the non-brokered private placement as amended (and further amended on October 4, 2017, to further increase the number of Special Warrants issuable under the placement as amended, to 1,250,000), raising gross cash proceeds of \$1,858,325 through the issuance of 116,578 units and 423,698 Special Warrants (including 9,327 Special Warrants issued as finder's fees).

The Company entered into Debt Settlement Agreements with certain directors and officers of the Company pursuant to which, the Company agreed, subject to the approval of the TSX and disinterested shareholders at a special meeting of shareholders held on December 15, 2017 (the "**Special Meeting**"), to issue an aggregate of 42,254 units, in satisfaction of an aggregate of \$147,898 of indebtedness currently owed by the Company to such persons.

The Company entered into a Consulting Agreement with Skanderbeg Capital Advisors Inc. ("**Skanderbeg**") to explore and evaluate strategic alternatives to maximize value for Prophecy's non-core assets in exchange for the issuance of 98,420 units provided TSX and shareholder approval for the issuance of the units was obtained at the Special Meeting.

The Company entered into an Advisory Agreement with Hillcrest Merchant Partners Inc., who agreed to provide corporate development and financial advisory services related to the Gibellini vanadium project in Nevada, USA (the “**Gibellini Project**”), including equity and debt arrangement, product off-take and merger and acquisition negotiations with any strategic investors in exchange for annual aggregate payments totaling \$156,000;

- (z) “Technical Report, Titan Project, Ontario, Canada” (the “**Titan Technical Report**”) dated October 23, 2017, prepared in accordance with the CIM Standards that fulfills the disclosure requirements of NI 43-101 prepared by Neil Prenn and Neil Pettigrew of Mine Development Associates who were Qualified Persons under NI 43-101 as of the effective date and the filing date of the report;
- (aa) “Gibellini Vanadium Project, Nevada, USA, NI 43-101 Technical Report” (the “**Gibellini Technical Report**”) dated November 10, 2017, prepared in accordance with the CIM Standards that fulfills the disclosure requirements of NI 43-101 prepared by Edward J.C. Orbock of Amec Foster Wheeler E&C Services Inc. (“**Amec E&C**”) who was a Qualified Person under NI 43-101 as of the effective date and the filing date of the report;
- (bb) “Updated Mineral Resource Estimate Technical Report for the Pulacayo Project” (the “**Pulacayo Technical Report**”) dated October 14, 2017, prepared in accordance with the CIM Standards that fulfills the disclosure requirements of NI 43-101 prepared by Peter Webster and Michael Cullen of Mercator who were Qualified Persons under NI 43-101 as of the effective date and the filing date of the report;
- (cc) Material Change Report dated February 15, 2018 disclosing the Company acquired an additional 105 unpatented lode mining claims adjacent to its existing Gibellini Project, through the arm’s-length acquisition of 1104002 B.C. Ltd., a privately held company incorporated in British Columbia, and its subsidiary, a privately held company incorporated in Nevada. As consideration, the Company paid a total of \$335,661.40 and issued 50,000 Common share purchase warrants to the shareholders of 1104002 B.C. Ltd., in addition to settling \$14,338.60 in debt owed by the acquired companies; and
- (dd) Material Change Report dated February 27, 2018 disclosing the Company’s Shares began trading on the OTCQX® Best Market under the ticker symbol “PRPCF”.

The above documents are available for review under the Company’s SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com).

## 2. CORPORATE STRUCTURE

### 2.1 Name, Address and Incorporation

Prophecy Development Corp. (formerly Prophecy Coal Corp.) is an exploration and development stage company focusing on mining and energy projects in the USA, Canada, Bolivia and Mongolia.

Prophecy is a reporting issuer in the provinces of British Columbia, Alberta, and Ontario. The Company’s Common shares (the “**Shares**” or “**Prophecy Shares**”) are listed for trading on: the TSX under the symbol “PCY”, the OTCQX® Best Market under the symbol “PRPCF” and the Frankfurt Stock Exchange under the symbol “1P2N”.

Prophecy’s head and registered offices are located at Suite 1610 – 409 Granville Street, Vancouver, British Columbia, V6C 1T2. The Company’s website is [www.prophecydev.com](http://www.prophecydev.com).

Prophecy, in its current form, is primarily the product of an April 2010 business combination between Red Hill Energy Inc. (at the time, TSX.V-RH) and a company formed in 2006, Prophecy Resource Corp. Red Hill Energy Inc. was incorporated on November 6, 1978 under the *Corporations Act* (British Columbia) under the name “Banbury Gold Mines Ltd.” Banbury changed its name to “Enerwaste Minerals Corp.” on July 3, 1992 and to “Universal Gun-Loc Industries Ltd.” on December 17, 1993. On April 24, 2002, Universal



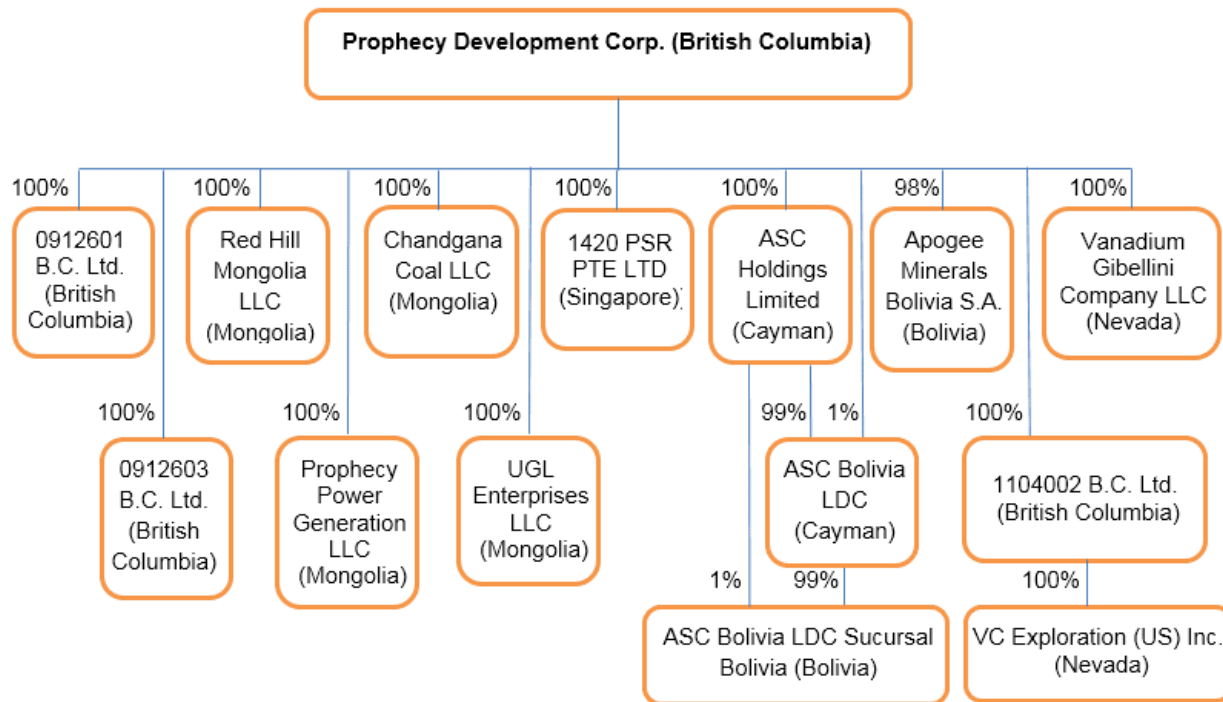
Gun-Loc changed its name to “UGL Enterprises Ltd.” and to “Red Hill Energy Inc.” on May 29, 2006. On May 10, 2005, the Company, as UGL, transitioned under the new (2002) *Business Corporations Act* (British Columbia) (“**BCBCA**”) which is the corporate law statute as amended, which continues to govern the Company.

On April 16, 2010, the Company (then Red Hill Energy Inc.) changed its name to “Prophecy Resource Corp.” in conjunction with the Red Hill Energy Inc. merger. On June 13, 2011, the Company changed its name to “Prophecy Coal Corp.” in connection with its amalgamation with Northern Platinum Ltd. and Prophecy Holdings Inc. and an asset spin-off to capitalize the Company’s controlled (at that time), affiliate, publicly traded Wellgreen Platinum Ltd. (formerly Prophecy Platinum Corp.). On January 5, 2015, the Company changed its name to “Prophecy Development Corp.” in connection with an acquisition of assets primarily located in Bolivia and to better reflect its various interests in its current mining and energy projects in the USA, Canada, Bolivia and Mongolia.

## 2.2 Inter-Corporate Relationships

Prophecy currently has ten direct wholly-owned, one direct 98%-owned, and three indirect wholly-owned subsidiaries (collectively, the “**Subsidiaries**”).

Figure 1 describes the inter-corporate relationships among Prophecy and its Subsidiaries, the percentage of voting securities of the Subsidiaries owned by Prophecy, and the Subsidiaries’ jurisdiction of incorporation as of the date of this AIF.



**Figure 1**

Prophecy holds mining and energy properties and projects through the following subsidiaries’:

- |                       |   |
|-----------------------|---|
| Red Hill Mongolia LLC | <ul style="list-style-type: none"> <li>• 100% interest in the Ulaan Ovoo coal property (the “<b>Ulaan Ovoo Property</b>”) located in Selenge province, Mongolia.</li> </ul> |
| Chandgana Coal LLC    | <ul style="list-style-type: none"> <li>• 100% interest in the Chandgana Tal coal property (the “<b>Chandgana Tal Property</b>”) and Khavtgai Uul coal</li> </ul>            |

Prophecy Power Generation LLC	<ul style="list-style-type: none"><li>property (the “<b>Khavtgai Uul Property</b>”) (together, the “<b>Chandgana Project</b>”) located in Khentii province, Mongolia.</li><li>• Holds the land use right and construction licence for the Chandgana 600MW Coal-Fired Mine Mouth Power Plant project planned in Khentii province. Mongolia (the “<b>Chandgana Power Plant Project</b>”).</li></ul>
912601 B.C. Ltd.	<ul style="list-style-type: none"><li>• 100% interest in the Titan vanadium-titanium-iron property located in the Province of Ontario, Canada.</li></ul>
ASC Bolivia LDC Sucursal Bolivia	<ul style="list-style-type: none"><li>• Holds the mining joint venture interest in the Pulacayo Paca silver-lead-zinc property (the “<b>Pulacayo Project</b>”) located in Quijarro province, Bolivia.</li></ul>
Vanadium Gibellini Company LLC	<ul style="list-style-type: none"><li>• Has claimed 209 lode mining claims that comprise a portion of the Gibellini Project in Nevada, including three of the 17 claims that comprise the expanded Louie Hill group of claims. These claims are in adjudication as of the time of this AIF.</li></ul>
VC Exploration (US) Inc.	<ul style="list-style-type: none"><li>• 100% interest in 105 unpatented lode mining claims that comprise a portion of the Gibellini Project in Nevada.</li></ul>

Additionally, Prophecy holds through lease, the 40 unpatented lode mining claims that make up the Gibellini group of claims.

### 3. GENERAL DEVELOPMENT OF THE BUSINESS

#### 3.1 Three Year History

##### 2015

- On January 5, 2015, the Company announced that it changed its name to “Prophecy Development Corp.”
- On January 20, 2015, the Company announced the approval by the Ministry of Roads and Transportation of Mongolia of the Road Feasibility Study for the construction of a 17 km road to connect Ulaan Ovoo mine to the Zelter Russian border.
- On March 12, 2015, the Company entered into the Credit Facility in order to meet interim working capital requirements to fund the Company’s business operations and financial commitments. The Credit Facility is revolving, has a maximum principal amount available for advance of \$1.5 million, a two year term, as it was amended on May 5, 2015, with an option to extend it for any number of subsequent one-year terms subject to TSX approval, and bears

a simple interest rate of 18% per annum.

- On March 27, 2015, the Company announced that the private placement with TBF Capital Management Group (HK) Limited previously announced on December 8, 2014 and February 25, 2015 had not closed by the deadline stipulated by the TSX.
- On April 14, 2015, the Company filed a Notice of Civil Claim in the Supreme Court of British Columbia against TBF Capital Management Group (HK) Limited for breach and repudiation of an Amended and Restated Subscription Agreement for Shares between the parties dated February 6, 2015.
- On May 5, 2015, the Company, through its wholly-owned subsidiary, Red Hill, entered into a Purchase Agreement with an arm’s-length party in Mongolia to sell substantially all of its mining and transportation equipment at the Company’s Ulaan Ovoo mine for total proceeds of approximately \$2.34 million. The sale, together with the sale of additional equipment to other arm’s-length parties, was completed in

June 2015 and the Company received approximately \$2.9 million in cash.

The Company received consent to the sales of the equipment, from Linx, and in consideration, Mr. Lee, the beneficial owner of Linx, received the equivalent of 120,000 share purchase warrants of the Company exercisable at the equivalent of \$5.00 per Share for a period of five years expiring on May 22, 2020.

- On May 5, 2015 the Credit Facility was amended to extend the term to two years.
- On September 1, 2015 the Company announced a non-brokered private placement involving the issuance of up to the equivalent of 400,000 units at a price of the equivalent of \$5.00 per unit. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of the equivalent of \$7 per Share for a period of five years from the date of issuance.
- On September 25, 2015 Red Hill further amended the Line of Credit Agreement with the Trade and Development Bank by extending the maturity date by five months.
- On September 30, 2015, the Company closed a first cash tranche of the placement announced on September 1, 2015, which raised gross cash proceeds of \$556,000 through the issuance of the equivalent of 111,200 Units of Prophecy.
- On November 5, 2015, the Company filed the Paca Technical Report.
- On November 12, 2015 the Company announced a non-brokered private placement involving the issuance of up to the equivalent of 250,000 units at a price of the equivalent of \$4.00 per unit. Each unit under this placement consists of one Share and one Share purchase warrant.
- On November 13, 2015, the Company closed the placement announced on November 12, 2015, which raised gross proceeds of \$250,000 through the issuance of the equivalent of 62,500 units of Prophecy.
- On December 18, 2015, the Company signed an EPC Agreement, Equity Investment

Agreement, and Share Purchase Agreement with SEPCO2 to invest in, and build the Company's 600 MW Chandgana Power Plant Project in Mongolia.

- On December 22, 2015, the Company signed a non-binding Joint Development Agreement with a Chinese partner to invest in the Chandgana Power Plant Project.

## 2016

- On January 25, 2016, the Company closed a non-brokered private placement involving the issuance of the equivalent of 80,000 units at a price of the equivalent of \$2.50 per unit. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of the equivalent of \$4.00 per Share for a period of five years from the date of issuance.
- On January 29, 2016, the Company announced that it voluntarily delisted its Shares from the OTCQX® Best Market.
- On February 24, 2016, the Company entered into an agreement to increase and amend the Credit Facility.
- On March 30, 2016, the Company entered into a Debt Settlement Agreement with Linx and Mr. Lee pursuant to which, the Company agreed to issue the equivalent of 750,000 units to Mr. Lee, in satisfaction of \$1,500,000 of indebtedness owed by the Company to Linx under the Credit Facility. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of the equivalent of \$4.00 per Share for a period of five years from the date of issuance.
- On May 4, 2016, the Company paid off and closed out the USD1.5 million line of credit facility with the Trade and Development Bank of Mongolia.
- On June 2, 2016, the Company held its Annual General Meeting where shareholders approved among other things, a new Share-Based Compensation Plan.
- On June 6, 2016, the Company issued the equivalent of 750,000 units at a value of the

equivalent of \$2.00 per unit to Mr. Lee, in satisfaction of \$1,500,000 of indebtedness owed by the Company to Linx under the Credit Facility. Each unit consists of one Share and one share purchase warrant. Each share purchase warrant entitles the holder to acquire an additional Share at a price of the equivalent of \$4.00 per Share for a period of five years from the date of issuance.

- On June 7, 2016, the Company completed the Share Consolidation.
- In June 2016, the Company commenced its sampling program at the Paca deposit in Bolivia.
- On August 12, 2016, the Company announced, the assay results for the first group of 40 samples collected from the Paca exploration program at its Pulacayo Project.
- On August 29, 2016, the Company closed an oversubscribed non-brokered private placement involving the issuance of 202,735 units at a price of \$3.80 per unit as previously announced on August 8, 2016 for gross proceeds of \$770,393. Each unit consists of one Share and one half of one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of \$4.40 per Share for a period of five years from the date of issuance.
- On September 22, 2016, the Company sold its 60% interest in the Okeover, copper-molybdenum project located in British Columbia to Lorraine Copper Corp. (“**Lorraine**”). Under the terms of the agreement, Lorraine issued 2,200,000 common shares of Lorraine (valued at \$0.08/share) to Prophecy and assumed Prophecy’s \$19,079 payment obligation to Eastfield Resources Ltd. under such parties’ existing Joint Venture Agreement. Prophecy will additionally be entitled to receive 30% of any payments or proceeds resulting from third party agreements related to the project entered into within five years, which payments shall be limited to a maximum amount payable to Prophecy, of \$1,000,000.
- On September 29, 2016, the Company announced its plans for definition drilling and priority objectives at the Pulacayo Project, which are to: 1) study the possibility of commissioning Pulacayo and/or Paca to production at current metal prices, part of which

includes definition drilling; and 2) apply modern exploration techniques to the Pulacayo district to test mineralization found during reconnaissance exploration.

- On November 24, 2016, the Company announced the exploration of an additional vein system (the “**AVS**”) at the Pulacayo Project which is within 100 metres of the surface and is accessible via existing tunnels and which was not included in the Pulacayo deposit resource estimate prepared in 2015 by Mercator. The Company plans to continue exploration of the AVS to assess whether further exploration is warranted.
- On December 23, 2016, the Company announced the silver, zinc, lead assay results of 22 samples collected from the AVS at the Pulacayo Project.
- On December 28, 2016, the Company announced that it has signed two Coal Sales and Purchase Agreements to sell a total of 16,000 tonnes of coal from the existing stock pile at Ulaan Ovoo mine to local customers.

## 2017

- On January 13, 2017, the Company closed a non-brokered private placement involving the issuance of 49,999 units at a price of \$3.00 per unit as previously announced on January 8, 2016. Each unit consists of one Share and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of \$4.00 per Share for a period of five years from the date of issuance.
- On January 13, 2017, the Company announced that pursuant to the terms of its 2016 Share-Based Compensation Plan it has granted in aggregate, 39,000 bonus shares at a value of \$4.88 per bonus share and 91,000 incentive stock options to various directors, officers and consultants of the Company. The options are exercisable at a price of \$4.88 per Share for a term of five years expiring on January 12, 2022 and vest at 12.5% per quarter for the first two years following the date of grant.
- On January 13, 2017, the Company and Linx entered into a Debt Settlement Agreement to settle most of the outstanding balance owing by the Company to Linx under the Credit Facility,

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

- On February 10, 2017, the Company acquired the remaining 20% title interest held by Randsburg International Gold Corp. (“**Randsburg**”) in the patented claims that comprise the Titan Project by issuing to parties designated by Randsburg 20,000 Prophecy Shares.
- On March 14, 2017, the Company announced a non-brokered private placement involving the issuance of 100,000 units at a price of \$4.00 per unit. Each unit consists of one Share and one Share purchase warrant. Each Share purchase warrant entitles the holder to acquire an additional Share at a price of \$5.00 per Share for a period of five years from the date of issuance.
- On April 12, 2017, the Company closed a non-brokered private placement involving the issuance of 103,250 units at a price of \$4.00 per unit as previously announced on March 14, 2017.
- On May 8, 2017, the Company entered into a binding letter agreement with an arm’s-length, private party (the “**Gibellini Lessor**”) to acquire through lease, the Gibellini Project. Under the letter agreement, Prophecy agreed to lease the Gibellini mining claims which constitute the Gibellini Project by paying to the Gibellini Lessor, annual advance royalty payments which will be tied, based on an agreed formula (not to exceed USD120,000 per year), to the average vanadium pentoxide price of the prior year. Upon commencement of production, Prophecy intends to maintain its acquisition through lease of the Gibellini mining claims by paying to the Lessor, a 2.5% net smelter return (“**NSR**”) until a total of USD3 million is paid. Thereafter, the NSR will be reduced to 2% over the remaining life of the mine (and referred to thereafter, as “production royalty payments”). All advance royalty payments made, will be

deducted as credits against future production royalty payments. The lease is for a term of 10 years, which can be extended for an additional 10 years at Prophecy’s option.

- On June 13, 2017, the Company held its Annual General Meeting. There were no changes to the board of directors; all proposed resolutions were approved by the Company’s shareholders including amendments to the terms of certain issued and outstanding warrants by extending their expiry date, and the Company’s Share-Based Compensation Plan to increase the number of Shares available for issuance under the plan.
- On June 13, 2017, the Company issued 59,659 units at a price of \$4.00 per unit, to certain of its directors and officers to settle various debts owing to them pursuant to the terms of Debt Settlement Agreements entered into with those directors and officers. Each unit consists of one Share and one Share purchase warrant. Each Share purchase warrant entitles the holder to acquire an additional Share at a value of \$5.00 per Share for a period of five years from the date of issuance.
- On June 13, 2017, the Company granted in aggregate, 145,000 incentive stock options to various directors, officers and consultants of the Company. The options are exercisable at a price of \$3.30 per Share for a term of five years expiring on June 12, 2022 and vest at 12.5% per quarter for the first two years following the date of grant.
- On June 23, 2017, the Company announced that it acquired through lease, the Gibellini Project by paying USD35,000 in cash to the Gibellini Lessor with the intent to carry-out mining operations there.
- On July 13, 2017, the Company acquired through lease, the Louie Hill group of claims in Nevada, USA, by paying USD10,000 in cash to arm’s-length, private parties (the “**Louie Hill Lessors**”) with the intent to carry-out mining operations there. Under the Mineral Lease Agreement, Prophecy will lease the Louie Hill group of claims by paying to the Louie Hill Lessors, annual advance royalty payments which will be tied, based on an agreed formula (not to exceed USD28,000 per year), to the average vanadium pentoxide price for the prior year. Upon commencement of production,

- Prophecy will maintain its acquisition through lease of the Louie Hill group of claims by paying to the Louie Hill Lessors, a 2.5% NSR of which, 1.5% of the NSR may be purchased at any time by Prophecy for USD1 million leaving the total NSR to be reduced to 1% over the remaining life of the mine (and referred to thereafter, as “production royalty payments”). All advance royalty payments made, will be deducted as credits against future production royalty payments. The lease is for a term of 10 years, which can be extended for an additional 10 years at Prophecy’s option.
- On July 21, 2017, the Company announced that it entered into a binding letter agreement (the “**Buttercup Letter Agreement**”) with Fairmont Resources Inc. to acquire the fully-permitted Buttercup iron-titanium-vanadium project in Quebec, Canada. The parties agreed to replace the Buttercup Letter Agreement with a more comprehensive definitive agreement by November 1, 2017, subject to due diligence and other conditions being satisfied.
  - On August 25, 2017, the Company announced that as a result of a review by the British Columbia Securities Commission it retracted certain disclosures previously made regarding its Gibellini, Pulacayo and Titan Projects.
  - On August 25, 2017, the Company announced that it entered into a binding letter agreement with an arm’s-length party to acquire the Dabolava gold project located in the Republic of Madagascar.
  - On August 25, 2017, the Company announced a non-brokered private placement involving the issuance of up to 888,000 units at a price of \$3.50 per unit. Each unit consists of one Share and one half of one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of \$4.00 per Share for a period of three years from the date of issuance.
  - On September 1, 2017, the Company announced its intent to increase the size of the non-brokered private placement announced on August 25, 2017, to a maximum of \$5,757,360. The placement, as amended, included the issuance of units as well as up to 900,000 Special Warrants.
  - On September 1, 2017 the Company the Company granted in aggregate, 167,000 incentive stock options to various directors, officers and consultants of the Company. The options are exercisable at a price of \$3.50 per Share for a term of five years expiring on September 1, 2022 and vest at 12.5% per quarter for the first two years following the date of grant.
  - On September 20, 2017, the Company announced the closing of the first tranche of the non-brokered private placement initially announced on August 25, 2017, as amended, through the issuance of 667,968 units and 716,013 Special Warrants.
  - On October 4, 2017, the Company again amended the non-brokered private placement initially announced on August 25, 2017 to increase the number of Special Warrants for issuance to 1,250,000.
  - On October 16, 2017, the Company announced the closing of the second and final tranche of the non-brokered private placement initially announced on August 25, 2017, as amended, through the issuance of 116,578 units and 423,698 Special Warrants.
  - On October 16, 2017, the Company announced that it entered into Debt Settlement Agreements with certain directors and officers of the Company pursuant to which the Company agreed, upon TSX and disinterested shareholder approval being obtained at the Company’s Special Meeting, to issue an aggregate of 42,254 units in satisfaction of an aggregate of \$147,898 of indebtedness by the Company to such persons. The units are comprised of one Share and one half of one Share purchase warrant. Each warrant entitles the holder to purchase an additional Share at a price of \$4.00 per Share for a period of three years from the date of issuance.
  - On October 16, 2017, the Company announced that it entered into a Consulting Agreement with Skanderbeg to explore and evaluate strategic alternatives to maximise value for the Company’s non-core assets in exchange for 98,420 units provided TSX and disinterested shareholder approval being obtained at the Company’s Special Meeting. The units are comprised of one Share and one half of one Share purchase warrant. Each warrant entitles

the holder to purchase an additional Share at a price of \$4.00 per Share for a period of three years from the date of issuance.

- On October 16, 2017, the Company announced that it entered into an Advisory Agreement with Hillcrest Merchant Partners Inc., who agreed to provide corporate development and financial advisory services related to the Gibellini Project, including equity and debt arrangement, product off-take and merger and acquisition negotiations with any strategic investors in exchange for annual aggregate payments totalling \$156,000.
- On November 8, 2017, the Company announced that it mutually agreed with Fairmont Resources Inc. to terminate the Buttercup Letter Agreement due to Prophecy not completing its due diligence within the timeframe required.
- On November 8, 2017, the Company filed the Titan Technical Report.
- On November 20, 2017, the Company filed the Gibellini Technical Report.
- On November 22, 2017, the Company filed the Pulacayo Technical Report.
- On November 28, 2017, the Company closed out the Credit Facility.
- On December 5, 2017, the Company announced it significantly expanded the land position at its Gibellini Project by staking a total of 198 new claims immediately adjacent to the Gibellini Project covering 4091 acres sufficient to enable future vanadium mining, processing and extraction.
- On December 15, 2017, the Company held its Special Meeting where shareholders of the Company approved all resolutions brought before them at the meeting.
- On December 18, 2017, the Company converted the 1,139,711 Special Warrants previously issued under the non-brokered private placement initially announced on August 25, 2017, as amended, into units of the Company.
- On December 18, 2017, the Company issued

42,254 units at a price of \$3.50 per unit, to certain of its directors and officers to settle various debts owing to them pursuant to the terms of Debt Settlement Agreements entered into with those directors and officers. Each unit is comprised of one Share and one half of Share purchase warrant. Each Share purchase warrant entitles the holder to acquire an additional Share at a value of \$4.00 per Share until December 18, 2020.

- On December 18, 2017, the Company issued 98,420 units at a price of \$3.50 per unit, to Skanderbeg pursuant to the terms of the Consulting Agreement entered into with Skanderbeg. Each unit is comprised of one Share and one half of Share purchase warrant. Each Share purchase warrant entitles the holder to acquire an additional Share at a value of \$4.00 per Share until December 18, 2020.

#### **2018 to date**

- On January 31, 2018, the Company received preliminary results from batch metallurgical testing of samples obtained from its Titan property.
- On January 31, 2018, the Company announced that it was unable to complete project due diligence on the Dabolava gold project and enter into a comprehensive definitive agreement with the seller before the November 30, 2017 deadline.
- On February 15, 2018, the Company acquired an additional 105 unpatented lode mining claims located adjacent to its existing Gibellini Project in Nevada, USA, through the acquisition of 1104002 B.C. Ltd. and its Nevada subsidiary, by paying a total of \$335,661 in cash, settling \$14,338 in debt and issuing 50,000 Share purchase warrants to arm's-length, private parties.
- On February 26, 2018, the Company announced the following executive management appointees:
  - (a) Michael Drozd, Vice-President, Operations;
  - (b) Danniell Oosterman, Vice-President, Exploration;
  - (c) Bekzod Kasimov, Vice-President, Business Development; and

(d) John Young, Environmental Permitting Consultant.

- On February 27, 2018, the Company announced that its Shares began trading on the OTCQX® Best Market. The ticker symbol is "PRPCF". Investors can find current financial disclosure and Real-Time Level 2 quotes for the Company on [www.otcmarkets.com](http://www.otcmarkets.com).
- On March 12, 2018, the Company announced that it entered into a Technical Advisory and Cooperation Agreement with Northwest Nonferrous Metals Mining Group Co., Ltd. to advance the Gibellini Project. A technical team from Northwest Nonferrous Metals Mining

Group Co., Ltd. concluded a visit to the Gibellini site and collected representative oxide and supergene samples.

- On March 28, 2018, the Company announced that following a meeting between the Company and staff of the Battle Mountain District-Mt. Lewis field office of the Bureau of Land Management (the "BLM") on March 23, 2018, the Gibellini Project will be one of the first projects to undergo National Environmental Policy Act ("NEPA") review under Secretary of the Interior Order No. 3355 with the following subject: Streamlining National Environmental Policy Reviews and Implementation of Executive Order 13807.

### 3.2 Significant Acquisitions

Any and all significant acquisitions by the Company during the years ended December 31, 2017, 2016 and 2015 are described in Section 3.1 – *Three Year History* of this AIF above.

## 4. DESCRIPTION OF THE BUSINESS

### 4.1 General

Prophecy's business strategy focus is to make the Gibellini Project the first operating primary vanadium mine in North America, offering the best quality vanadium pentoxide product that exceeds customer requirements in a variety of high-tech applications such as batteries and aerospace. All of the Gibellini deposit measured and indicated resources are in the oxide and transition zones of the Woodruff Formation black shale where the mineralization has a low content of deleterious elements (less than 1% Fe, Ti, and MgO). The deposit is amenable to open pit mining and the mineralization appears amenable to metal recovery by heap leach followed by solvent extraction methods without an initial roasting step to produce V<sub>2</sub>O<sub>5</sub> as a bagged product on site that meets the specifications for high-tech applications. The Company is considering development of its Titan Project and acquisition of other vanadium resources to augment Gibellini and position Prophecy as a major producer of vanadium.

The vanadium resources are part of a portfolio of projects the Company is building that, through their diversity of locations, commodities and products, reduces exposure to adverse regulation and political climates and changes in specific commodity prices. A diverse portfolio of projects from which a variety of minerals are mined and sold provides multiple opportunities to maintain revenue and is one facet of Prophecy's efforts to attain its ultimate objective of stable positive cash flow.

### Market and Marketing

Prophecy is working to bring Gibellini into production as soon as possible in order to address the supply-demand gap for vanadium projected to begin during 2018. The projected demand is largely driven by environmental-related actions by the Chinese government which is intensified by increasing demand for vanadium redox flow storage batteries. The supply-demand gap will affect all uses of vanadium including steel manufacture, high tech applications and large capacity vanadium redox flow batteries.

Prophecy's marketing efforts have mostly been in assessing the reasons and sources of demand, but they have also conducted conceptual-level negotiations for supplying Gibellini vanadium to traders and battery manufacturers. As the Gibellini Project develops and more reliable information concerning timing, volume and quality become available, the Company will increase its marketing efforts.



## **Competitive Conditions**

The mineral exploration and mining industry is generally competitive in all phases of exploration, development and production. Prophecy competes with other mining companies, some of which have greater financial resources and technical facilities, for the acquisition of mineral interests for exploration and development projects.

International mineral commodity pricing is generally established in US dollars and the competitive positioning between producers can be significantly affected by fluctuations in exchange rates. The competitiveness of mineral producers is significantly determined by the grade or quality of the deposit, production costs and transportation costs relative to other producers. Such costs are largely influenced by the location and nature of mineral deposits, mining and processing costs, transportation and port costs, currency exchange rates, operating and management skills, and differing taxation systems between countries.

## **Components**

All of the raw materials Prophecy requires to carry on its business are available through normal supply or business contracting channels.

## **Mining Cycles**

The mining business is subject to mineral commodities price cycles. If the global economy stalls and commodity prices decline as a consequence, a continuing period of lower prices could significantly affect the economic potential of the Company's properties and result in the Company determining to cease work on or drop its interest in, some or all of such properties. Prophecy's ability to fund ongoing exploration is affected by the availability of financing which is, in turn, affected by prices of commodities, the strength of the economy and other general economic factors.

## **Economic Dependence**

Prophecy's business is not substantially dependent on any one contract such as a property option agreement or a contract to sell the major part of its output. It is not expected that Prophecy's business will be affected in the current financial year by the renegotiation or termination of contracts or sub-contracts.

## **Environmental Protection**

All aspects of Prophecy's field operations are subject to environmental regulations and generally require approval by appropriate regulatory authorities prior to commencement and continuous monitoring. Any failure to comply could result in fines and penalties. Environmental protection is a somewhat greater concern for the Mongolia projects because of the Mongolian Law to Prohibit Mineral Exploration and Mining Operations at Headwaters of Rivers, Protected Zones of Water Reservoirs and Forested Areas (the "**Long Named Law**"). This law provides for certain environmental protection standards when issuing exploration and exploitation licenses to mining companies, specifically stipulating that mining activities are prohibited at the headwaters of rivers, water protection zones along rivers and lakes and forested areas, which could affect Prophecy's ability to develop certain of its Mongolian properties. Recently the relevant Mongolian ministry has reviewed the Company's projects in light of the requirements of the Long Named Law. Where the Company's projects conflicted with the Long Named Law, the Company successfully mitigated the conflict or is in process of mitigation which is described in the history of the project. The Company is either addressing environmental protection issues with the relevant government agency or has no issues at the Bolivia and United States projects.

Should any projects advance to the production stage, in addition to Ulaan Ovoo, more time and money would be involved in satisfying environmental protection requirements. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. There is no assurance that regulatory and environmental approvals will be obtained on a timely basis or at all. The

cost of compliance with changes in governmental regulations has the potential to reduce the profitability of operations or to preclude entirely the economic development of a property.

### **Employees**

As of December 31, 2017, Prophecy had three employees in Canada, 14 employees in Mongolia, and seven non-independent consultants working in Bolivia, Canada and the USA.

Prophecy relies on and engages consultants on a contract basis to assist the Company to carry on its administrative and exploration/development activities.

### **Foreign Operations**

Prophecy currently holds an interest in certain exploration stage and development stage mineral resource properties located in Bolivia and Mongolia and, as such, Prophecy's business is exposed to various degrees of political, economic and other risks and uncertainties inherent in any developing economy. Prophecy's operations and investments may be affected by local political and economic developments, including expropriation, nationalization, invalidation of government orders, permits or agreements pertaining to property rights, political unrest, labour disputes, limitations on repatriation of earnings, limitations on mineral exports, limitations on foreign ownership, inability to obtain or delays in obtaining necessary mining permits, opposition to mining from local, environmental or other non-governmental organizations, government participation, royalties, duties, rates of exchange, high rates of inflation, price controls, exchange controls, currency fluctuations, alleged political and bureaucratic corruption, taxation and changes in laws, regulations or policies as well as by laws and policies of Canada and the USA affecting foreign trade, investment and taxation of repatriated earnings, if any.

### **Bankruptcy and Similar Procedures**

There are no bankruptcy, receivership or similar proceedings against Prophecy, nor is Prophecy aware of any such pending or threatened proceedings. There has not been any voluntary bankruptcy, receivership or similar proceedings by Prophecy during its last three financial years.

### **Reorganization**

Prophecy has not completed any reorganization in the last three financial years.

### **Social and Environmental Policies**

Prophecy monitors its operations to ensure that it complies with all applicable environmental requirements and takes actions to prevent and correct problems if needed. Prophecy's management, with the assistance of its contractors and advisors, ensures its ongoing compliance with local environmental and other laws in the jurisdictions in which it does business.

Prophecy is committed to continually improving the lives of those who work for, partner with and host Prophecy in their communities. Prophecy's goal is to work with community stakeholders to make positive contributions to local economic development. Prophecy places a priority on hiring local workers and assisting in supporting local community development projects, where it can.

## **5. MINERAL PROJECTS**

The information in this Section of this AIF has been extracted fully or where appropriate in part, from the Gibellini Technical Report, Titan Technical Report, Pulacayo Technical Report, Ulaan Ovoo PFS, Chandgana Inspection Report, Chandgana Technical Report, and Chandgana Tal PEA, as applicable. The Gibellini Project discussion includes the Gibellini and Louie Hill vanadium deposits, claims leased by the Company and claims held by Company subsidiaries Vanadium Gibellini Company LLC and VC Exploration (US), Inc. located in the state of Nevada, USA. The Titan Project discussion includes the Titan vanadium-

titanium-iron deposit and related claims located in Ontario province, Canada. The Pulacayo Project discussion includes the Pulacayo and Paca silver-lead-zinc deposits and related concessions located in Bolivia. The Ulaan Ovoo Property discussion includes the Ulaan Ovoo coal deposit, coal leases and Ulaan Ovoo mine and the Khujirt exploration license. Discussion of the Chandgana Project includes the Khavtgai Uul and Chandgana Tal coal deposits, coal leases and Chandgana Tal mine. The Chandgana Power Plant Project discussion includes a land right located in Mongolia. For each project, activities to the year of the AIF are summarized in the project description and activities during the year of the AIF are described in a separate section. Portions of the following excerpts are based on the assumptions, qualifications and procedures set forth in the respective technical reports which are not fully described herein. For a complete description of assumptions, qualifications and procedures associated with the information contained in each technical report, reference should be made to the full text of each technical report available under Prophecy's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com).

## 5.1 Gibellini Project

### Project Location

The Gibellini Project claims include the Gibellini group of claims leased by the Company, the VC Exploration group of claims and the Vanadium Gibellini Company group of claims. Figure 2 shows the location of the claims. These two groups of claims were previously referred to by the Company as the Gibellini Project. On June 22, 2017, the Company acquired (through lease) the Gibellini group of claims which is located in Eureka County, Nevada, United States of America about 25 miles south of the town of Eureka and is easily accessed by a graded, gravel road extending south from US Highway 50. The Gibellini group of claims is comprised of 40 unpatented lode claims totaling approximately 771 acres. Under the mineral lease agreement, Prophecy leased the mining claims which constitute the Gibellini Project by paying to the Gibellini Lessors, annual advance royalty payments which will be tied, based on an agreed formula (not to exceed USD120,000 per year), to the average vanadium pentoxide price of the prior year. Upon commencement of production, Prophecy will maintain its acquisition through lease of the Gibellini Project mining claims by paying to the Gibellini Lessor, a 2.5% NSR until a total of USD3 million is paid. Thereafter, the NSR will be reduced to 2% over the remaining life of the mine (and referred to thereafter, as "production royalty payments"). All advance royalty payments made, will be deducted as credits against future production royalty payments. The lease will be for a term of 10 years, which can be extended for an additional 10 years at Prophecy's option.

On July 13, 2017, the Company acquired (through lease) 10 unpatented lode claims totaling approximately 207 gross acres that formerly comprised the Louie Hill group of claims located approximately 500 metres south of the Gibellini group of claims. These claims were subsequently abandoned by the holders, and on March 11-12, 2018, the Company staked the area within and under 17 new claims totaling approximately 340 gross acres which now collectively comprise the expanded Louie Hill group of claims. Opportunities exist to further expand the project beyond its current definition.

The Company is currently negotiating a royalty agreement with one of the Louie Hill Lessors to replace on substantially similar terms, the mineral lease agreement, under which, Prophecy will lease the mining claims which formerly constituted the Louie Hill group of claims by paying to the Louie Hill Lessors, annual advance royalty payments which will be tied, based on an agreed formula (not to exceed USD28,000 per year), to the average vanadium pentoxide price for the prior year. Upon commencement of production, Prophecy will maintain its acquisition through lease of the former Louie Hill mining claims by paying to the Louie Hill Lessors, a 2.5% NSR of which, 1.5% of the NSR may be purchased at any time by Prophecy for USD1 million, leaving the total NSR to be reduced to 1% over the remaining life of the mine (and referred to thereafter, as "production royalty payments"). All advance royalty payments made, will be deducted as credits against future production royalty payments. The lease is for a term of 10 years, which can be extended for an additional 10 years at Prophecy's option.

The expanded Louie Hill group of claims is located in the same formation and lithologic units as the Gibellini group of claims. The general geology in this area is considered to be similar to the Gibellini group of claims.

The VC Exploration group of claims include 105 lode claims that were acquired indirectly by the Company through the indirect acquisition of VC Exploration (US), Inc. in early 2018. The Vanadium Gibellini Company group of claims consist of 209 lode claims claimed by Vanadium Gibellini Company LLC in early 2018. The Vanadium Gibellini Company group of claims are in adjudication as of the date of this AIF.

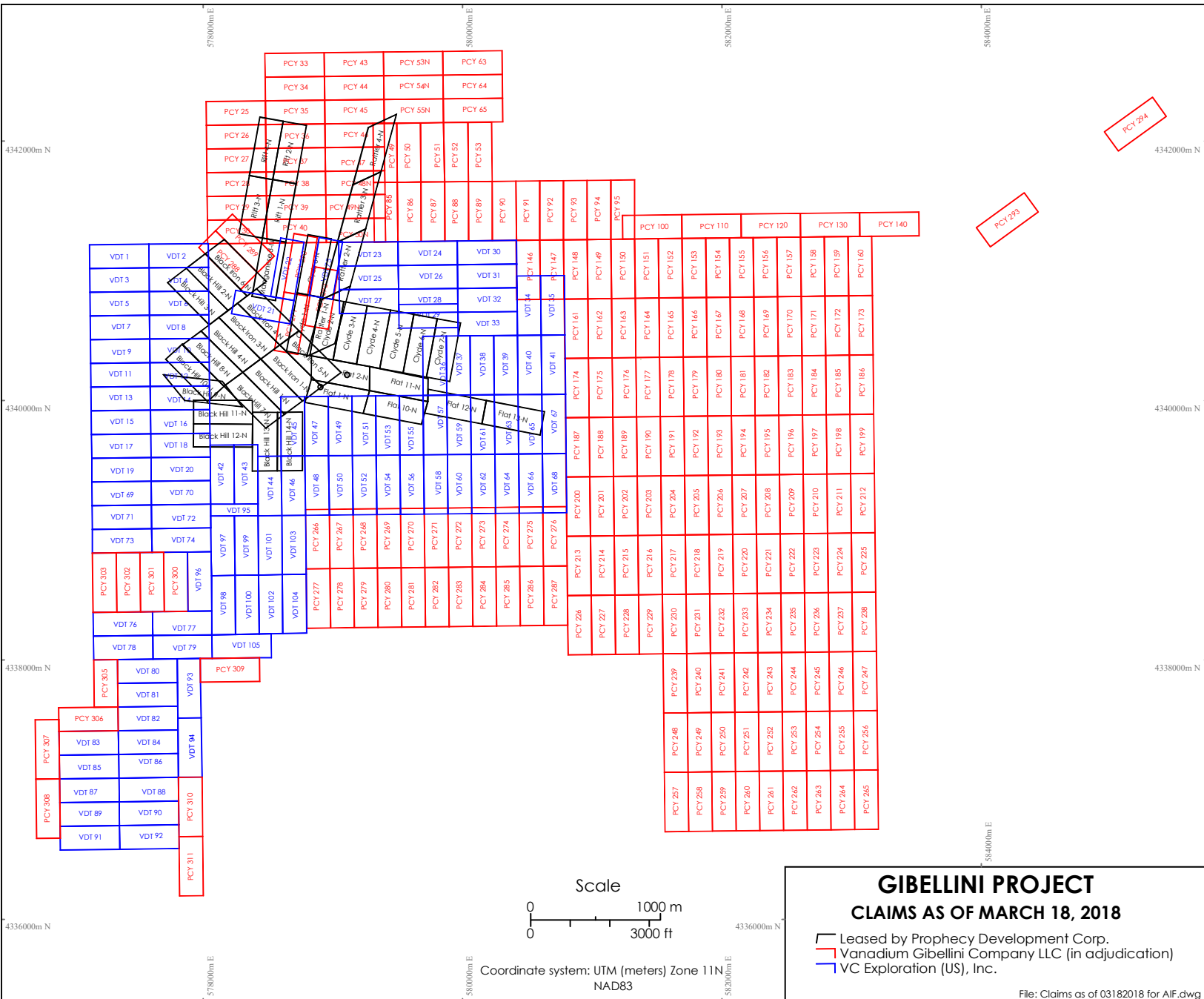


Figure 2



Figure 3

## Resources

On November 20, 2017, the Company received an independent technical report titled “Gibellini Vanadium Project Nevada, USA NI 43-101 Technical Report” with an effective date of November 10, 2017 prepared by Amec E&C. The Gibellini Technical Report has been filed under the Company’s SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com).

### *Gibellini Deposit*

The Gibellini Technical Report disclosed an estimated 7.85 million tons at a weighted average grade of 0.316% vanadium pentoxide ( $V_2O_5$ ) in the Measured category and 14.16 million tons at a weighted average grade of 0.281%  $V_2O_5$  in the Indicated category leading to a total combined Measured and Indicated Mineral Resource of 22.01 million tons at a weighted average grade of 0.294%  $V_2O_5$ . Total contained metal content of the Measured and Indicated Mineral Resources is 129.28 million pounds  $V_2O_5$ . The Inferred Mineral Resource estimate is 9.82 million tons at a weighted average grade of 0.19%  $V_2O_5$ . The total contained

metal content of the Inferred Mineral Resource estimate is 37.27 million pounds V<sub>2</sub>O<sub>5</sub>. Table 2 below contains a summary of the Gibellini deposit resource estimate.

**Table 2**

<b>Gibellini Deposit Mineral Resource Statement</b>							
Resource Category	Domain	Cut-off (%)	V <sub>2</sub> O <sub>5</sub>	Tons (M)	Grade (%V <sub>2</sub> O <sub>5</sub> )	Metal (M lbs V <sub>2</sub> O <sub>5</sub> )	Content
Measured	Oxide	0.116		3.90	0.253	19.74	
	Transition	0.105		3.95	0.379	29.88	
Indicated	Oxide	0.116		7.04	0.235	33.12	
	Transition	0.105		7.12	0.327	46.55	
Total Measured and Indicated				22.01	0.294	129.28	
Inferred	Oxide	0.116		0.14	0.179	0.50	
	Transition	0.105		0.01	0.179	0.03	
	Reduced	0.134		9.68	0.190	36.75	
Total Inferred				9.82	0.190	37.27	

**Notes to accompany mineral resource table for Gibellini deposit:**

(1) The Qualified Person for the estimate is Mr. E.J.C. Orbock III, RM SME, an Amec E&C employee. The Mineral Resource estimate has an effective date of 10 November, 2017.

(2) Mineral Resources are reported at various cut-off grades for oxide, transition, and reduced material.

(3) Mineral Resources are reported within a conceptual pit shell that uses the following assumptions: mineral resource V<sub>2</sub>O<sub>5</sub> price: \$10.81/lb; mining cost: \$2.21/ton mined; process cost: \$13.14/ton processed; general and administrative (G&A) cost: \$0.99/ton processed; metallurgical recovery assumptions of 60% for oxide material, 70% for transition material and 52% for reduced material; tonnage factors of 16.86 ft<sup>3</sup>/ton for oxide material, 16.35 ft<sup>3</sup>/ton for transition material and 14.18 ft<sup>3</sup>/ton for reduced material; royalty: 2.5% NSR; shipping and conversion costs: \$0.37/lb. An overall 40° pit slope angle assumption was used.

(4) Rounding as required by reporting guidelines may result in apparent summation differences between tons, grade and contained metal content. Tonnage and grade measurements are in US units. Grades are reported in percentages.

**Louie Hill Deposit**

The Louie Hill deposit lies approximately 1,600 ft south of the Gibellini deposit.

The Gibellini Technical Report reported an Inferred Mineral Resource of 7.06 million tons at a weighted average grade of 0.284% vanadium pentoxide (V<sub>2</sub>O<sub>5</sub>). The oxidation domains were not modeled. The total contained metal content of the estimate is 40.16 million pounds V<sub>2</sub>O<sub>5</sub>. Table 3 below summarizes the Louie Hill deposit resource estimate.

**Table 3**

<b>Louie Hill Deposit Mineral Resource Statement</b>							
Resource Category	Domain	Cut-off (%)	V <sub>2</sub> O <sub>5</sub>	Tons (M)	Grade (%V <sub>2</sub> O <sub>5</sub> )	Metal (M lbs V <sub>2</sub> O <sub>5</sub> )	Content
Inferred	Not modeled	0.116		7.06	0.284	40.16	

**Notes to accompany mineral resource table for Louie Hill:**

(1) The Qualified Person for the estimate is Mr. E.J.C. Orbock III, RM SME, an Amec E&C employee. The Mineral Resources have an effective date of 10 November 2017. The resource model was prepared by Mr. Mark Hertel, RM SME.

*(2) Oxidation state was not modeled.*

*(3) Mineral Resources are reported within a conceptual pit shell that uses the following assumptions: mineral resource price: \$10.81/lb; mining cost: \$2.21/ton mined; process cost: \$13.14/ton processed; general and administrative (G&A) cost: \$0.99/ton processed; metallurgical recovery assumptions of 60% for mineralized material; tonnage factors of 16.86 ft<sup>3</sup>/ton for mineralized material, royalty: 2.5% NSR; shipping and conversion costs: \$0.37/lb. For the purposes of the resource estimate, an overall 40° slope angle assumption was used.*

*(4) Rounding as required by reporting guidelines may result in apparent summation differences between tons, grade and contained metal content. Tonnage and grade measurements are in US units. Grades are reported in percentages.*

A total of 280 drill holes (about 51,265 ft) have been completed on the Gibellini Project since 1946, comprising 16 core holes (4,046 ft), 169 rotary drill holes (25,077 ft; note not all drill holes have footages recorded) and 95 reverse circulation holes (22,142 ft).

The vanadium-host black shale unit ranges from 175 to over 300 ft thick and overlies gray mudstone. The shale has been oxidized to various hues of yellow and orange to a depth of 100 ft. Alteration (oxidation) of the rocks is classified as one of three oxide codes: oxidized, transitional, and reduced.

No work has been conducted on the Gibellini Project since 2011. Prophecy has completed no exploration or drilling activities since the Gibellini Project acquisition.

### **Activities During 2017**

In December 2017, the Company significantly expanded the land position at its Gibellini Project by staking 198 new claims immediately adjacent to the Gibellini Project covering 4091 acres that are sufficient to enable future vanadium mining, processing and extraction.

During the year ended December 31, 2017, the Company incurred total costs of \$431,566 for the Gibellini Project including \$74,876 for claims registration and annual maintenance fees, \$272,620 for geological services, and \$84,071 for general and administrative expenses.

### **Planned Activities**

Prophecy decided to commission an updated preliminary economic assessment for the Gibellini Project in 2018. Contingent upon the results of the updated preliminary economic assessment and obtaining all necessary permits and authorizations for the Gibellini Project, a mine construction decision may be considered by the Company's board of directors, and, if positive, be accompanied by an actionable project financing plan. A positive production decision would not be based on a feasibility study of mineral reserves demonstrating economic and technical viability so would carry increased uncertainty and the risk of failure as to the mining method and profitability. The Company intends to continue preparations to re-start the environmental and permitting process, sourcing water and review of previous metallurgical work and current metallurgical technologies to consider additional work that would enhance the project.

In line with these intentions, the Company met with staff of the Battle Mountain District-Mt. Lewis field office of the BLM on March 23, 2018 to outline needed environmental work. During the meeting the Company was told that the Gibellini Project will be one of the first projects to undergo NEPA review under Secretary of the Interior Order No. 3355 (the "Order"). Under the Order environmental impact statements are to undergo a streamlined process wherein the document will have a maximum 150 pages and be completed in 12 months. Please refer to the Company's news release dated March 28, 2018.

## **5.2 Titan Project**

The Company holds a 100% interest in the Titan Project located in the Province of Ontario, Canada.

### **Project Location**

The Titan Project is located in eastern Ontario, approximately 120km northeast of Sudbury, straddling the boundary between Angus and Flett Townships, and has access to water, roads and electrical power. The



Titan property consists of 262 contiguous hectares comprising 17 patented claims. In February 2017, Prophecy consolidated its ownership over the Titan Project by acquiring the remaining 20% title interest held by Randsburg in the patented claims.

## Geology

The magnetite, ilmenite, titanium dioxide and vanadium mineralization at Titan occurs in a southeast plunging body in gabbro to leucotroctolite in the northeastern corner of the Fall Lake complex. The Titan deposit is located at the northern end of an aeromagnetic anomaly that is approximately 1,200 metres long by 800 metres wide.

A total of 4,898 assayed intervals are recorded from 38 core holes drilled by Randsburg on the property. Drilling highlights reported by Randsburg included 142 metres of 0.27% vanadium (0.48% vanadium pentoxide) from hole RA-5-21, and 174 metres of 0.26% vanadium (0.46% vanadium pentoxide) from hole RA-5-10. The mineralization starts from surface to an open vertical depth of 500 metres. The complete horizontal and vertical extent of the deposit is still to be determined.

Prophecy has expended a significant amount on acquisition, tenure maintenance and exploration to date. The Company 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 in 2013 was approved by the relevant authorities. During 2014, the Company completed an assessment of the claim posts by use of a GPS receiver. No exploration work was conducted at Titan during the years of 2015 to 2017.

Due to market conditions and the difficulty in raising additional financing, as well as Prophecy's inactivity on the Titan property in recent years, management impaired the value of the property to \$nil at the year ended December 31, 2014. As there were no benchmark or market changes from January 1, 2015 to December 31, 2017, the impaired value of \$nil for Titan property remains unchanged.

The Titan Project's previous operator completed a preliminary metallurgical test on material from one core hole at the facilities of Altairnano Inc. in the USA in 2009, which used a proprietary patented "Altair Hydrochloride Pigment Process" dissolution test on the composites. This process uses hydrochloric acid and hydrochloride gas to dissolve iron, titanium and vanadium metals. The test concluded that 88% of the iron, 96% of the titanium and 80% of the vanadium could be dissolved after 4 hours under this process. Since then, there has been a few maturing, patented hydrometallurgical technologies developed to extract titanium dioxide, iron, and vanadium from titaniferous-vanadiferous deposits.

## Mineral Resources

The Company engaged Mine Development Associates to prepare the Titan Technical Report which was prepared in compliance with NI 43-101 and reports an inferred resource for the project that is summarized in Table 4 as follows:

**Table 4**

Resource Class	Tonnes (t)*	Fe <sub>2</sub> O <sub>3</sub> (%)**	V (%)**	TiO <sub>2</sub> (%)**
Inferred	46.0 million	48.32	0.24%	14.88

*V converted to V<sub>2</sub>O<sub>5</sub>: 0.24 % V = 0.43% V<sub>2</sub>O<sub>5</sub>*

*The metal content calculated by the Company totals 434 million pounds of vanadium pentoxide content and 6,844 million kgs of titanium dioxide\*\*.*

*\*Based on resource estimated at cutoff grade of 40% Fe<sub>2</sub>O<sub>3</sub> inside an optimized pit.*

*\*\*100% metals recovery is assumed.*

## Activities During 2017

Prophecy sent samples from the Titan Project to two independent laboratories in Canada for testing. Each sample was to undergo bench-scale testing to determine the percentage of metals dissolvable into solution and the recovery rate of metals from solution. Prophecy has no preference as to a particular recovery technology but rather, seeks the best technology to recover valuable metals from the Titan Project that will be both environmentally friendly and cost effective. Each laboratory has its own proprietary, patented hydrometallurgical process to treat materials similar to those found at the Titan Project.

On January 31, 2018, the Company received the batch metallurgical testing results from NMR360. Testing of other samples has not been completed. A core sample was obtained by staff from NMR360, a recognized metallurgical testing laboratory and remained securely in their possession during transport, storage and through testing. The sample was crushed to -60 mesh. A representative subsample was obtained for a head analysis. The head analysis results are shown below in Table 5.

**Table 5**

Sample	TiO <sub>2</sub> (wt %)	V <sub>2</sub> O <sub>5</sub> (wt %)	Fe <sub>2</sub> O <sub>3</sub> (wt %)
1	19.2	0.64	62.2
2	19.2	0.63	61.9

Two 200g representative subsamples of -60m material were leached in 800mL of concentrated (33%) hydrochloric acid at two different temperatures (60°C and 90°C). The results indicate that vanadium dissolution occurred almost instantaneously at both temperatures, with extraction rates >95%. A summary of the acid dissolution results are shown below in Table 6.

**Table 6**

Temperature (°C)	Time (hr)	Solution (g/L)			Extraction (%)		
		Fe	Ti	V	Fe	Ti	V
60	2	75.6	4.2	0.80	73.1	16.1	96.3
	4	75.5	5.6	0.83	74.6	21.7	96.6
90	2	NA	14.2	0.77		52.9	95.1
	5	NA	18.6	0.82	99.9	74.9	97.7

**Note:** Fe extraction for 90°C test calculated on solids analyses only.

Temperature (°C)	Time (hr)	Residue Fall (%)	Extraction (%)		
			Fe	Ti	V
60	4	47.2	24.1	18.9	0.027
90	5	22.0	14.6	10.4	0.032

These quick tests suggest the possibility of recovering both vanadium and titanium in solution through a simple processing circuit. The circuit could include a selective vanadium leach (with little accompanying titanium extraction) at lower temperature and short duration, followed by a higher-temperature, longer duration titanium leach.

## Planned Activities

Prophecy is very encouraged by the positive preliminary results reported by NMR360 and is considering further work. One scope of work under consideration would involve the testing of a 150kg sample of Titan Project material under realistic conditions that would be adequate to generate preliminary engineering and cost data. Simultaneously, such a program would generate samples of vanadium pentoxide (0.5-1.0 kg) and titanium dioxide (10-15 kg) and hematite for end-user evaluation.

Management continues to evaluate appropriate financing and strategic alternatives to move the project forward. The work planned for the project includes detailed geological review to determine the need for further work such as surveying the drill hole locations, topographic mapping, exploration, and further metallurgical testing.

### 5.3 Pulacayo Project

The Pulacayo Project consists of many licenses within which are located the Pulacayo and Paca mineral deposits, several areas of potential mineralization, and historic tailings piles. Previously the property has been called the 'Pulacayo property' but 'Pulacayo Project' is used in this AIF because it better reflects the size, multi-deposit nature, and development of the property. The reader is referred to the Pulacayo Technical Report for further information on the historical background of the project.



Figure 3

#### Project Location

The Pulacayo Project is located 18 km northeast of the city of Uyuni (Canton of Pulacayo, Quijarro Province) in the Department of Potosí in south western Bolivia, 460 km south east of the capital city, La Paz, and 130 km south west of Potosí, the department capital (Figure 3). The approximate coordinates of the center of the project are 740 000 m East and 7 746 000 m North UTM Zone 19 south projection WGS84 datum, and at an elevation of 4,305 m ASL.

Pulacayo has a semi-arid climate with low annual rainfall and a mean summer temperature of 12°C between October and March. During winter, minimum temperatures reach the -20 to -25 °C range and summer maximums in the 18 to 20°C range occur between June and July. The yearly mean temperature is 5.5°C.

#### Accessibility, Climate, Local Resources, Infrastructure and Physiography

##### Project Access

Local Bolivian airlines fly regular domestic flights between major cities to Uyuni city. The principal highways are generally paved and heavy trucks and buses dominate road traffic outside of the major cities. For the most part, road freight service functions adequately even to small remote villages. The Pulacayo Project is accessed from La Paz by means of a paved road through Oruro. It can also be accessed by the gravel road between Oruro and Potosí and from Potosí to Uyuni by a good quality gravel road. The road from Potosí to Uyuni is paved. There is also a reasonably well-developed rail system with connections south to Argentina, east to Brazil and west to Chile and the port of Antofagasta. Rail service from Uyuni connects

with Oruro, Atocha, Tupiza, and Villazon (on the border with Argentina). Uyuni is also connected by railway to Chile through Estación Abaroa.

### *Climate*

Pulacayo has a semi-arid climate, with annual rainfall of approximately 100 mm. During winter, minimum temperatures reach the -20° to -25° C range and summer maximums in the 18 to 20°C range. The rainy period lasts from November to March corresponding with the southern hemisphere's summer season. Potosí receives regular snowfalls, typically between February and April at the end of the rainy season. On the Altiplano and in higher altitude areas, sub-zero temperatures are frequent at night throughout the year.

### *Infrastructure and Local Resources*

The electrical power supply to the mine must be upgraded to 115 kV. Potable water is supplied for the Pulacayo Mining Cooperative, the Pulacayo population, and the town of Uyuni by pipeline from the Yanapollera dam and reservoir facility located 28 km from Pulacayo. To ensure an adequate consistent supply of water for the mine and concentrator a water storage reservoir possibly supplemented by groundwater sources is being considered. Telephone services include an ENTEL-based long distance service and a GSM signal cellular telephone service. Internet access is available in most areas. Two antennae provide reception and transmission of signals from national television stations. Apogee Silver Ltd ("**Apogee**") installed a satellite receiver to provide internet access for its operation, which is shared with the Cooperative Social del Riesgo Compartido (Shared Risk Cooperative).

Approximately 600 people currently live in Pulacayo on a permanent basis. The village has a state-operated school and medical services. A hospital and clinic function independently. Numerous dwellings and mining related buildings in Pulacayo are owned by COMIBOL, some of which have been donated to the Pulacayo Mining Cooperative. Under the Shared Risk Contract, COMIBOL makes some mining infrastructure available for use by Apogee. Many of the residents have mining experience through working for the Pulacayo Mining Cooperative.

Basic exploration services are available in Bolivia and include several small diamond core drilling contractors, sample preparation (ALS Group, located in Oruro, and assay laboratories (SGS Group located in La Paz, and several locally owned assay facilities). The Bolivian National School of Engineering operates a technical college in Oruro (Universidad Técnica de Oruro) that includes a mineral processing department and laboratory facilities that provide commercial services to the mining industry. In general, an adequate supply of junior to intermediate level geologists, metallurgists, mining engineers and chemists is currently considered to be present in Bolivia.

### *Physiography*

The Pulacayo Project area is located in the Altiplano region, a high altitude plain broken by small mountains and hilly areas. It is immediately south west of the Cosuño Caldera where local topographic relief is gentle to moderate, with elevations ranging between 4,000 m and 4,500 m above sea level.

The Paca and Pulacayo domes are volcanic structures that exist as prominent topographic highs in this area.

### *Property*

Ownership of the Pulacayo Project properties is through Option and Joint Aenture Agreements. Apogee Minerals Ltd. (renamed "Apogee Silver Ltd." in March 2011) controlled 100% of the Pulacayo Project through an agreement with Golden Minerals Company ("**GMC**"), the successor of Apex Silver Company before its acquisition by Prophecy. GMC's former Bolivian subsidiary, ASC Bolivia LDC Sucursal Bolivia ("**ASC**"), holds the mining rights to the concessions through a series of Option and Lease Agreements with the Pulacayo Mining Cooperative and COMIBOL, the state mining corporation of Bolivia. On 21 January 2011, Apogee entered into a definitive agreement with GMC to acquire all of the issued share capital of

ASC, which holds a 100% interest in the Pulacayo Project. Pursuant to the agreement, Apogee acquired all of the issued and outstanding shares of the subsidiary from GMC in consideration for common shares of the company upon closing of the transaction, and an additional block of common shares and a cash fee eighteen (18) months following closing of the transaction. Prophecy Coal Corp. (predecessor to Prophecy) completed purchase of Apogee Minerals Bolivia S.A., ASC Holdings Limited and ASC Bolivia LDC (which hold ASC, the holder of Apogee's mining joint venture interest in the Pulacayo Project) (collectively, the "**Apogee Subsidiaries**") and thus Apogee's interest in the mining joint venture in January 2015. Please refer to the Company's news release dated January 2, 2015, filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website, for more information. Figure 4 shows the distribution of mineral concessions at the time Prophecy purchased the Apogee Subsidiaries.

### **History of Production**

Mining of silver deposits at Pulacayo began in the Spanish Colonial Period (c. 1545) but production details do not exist. The first recorded work was carried out in 1833 when Mariano Ramírez rediscovered the Pulacayo deposit. In 1857 Aniceto Arce founded the Huanchaca Mining Company of Bolivia and began development and production. Revenue from the mine funded the first railway line in Bolivia which in 1888 connected Pulacayo to the port of Antofagasta, Chile. Annual silver production reached 5.7 million ounces in 1891 with production predominantly from the rich Veta Tajo (Tajo Vein System). In 1923, mining operations ceased due to flooding of the main working levels.

In 1927, Mauricio Hochschild bought the property and re-started mine development with focus on the Veta Cuatro vein. During this time, the 2.8 km long San Leon access tunnel was developed to facilitate ore haulage and the first recorded exploration work in the area was undertaken. Work continued through the intervening years, and in 1952, the Bolivian government nationalized the mines and administration of the Pulacayo deposit and management was assumed by the state mining enterprise COMIBOL. COMIBOL continued operations producing 678 million ounces of silver, 200,000 tons of zinc and 200 000 tons of lead until closure in 1959 due to exhaustion of reserves and rising costs. COMIBOL also imposed cutbacks on exploration at this time. In 1962, a local cooperative group named Cooperativa Minera Pulacayo (the "**Pulacayo Mining Cooperative**") was founded and this group leased the Pulacayo mine from COMIBOL. The Pulacayo Mining Cooperative has operated small-scale mining in the district since that time and continues to do so. During the period from November 2011 to May 2013 Apogee performed trial mining, which is described in the Mining section.

There is limited mining at the Paca deposit. But the dates of mining, production, and grade are not known.

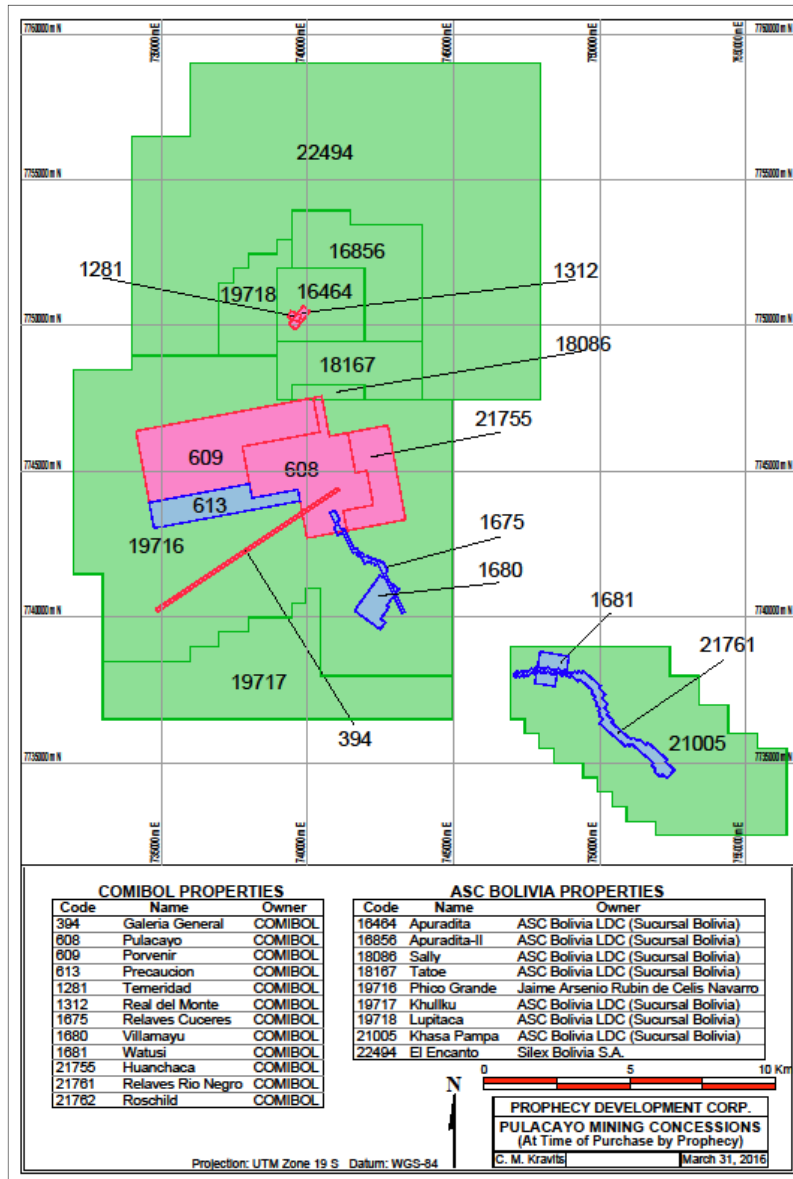


Figure 4

## Geology

### General

In south western Bolivia, the Andes Mountains consist of three contiguous provinces, which are, from west to east, the Cordillera Occidental, the Altiplano, and the Cordillera Oriental. The basement beneath the area, which is as thick as 70 km, is believed to be similar to the rocks exposed immediately to the east, in the Cordillera Oriental, where a Phanerozoic-age fold and thrust belt consists largely of Paleozoic and Mesozoic-age marine shales and sandstones. Deposited mostly on Precambrian basement, the rocks of the Cordillera Oriental were deformed during at least three mountain-building cycles. The Altiplano is a series of high basins located between mountain ranges that formed apparently in response to folding and thrusting. Its formation involved the eastward underthrusting of the basement rocks of the Cordillera Occidental, concurrent with the westward overthrusting of the sedimentary rocks of the Cordillera Oriental. These thrusts resulted in continental foreland basins that received as much as 15,000 m of sediment and interlayered volcanic rocks during the Cenozoic. Igneous activity accompanying early Andean deformation

was primarily focused further west, in Chile. During the main pulse of Andean deformation, a number of volcano-plutonic complexes were emplaced at several localities on the Altiplano, particularly along its eastern margin with the Cordillera Oriental and to the south. During glacial time, most of the Altiplano was covered by large glacial lakes of which the great salars of Uyuni and Coipasa are remnants. The Cordillera Occidental consists of late Miocene to Recent volcanic rocks, both lava flows and ash flow tuffs that have erupted in response to the subduction of the Nazca plate beneath the continent of South America. This underthrusting continues, and many of the volcanoes that form the crest of the Andes and mark the international border with Chile are presently active.

*Exploration*

Modern era exploration in the project area included surface and underground mapping, drilling and sampling by ASC and topographic mapping, surface mapping, geophysical surveying and drilling by Apogee. ASC performed preliminary geologic mapping during 2003. They completed exploration drilling using diamond coring method between July 2002 and November 2002, February 2003, and September 2003. The drilling information is summarized below in Table 7. These drilling programs outlined disseminated, veinlet and stock work style mineralization occurring between previously mined high-grade veins.

**Table 7. Summary of Modern Era Drilling**

<b>Party</b>	<b>Deposit</b>	<b>Period</b>	<b>Number of Drill Holes</b>	<b>Meters of Drilling</b>	<b>Drill Holes By Spud Location</b>
ASC	Pulacayo	Jul–Nov 2002	14	3,905	11 surface 3 underground
	Pulacayo	Feb 2003	2	554	0 surface 2 underground
	Pulacayo	Sep–Oct 2003	8	1,302	6 surface 2 underground
	Paca	2002–2005	36	4,344	36 surface 0 underground
<b>Total</b>			61	10,105	54 surface 7 underground
Apogee	Paca	Feb–Apr 2006	23	2,302	23 surface 0 underground
	Pulacayo	Feb–Jun 2006	19	4,418	15 surface 4 underground
	Paca	Jun–Nov 2006	46	10,444	46 surface 0 underground
	Paca	Nov–Dec 2006	7	886	7 surface 0 underground
	Paca	Nov 2007	14	3,745	14 surface 0 underground
	Paca	Jan–May 2008	54	14,096	46 surface 8 underground
	Pulacayo	Jun 2009	49	12,756	26 surface 23 underground
	Pulacayo	Nov 2010–Dec 2011	45	29,936	45 surface 0 underground
	Pulacayo	Aug 2011–Jun 2012	34	3,166	0 surface 34 underground
	<b>Total</b>			291	81,749
<b>Grand Total</b>			352	91,854	276 surface 76 underground

Apogee commissioned a topographic survey of the Pulacayo and Paca areas in 2006 to provide a topographic base map for use in establishing road access, geological mapping and surface sampling, and

locating drill collars and geophysical lines. A surface mapping and sampling program was done during 2005 and initially utilized the ASC preliminary geological maps. The company completed detailed surface mapping that covered all the exploration licenses. The sampling consisted mostly of rock chip samples taken from outcrops and accessible underground mine workings for a total of 549 samples. During 2006 Apogee also commissioned a detailed, three-dimensional digital model of the historic underground mine workings. The model was subsequently modified by Apogee to conform to the current datum and adjusted to align with the +1% incline grade of the San Leon tunnel. An induced polarization (IP) geophysical survey was carried out by Apogee between November and December 2007. A total of 29 line km of IP surveying was completed on the Pulacayo Project including seven lines at Pulacayo oriented north-south perpendicular to the east-west strike of the Tajo Vein System (TVS) and five similarly oriented survey lines at Paca.

Following the acquisition of the Pulacayo Project, Apogee initiated a diamond core exploration drill program that consisted of 19 holes. During 2007-2008 Apogee focused on the Paca deposit and completed 68 drill holes in two programs with 14 completed during November 2007 and 54 holes completed during 2008. Subsequent drilling occurred during June 2009, between November 2010 and December 2011, and between August 2011 and June 2012. The drilling information is summarized in Table 7. Overall core recovery reported by Apogee exceeds 90% in most cases though proximity to old mine workings reduces the recovery potential due to associated bedrock instability. Particular attention was paid to the planning and documentation of drill holes. Planning is based on the logging and interpretation of geological cross sections generated by Apogee staff geologists. Drill hole coordinates are established from digital maps and surface drill hole collars are located on the ground by field geologists using a hand-held GPS receiver. The completed drill hole is later surveyed by company surveyors. Drill hole azimuth and inclination are established using a compass and clinometer. Collar coordinates for underground drilling are established by company surveyors and hole azimuth and inclination are set by transit. Downhole deviation is determined for both surface and underground holes at approximately 50 m intervals using down hole survey tools.

Work during 2015 included mapping, sampling, assays and metallurgical tests under Phase 2 of the exploration plan, planning for Phase 2 (geophysics, drilling and assays), and preparation and submittal of the permit application for Phase 2. The exploration centered on assessing the historical tailings piles and potential mineralized areas suggested by historical exploration. On February 2, 2015, the Company announced the assay results received January 22, 2015 from ALS Minerals Ltda., for samples obtained during the reconnaissance sampling program of tailings piles materials. The tailings piles are the remaining materials from processing ore, extracted from the Pulacayo mining district between approximately 1850 and 1950. The ore was processed by a mill on site which has since been dismantled.

A total of 12 tailings piles were identified at the start of the mapping and sampling program and a total of 299 samples from the 12 tailings piles were obtained. Samples were obtained at random locations on the top surface of those piles from small holes excavated with an excavator and systematically at 2 meter spacings in the walls (slopes) of the piles from hand dug or excavated trenches, all at depths of 1.2 to 1.5 meters. The samples were then preserved, stored, secured, and transported following industry standard methods. The assay program was performed by ALS Minerals Ltda. of Lima, Perú and included standard Quality Assurance and Quality Control (QA/QC) samples to enforce the validity of the results. The results indicate silver grades up to 1200 g/t, gold grades up to 7 g/t and indium grades up to 154.5 g/t. On September 10, 2015, the Company reported results from preliminary metallurgical test work conducted on samples collected from various tailing piles at the Pulacayo Project showing up to 64.39% silver recovery. Please refer to the Company's news releases dated February 2, 2015 and September 10, 2015, filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website, for more information concerning these announcements.

Surface mapping and sampling was completed during June to August 2015 on four potential mineralized areas (El Abra, Pero, Paca, and Pacamayo). The sampling included close spaced grab and chip samples obtained systematically where the trend of the mineralization is apparent or in historic mine adits and random spot sampling where the trend is not apparent. The samples were obtained through the aid of trenching to allow sampling of fresher material, where possible. The samples were then preserved, stored, secured, and transported following industry standard methods. The assay program was performed by ALS



Minerals Ltda. and included standard QA/QC samples to enforce the validity of the results. On August 27, 2015 and September 9, 2015, the Company announced assay results of the first and second group of samples from the potential mineralized areas at the district exploration program. On September 18, 2015, the Company announced the assay results of the three Pacamayo samples where the silver grade was reported as more than 1,500 g/t. These samples have undergone reanalysis using the fire assay and gravimetric finish method which has a greater upper detection limit.

An exploration permit application was submitted during early 2015. The exploration permit would allow geophysical work to complete Phase 1 then after review of the Phase 1 information and previous exploration information and planning, completion of Phase 2.

Planning and budgeting for exploration to prove the planned stopes in the internally-developed mining plans was completed. This exploration plan included in-mine drilling and mining new drivages to explore new areas, mapping of existing exposures and new drivages, sampling of existing exposures, new drivages, and drill core for laboratory analysis and metallurgical testing.

### *Mineralization*

Pulacayo is a low sulphidation epithermal polymetallic deposit hosted by sedimentary and igneous rocks of Silurian and Neocene age (Pressacco et al., 2010). The Silurian sediments underlie the volcanic rocks and include diamictites, sandstones and shales. The Neocene rocks are predominantly volcano-sedimentary in origin and include conglomerates, sandstones, rhyolitic tuffs, dacitic-rhyolitic domes, andesitic porphyries and andesitic flows. The Pulacayo Project is located on the western flank of a regional anticline that affects sedimentary and igneous rocks of Silurian, Tertiary and Quaternary ages on the western flank of the Cordillera Oriental, near the Cordillera-Altiplano boundary. The major geologic features of the area are faults and an anticline that are considered to be important with respect to the location of mineralization.

The Uyuni-Khenayani Fault is a reverse fault located about 4 km west of Pulacayo, which is believed to have controlled localization of volcanic center complexes in the area and related mineralized areas including at Pulacayo. The Pulacayo, Paca Mayo and Paca volcanic dome complexes occur along a north-south corridor defined by two parallel, north-south trending regional faults that are approximately 2.7 km apart. The domes occur over a distance measuring approximately 10 km in length. Polymetallic vein and wall rock mineralization at Pulacayo is controlled by east-west trending secondary faults that cut the Tertiary age sedimentary and volcanic rocks of the Pulacayo dome. The stock work vein system was emplaced on the southern side of the Pulacayo dome complex and is best exemplified by the TVS which holds the largest metal resource. The TVS bifurcates in andesitic rocks to form separate veins that collectively form a dense network or stock work of veinlets along strike. The bifurcating, polymetallic veins are commonly separated by altered andesitic composition rock that contains disseminated sulphide mineralization. The mineralized zones at Pulacayo, Paca Mayo and Paca all occur on the west flank of a north-south striking anticline primarily comprised of folded sedimentary rocks. Local topographic highs define domes and stocks composed of Lower Miocene age dacitic-andesitic composition igneous rocks that intrude the folded sedimentary rocks. A younger phase of volcanic activity is also superimposed on the anticline and is marked by volcanic rocks of andesitic and rhyolitic composition. Volcanic ash deposits associated with the Cosuño Caldera are the youngest volcanic deposits in the area.

Hydrothermal wallrock alteration is spatially associated with the main vein system trends and includes propylitic, sericitic, moderate-advanced argillic, and siliceous assemblages. Host rock composition exerts a strong local influence on both the nature of alteration assemblages present and their relative intensity of development. On this basis, spatial distribution of hydrothermal alteration assemblages is a useful indicator of proximity to mineralized structures. Moderate argillic alteration is observed throughout the area and transitions to intense argillic alteration in close proximity to veins and disseminated-stock work zones. Haloes of silicification up to several centimeters in width are developed around vein contacts in some cases. Silicification grades into advanced argillic alteration as distance into the wall rock increases and this gradually grades to argillic and propylitic zones with greater distance.

As referenced by Pressacco et al. (2010), the Pulacayo deposit is considered an example of a sub-volcanic epithermal mineralization system showing well developed vertical metal zonation. The TVS is the main mineralized vein and stock work system at the Pulacayo Project. The east-west striking faults are interpreted to have acted as a conduit system for mineralizing fluids, with sulphide precipitation in open spaces to form veins and along fractures or by replacement to form zones of disseminated mineralization. Changes in temperature, pressure and the chemical state between the wall rock and fluid are thought to have influenced the style and intensity of mineralization. The high grade parts of the TVS were historically mined as single 1 m to 3 m wide veins but it transitions into zones of complex quartz-sulphide or sulphide vein arrays that occur over widths ranging from less than a meter up to 120 m. Mineralization of economic interest at Pulacayo is predominantly comprised of sphalerite, galena and tetrahedrite in sulphide-rich veins that are accompanied by locally abundant quartz, barite and pyrite with disseminated sphalerite, galena and tetrahedrite in the wallrock between the veins. To date, the TVS system has been continuously proven by mining and/or surface exposure along a strike length of 2,700 m and to a vertical depth of 1,000 m below surface, is open in both strike and dip components, and locally reaches approximately 120 m of mineralized width. Figure 4 presents a geological section perpendicular to the TVS.

As to the Paca deposit, faulting is also considered to have provided conduits for mineralizing fluids. The faulting includes north-south trending reverse faults and east-west trending extensional faults that are located concentrically around Paca dome. The assemblage of propylitic, sericitic, moderate to advanced argillic, and siliceous wall rock alteration spatially associated with silver-zinc-lead mineralization as at the Pulacayo deposit is also found at the Paca deposit. But at Paca disseminated (mantos) style and breccia hosted styles of mineralization are most common though a locally mineralized conglomerate is also found. Generally, discrete veins of mineralization having significant width and length are not common. The sulphide mineral phases commonly associated with economic grades recognized at Paca include sphalerite, galena, silver sulphosalts, tennantite, smithsonite, barite, manganese oxide, gypsum, jarosite, specularite, cerussite, dolomite, aragonite and calcite. A geological section perpendicular to the mineralization is presented in Figure 5.

### *Sampling*

The core is initially examined by core technicians and all measurements are confirmed. Core is aligned and repositioned in the core box where possible and individual depth marks are recorded at 1 m intervals on the core box walls. Core technicians photograph all core, measure core recovery between core depth blocks, complete magnetic susceptibility readings and specific gravity measurements, and record the information on hard copy data record sheets. This information is initially entered into Excel digital spreadsheets and then incorporated into the project digital database. Drill site geologists then complete a written quick log of rock types along with a graphical strip log that illustrates the rock types. They subsequently complete a detailed written description of rock types, alteration styles and intensities, structural features, and mineralization features. The drill hole logs are drawn on paper cross sections when logging is completed and lithologies are graphically correlated from drill hole to drill hole. Mineralized intervals are marked for sampling by the logging geologist using colored grease pencils and the depths of the intervals and associated sample numbers are recorded on a hardcopy sample record sheet. All paper copy information for each hole, including quick logs, detailed logs, graphical logs, sample record sheets and assay certificates are secured together in a drill hole file folder to provide a complete archival record for each drill hole. Subsequent to logging and processing, down hole litho-coded intervals, sample intervals and drill hole collar and survey information are entered into digital spreadsheets and then incorporated into the project digital database. The sample intervals marked by the logging geologist are cut in half by the core technicians using a diamond saw. Friable core is cut in half with a knife. Each half core sample is assigned a unique sample tag and number and placed in a correspondingly numbered 6 mil plastic sample bag. A duplicate tag showing the same number is secured to the core box at the indicated sample interval. All sample intervals and corresponding numbers are recorded on a hardcopy sample data sheet and are subsequently entered into a digital spreadsheet for later incorporation in the project database. The secured 6 mil plastic sample bags are grouped in batches of 6 to 10 samples and secured in a larger plastic mesh bag in preparation for shipment to the laboratory.

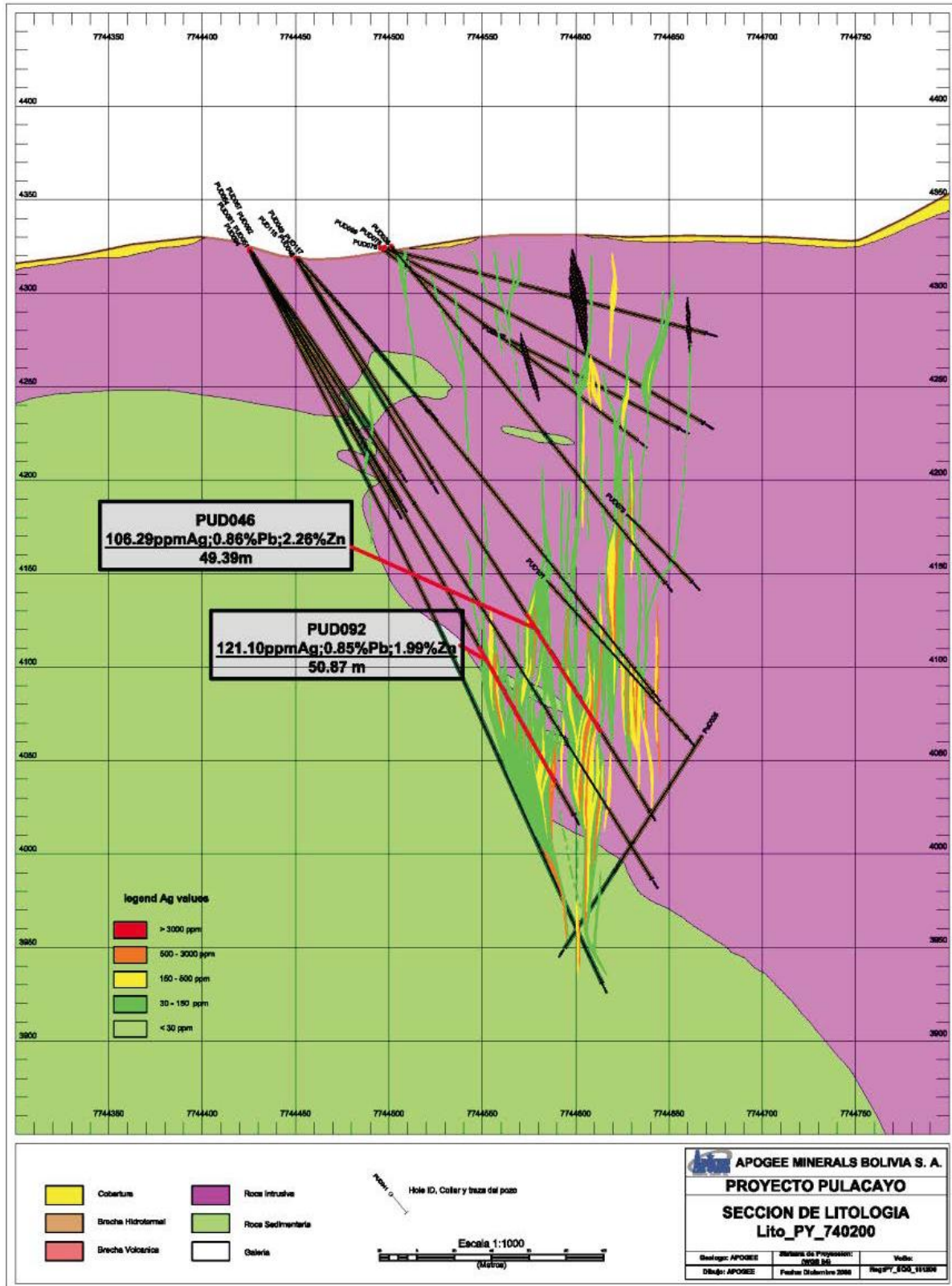
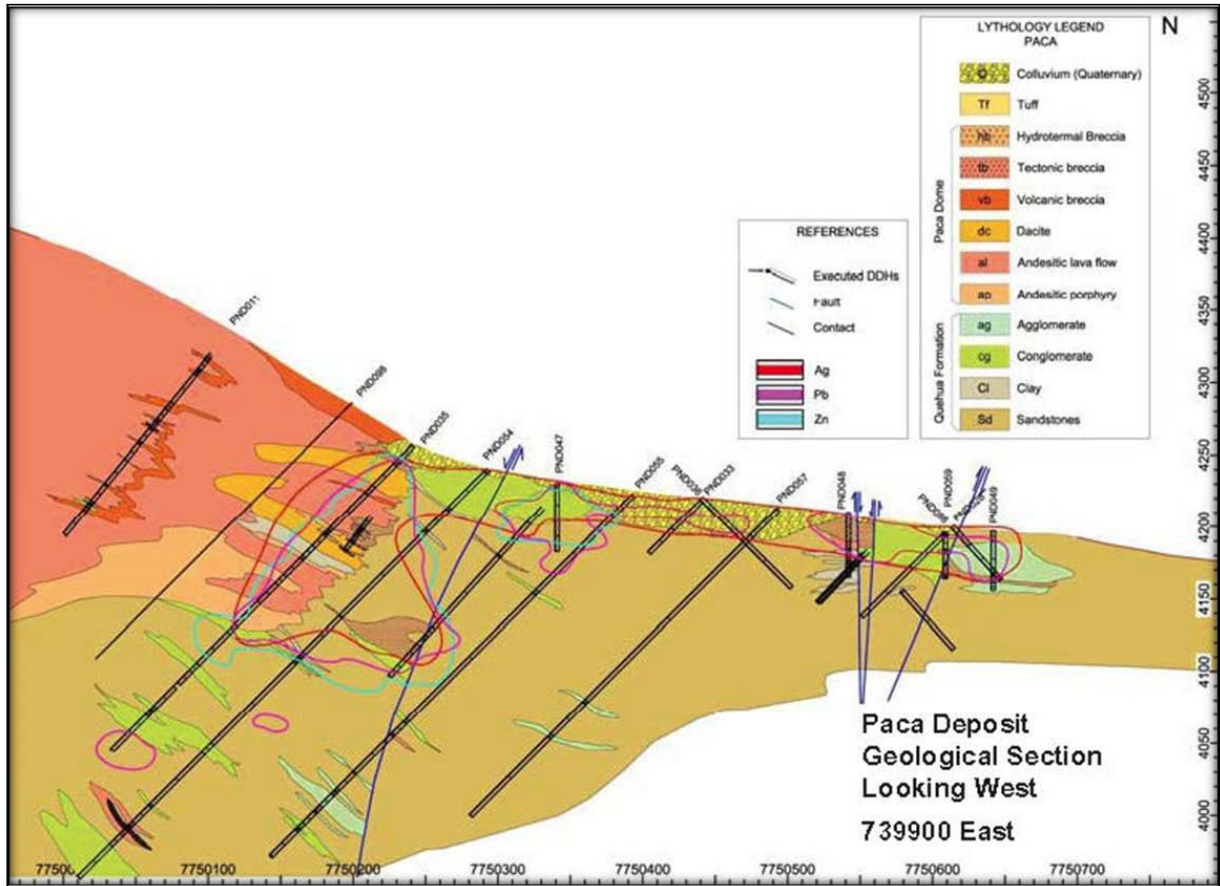


Figure 5

Drill site procedures pertinent to the ASC drilling were confirmed by Apogee staff familiar with the ASC program to be generally similar to those employed by Apogee with respect to core logging and sampling. All ASC drill core samples were processed at the Oruro, Bolivia laboratory of ALS Chemex (formerly Bondar-Clegg), with those from the first phase of drilling being analyzed at ALS Chemex facilities in Vancouver, BC, Canada. In both instances, standard core preparation methods were used prior to elemental analysis.



(Taken from Iriondo et al., 2009)

**Figure 5**

### Security of Samples

Apogee staff was responsible for transport of core boxes by pick-up truck from drill sites to the company's locked and secure core storage and logging facility located in the town of Pulacayo. The secured 6 mil plastic sample bags are grouped in batches of 6 to 10 samples and secured in a larger plastic mesh bag in preparation for shipment to the ALS Chemex preparation laboratory located in Oruro, Bolivia. All bagged samples remained in a locked storage facility until shipment to the laboratory. Samples are transported from the core storage area to the ALS Chemex facility by either Apogee personnel or a reputable commercial carrier. Sample shipment forms are used to list all samples in each shipment and laboratory personnel crosscheck samples received against this list and report any irregularities by fax or email to Apogee. Apogee has not encountered any substantial issues with respect to sample processing, delivery or security for the Pulacayo drilling programs. The transport and security of samples pertinent to the ASC drilling were confirmed by Apogee staff familiar with the ASC program to be generally similar to those employed by Apogee. The security of Paca exploration samples followed the same procedures.

### *Sample Preparation, Analysis and Quality Assurance/Quality Control*

All drill core samples from the ASC 2002 and 2003 drilling programmes were processed at the Oruro, Bolivia laboratory of ALS Chemex, with those from the first phase of drilling being analyzed at ALS Chemex facilities in Vancouver, BC, Canada. In both instances, standard core preparation methods were used prior to elemental analysis. During the 2006 to 2012 Apogee drilling programmes Apogee staff carried out immersion method specific gravity determinations but did not carry out any form of direct sample preparation or analytical work on project samples. Analytical work was completed by ALS Minerals Ltda. at its analytical facility in Lima, Peru after completion of sample preparation procedures at the ALS facility located in Oruro Bolivia. ALS was at the time and remains an internationally accredited laboratory with National Association of Testing Authorities certification and also complies with standards of International Organization for Standardization (ISO) 9001:2000 and ISO 17025:1999. The laboratory utilizes industry standard analytical methodology and utilizes rigorous internal QA/QC procedures for self-testing. Samples from the ASC drilling programs carried out in 2002 and 2003 were also prepared and analyzed by ALS. However, after preparation at the facility in Oruro, Bolivia under the same protocols as for Apogee, analytical work was carried out at the company's laboratory in Vancouver, BC, Canada. This facility was fully accredited at the time and analytical protocols were the same as those described above for Apogee.

Apogee developed an internal QA/QC program that includes blind insertion of reference standards, blanks and duplicates in each analytical shipment that was used for the 2006 to 2012 drilling programs. A blank is inserted at the beginning of each sample batch, standards are inserted at random intervals throughout each batch of 50 samples and duplicates are analyzed at the end of each batch. All data gathered for QA/QC purposes is captured, sorted and retained in the QA/QC database. The QA/QC samples include commercial reference standards, an in-house standard, and commercial prepared blank materials. Coarse field blanks were also prepared by Apogee. Analysis of duplicate samples of quarter core is accommodated through their blind inclusion in the sample stream and analysis of duplicate prepared pulp splits are also requested for each batch. Apogee's protocol also includes a check sampling program based on analysis of sample splits at a second accredited laboratory. Bulk density measurements (specific gravity) were systematically collected by Apogee staff using standard water immersion methods and unsealed core samples. Characteristics of lithology and alteration were also recorded as part of the density program and all information was assembled in digital spreadsheets.

QA/QC procedures pertinent to the ASC 2002-2003 drilling programs were not documented. However, the first drilling program carried out by Apogee in 2006 was intended to confirm earlier ASC analytical data. Full QA/QC protocols instituted by Apogee were applied to this program and results of the Apogee re-drill program correlate well with those of ASC suggesting that acceptable standards were being met by ASC. Though preparation, analysis, and QA/QC procedures were not documented for the early ASC drilling on Paca, the results of the 2006 re-drill program and check sampling by Mercator during 2015 were comparable and suggests acceptable procedures were followed for the Paca deposit samples. Sampling from later drilling at Paca followed Apogee's QA/QC procedures described above. Bulk density measurements were also obtained.

### *Data Verification*

Core sample records, lithologic logs, laboratory reports and associated drill hole information for all drill programs completed by Apogee and ASC were digitally compiled by Apogee staff. Information pertaining to the exploration history in the property area was also compiled by Apogee and was reviewed to assess consistency and validity of Apogee results. The digital drill hole records compiled by Apogee were checked in detail against the parameters (collar data, down hole survey values, hole depths, lithocodes) of the original hard copy source documents to assess consistency and accuracy. This was followed by review and validation of approximately 10% of the compiled core sample dataset against original source documents. Review of logging and sample records showed consistently good agreement between original records and digital database values. The drilling and sampling database records were further assessed through digital error identification methods available through the Gemcom-Surpac Version 6.2.1® software for such errors as sample record duplications, end of hole errors, survey and collar file inconsistencies and some potential lithocode file errors. The digital review and import of the manually checked datasets through

Surpac provided a validated Microsoft Access® database that is considered to be acceptable for resource estimation.

Apogee hosted two site visits by experts for review of procedures and verification of conditions and work programs. The first during August 2011 included review of drilling program components, core check sampling, verification of drill hole locations, and discussion with Apogee staff and consultants. The experts determined that, to the extent reviewed during the visit, evidence of work programs carried out to date on the property is consistent with descriptions reported by the company and that procedures employed by Apogee staff are consistent with current industry standards and of good quality. The second site visit occurred during April 2012 and included additional review of on-going drilling and resource estimation program work pertaining to oxide zone mineralization. The experts determined their drill hole coordinates compared well with Apogee's coordinates and reasonable correlation exists between the original sample analyses and the check sample analyses.

The data verification performed for the Paca deposit was similar to that for the Pulacayo deposit described previously. Micon International Limited of Toronto, Canada, considered the field standard used by Apogee in its QA/QC program to be unacceptable and suggested use of a commercial standard or an in-house standard supported by industry best practices.

#### *Mineral Processing and Metallurgical Testing*

To date, four metallurgical test programs were completed by outside experts. These programs include: Resource Development Inc, Denver, USA in 2003, UTO (Universidad Técnica de Oruro), Oruro, La Paz, Bolivia in 2009, ED&ED Ingeniería y Servicios S.A.C. ("**ED&ED**"), Lima, Peru in 2011, and UTO and Maelgwyn Mineral Services Laboratory in South Africa during 2012. A fifth program was managed by Apogee where bulk samples from trial mining were sent to local concentrators.

During 2003, Resource Development Inc. tested 120 kg of core sample from two drill holes. Preliminary metallurgical test work was performed to evaluate the silver and sulfide base metals recovery potential including in-place densities, feed characterization, mineralogy, leaching, gravity concentration, and bench-scale open circuit and locked cycle tests (LCT's). Silver minerals were found not to be amenable to leaching by NaCN or gravity concentration. Grinding test data determined the time required to achieve a P80 of 150 # (104 µm) was 20 minutes. Bench scale open circuit flotation tests (OCT's) were performed using the flotation reagent suite developed for the San Cristobal Project. The overall silver recovery in the lead rougher concentrates was 97.1%. The lead cleaner concentrate recovered 2.8% of the weight, 84.6% of lead, 3.1% of zinc and 46.9% of silver. The lead concentrate assayed 60.8% Pb, 4.22% Zn and 8,440 g/t Ag. The zinc cleaner concentrate recovered 7.8% of weight, 1.3% of lead, 84.7% of zinc and 38.8% Ag. The concentrate assayed 0.324% Pb, 41.2% Zn and 2,463 g/t Ag. Large scale two cycle locked cycle flotation tests were performed using the process flowsheet similar to that developed for San Cristobal deposit. The lead concentrate assaying 62.2% Pb, 4.46% Zn and 10,891 g/t Ag, recovered 3.1% weight, 88.8% of lead, 3.9% of zinc and 63.4% of silver. The zinc concentrate assayed 61.5% Zn, 0.9% Pb and 3,303 g/t Ag, recovered 5% weight, 87.6% of zinc, 2.1% of lead and 31.3% of silver. The tailings were very difficult to settle due to high proportions of clay in the ore, which will impact the process flow sheet and overall plant design. The lead and zinc third cleaner concentrates were analyzed for impurities and found that penalties may be incurred on the concentrates for several impurities.

UTO conducted a metallurgical test program during 2009 on three samples comprising comminution (only Bond Ball Work Index), OCT's, LCT's, OCT tailings (non-float) size by size analyses, and OCT tailings (non-float) sedimentation tests. Clay mineralogy studies were not carried out to determine the presence of clays that may produce very fine slimes though during the test work, slimes were produced affecting the flotation performance, settling of tailings, and flotation pulp rheology. The samples were drill cores composited to represent a higher grade, a medium grade, and a lower grade. Comminution was evaluated using the Bond Ball Mill Work Index test and categorized the samples as medium to hard. Abrasion index, crushing work index, and rod work index tests were not performed. Specific gravity tests were performed. Flotation test work focused on lead and silver recovery using both batch open circuit and closed circuit flotation tests. Locked cycle tests of the high-grade sample indicated that conventional selective lead-silver and zinc-silver

flotation techniques recovered 56% of the silver in the lead concentrate and 27% of the silver in the zinc concentrate with lead recovery of 79% and zinc recovery of 81%. Silver grades were 6,620 g/t in the lead concentrate and 2,010 g/t in the zinc concentrate. LCT test results of the medium grade sample indicated that it is possible to recover almost 34% of the silver in the lead concentrate and 50% of the silver in the zinc concentrate, with lead and zinc grades at 51% and 58%, lead and zinc recoveries at 74% and 83%, and silver grades at 6,220 g/t and 2,990 g/t. LCT test results of the low-grade sample indicated that it is possible to recover almost 30% of the silver in the lead concentrate and 21% of the silver in the zinc concentrate, with lead and zinc grades at 51% and 58%, lead and zinc recoveries at 74% and 83%, and silver grades at 6,220 g/t and 2,990 g/t, respectively. The results seem to be reasonable and in accordance with expectations from the mineralogy of the ore. These results constitute the design basis for the flow sheet. Full OCT's of sulphide minerals flotation were conducted initially on each sample as a proof of concept of the overall circuit and to establish a workable set of flotation conditions and reagents. These tests demonstrated that sulphide flotation to saleable lead and zinc concentrates at acceptable (for batch tests) recoveries was possible.

During 2011, the laboratory facility of ED&ED, performed a series of flotation tests and contracted mineralogical analyses on a high grade and low-grade sample. The initial ED&ED flotation test work was not successful then after pre-conditioning the samples with activated carbon and subsequent differential flotation, was moderately successful. The minerals present included sphalerite, galena, pyrite and quartzite gangue with galena-sphalerite assemblages (intertwined specimens) present to some extent. Twelve (12) OCT's were conducted on each of the samples to confirm the previous flotation results by UTO and to evaluate the effect of flotation response at finer grind sizes as seen in the flowcharts. The flotation tests, carried out on the high-grade samples indicated that it is possible to obtain commercial lead and zinc concentrates with grades of lead and zinc of 42.1% and 43%, respectively. The concentration of silver in the lead and zinc concentrates were reported as 7,010 g/t and 198.2 g/t, respectively. The straightforward conventional selective lead-silver and zinc-silver flotation techniques after carbon pre-treatment are able to recover 85.7% of silver in the lead concentrate (with a mass pull of 3.1%) and 2.93% of silver in the zinc concentrate (with a mass pull of 3.75%). The lead and zinc recoveries are estimated as 80% and 77.8%, respectively. The flotation tests, carried out on the low-grade samples indicated that it is possible to obtain commercial lead and zinc concentrates with grades of lead and zinc of 41% and 43.1%, respectively. The concentration of silver in the lead and zinc concentrates were reported as 6,734 g/t and 207 g/t, respectively. The straightforward conventional selective lead-silver and zinc-silver flotation techniques after carbon pre-treatment are able to recover 74% of silver in the lead concentrate (with a mass pull of 1.95%) and 3.27% of silver in the zinc concentrate (with a mass pull of 2.8%). The lead and zinc recoveries are estimated as 77.6% and 71.9%, respectively. In overall, better flotation (open circuit tests) performances are obtained at a grind size of P80 of 74 µm. Locked cycle tests at this grind size will be necessary to confirm these results. A set of paste thickening tests were run on dry samples of the flotation test (tailings) to investigate the performance of the FLSmith Deep Cone Paste thickening technology. Screening flocculent tests were carried out. Anionic flocculent (Floenger PHP 50 Plus) was selected to improve sedimentation performance based on settling rates and observed visual supernatant clarity. Experience has shown that it is difficult to scale paste flow characteristics from small-scale tests to full-scale pipeline conditions, pilot-scale pumping tests are usually necessary. The lab flotation concentrates (open circuit tests) were assayed to determine the deleterious elements in the concentrate and for use in the NSR calculations and included mineralogical analyses. The results showed that the lead concentrate assayed 47.2% Pb and 6,273 g/t Ag with 1.3% Cu, 1.45% As and 1.23% Sb. The zinc concentrate assayed 53.8% Zn with negligible copper, arsenic or antimony. The lead, silver and zinc concentrate grades are in agreement with the LCT carried out before. Concentrations of deleterious elements appear below typical smelter penalty thresholds, with arsenic appearing as the principal penalty element.

During 2012, UTO conducted further metallurgical test work including a single collective flotation test, a series of open circuit differential flotation tests (with a de-sliming step), a single locked cycle flotation test (with de-sliming step), and PORCO flow sheet testing. This test work was designed to explore the flotation response of the ore to conventional differential flotation and to establish the operating conditions, reagent scheme, and consumptions. The sample was prepared and provided by Apogee (ASL) and consisted of a bulk composite sample from drill cores with grain sizes up to 76.2 mm (3 inches). The first exploratory test indicated that silver recovery to bulk concentrate is about 72%, while the lead and zinc recoveries are

approximately 66% and 78% respectively. The floating fraction accounted for about 13%, the slimes fraction 18%, and the rest is lost as final tailings. Lead and silver losses are up to 23% and 13%, respectively. The open batch flotation tests indicated that lead recovery is between 48% and 54%, while zinc recovery is in the range from 50.1% to 72%. Total silver recovery to both lead and zinc concentrates is between 30% and 68%. Lead concentrate grades range from 33.5% to 59%, zinc concentrate grades range from 49% and 55%. Similarly, silver grades in both concentrates range from 9,875 g/t to 15,333 g/t. A single LCT, a repetitive batch used to simulate a continuous circuit where all the intermediate material added to the appropriate location in the flowsheet, was conducted to produce a metallurgical projection of the sample tested and to assess if the flowsheet and reagent suite is stable. A good locked cycle test typically achieves steady state over the last three cycles. Steady state implies both stability and mass conservation. Stability implies constancy. It was not indicated whether the test reached stability or whether mass conservation was achieved. Assuming that steady state was reached, the results indicated that lead and zinc recoveries were 60.1% and 76.5%, respectively. Lead concentrate assayed 11,114 g/t Ag, 49.1% Pb and 4.81% Zn. Additionally, the metal values in the zinc concentrate were 2,220 g/t Ag, 2.29% Pb and 48.6% Zn. Concentrates account for about 2.9% w/w of the feed (0.81% lead and 2.1% zinc). Silver metal loss in the slimes is as high as in the tailings. Lead and silver losses in the final tails are 23.1% and 9.12% respectively. The PORCO flowsheet is basically a bulk flotation followed by lead and zinc flotation, this processing route should be carried out at high pH (12.2) intended to depress pyrite at the outset. However, the Pulacayo ore did not respond well mainly because of lead and silver selectivity issues and high consumption of acid (H<sub>2</sub>SO<sub>4</sub>) to drop the pH to a level suitable for lead flotation after the bulk stage.

Maelgwyn Mineral Services Africa carried out laboratory flotation optimization test work on ore samples from the Pulacayo Project during 2012. The objectives of the work were to: (i) test the flotation conditions supplied by Apogee on the core samples to determine the metal recoveries and grades achievable by differential flotation of the Pb and Zn minerals; (ii) to optimize the flotation conditions for effective differential of the Pb and Zn minerals and to achieve saleable grades of Pb and Zn concentrates; and (iii) to perform locked cycle testing of the optimized flotation conditions using selected variability core samples. Laboratory rod milling curves were produced for all the samples and found that the milling times required for the samples indicated a high degree of variability in hardness between the sample types. Flotation tests included 65 OCT's (exploratory test work) and four locked cycle flotation tests. In summary, the locked cycle tests yielded Pb concentrates of 55-69% Pb at recoveries between 88% and 93% and Zn concentrates of 37% to 56% Zn at recoveries of 79% to 90% with a large variation in head grade from 1.5% Pb to 4.3% Pb. The silver recoveries ranged between 68% and 94% with a variation in head grade of between 136 g/t Ag and 375 g/t Ag.

The test mining between November 2011 and May 2013 produced 12,550 tons of ore that were used in a toll milling program to evaluate ore processing. The ore was hauled by truck to four concentrators – Tatasi, Fedecomín, La Estrella, and Zabaleta. The Zabaleta concentrator attained the best recoveries for which the results are presented in Table 8 below.

**Table 8. Pulacayo Deposit Zabaleta Toll Milling Results**

Material	Concentrate Grade			Recoveries		
	Pb (%)	Zn (%)	Ag (g/t)	Pb (%)	Zn (%)	Ag (%)
Lead Concentrate	47.95	12.85	6,295	64.62	16.26	72.13
Zinc Concentrate	8.47	39.45	941	9.97	43.57	8.41
Tailings	0.58	0.97	49	25.41	40.16	18.45
<b>Total Ag recovery: 81.55%</b>						

Only one series of metallurgical tests were performed on samples from the Paca deposit. The tests were completed on three samples composited from drill cores and included feed characterization, leaching, flotation and gravity tests, in-place bulk density determination, and mineralogy. Study of the three composite samples found the silver grade varied from 44.5 g/t Ag to 228.6 g/t Ag, lead minerals 0.56% Pb to 0.8% Pb, and zinc minerals 0.05% Zn to 0.41% Zn). The other sulfide minerals identified were sulphosalts and chalcocite. Coarse native silver was detected in one of the samples. The silver minerals were amenable to cyanide leaching for most of the composite samples (i.e. 28% to 82% Ag extraction)



however, extraction of silver was size dependent and improved with fineness-of-size. The lime consumption in leach varied from 0.8 to 2.4 kg/t. The NaCN consumption was dependent on both ore type and particle size, increasing with fineness of a particular size and in general, averaged  $\pm 1.5$  kg/t. Due to the presence of coarse native silver, the silver leaching was not completed in 120 hours, hence, the data was extrapolated to 240 hours leach time to project anticipated silver recovery and indicated that over 90% of silver could potentially be recovered at fine particle size for two of the three composites. Assay of the final pregnant solution from selected tests found measurable quantities of gold, hence, it is reasonable to conclude that gold is present in those samples. Some of the copper minerals present in the samples are also readily soluble in cyanide. Differential lead/zinc flotation process recovered over 90% of silver in the combined lead and zinc concentrate for the composite assaying 228.6 g/t Ag. The flotation process shows promise of recovering silver. However, the flotation process did not recover acceptable silver values from the other composites. The gravity concentration process did not concentrate silver in the gravity concentrate, hence, it cannot be used alone as a process for recovering silver minerals. The average density was  $\pm 2.2$  gm/cc for the samples tested, but the in-place bulk densities were extremely variable for one composite (i.e., 1.79 and 2.58 gm/cc). In summary, the preliminary results were encouraging to warrant additional drilling and metallurgical testing.

## **Mining**

Mineralization is found from the surface to at least 1,000 m depth at the Pulacayo deposit thus both surface and underground mining methods are likely. It is envisioned that surface mining will recover the oxidized ore and some sulphide ore to an elevation below which a crown pillar will be left and below which underground mining methods would start. Mineralization at the Paca deposit is found from the surface to approximately 60 m depth for the mantos-style mineralization and from approximately 10 m to 240m depth for the stockwork and vein style mineralization. Thus it is anticipated mining will be mostly by surface methods.

Trial mining was conducted between November 2011 and May 2013 at the Pulacayo deposit. The trial mining was done to obtain geotechnical information, better understand mining dilution, obtain a large sample for process testing, and train the workforce. The mining methods included jack leg drill and blast with tracked haulage for development and drill and blast with trackless haulage for production by the shrinkage and reusing stoping methods. The haulage way was advanced and three stopes were mined. The trial mining produced 12,550 tons of ore.

## **Mineral Resources and Reserves**

On November 22, 2017, the Company received an independent technical report with an effective date of October 20, 2017 titled "Updated Mineral Resource Estimate and Technical Report for the Pulacayo Project", prepared by Mercator. The Pulacayo Technical Report has been filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com).

The Pulacayo Technical Report describes resources estimated following the guidelines of the CIM Standards. Two mineral resource estimates were disclosed according to the requirements of NI 43-101 – one for the Pulacayo deposit and the second for the Paca deposit.

### Pulacayo Deposit

Results of the mineral resource estimate prepared by Mercator for the Pulacayo deposit are presented below in Table 9.

The Pulacayo Technical Report outlined 2.08 million tonnes at a weighted average grade of Ag 455 g/t, Pb 2.18%, Zn 3.19% (Ag Eq. 594 g/t) in the indicated category and 0.48 million tonnes at a weighted average grade of Ag 406 g/t, Pb 2.08%, Zn 3.93% (Ag Eq. 572 g/t) in the inferred category. The contained metal content estimated by the Company, of the indicated category resources is 30.4 million ounces of silver, 100.0 million pounds of lead, 146.3 million pounds of zinc. The contained metal content estimated by the

Company, of the inferred category resource is 6.3 million ounces of silver, 22.0 million pounds of lead, and 41.6 million pounds of zinc (more resource details in Table 9 below).

**Table 9. Pulacayo Indicated and Inferred Mineral Resource Statement Details**

<b>Pulacayo Mineral Resource Statement – Effective October 20, 2017</b>						
Ag Eq. Cut-Off (g/t)	Category	Tonnes*	Ag (g/t)	Pb (%)	Zn (%)	Ag Eq. (g/t)
<b>400</b>	Indicated	2,080,000	455	2.18	3.19	594
	Inferred	480,000	406	2.08	3.93	572

**Notes:**

(1) Mineral resources are estimated in conformance with the CIM Standards referenced in NI 43-101.

(2) Raw silver assays were capped at 1,700 g/t, raw lead assays were capped at 15% and raw zinc assays were capped at 15%.

(3) Silver equivalent Ag Eq. (g/t) = Ag (g/t)\*89.2% + (Pb% \*(USD0.94/ lb. Pb /14.583 Troy oz./lb./USD16.50 per Troy oz. Ag)\*10,000\*91.9%) + (Zn% \*(USD1.00/lb. Zn/14.583 Troy oz./lb./USD16.50 per Troy oz. Ag)\*10,000\*82.9%).

(4) Metal prices used in the silver equivalent calculation are USD16.50/Troy oz. Ag, USD0.94/lb Pb and USD1.00/lb. Zn. Metal recoveries used in the silver equivalent equation reflect historic metallurgical results disclosed by Apogee (Porter et al., 2013).

(5) Metal grades were interpolated within wire-framed, three-dimensional silver domain solids using Geovia-Surpac Ver. 6.6.1 software and inverse distance squared interpolation methods. Block size is 10m(X) by 10m(Z) by 2m(Y). Historic mine void space was removed from the model prior to reporting of resources.

(6) Block density factors reflect three-dimensional modeling of drill core density determinations.

(7) Mineral resources are considered to have reasonable expectation for economic development using underground mining methods based on the deposit history, resource amount and metal grades, current metal pricing and comparison to broadly comparable deposits elsewhere.

(8) Rounding of figures may result in apparent differences between tonnes, grade and contained ounces.

(9) Mineral resources that are not mineral reserves do not have demonstrated economic viability.

(10) Tonnes are rounded to nearest 10,000.

The contained metals estimated by the Company based on in the Pulacayo Technical Report are presented in Table 10 below.

**Table 10. Contained Metals Based on October 20, 2017 Pulacayo Deposit\*\* Mineral Resource Estimate**

<b>Metal</b>	<b>Indicated Resource</b>	<b>Inferred Resource</b>
Silver	30.4 million oz.	6.3 million oz.
Lead	100.0 million lbs.	22.0 million lbs.
Zinc	146.3 million lbs.	41.6 million lbs.

\*\*Based on the resource estimate Ag Eq. cut-off value of 400 g/t and 100% recovery; figures are rounded to the nearest 100,000th increment.

Between 2006 and 2012, a total of 69,739 metres of diamond drilling (226 surface and 42 underground drill holes) was conducted at Pulacayo, results of which support the mineral resource estimate. The Pulacayo site is currently permitted for production at a milling rate of 560 tonnes per day and no known legal, political, environmental, or other risks that would materially affect potential future development have been identified by Prophecy at the effective date (October 20, 2017) of the Pulacayo Technical Report.

Approximately 85% of the resource tonnage identified at the 400 g/t Ag Eq. cut-off value occurs within 150 meters vertical distance from the main San Leon tunnel, which may facilitate future mineral extraction.

Historic Pulacayo production was predominantly from the Tajo vein system which extends over a strike length of more than 2.5 km and to a depth of at least 1,000 meters. Prior resource drilling only covered approximately 20% of the Tajo vein system strike length. With new drilling, Prophecy believes that there is potential to discover additional resources along the Tajo structure.

#### Paca Deposit

In June 2016, the Company commenced its sampling program at the Paca deposit. Samples were obtained at one metre intervals from near surface drifts within the Paca mine which appears to have limited historic development. The area of sampled drifts has an estimated dimension of 90 metres length (east to west) and 75 metres width (north to south) and occurs at an average depth of 100 metres. Mineralization mainly consists of silver sulphides (mostly tennantite), galena and sphalerite in the pores of the sedimentary rocks and in breccias.

On August 12, 2016, the Company announced the assay results for the first group of 40 samples collected from the Paca deposit exploration program at its Pulacayo Project (Table 11). During the sampling program, 233 samples were collected. However, due to a backlog at the testing laboratory, Prophecy prioritized the 40 most prospective samples for assay. Thus, the assayed samples are not representative of the sample population. These results are taken from the first group of samples Prophecy delivered. Samples were obtained by continuous chip channel sampling across the width of the vein mineralization at locations one metre apart.

**Table 11. Summary of Paca Samples Results**

Number of Samples	Ag (g/t)			Zn (%)			Pb (%)			Ag Eq (g/t)		
	Min	Max	Avg	Min	Max	Avg	Min	Max	Avg	Min	Max	Avg
40	15.0	1500.0	331.2	0.1	2.5	6.0	0.5	6.7	1.9	45.7	1617.0	407.3

*Silver assays include one sample assayed at >1500 g/t and used as 1500 g/t in the summary table. Silver equivalent (AgEq.) calculations are based on the following closing prices as of August 9, 2016: USD19.79/oz for Ag ([www.kitco.com](http://www.kitco.com)), USD1.03/lb for Zn and USD0.81/lb for Pb (London Metals Exchange spot prices). Metal recoveries are assumed to be 100%.*

The samples were delivered to ALS Geochemistry Laboratory in Oruro, Bolivia (“ALS”) for assay and included QA/QC samples. Standard reference, duplicate and blank samples were used – all of which, produced acceptable results. ALS is an independent laboratory and was qualified and accredited by the Colombian Institute of Technical Standards and Certification (the “ICONTEC”) and the Standards Council of Canada for the methods used during the time the samples were prepared and assayed. Records were maintained to document the secure handling of the samples and to verify their identities were maintained.

Chip channel sample P225 returned a silver grade that is greater than the 1,500 g/t detection limit. It is planned to submit the sample for another assay for precious metals content using methods having a greater upper detection limit.

Samples were obtained from shallow depth drifts within the Paca mine which appear to have limited historic development. The area of sampled drifts has an estimated dimension of 90 metres length (east to west) and 75 metres width (north to south) and occurs at an average depth of 100 metres. Mineralization mainly consists of silver sulphides (mostly tennantite), galena and sphalerite in the pores of the sedimentary rocks and in breccias.

The Company has undertaken studies (for production scenarios ranging from 200 to 500 tonnes per day) with the aim to bring Pulacayo into production at minimum capital expense given the current challenging metals market. A positive production decision would not be based on a feasibility study of mineral reserves demonstrating economic and technical viability so would carry increased uncertainty and the risk of failure as to the mining method and profitability.

On September 29, 2016, the Company announced its two-fold priority objective and plans for definition drilling at the Pulacayo Project. The objective includes: (i) Study the possibility of commissioning Pulacayo and/or Paca to production at current metal prices, part of which includes definition drilling; and (ii) Apply modern exploration techniques (District-wide Three-Dimensional Induced Polarization Program (“3D IP”)) to the Pulacayo district to test mineralization found during reconnaissance exploration. The definition drilling to support any decision to commission Pulacayo and/or Paca to production and detailed three-dimensional induced polarization surveys were described. A detailed presentation about the exploration and maps showing prior sample location and assay results and proposed IP line locations are available on Prophecy’s website. A positive production decision would not be based on a feasibility study of mineral reserves demonstrating economic and technical viability so would carry increased uncertainty and the risk of failure as to the mining method and profitability.

The Company selected a drilling company and expected to start drilling at Pulacayo in Q2 2017 targeting near surface resource blocks with elevated silver grades and relatively easy access that make them potentially suitable to be mined first should a decision be made to start mining. Results of the mineral resource estimate prepared by Mercator on October 20, 2017 for the Paca deposit are presented below in Table 12.

The Pulacayo Report outlined 2.54 million tonnes at a weighted average grade of Ag 256 g/t, Pb 1.03%, Zn 1.10% (Ag Eq. 342 g/t) in the inferred category. The contained metal content estimated by the Company, of the inferred category resources is 20.9 million ounces of silver, 57.7 million pounds of lead, 61.6 million pounds of zinc. (more resource details in the Table 12 below).

**Table 12. Paca Inferred Mineral Resource Statement Details**

Paca Mineral Resource Statement – Effective October 20, 2017								
Ag (g/t)	Eq.	Cut-Off	Category	Tonnes*	Ag (g/t)	Pb (%)	Zn (%)	Ag Eq. (g/t)
200			Inferred	2,540,000	256	1.03	1.10	342

**Notes:**

- (1) Mineral resources are estimated in conformance with the CIM Standards referenced in NI 43-101.
- (2) Raw silver assays were capped at 1,050 g/t, raw lead assays were capped at 5% and raw zinc assays were capped at 5%.
- (3) Silver equivalent Ag Eq. (g/t) = Ag (g/t) + (Pb% \*(USD0.94/ lb. Pb /14.583 Troy oz./lb./USD16.50 per Troy oz. Ag)\*10,000) + (Zn% \*(USD1.00/lb. Zn/14.583 Troy oz./lb./USD16.50 per Troy oz. Ag)\*10,000). 100 % metal recoveries are assumed based on lack of comprehensive metallurgical results.
- (4) Metal prices used in the silver equivalent calculation are USD16.50/Troy oz. Ag, USD0.94/lb Pb and USD1.00/lb Zn and reflect those used for the Pulacayo deposit mineral resource estimate reported above.
- (5) Metal grades were interpolated within wire-framed, three-dimensional solids using Geovia-Surpac Ver. 6.7 software and inverse distance squared interpolation methods. Block size is 5m (X) by 5m (Z) by 2.5m (Y). Historic mine void space was removed from the model prior to reporting resources.
- (6) A block density factor of 2.26g/cm<sup>3</sup> was used and reflects the average of 799 density measurements.
- (7) Mineral resources are considered to have reasonable expectation for economic development using combined underground and open pit methods based on the deposit history, resource amount and metal grades, current metal pricing and comparison to broadly comparable deposits elsewhere.
- (8) Mineral resources that are not mineral reserves do not have demonstrated economic viability.
- (9) \*Tonnes are rounded to nearest 10,000.

The contained metals estimated by the Company based on the Pulacayo Technical Report are presented below in Table 13.

**Table 13. Contained Metals Based on October 20, 2017 Paca Deposit\*\* Mineral Resource Estimate**

<b>Metal</b>	<b>Inferred Resource</b>
Silver	20.9 million oz.
Lead	57.7 million lbs.
Zinc	61.6 million lbs.

*\*\*Based on the resource estimate Ag Eq. cut-off value of 200 g/t and 100% recovery; figures are rounded to the nearest 100,000th increment*

The resource estimate is based on results of 97 diamond drill holes and 1 reverse circulation drill hole totaling 18,160 meters completed between 2002 and 2007. The geology of the Paca deposit includes a core zone of feeder-style mineralization associated predominantly with brecciated andesite, plus additional zones of shallowly dipping mantos-style mineralization that are hosted by the surrounding volcano-sedimentary sequence. The Paca deposit remains open at depth and along strike. The Paca mineralization starts from surface and the deposit may be amenable to open-pit mining and this will be evaluated further in the future.

Mineral resources that are not mineral reserves do not have demonstrated economic viability. The estimate of mineral resources may be materially affected by environmental permitting, legal, title, taxation, sociopolitical, marketing, or other relevant issues.

### **Environmental**

Prophecy through acquisition of ASC and later transfer of the environmental license has a valid and in force environmental license issued by the Bolivian Ministry of Environment and Water that is valid to 2023 for the Pulacayo licenses. The license allows for construction of a mine and concentrator with capacities up to 560 tons per day. Granting of the environmental license includes approval of the Environmental Impact Evaluation Study and Environmental Base Line Audit. Bolivian environmental law absolves Prophecy of environmental liability created by its predecessors.

### **Project Risks and Mitigation**

The major risks to developing the Pulacayo Project include the inability to obtain financing, decreases in metal prices, and adverse political and social changes. The inability to obtain financing will be mitigated through pursuit of equity investors and cash flow from sale of available material. The risk from decrease in metal prices will be mitigated by the timing of the project in that the start of the project is at the time of lowest metal prices in several years and concentrate sales will start when metal prices are projected to be much higher. Adverse political and social changes are also mitigated by the timing of the project. The national government has started to become much more supportive of mining and recently the local government and population have shown strong support for re-starting the mine.

### **Other Work**

#### *Exploration*

Exploration was conducted in mid- to late 2016 at the Pulacayo and Paca deposits. Mapping and sampling at the Pulacayo deposit was performed at the AVS located approximately 200 metres west of the Rothschild shaft, at a level 50 metres above the San Leon adit level (level 0, 4128 m elevation). The reader is referred to Prophecy's news release dated November 24, 2016, filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website, for more information. The principal vein measures 1.0 to 1.5 metres in width. The strike and vertical extent of the principal vein are unknown. The location of the AVS is approximately 600 metres west of the San Leon adit and passes outside the western boundary of the area where Apogee conducted 70,000 metres of drilling between 2005 and 2012, and

therefore was not included in the Pulacayo deposit resource estimate disclosed in the Pulacayo Technical Report. Additional sampling was completed at underground mining area 1 (“**UG1**”) where initial mining may occur. UG1 is located at level 0 approximately 110 metres east of the San Leon adit and within 100 metres from the Central shaft. UG1 measures approximately 117 metres in strike, 93 metres in width and 38 metres in height. A total of 22 samples were obtained from the AVS and UG1 areas and sent for assay and the results received. These results are presented in Table 14 below. The samples were obtained by continuous chip channel sampling across the width of the vein mineralization at locations one metre apart. The reader is referred to Prophecy’s news release dated December 23, 2016, filed under the Company’s SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company’s website, for more information.

**Table 14. UG1 and AVS Sample Assay Results**

<b>Sample ID</b>	<b>Ag (g/t)</b>	<b>Zn (%)</b>	<b>Pb (%)</b>	<b>Area</b>	<b>Sampling Method</b>	<b>Width (m)</b>
1912	1,400	18.4	>20.0	UG1	chip channel	1 m
1920	915	22.7	1.0	UG1	chip channel	1 m
1908	490	20.0	1.6	UG1	chip channel	1 m
1907	688	14.7	3.3	UG1	chip channel	0.6 m
1918	405	21.6	0.4	UG1	chip channel	1 m
1906	432	15.9	1.8	UG1	chip channel	1 m
1911	583	8.4	7.0	UG1	chip channel	1 m
1919	732	7.8	0.3	UG1	chip channel	1 m
1909	682	6.1	0.8	UG1	chip channel	1 m
1910	261	11.8	0.7	UG1	chip channel	1 m
1921	161	8.4	1.6	UG1	chip channel	1 m
1917	291	6.8	0.4	UG1	chip channel	1 m
1916	101	9.9	0.3	UG1	chip channel	1 m
1915	67	5.0	0.3	UG1	chip channel	1.3 m
1922	54	2.9	0.1	UG1	chip channel	1 m
1913	62	1.6	0.5	UG1	chip channel	1 m
1914	39	0.3	0.1	UG1	chip channel	1 m
1905	392	23.0	12.0	AVS	chip channel	1 m
1904	284	17.6	6.6	AVS	chip channel	1 m
1901	250	6.3	6.2	AVS	chip channel	1 m
1903	96	7.7	2.7	AVS	chip channel	1.5 m
1902	17	5.7	0.5	AVS	chip channel	1 m

The samples including QA/QC samples, were delivered to ALS Bolivia Ltda. located in Oruro, Bolivia for preparation after which splits were sent the ALS laboratory located in Lima, Peru (both locations collectively referred to as “**ALS**”). ALS is an independent laboratory and was qualified and retains current accreditation by the ICONTEC and the Standards Council of Canada for the methods used during the time the samples were prepared and assayed. Normal QA/QC procedures were followed when handling and processing the samples as described in Prophecy’s Sample Procedures, QA/QC for Sampling manual (QA/QC manual), National Instrument 43-101 Standards of Disclosure for Mineral Projects, and the Canadian Institute of Mining, Metallurgical and Petroleum Engineers Exploration Best Practices Guidelines. These procedures included use of a chain of custody to document possession, delivery and security of the samples from Prophecy to the laboratory and secure storage until transported. The laboratory was assessed to ensure it has the technical qualifications for preparation and assay of the type of sample and range in mineral content, follows proper procedures to ensure correct sample identification and security, and maintains confidentiality of assay results. Quality control materials including a blank and certified reference materials were included

with the sample group for assay. Duplicate assays were also performed. The quality control material assay results were found within acceptable limits of the known values and the duplicate assay results were within acceptable limits supporting acceptance of the assay results of the samples. Access to the analytical results was restricted to the chief executive officer, chief geologist, vice president of operations, and general mining manager. The information was verified by Christopher M. Kravits CPG, LPG, the Company's Qualified Person and Chief Geologist, through discussion with relevant parties, review of documents and comparison to known values. There were no limitations on verification. Mr. Kravits has reviewed and approved the data and records supporting the above statements.

Geologic mapping and sampling at 233 locations was completed in the historic Paca mine drifts. The area is within the boundary of the Paca deposit resource estimate disclosed in the Paca Technical Report, but was not included in the block model used to estimate resources. Because of a backlog at the assay laboratory the Company prioritized the most prospective 40 samples for assay. Thus, the assayed samples are not representative of the sample population. These results, shown in Table 15 below, are taken from the first group of samples Prophecy delivered. Samples were obtained by continuous chip channel sampling across the width of the vein mineralization at locations one meter apart.

**Table 15. Summary of Paca Mine Drift Sample Assay Results**

Number of Samples	Ag (g/t)			Zn (%)			Pb (%)			Ag Eq (g/t)		
	Min	Max	Avg	Min	Max	Avg	Min	Max	Avg	Min	Max	Avg
40	15.0	1500.0	331.2	0.1	2.5	6.0	0.5	6.7	1.9	45.7	1617.0	407.3

*Silver assays include one sample assayed at >1500 g/t and used as 1500 g/t in the summary table. Silver equivalent (AgEq.) calculations are based on the following closing prices as of August 9, 2016: USD19.79/oz for Ag ([www.kitco.com](http://www.kitco.com)), USD1.03/lb for Zn and USD0.81/lb for Pb (London Metals Exchange spot prices). Metal recoveries are assumed to be 100%.*

Silver equivalent (Ag Eq.) calculations were based on the following closing prices as of August 9, 2016: USD19.79/oz for Ag ([www.kitco.com](http://www.kitco.com)), USD1.03/lb for Zn and USD0.81/lb for Pb (London Metals Exchange spot prices). Metal recoveries were assumed to be 100%.

The samples were delivered to ALS Geochemistry Laboratory in Oruro, Bolivia ("**ALS Bolivia**") for assay and included QA/QC samples. Standard reference, duplicate and blank samples were used – all of which, produced acceptable results. ALS Bolivia is an independent laboratory and was qualified and accredited by the ICONTEC and the Standards Council of Canada for the methods used during the time the samples were prepared and assayed. Records were maintained to document the secure handling of the samples and to verify their identities were maintained. Please refer to Prophecy's news release dated August 12, 2016, filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website for more detail.

Planning for Phase 2 of the exploration which will include 1,500m of drilling and 20km of 3D IP surveys was completed. The reader is referred to Prophecy's news release dated September 29, 2016, filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website for more information. The planning included selection of anomalies to be explored, design of the exploration programme, budgeting, and tendering for the Pulacayo and Paca deposits and several of the surface anomalies previously identified by surface mapping and sampling. The objective of the 3D IP surveys followed by drilling is to assess the potential of the Pulacayo district for near-surface mineralization. A detailed presentation about the exploration including maps is available on the Company's website. The exploration permit application was not approved as of the end of 2017.

#### *Legacy Financial Obligations*

As part of the transaction with Apogee, Prophecy agreed to assume within certain limitations all liabilities associated with the Apogee Subsidiaries and the Pulacayo Project. During 2014, Apogee received notice

from the national tax authority in Bolivia alleging that its wholly owned subsidiary ASC owes approximately Bs42,000,000 (USD6,536,326) of taxes, interest and penalties relating to a historical tax liability. The Company continued to dispute the assessment and hired local legal counsel to pursue an appeal of the tax authority's assessment on both substantive and procedural grounds. The Company received on May 26, 2015 a positive Resolution issued by the Bolivian Constitutional Court that declared null and void the previous Resolution of the Bolivian Supreme Court issued in 2011 and sent the matter back to the Supreme Court to consider and issue a new Resolution. The Company continued to defend its position and make submissions to the Supreme Court during the new hearing. This activity is better described in Section 15 - *Material Contracts*.

#### *Key Personnel*

During 2015, the Company hired a Country Manager, Chief Geologist, Mine Manager, Mine Planner, and Translator/Assistant. The Country Manager and Chief Geologist had previous experience with the Pulacayo Project through employment with Apogee. The Country Manager was responsible for government relations, environmental, health and safety issues, legal issues, and concession issues. The Chief Geologist planned and budgeted exploration, assisted with mine plans, and advised on concession issues. The Mine Manager and Mine Planner worked together to develop mining scenarios, staffing schedules, budgets, and sourcing of equipment and materials. The Translator/Assistant mostly translated documents but also assisted the other staff. All but the Country Manager were later released as a consequence of the depressed metals prices or left for other employment.

#### *Upgrade Utilities*

The Company assessed the water supply and electrical power supply and options to upgrade them to conduct mining and processing at the Pulacayo deposit during 2015. The water supply was studied and found sufficient but requires repair. An estimate was obtained to perform the repair. Reuse of water collected by the mine dewatering system as part of mining plans was considered when assessing the water supply. Several options were considered for supplying sufficient electrical power and delivery to the mine and processing plant. The work included surveys of the existing facilities, cost and time estimates of upgrades and financing alternatives.

#### *Future Plans*

During 2016, the Company continued its study of optimal mining production and processing scenarios with the intention to announce a production decision at the conclusion of the study in conjunction with a financing plan should a positive production decision be reached. Later during 2016, the Company announced its objective of studying the possibility of commissioning the Pulacayo and/or Paca deposits to production at current metal prices which would involve updating the financial analysis, definition drilling and modern exploration techniques to test mineralization found during the reconnaissance exploration. The reader is referred to the Company's news release dated September 29, 2016, filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website for more information. The Company started an update to its mining budget and revenue projections considering the current metal prices. Further, the Company diligently assessed potential suppliers, service companies and off-takers, and engaged with selected highly-qualified local and international firms through non-binding letters of intent. Please refer to the Company's news releases dated June 16, 2016, November 22, 2016, December 6, 2016 and December 14, 2016 filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website for more details. A positive production decision would not be based on a feasibility study of mineral reserves demonstrating economic and technical viability so would carry increased uncertainty and the risk of failure as to the mining method and profitability.

#### *Concessions*

The concession relinquishments were concluded in early 2016. The project is now comprised of two groups of contiguous mining concessions. The largest group is centered over the town of Pulacayo and includes the extent of the Pulacayo deposit, several potential mineralized areas and tailings piles. The smaller group



is centered over the Paca deposit and includes potential mineralized areas and several tailings piles. Both groups of concessions include area for future surface facilities. The groups of concessions are located approximately 2 kilometres apart. The relinquishments reduced the total gross concession holdings to 3,560 ha. Figure 6 shows the resulting concession holdings of the Company.

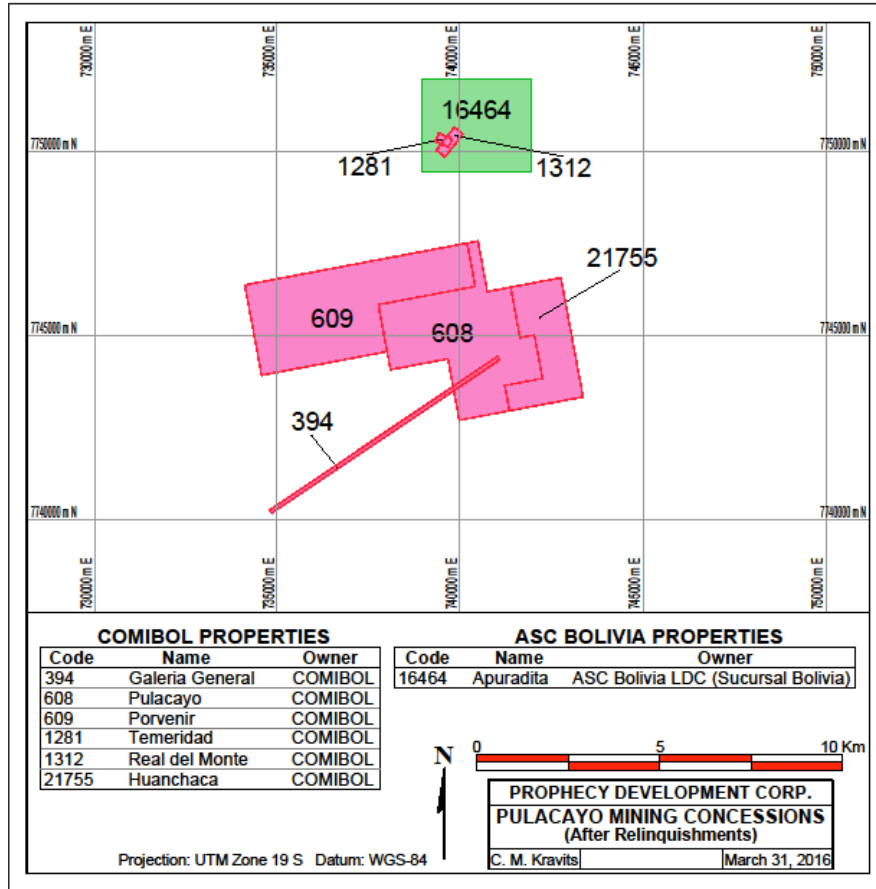


Figure 6

*Mining Permission and Financial*

The Company worked with government officials to obtain assurances that its investments in exploring and mining at the Pulacayo Project are safe. These included a meeting with the Bolivian government’s mining minister and other mine operators, a meeting with the minister at the Embassy of Canada and assistance in coordinating and preparing for his participation in the 2017 *Prospectors & Developers Association of Canada (PDAC)* convention. Please refer to Prophecy’s news release dated November 10, 2016, filed under the Company’s SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company’s website, for more information. More detail is provided in Section 6 - *Risk Factors*.

Work to obtain sufficient financing for the Pulacayo Project continued. Most notably, this resulted in a significant investment by a strategic investor which is described on more detail in Section 3 - *General Development of the Business*. This is important from an operational view, because the strategic investor will provide advice and work with the Company regarding the future technical implementation and direction of the project. The reader is referred to Prophecy’s November 2, 2016 news release filed under the Company’s SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company’s website for more information.

The Company continued work to resolve the legacy financial obligations.

## Activities during 2017

Work during 2017 included updating of mining scenarios and budgets, negotiations to resolve the legacy financial obligations, and deliberations to obtain permission to restart the mine.

During 2017, the price of silver increased from USD15.88/oz to USD16.90/oz (6%), while the price of zinc increased from USD1.16/lb to USD1.50/lb (29%). Those trends bode well for Pulacayo while the Company remains positioned to restart the mine and intends to announce a production decision, should a decision be reached in the future. A positive production decision would not be based on a feasibility study of mineral reserves demonstrating economic and technical viability so would carry increased uncertainty and the risk of failure as to the mining method and profitability.

## Impairment Analysis

None of the impairment factors are triggered. The licenses, permits, and other permissions remain in good standing. Management has budgeted and plans for further exploration and evaluation work, mine re-start, and concentrator construction.

## 5.4 Ulaan Ovoo Property

### History and Operational Statistics

Prophecy (Red Hill Energy Inc. at the time) entered into a letter of intent, dated November 24, 2005, as amended February 19, 2006, with Ochir LLC and a wholly owned subsidiary of Ochir LLC, both privately owned Mongolian companies that set out the terms to acquire a 100% interest in the Ulaan Ovoo Property. The purchase price for the 100% interest, together with all equipment, buildings and other facilities, assembled and constructed at the Ulaan Ovoo Property was USD9.6 million. The purchase price has been paid in full by the Company. Ochir LLC retained a 2% royalty on production from licenses, which was subsequently assigned to a third party.

On November 15, 2006, the Company entered into an agreement with a private Mongolian company to purchase 100% of the 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 USD400,000. Under the terms of the agreement, the vendor retained a 2% NSR royalty on the five newly acquired licenses.

On March 11, 2010, the Company entered into a Royalty Purchase Agreement, dated for reference March 5, 2010, with Dunview Services Limited, a private British Virgin Islands company holding a 2% royalty on production from the licenses of the Ulaan Ovoo Property, to acquire such royalty in full in exchange for USD130,000 and the issuance of the equivalent of 20,000 Shares. This transaction was completed on April 30, 2010.

Ulaan Ovoo site establishment commenced on July 13, 2010. In October 2010, Prophecy provided 10,000 tonnes of coal as a trial run to power stations in Darkhan and Erdenet, Mongolia's second and third largest cities, respectively, behind its capital Ulaanbaatar. At the request of the Mongolian Ministry of Mineral Resources and Energy, Prophecy commenced mining and trucked the first coal shipment to the Sukhbaatar rail station, ready to be transported to Darkhan power plant by rail.

On November 9, 2010, Prophecy received the final permit to commence mining operations at the Ulaan Ovoo Property and an official mine opening ceremony was held on November 20, 2010.

In 2011, the Company spent \$32.6 million on preparing the Ulaan Ovoo Property for commercial production through development of infrastructure (\$2.7 million), purchase of mining and mobile equipment (\$16.4 million), transportation (\$2.7 million), mine development (\$9.3 million), and general working capital (\$1.6 million).

In 2012, the Company spent additional \$15.7 million for the Ulaan Ovoo Property. However, in July 2012, the Company temporarily suspended pre-commercial production at Ulaan Ovoo due to soft market prices for coal and rising costs, and because at that time, Prophecy had sufficient coal inventory to meet anticipated demand for the remainder of 2012 and part of 2013.

Mining re-commenced in November 2013. All required mining, safety, and transportation staff were re-hired. All of the Company's leased-out mining and transportation equipment were recalled and arrived back on site including a fleet of three operating mining excavators, five dump trucks, tipper trucks and other ancillary equipment.

During 2014, the Company faced challenges, such as significant dewatering of the resource, lack of demand, depressed coal sales prices, and higher than expected operating/transportation costs, resulting in limited production throughout the period. Pit dewatering had become a significant impediment to achieving consistent production, especially following mine standby during the periods of low market demand. The mine was placed on standby in Spring 2014 but continued coal loading and sales from the existing stockpiles. Due to the lack of sustained production, management has not sufficiently tested the mine plant and equipment to conclude that the mine has reached the commercial production stage.

During the beginning of 2015, due to minimal increase in coal prices and decreased demand because of a mild winter, the Company decided to maintain the operations on standby though coal loading and sales from existing stockpiles continued to customers. The Company decided to sell the mining equipment to generate cash so that operations may continue. Open-pit mining operations at Ulaan Ovoo may be restarted in short order by signing with any one of several available third party contract-mining companies in Mongolia that provide a turnkey solution with labor and equipment. The Company believes contract mining is a more efficient way to operate in Mongolia since contract mining firms will be responsible for labor agreements and equipment maintenance.

In April 2015, the Company, through its wholly-owned subsidiary, Red Hill, entered into a Purchase Agreement with an arm's-length party in Mongolia to sell substantially all of its mining and transportation equipment at the Company's Ulaan Ovoo mine for total proceeds of approximately \$2.34 million. The sale of equipment was completed in June 2015. Total proceeds (including the sale of equipment to other arm's-length parties) amounted to \$2.9 million in cash.

Revenue generating, cost reduction and debt reduction efforts continued. Besides sale of stockpiled coal, other revenue generation efforts included sale of a portion of the remaining equipment and certain parts and supplies. Terminating contractor agreements, staff reductions, office relocation, and other actions were completed to reduce costs. Debt reduction efforts included rescheduling of debt and transfer of pending payments to certain Company debtors. A summary of operational results by year is given in Table 16 below.

**Table 16. Summary of Operational Results at Ulaan Ovoo Mine**

	<b>Topsoil/Overburden Removed, m<sup>3</sup></b>	<b>Coal Produced, t</b>	<b>Coal Sold, t</b>	<b>Revenue, USD</b>	<b>Average Price, USD/t</b>
2010	1,011,274	70,678	19,396	274,649	14
2011	1,601,416	205,241	127,271	2,578,084	20
2012	770,315	165,712	131,719	2,511,446	19
2013	190,571	89,085	124,848	3,621,639	29
2014	321,097	151,395	130,145	3,998,566	31
2015	Nil	Nil	33,824	677,888	20
2016	Nil	Nil	3,015	49,480	16
2017	Nil	Nil	17,335	280,893	16

Regulations were passed by Mongolia's Parliament that provided options for those mineral license holders who acquired their licenses before passage of the Long Named Law to retain legally allowed portions of their licenses affected by the law. The Company chose the option of diverting the north branch of the Zelter River in order to retain the licenses. Preliminary work was completed for the river diversion including

selection of a location and cost estimation and negotiations progressed with government officials as of the end of 2015.

Since November 2010, the Company has removed and stockpiled approximately 3.9 million bank cubic metres of topsoil, overburden and waste and produced 682,111 tonnes of thermal coal of different grades from the Ulaan Ovoo Property. Of this, the Company sold 570,218 tonnes for a total value of USD13.7 million. As of December 31, 2016, the coal stockpile balance was approximately 78,595 tonnes.

At December 31, 2014, the Company determined there were several indicators of impairment of the Ulaan Ovoo development property, including depressed coal prices, decline of the Russian Ruble, and a history of operating losses combined with a current loss. While management believes that Ulaan Ovoo is a property of merit and warrants continued development a write down, in accordance with IFRS guidance of the capitalized deferred exploration costs to \$nil has been recognized. This non-cash accounting charge does not impact the Company's financial liquidity or any future operations and management believes the adjustment to the book value of this long-lived asset more accurately reflects the Company's current market capitalization. As a result of the write down of previously capitalized deferred exploration costs, the Company has recognized an impairment charge of \$11.2 million on the Ulaan Ovoo Property and equipment.

As there were no benchmark or market changes from January 1, 2015 to December 31, 2017, the impaired value of \$nil for deferred development costs remains unchanged.

The Company continues to evaluate project operating optimization alternatives for the Ulaan Ovoo Property, in addition to investigating potential strategic partner and joint venture arrangements, sale of part or whole of the project, and coal marketing arrangements both domestically and potentially to access higher international coal market prices. However, Prophecy is unable to determine with certainty, how long coal markets will remain depressed, when, if at all, access to Russian coal markets will be opened, the extent of project changes and operational modifications that would be required to more fully realize, beyond its pre-commercial operating history, on the potential value of the project.

### Property Location, Ownership

The Ulaan Ovoo Property is located in the territory of Tushig soum (sub province) of Selenge aimag (province) in Northern Mongolia. It is 8 kilometres west of the central village of Tushig soum and 17 km away from the Mongolian-Russian border port of Zelter (Figure 7).



Figure 7

The Ulaan Ovoo Property is situated in the Zelter River valley, which flows between the Zed and Buteel Mountain Ranges in Northern Mongolia. The Ulaan Ovoo deposit covers an area of approximately 790 hectares. Red Hill, which is owned and controlled by Prophecy, holds the Ulaan Ovoo Property under mining licenses MV-1231, which covers an area of 214 ha and mining license MV-14657 with an area of 355 ha. The licences are for a term of 30 years with a 40-year extension option. In November 2006, Red Hill purchased 100% of the title and interest in six exploration licences - 6830, 6831, 6832, 6834, 6837 and 12170 - contiguous to or near MV-1231 and MV-14657.

## **Accessibility, Climate, Local Resources, Infrastructure and Physiography**

### *Property Access*

The Ulaan Ovoo Property is accessible via paved highway, maintained double lane dirt road and then unmaintained road; or by railway followed by unmaintained road. The various means of access are:

- Access by road from Ulaanbaatar (427 km) – Proceed northward from Ulaanbaatar via Altanbulag-Ulaanbaatar highway A0401 to the central village of Shaamar soum (sub-province) (300 km). Then, via a maintained dirt road, which connects Shaamar, Zuunburen, Tsagaannuur and Tushig soums (119 km). This segment of the road includes crossings of the Orkhon, Selenge and Zelter Rivers by concrete bridges. The last segment of the trip is via a maintained dirt road from the central village of Tushig soum, to the deposit (8 km);
- Access by railway (498 km) – The Trans-Mongolian railroad runs to Shaamar Soum station from Ulaanbaatar (384 km) from where a maintained dirt road leads to the deposit area as described above (114 km);
- Access by road from Russia (162 km) – Access to the project is via a 120 km concrete road from Galuutnuur village to Petropavlovsk village, then another 25 km on maintained dirt road to the border village of Zheltura port, then another 17 km on dirt road to the project site; and
- Access to market – the Ulaan Ovoo Property is 137 km from year-round Naushki border port and 12 km from Zelter border port which Prophecy is in process of reopening.

### *Climate*

The Ulaan Ovoo Property has a sharply continental climate with predominately hot summers and cold winters. The area is hot and relatively rainy in summer, with highest temperatures of 35° to 40° C in June and July and cold in the winter, with lowest temperatures in the range of minus (-) 35° to -40°C in December and January. Annual precipitation fluctuates between 100 millimetres (mm) and 500 mm and most (60% to 70%) of it falls as rain in August. Maximum snow depths may reach up to 2 m where drifted but averages 10 centimetres (cm) to 20 cm where not drifted. Wind usually blows from northwest to southeast with an average speed of 14 kilometres per hour (km/h) to 24 km/h.

### *Local Resources & Regional Infrastructure*

The Ulaan Ovoo Property is located within the territory of Tushig soum (sub-province) of Selenge aimag (province) and the nearest settlement to the deposit is the soum's central village, also called Tushig, located approximately 7 km to the southeast of the project area. The soum borders the state of Buryatia of Russia to the north, Bugat soum of Bulgan aimag to the west and Tsagaannuur soum of Selenge aimag to the east and south. Tushig soum has a territory of 276 square kilometres (km<sup>2</sup>) and a population of 7,500.

### *Physiography*

The Ulaan Ovoo Property is situated in the Zelter River valley, which runs between the Zed and Buteel Mountain Ranges in Northern Mongolia. The river flows from southwest to northeast and exits northward into Russia at the Zheltura Border Crossing, 17 km northeast of the project area. Geographically, the district is included in a region having medium-sized mountains, the highest altitude being 1,800 m. The south half of the deposit underlies the flood plain of the Zelter River and the north half lies on the southern flank of a low hill to the north of and topographically above the flood plain. Surface elevations at the project site range from 764 m to 820 m above sea level.

Mountainous parts of the region have taiga-like forests of conifer and deciduous trees. The southern aspects of the hills in the area tend to be relatively treeless. Braided stream deposits covered with a mixture of small trees and bushes form the Zelter River valley flood plain. The north half of the coal deposit area is

treeless and the south half is covered by willows and birch. Fertile soil is up to 4 m thick at the flood plain of the river valley and 20 cm to 30 cm on the adjacent hillsides.

## **History**

### *History of Property*

Under the Mining Law of Mongolia approved in 1994, Erdenet, a Mongolian-Russian state-owned joint venture, was granted Mining License Number (No) 166 for the Ulaan Ovoo Property in Tushig soum, Selenge aimag, on 2<sup>nd</sup> November 1995, by the Ministry of Energy, Geology and Mining, for a term of 10 years.

After the enactment of the new Minerals Law of Mongolia in July 1997, the Director of the Office of Geological and Mining Cadastre granted a revised mining licence certificate No 1231A to the Ulaan Ovoo Property to Erdenet, the Mongolian-Russian joint venture.

Under decision No. 880 (2002) the Director of the Office of Geological and Mining Cadastre and with accordance to Minerals Law of Mongolia, the Mining Licence No. 1231A was then transferred to a Mongolian-Chinese joint venture company called Mongolia Mid Asia International (MMAI) on 14<sup>th</sup> December 2002.

MMAI was restructured into a 100% Mongolian-owned company in 2005. The State Registration Office registered the company and the mining licence of the Ulaan Ovoo Property was renewed and granted to the newly restructured MMAI in compliance with the Minerals Law of Mongolia on 5<sup>th</sup> June 2005, for a term of 55 years.

Exploration Licence No. 5895X, covering an area adjacent to the licence No. 1231A, was granted by the Director of the Office of Geological and Mining Cadastre to MMAI to be an additional portion of the Ulaan Ovoo Property on 6<sup>th</sup> June 2003.

An option to purchase these properties was entered into between UGL Enterprises LLC, a fully-owned Mongolian subsidiary company of Red Hill, and Ochir LLC, the parent company of Mongolian MMAI, in November 2005.

In November 2005, Red Hill purchased both licences and in November 2006, purchased the 6 exploration licences surrounding the deposit.

### *History of Geological Exploration Work*

The first official geological survey work was undertaken by the Russians in 1974-1975. The fact that the area of the future Ulaan Ovoo Property had coal was known before this survey because a ravine adjacent to the deposit had been traditionally called the 'coaly ravine'. This study recommended further coal exploration work and drilling.

Between 1979 and 1982, the Russians conducted geological mapping studies in Selenge and Bulgan aimags. This work integrated stratigraphic, magmatic and regional tectonic data around the future Ulaan Ovoo Property area and resulted in the first 1:200,000-scale geological map of the area. The exploration work included mapping, trenching and drilling undertaken in 1979.

In-fill drilling and coring was conducted in 1993 through to 1995.

In April 2006, a programme to confirm previous exploration was undertaken by Red Hill. The previous drilling was conducted under the Russian system and there was some question as to whether or not the drilling adequately portrayed the deposit. In all, 11 holes were drilled under the aegis of this new programme.

### *History of Production*

At the request of the authorities of Tushig and Tsagaannuur soums, a small open pit in the sooty (weathered) coal was exploited starting 1998. The open pit or strip mine was 70 m long and 30 m to 35 m wide. The high wall was 5.3 m to 5.6 m high and the average mining output was 1,500 to 2,000 tonnes per year. The mining was extremely simple as the sooty coal was loaded by hand shovel onto the consumer's truck and hauled from the site.

The combined consumption of the two soum centres was 1,500 t/a to 2,000 t/a, judging by the extent of exploitation. At the beginning of October 2005, the current licence holder, MMAI, signed a contract with the local authority providing that the payment for the coal mined be credited to an environmental protection fund in an account created by the Governor of the Tushig soum. In accordance with the Mineral Law of Mongolia, MMAI prepared a mine plan. Red Hill has paid the Mongolian Government the corresponding mining licence fees since 2006.

In August 2008, approximately 25,000 t of partially oxidised coal was removed from the open pit to a maximum depth of 15 m, as part of the preparation work required to take a bulk sample. The coal was separated from the overburden and stockpiled south of the pit for easy access. The resulting much larger pit was closed to vehicle access but enough stockpiled coal remained to supply local consumers for several years.

### **Geology**

#### *General*

The Ulaan Ovoo Property is in the Orkhon-Selenge coal district and the Zelter coal basin and is the middle deposit of a series of five coal deposits that trend northeast to southwest and parallel the Zelter River. The coal seams found in the property are part of the Sharyn Gol formation which is composed of continentally derived tuffaceous-sandstone, tuffaceous-conglomerate, conglomerate, sandstone, siltstone, mudstone and coal.

Sediments in the Sharyn Gol formation are thought to be about 500 m thick and are subdivided into three members as follows:

- Upper Member: 130 m of shale with ash grey colour, medium-grained grey sandstone and a low hydrocarbon content oil shale;
- Middle Member: 170 m of shale, conglomerate, coal and carbonaceous coal; and
- Lower Member: 200 m of tuffaceous conglomerate and sandstone, andesite basalt, schist and conglomerate.

The northeast outcrop of the coal has burned at the north end of the deposit forming red clinker material. A hill has formed over this more resistant clinker. The Mongolian language words for this red hill are "ulaan ovoo" from which the property and mine obtain their name "Ulaan Ovoo". It is thought that the coal was set on fire by lightning or some other natural cause.

The structure at the site consists of a gentle to moderate-dipping basin or syncline within a fault block bounded by faults. The syncline is 1.5 km wide and 2 km long.

There are high angle normal faults on the east, south and west sides. The fault on the east side trends roughly North (N) 10 degrees (°) West (W) and the downthrown side is the coal-bearing west side; the fault on the south side is also a high angle normal fault trending N 70° East (E) with the downthrown side being to the north and the west fault is a normal fault trending N 10° W with the downthrown side being the east side.

A high angle reverse fault trends northwest-southeast through the centre of the deposit and divides it into north and south (S) blocks. Throw on the fault is 10 m - 20 m and the downthrown side is the north. A moderate (20° - 30°) to steeply (60° - 80°), southward dipping coal subcrop is found on the north side of the deposit. Igneous activity is evidenced by the 137 m of horizontally-bedded basalt.

### Exploration

During 2006, Red Hill conducted an exploration drilling programme which undertook the drilling of 11 drill holes from the surface to confirm previous drilling, test for the presence of coal away from known areas, obtain samples for analysis and otherwise better delineate the coal seams present at the site.

In April 2010, the Company merged with Red Hill as described in Section 2 - *Corporate Structure* and therefore assumed control of the permits and licences under the auspices of Red Hill. During 2010 Red Hill drilled one drill hole to obtain samples for grade control and marketing efforts. During 2011 Red Hill drilled nine drill holes to obtain grade control information and rock mechanics data.

### Mineralization

The Ulaan Ovoo Property, which is part of the 520 m thick Sharyn Gol Formation, has two main coal seams that contain five sub-units of coal (Figure 8).

Mod Coal Seam (formerly Coal Seam I): This seam is the lower of the two main coal sequences. It merges with the upper and thicker Gol Coal Seam in the north-eastern part of the area and splits to the southwest. It is well developed in the western part of the syncline. Its thickness ranges from 2.0 m to 7.5 m and thins in the south-western part of the deposit. The seam contains up to three partings with thicknesses of 0.56 m to 0.77 m. In the area where it is best developed, the Mod Coal seam is separated from the Gol Coal Seam by a sandstone parting which may exceed 30 m in thickness.

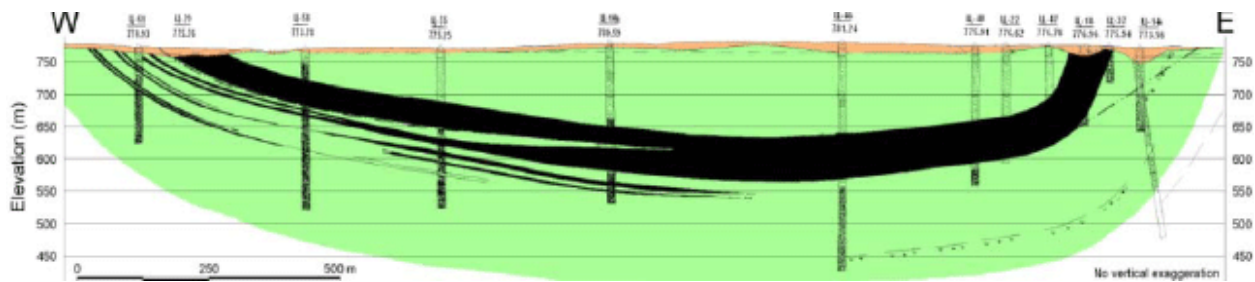


Figure 8

Gol Coal Seam (formerly Coal Seam II): This is the uppermost of the two main coal seams. Because of limited drilling south of the Central fault, it had previously only been clearly defined in the northern half of the syncline. It has relatively consistent thickness in the northern half of the deposit, ranging from 29.8 m to 63.9 m. In the west, the Gol Seam splits into two major sub-seams and its aggregate thickness diminishes where it splits. Further to the west, the lower split further subdivides into two smaller sub-seams. The Gol seam may contain as many as 11 partings. These partings consist mainly of clayey rocks and coal-bearing mudstone with a thickness of 0.15 m to 1.0 m. With proper design, the thickest of these partings can be removed during the mining process. Consequently, the partings will not represent a serious diminution of coal quality if properly handled.

Several thin coal seams are encountered to the west of the syncline, in the lower part of the middle member of the Sharyn Gol formation. Their thickness ranges between 0.9 m and 2.0 m. The extent of these thin seams is not known at this time, but they do not add materially to the coal resource base of the deposit.

### Drilling

The Company has conducted three drilling programmes on the property. Eleven holes were drilled by Red



Hill in 2006 to obtain coal resource and coal quality information. During the Red Hill 2006 drilling, the average core recovery was reported at over 90% for 10 of the holes and over 98% for 6 of the holes. Core recovery for hole UGL-06-002 was less than 35% and the hole was re-drilled as hole UGL-06-003. One drill hole was drilled in 2010 for grade control and marketing efforts. Nine drill holes were drilled in 2011 within the mine pit area to obtain grade control information and rock mechanics data. The 2011 drill holes generally had poor core recovery because the drilling was done in the winter.

### *Sampling and Analysis*

Sampling during the 1979 and 1992-1995 programmes focused on determining the quality and calorific value of the coal, its petrography and composition and strength properties of the confining rocks and partings. Coal seams were sampled separately from over, inter and under-burden material. Different tests were run on different coal samples depending upon visual features in the coal.

The sampling from the 2006, 2010 and 2011 Ulaan Ovoo drilling was done at constant intervals to allow for comparison of coal quality. Samples were obtained every 0.9 m to 1.2 m for oxidised coal and every 3 m to 5 m for non-oxidised coal. When partings were greater than 0.1 m in thickness, they were sampled separately for analysis.

### *Security of Samples*

The coal sampling undertaken for the 2006, 2010 and 2011 drilling programmes followed standard industry procedures. Sampling was conducted in 1 m intervals and at the start and stop of core runs and in a timely fashion after all necessary core descriptions and photography tasks had been completed. The core was then washed to remove contaminants and allowed to drain away from the core. The core was then placed in plastic sleeves (15 micron) and then into wooden core boxes for protection.

The criteria used for selecting sample intervals included: Bone coal was sampled in a similar manner as coal. Partings that were less than 0.3 m thick were included with coal; where partings were encountered between 0.3 m and 1.0 m in thickness they were divided into three portions, the upper and lower portions were sent to the laboratory and the middle portion was archived. For partings over 1.0 m thick, the lower and upper 0.5 m portions were sampled separately and sent to the laboratory and the middle portion was archived. Where the coal seam is flanked by rock then samples were obtained from above and below the coal seam and are referred to as the roof and floor materials, respectively. Stray coal seams greater than or equal to 0.5 m were sampled. The maximum sample length was limited to the core barrel length (3.05 m) where coal was not interrupted by partings greater than 0.3 m thick.

All laboratory analyses were conducted following ASTM International (ASTM) standard procedures by SGS Laboratories in Denver, Colorado and all laboratory reserve and duplicate samples were stored there. All core samples not sent for analysis remained in plastic sleeves, placed in wooden boxes and stored in a secure warehouse on site. All sample handling used chains of custody to monitor the possession of the samples.

### **Mining**

A mining contractor was selected to mine 250,000 tonnes (t) of product coal in 2010 and 1.1 million (M) t of product coal in 2011. The contractor would operate the owner's mining equipment in years 2011 and 2012 on a fee basis. Mining was done by an owner-operator mining team in year 2012 and by Red Hill in subsequent years.

Mining was completed using 5.4 and 4.6 cubic meter backhoes loading 50 t capacity haul trucks. Since the initial mining was near the surface, drilling and blasting was not employed. Use of a contractor for the first year allowed for sufficient time to purchase, manufacture and ship the owner-operated mining fleet to site in 2011 for operation in 2012. As mining progressed, it was found that overburden could be removed directly with excavators such that drilling and blasting were not required and this method continued through the most recent mining.

A fleet of support and maintenance equipment maximised availability of the mining fleet. Mine haul roads and other infrastructure were designed and constructed to ensure high safety and productivity. Emphasis was placed on training the local labour force for skilled and unskilled jobs. The majority of the managerial, technical and skilled staff are Mongolians (mostly local residents) with some management being ex-patriots. Sites adequate for the disposal of topsoil, waste rock (spoil), and a suitable stockpile area for the coal were constructed within the property in the immediate area of the open pit.

## **Environmental**

A detailed Environmental Impact Assessment had been completed and approved by the Mongolian Government in 2008 and an Annual Environmental Protection Plan for 2010 had also been approved by the Mongolian Ministry of Environmental Protection.

## **Project Risks and Mitigation**

There are a number of project risks which have been mitigated where possible. The regional coal market has been difficult to penetrate and yet earn an acceptable margin on the coal. Though a number of coal supply contracts were signed for Ulaan Ovoo coal only a handful were for substantial volumes or had reasonable margins. The market is not fully open where an independent producer has an equal opportunity to compete. Transportation is not always available at the time, in the capacity, or at the cost desired. These risks have been mitigated to some degree by decreasing mining, overhead, and transportation costs which appear to have made other markets available. Receivable amounts from the large utility customers became overdue but during 2015 and 2016 some payments were received. The decreased revenues forced placing the mine on standby since sufficient coal was produced to meet customer's needs.

The Ulaan Ovoo Property does not include a preparation plant and so risks the shipment of non-specification coal. To mitigate this situation, high ash coal and partings were separated from the coal in the pit and quality was monitored at the coal stockpile area. This was done by the mine geologist identifying these materials, monitoring their removal by trained excavator operators during daylight hours, and constant supervision. Continual grade control sampling and assaying is performed and coal quality predictions made. This work has made for better control of the grades of coal produced.

Groundwater inflow to the pit, especially where recharged by the Zelter River is a risk to mining operations. Pumping water from the mine pit has stopped production at times. Larger capacity pumps were purchased which partially mitigated this risk. During 2011 dewater wells were proposed and budgeted to reduce the water inflow. The dewater wells were installed during 2012 and reduced water inflow into the mine. During 2015 diversion of the north branch of the Zelter River and construction of a protective dike were evaluated and were discussed with government officials.

## **Operational Data**

Ulaan Ovoo pre-commercial production started in November 2010. In July 2012, the Company temporarily suspended pre-commercial production at Ulaan Ovoo due to soft market prices for coal along with rising costs at a time when the Company had sufficient coal inventory to meet anticipated demand for the remainder of 2012 and into 2013. On December 31, 2012, the Company recorded a non-cash impairment write down of \$47 million on the Ulaan Ovoo coal property, which was reflected on the consolidated statement of operations. The impairment charge reduced previously capitalized deferred exploration within property and equipment, to a balance of \$2 million.

Mining re-commenced in November 2013. All required mining, safety, and transportation staff were re-hired and the Company's leased-out mining and transportation equipment were recalled. The Company installed significant water-pumping capacity and dewatered the pit area.

During 2014, the Company faced challenges, such as significant dewatering of the resource, lack of demand, depressed coal sales prices, and higher than expected operating/transportation costs, resulting

in limited production throughout the period. Pit dewatering has become a significant impediment to achieving consistent production, especially following mine standby during the periods of low market demand. The mine was placed on standby in Spring 2014 but continued coal loading and sales from the existing stockpiles. Due to the lack of sustained production, management has not sufficiently tested the mine plant and equipment to conclude that the mine has reached the commercial production stage.

On December 31, 2014, the Company recorded a non-cash impairment of \$7.7 million of previously capitalized deferred exploration costs to \$nil and an impairment charge of \$3.5 million on the Ulaan Ovoo mining equipment has been recognized. This non-cash accounting charge did not impact the Company's financial liquidity or any future operations and management believes the adjustment to the book value of this long-lived asset more accurately reflects the Company's current market capitalization.

The 2013 Long Named Law allows options for those mineral license holders who acquired their licenses before passage of the Long Named Law to retain legally allowed portions of their licenses affected by the law. The Company chose the option of diverting the north branch of the Zelter River in order to retain the licenses. The Company prepared documents and met with the Ministry of Environment to reach agreement on the river diversion. Changes are being made to the Ministry of Environment after the appointment of new Minister in October 2017 and as such the Company expects further actions will be taken after Ministry appointments are completed.

During 2015 and 2016, the Company maintained operations on standby, although coal loading and sales from existing stockpiles continued to local customers. During the year ended December 31, 2015, the Company sold most of its mining and transportation equipment for net proceeds of \$2.9 million to generate cash so that operations may continue. Revenue generation, cost reduction and debt reduction efforts continued. Besides sales of stockpiled coal, other revenue generation efforts included sale of a portion of the remaining equipment, parts and supplies, and lease of other equipment. Terminating contractor agreements, staff reductions, office relocation, and other actions were completed to reduce costs. On May 4, 2016, the Company fully repaid and closed out a \$1.5 million line of credit with the Trade and Development Bank of Mongolia and has been provided with a release/discharge of pledges.

The Company continued monitoring and providing support as and when requested by the Government of Mongolia for the government's work to re-open the Zelter border crossing and pave the Shamaar-Tushig road. The government supports re-opening the Zelter border crossing and in 2016, approved a budget to start paved road construction during 2017.

The Company continued monitoring and support of the government's efforts to upgrade the line power to Tushig soum with sufficient power to be brought to Ulaan Ovoo. Discussions have been held and information provided by the Company previously and support provided from the regional and local governments.

The Company negotiated with a Russian party for the sale of coal and executed Sale and Purchase Agreements with two Mongolian customers during 2016. On December 28, 2016, the Company executed Coal Sales and Purchase Agreements to sell a total of 16,000 tonnes of coal to two Mongolian customers. The two purchasers were Erdenet Mining Corporation (for 10,000 tonnes) and Selenge Energo Heat Plant (for 6,000 tonnes). Coal deliveries sourced from existing coal stockpiles began in December 2016 and was completed in February 2017. Please refer to Prophecy's news release dated December 28, 2016 and filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) or posted on the Company's website for more information concerning the Mongolian sales.

Normal license maintenance requirements including filings and payment of fees, were completed during 2016 and accepted by the relevant ministries. Environmental requirements were completed during 2016 and accepted by the relevant ministries. The Khujirt exploration license was determined by Company management not to be strategic to the Company. The license was relinquished, and the cancellation was accepted September 22, 2016 by the relevant ministry.

## Activities During 2017

The Company's activities during 2017 included fulfillment of license maintenance requirements and sale of coal. The Company sold 17,335 tonnes (2016 – 3,015 tonnes) of coal to Erdenet Mining Corporation and Selenge Energo Heat Plant and other local customers from existing stockpiles with total sales revenue of approximately \$364,600 (2016 - \$65,000). Sales revenue has been recorded against costs incurred at the mine, classified as costs in excess of recovered coal of \$109,187 on the consolidated statement of operations and comprehensive loss. As of December 31, 2017, the coal stockpile balance was approximately 60,000 tonnes (December 31, 2016 – 78,595).

## Planned Activities

Australian seaborne thermal coal was trading at USD102/t FoB port during early 2017, dipped to USD74 during May 2017 but has steadily increased since then to approximately USD106 during January 2018. The Company continues talks to sell coal into the Chinese market with transport by rail south through Mongolia. The continued increase in prices has renewed interest in seaborne export also. Given the strong prices for thermal coal in the region, the Company will continue its marketing efforts. Mining operations at Ulaan Ovoo may be restarted in short order since pit dewatering requires less than a month and other work needed to restart mining can be completed at the same time. The Company believes contract mining is a viable option for more efficient operation of the mine since a contract mining firm would be responsible for labor agreements, equipment maintenance and other key responsibilities and functions.

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

Prophecy intends to continue to pursue government support to open the Zelter border crossing, pave the 136 km Shamaar-Tushig road, as well as to upgrade the 35kV power line from Tsagaannuur soum to Tushig soum to bring power to Ulaan Ovoo. Otherwise, the Company intends to continue with normal license maintenance and environmental obligations.

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

## 5.5 Chandgana Project

The Chandgana Project consist of the Chandgana Tal Property and the Khavtgai Uul Property (formerly named Chandgana Khavtgai) mining and exploration licenses and the Chandgana Tal mine. The properties are located in the Nyalga Coal Basin, approximately 280 km east of Ulaanbaatar, and are 9 km apart (Figure 9). On November 22, 2006, Prophecy (then Red Hill Energy Inc.) entered into a letter agreement with a private Mongolian company that set out the terms to acquire a 100% interest in the Chandgana Tal Property consisting of two exploration licenses. These were converted during 2011 into mining licenses MV-010126 and MV-016767. On August 7, 2007, Prophecy (then Red Hill Energy Inc.) entered into a letter agreement with another private Mongolian company that set out the terms to acquire a 100% interest in the property known as Chandgana Khavtgai consisting of exploration license XV-011654. Under the terms of the Chandgana Khavtgai agreement, Prophecy paid a total of USD570,000. These properties are assets of Chandgana Coal LLC ("**Chandgana Coal**"), a subsidiary of Prophecy.

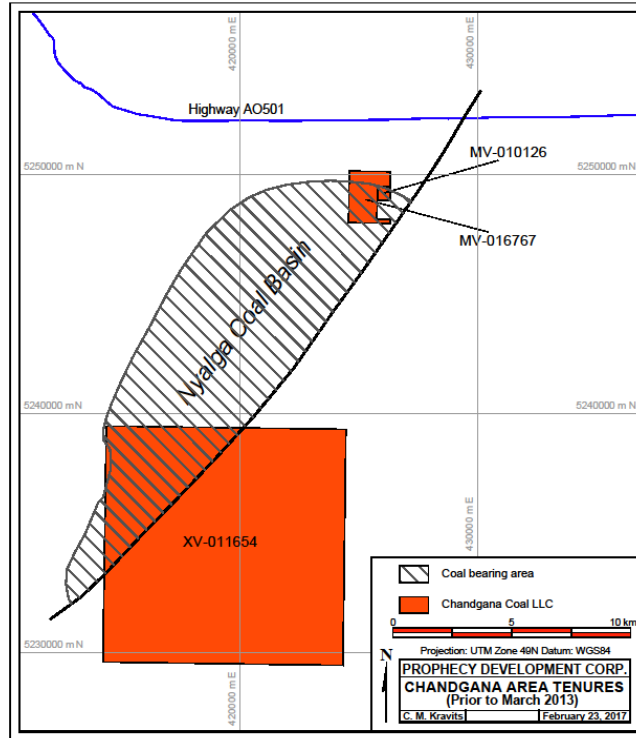


Figure 9

## Khavtgai Uul Property

### Property Description and Location

The Khavtgai Uul Property includes minerals exploration license XV-011654 located in the southwest portion of the Nyalga Coal Basin. The license is located in Moron soum (sub-province) of Khentii aimag (province), Mongolia. The coal-bearing portion comprises approximately 1,636 hectares. Adjacent licenses include a coal exploration license held by Adamas Mining LLC to the southwest and coal mining licenses held by Tugalgatai Mining LLC, a subsidiary of Cosmo LLC. The resource area has a continental climate with short warm summers and longer cold winters and is generally favourable for development of the coal resource.

The resource area is located in the Nyalga Depression within the Khentii Zone of the Khanga-Khentii fold system and is part of the Shorvogo Steppe physiographic province along the northern margin of the Gobi Desert. The topography is relatively featureless with a mean surface elevation of 1,142 metres. The coal seams belong to the Early Cretaceous age Zuunbayan Formation and are part of the southern end of the headwall portion of a faulted syncline. The coal seams subcrop at and just west of the western border of the license and dip approximately 4.5° to the southeast. The resource area is bounded to the southeast by the Nyalga Basin Fault Zone.

### Accessibility, Climate, Local Resources, Infrastructure and Physiography

#### Accessibility

Access to the Khavtgai Uul Property is possible by ground vehicle and helicopter or possibly small airplane. Ground vehicles may enter the resource area by driving the Ulaanbaatar-Ondorhaan highway (A0501) 295 kilometres east then turning south on any of several unpaved roads then driving 16 kilometres to the resource area. The highway is an all-weather road capable of supporting truck traffic. The unpaved roads on the resource area are generally in good condition and drivable throughout the year. However, the dirt

roads can only support truck traffic when dry and only on certain sections. Helicopters may fly to the resource area and land almost anywhere. Small airplanes may also fly to the resource area but landing and take-off is only possible on several stretches of unpaved road. The elevation is not too great for helicopters or small planes although winds may be an issue at certain times of the year.

There is no access by railroad or water. The nearest railroad spurs end at Bor-Ondor, 118 kilometres south and the Baganuur Coal Mine, 124 kilometres west of the Khavtgai Uul Property and adjacent to the Ulaanbaatar-Ondorhaan highway. The Herlen River is the closest major river and is not navigable.

#### *Climate and Vegetation*

The resource area has a continental climate with warm and dry but short summers and cold and dry winters. The area is generally windy with wind direction from the northwest or northeast at speeds of 4-7 m/sec but reaching 20 m/sec in the spring. The warmest temperatures are during June to July with highs around 40° C and the coldest during December to January with lows around -30° C. Snow accumulation averages 10 cm in flat areas but may drift to 1 metre deep. The annual precipitation varies from 10 to 50 cm and most falls as rain in August.

The surface is predominantly grass-covered although there are some low shrubs on the hills. There are no forested areas in or near the resource area.

#### *Local Resources*

Surface water is not readily available in the resource area. The nearest flowing water is the Herlen River 30 kilometres to the southeast. Otherwise surface water may only be available from dry stream courses and ephemeral lakes during the summer wet season. There are no lakes or reservoirs. Groundwater appears to be available because the 2007 exploration drilling encountered an artesian aquifer in three of the seven drill holes and water was observed in other 2007 and 2010 drill holes. The size and production capacity of this aquifer has not been evaluated.

#### *Infrastructure and Population Centres*

The infrastructure within or nearby the Khavtgai Uul Property includes the Ulaanbaatar-Ondorhaan highway (A0501), a 110 kV power transmission line to the south, a 35 kV distribution line to the Chandgana Coal mine, and cellular phone coverage. The highway is located 16 kilometres north and is a paved all-weather highway. There are no water or natural gas pipelines, telephone lines, canals, or water retention structures within or nearby the resource area.

#### *Physiography*

The resource area is located within an intermontane valley between the Nyalga Depression to the southwest and the Shorvogo Basin to the northeast. The Khentii Mountain Range is northwest and the Hongor Mountains are southeast of the resource area. The physiography of the resource area consists of a broad flat with low hills to the northwest and east otherwise there are no prominent physiographic features. The drainage bottoms are 1 to 5 metres below the adjacent surface and are usually dry. The bottoms of the ephemeral lakes are 0.5 to 4 metres below the adjacent surface.

The surface elevations of the resource area vary from 1,129 metres to 1,164 metres making for a relief of approximately 35 metres. The low flat areas average 1,135 metres and the hills 1,152 metres in elevation.

## *History*

The Khavtgai Uul mineral exploration license was originally granted to DeeJ Bayalag LLC and issued on April 7, 2007 under registration number 9011039094. No previous licenses are known. The second year license fee was paid on May 22, 2007. The license was transferred to Red Hill on October 12, 2007, under registration number 90190101078 with no change in the size or boundaries. The license was adjusted to decrease its size on April 8, 2009.

There has been previous exploration for coal near and within the resource area. The former Soviet government explored for coal by drilling and trenching in 1962 and drilling in 1980 in the northern end of the Nyalga Basin. Red Hill explored the Chandgana Tal coal licenses in the same area during the summers of 2007 and 2011. Eight core holes were drilled during 2007. Trenching was performed during 2009 to locate the coal subcrop. Red Hill drilled 13 drill holes and performed seismic survey lines during 2010. Red Hill drilled 15 drill holes during the summer of 2011 to better define the resource of the Chandgana Tal licenses. Both Tethys Mining LLC and Adamas Mining LLC conducted coal exploration on their licenses contiguous to Prophecy's license during 2007 and 2008. There is previous mining on Prophecy's Chandgana Tal Property and on the Berkh-Uul license nine kilometers to the northeast.

## **Geology**

### *General*

The resource area is located in the Nyalga Basin which is a portion of the Khentii Zone of the Khangai-Khentii fold system. The Khangai-Khentii fold system is a series of folded Silurian to Cretaceous age sedimentary rocks found in eastern Mongolia.

### *Surficial Deposits and Sedimentary Rocks*

Surficial materials include surface deposits and sedimentary rocks. Surface deposits appear to be Holocene in age and include alluvium, colluvium and playa deposits and are up to 70 metres thick. Sedimentary rocks are found in small areas at the surface but comprise all the subsurface rocks. These rocks range in age from Silurian to Tertiary and include nonmarine sand, clay, conglomerate, sandstone, siltstone, claystone, shale, and coal. A minimum thickness of 3,350 metres of sedimentary rocks is known.

### *Resource Area Geology*

Unconsolidated Holocene age sediments are found at the surface and no bedrock is exposed. The rocks found immediately below the surficial deposits belong to the nonmarine Early Cretaceous Zuunbayan Formation. The coal resource is found in the Zuunbayan Formation. Igneous dikes and sills have not been found to cut the Zuunbayan Formation.

### *Structural Geology*

The coal resources are found within the southern end of the Nyalga Basin. The basin appears to be a faulted syncline though seismic surveys suggest the coal-bearing rocks continue on the southeast side of the Nyalga Basin Fault Zone. The basin then may extend farther to the southeast than has been considered before. The coal seams subcrop along the western margin of the syncline, strike from N 20° to 65°E, and dip approximately 4.5° to the southeast. The wide variation in strike may be a result of faulting but cannot be proven with the information available. Resistivity-IP and seismic lines across the former Nyalga Basin Fault indicate a horst exists at this location. The former Nyalga Basin Fault is the northwest normal fault bounding the horst while another normal fault about 570 metres southeast bounds the horst on the other side. These two faults and possible smaller faults indicated by the seismic survey lines justified renaming the area the Nyalga Basin Fault Zone. The location of the fault zone is also partly supported by the change in lithology of float material, drilling results, apparent slight topographic expression and azimuth of topographic contours, and the change in lithology of the portion of the Zuunbayan Formation penetrated in drill holes on either side of the fault. Displacement along both faults is approximately 300 metres at their

north and south ends but appears to decrease at the middle. At this time the Nyalga Basin Fault Zone is considered to have a tectonic origin based on the type of deformation and observations from drill core which also agrees with the structural history of the area. Mass wasting that may affect the reliability of the coal resource estimate or impact coal recoverability has not been found.

The two 2007 drill holes southeast of the Nyalga Basin Fault and the three drill holes drilled east of the fault during 2011 did not encounter coal. These holes were plug drilled with a full face PDC bit to total depth with limited coring in zones of poor circulation and other drill holes core drilled to total depth. The cuttings and core samples were logged. The 2011 drill holes were plugged with cement upon completion of drilling.

Drilling provided the most reliable information including depth and thickness of coal seams and core samples. This allowed better mapping of the extent, elevation and thickness of the coal seams and better estimation of coal quality. The B Coal Seam is found throughout the resource area and is thick but locally thins in the west central and northeast portions of the area. Otherwise the B Coal Seam was found to be slightly thicker than expected. The other coal seams are thicker and have a greater extent than previously shown though they are found in the same general area. The elevation of the coal seams varies more than previously described suggesting local folds or faults are present. Assays of the coal core samples shows coal quality to be similar to that described previously. The greatest changes are a slight increase in moisture and ash and slight decrease in heating value.

### *Exploration*

The goals of the 2010 exploration was to place all of the resource in the measured and indicated assurance of existence categories, obtain more information on the depth, thickness, and grade of the coal seams, and locate the geologic limits of the resource more accurately. Exploration in subsequent years was completed to satisfy the license exploration requirement and was designed to further define the resource geology. Since most of the exploration was completed during 2008 and 2010, and during these years the policies and procedures were established, the activities of these years and the policies and procedures used are described in detail in the following sections. Exploration during subsequent years followed similar policies and procedures.

The exploration concept was that commonly used for relatively low dipping stratiform deposits where exploration was planned and executed to obtain information on depth, thickness, continuity, and quality of the resource. This information was obtained by surface mapping, trenching, drilling and geophysical methods. Two shallow trenches were excavated in 2009 for a total length of 189 metres. Approximately 15.7 kilometres of resistivity-induced polarization and 15.7 kilometres of magnetometer lines were run across the Nyalga Basin Fault in 2008. During 2010 Prophecy completed 13 drill holes and ran 11.3 kilometres of reflection seismic lines and 27.8 kilometres of magnetometer lines. This exploration supplemented that completed in 2007 which included remote imagery interpretation, surface mapping, trenching, and seven core drill holes. The new information has placed enabled more accurate mapping of the geologic limits of the resource area, and made for better characterization of the geology and estimation of coal resources and quality. Three drill holes were drilled during 2011 and 9 during 2015 and 4 trenches during 2012, 4 trenches during 2013, and 3 trenches during 2014. No development work or operations were conducted or are active in the license.

### *Mineralization*

Nine coal seams that contain coal resources are found in the resource area. The B Coal Seam contains 80% of the resource, followed by the F Coal Seam (8%) and E Coal Seam (7%) with the remaining coal seams containing smaller portions. The B Coal Seam is found throughout the resource area, has an average resource thickness of 34.2 metres and range from 6.2 to 60.5 metres thick including several, mostly thin partings. The known depth to the B Coal Seam varies from 27.7 to 266.8 metres but is probably even shallower in the northwest corner of the license. Other coal seams (formerly the Upper Coal Seams) are found above the B Coal Seam. These coal seams have a thinner resource thickness (0 to 16.0 metres) and are less extensive yet contain significant resources also. A representative cross section is presented in Figure 10. The coal seams are black, friable, readily slake and have poor competency. The partings are



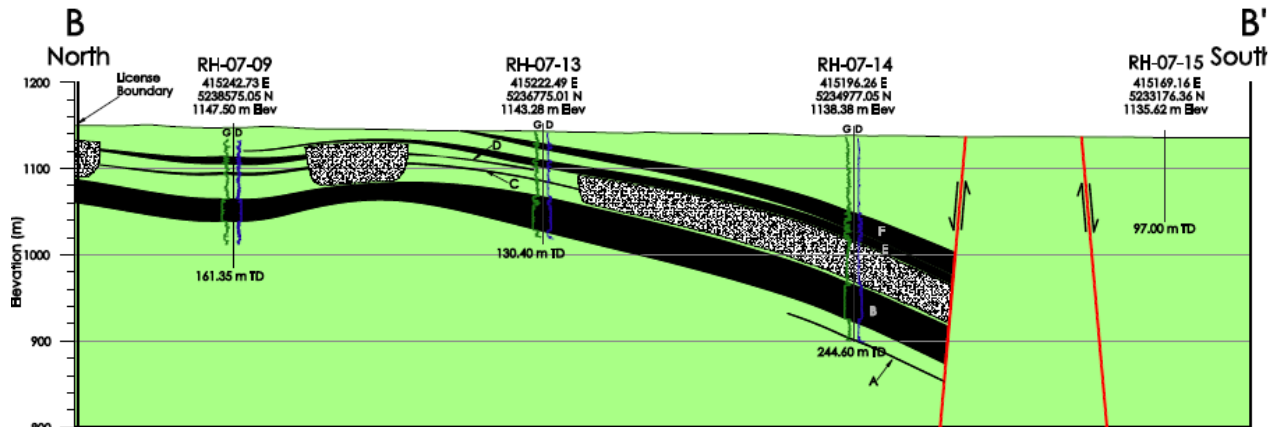


Figure 10

poorly indurated and have a moderate slake potential. The overburden is also poorly indurated with a moderate slake potential but contains few structural discontinuities. The coal seams are moderate grade low rank thermal coals. The thickness-weighted average in-place assay (as-received basis) of the sampled coal seams (A, B and C Coal Seam) within the resource area is 36.5% moisture, 10.1% ash, 3,636 kcal/kg heating value, and 0.6% sulphur (Table 17). Their agglutinating properties have not been assayed, but the coals are expected to be non-agglutinating. The apparent ASTM rank of the coal is between Subbituminous C and B based on the moist, mineral matter-free gross calorific value of core sample assays.

Table 17. Khavtgai Uul Weighted Average A, B and C Coal Seam Quality

Parameter	Short Proximate Analysis <sup>(1)</sup>			
	Moisture (wt. %)	Ash (wt. %)	Heating Value (kcal/kg)	Total Sulphur (wt. %)
	36.54	10.10	3,636	0.59

**Note:**

(1) As-received basis.

**Drilling**

For the 2007 drilling, Landdrill International Inc. of Ulaanbaatar, Mongolia, was contracted to drill the holes and used a truck-mounted Longyear Model 44 rig. The procedure was to: (i) drill with a 132 mm (HWT) full face PDC bit and set conductor casing; (ii) drill the overburden to core point with a 96 mm (HQ) full face PDC bit using polymer as a medium; and (iii) core from core point to total depth with an HQ-3 core drilling string. Coring was done using HQ rods behind a 96 mm OD diamond core bit with inert polymer as a medium. Wireline coring methods were used with a sleeved 3 metre core barrel assembly. All drilling was done on a 24-hour schedule. The drilling method, drilling procedures, and size of core obtained is considered appropriate for the logistics of the area, goals of the drilling, and type of analyses desired.

Five of the drill holes were drilled northwest of the Nyalga Basin Fault Zone and two southeast of the fault zone. Those in the resource area west of the fault zone were located to maximize characterisation of the resource and the reliability of the resource estimate. These five drill holes penetrated nearly the full thickness of the upper member of the Zuunbayan Formation. The two drill holes southeast of the Nyalga Basin Fault Zone were drilled to confirm the lack of coal and to help locate and characterize the fault zone. The drill hole locations and elevations were obtained by ground survey methods using a theodolite.

Drill cuttings were collected at one metre intervals, described and the lithologic information logged onto forms. The drill core was described in white light and ultraviolet light, the information logged on forms at a

scale of 3 cm=0.5 m, and the core photographed with a digital camera. The core information logged includes lithology, rock mechanics, and sampled intervals. Other information was noted during drilling and logging including water and gas encountered and unusual drilling conditions. After completion of the core logging, the core was sampled, placed in plastic sleeves, and the samples noted on the core log. The lithology and rock mechanics information are considered to be logged in acceptable detail.

After reaching total depth, the drill holes in the resource area were geophysically logged. Some of these were logged through the core rods if the hole was not stable. The logging suite included gamma, spontaneous potential, gamma-gamma density, single point resistivity, and caliper. Printed field copies at a scale of 1cm=2 metres and Log ASCII Standard (LAS) electronic files of the logs were provided to Red Hill.

Upon completion of logging the drill holes in the resource area or reaching total depth for the drill holes outside the resource area, the holes were plugged with bentonite chips and capped with 2 to 5 metres of cement. The conductor casing was pulled from some of the drill holes. A marker with drill hole identification information was placed in the top of the cement.

The 2010 drilling was performed by Best Drilling Inc. of Ulaanbaatar, Mongolia using a skid-mounted Longyear Model 44 rig. The drilling procedure was the same as that used in 2007. The drilling method, drilling procedures, and size of core obtained is considered appropriate for the logistics of the area, goals of the drilling, and type of analyses desired. Geologic data and samples were obtained using the same methods practised during the 2007 drilling. The lithology and rock mechanics information are considered to be logged in acceptable detail. Geophysical logging was performed similar to that performed in 2007 with one exception. The exception is that spontaneous potential was not logged, otherwise natural gamma, gamma-gamma density, single point resistivity, and caliper were logged.

Best Drilling Inc. performed the 2011 drilling and Top Diamond Drilling the 2015 drilling and followed similar procedures as those in 2010. Geologic data and samples were obtained using methods similar to those of 2010 and the information logged in acceptable detail.

The drilling completed during 2011 and 2015 also followed similar procedures and samples were obtained using similar methods.

### *Summary and Interpretation of Results*

The 2010 drilling provided the most reliable data to characterise the geology of the resource area, estimate resources and estimate coal quality. The drilling: (i) provided more information on the areal extent and thickness of the coal seams; (ii) further defined the structural geology; (iii) confirmed the presence of a significant coal resource; (iv) placed all of the resource in the measured and indicated assurance-of-existence categories; (v) better defined the geologic boundaries of the resource; (vi) better characterized the type, grade and rank of the coal seams; and (vii) gave indications of groundwater and mining conditions.

Accurate measurements of the depth and thickness of all the coal seams are now available and the closer spacing between drill holes allows all the coal seams to be correlated more reliably. Nine major coal seams are now known. The A Coal Seam is the stratigraphically lowest coal seam followed, in ascending order by the very thick B Coal Seam then seven (C through I) thinner coal seams. The B Coal Seam is the thickest ranging from 6.2 to 61.1 metres thick, is found at a maximum depth of 311.7 metres, and has the greatest areal extent. The E and F Coal Seams are thinner (0 to 23.5 m) but are found over most of the resource area. The other coal seams are thinner and are less extensive. All the coal seams contain partings that range in thickness from 0.1 to 9.1 metres thick.

The attitude of the rocks and faulting is much better known. The resource area has a more complex geology than previously thought in that there is either folding or faulting though overall dip is still to the southeast. The extent of the basin is slightly larger because the coal seams subcrop farther northwest and the coal-bearing rocks are probably present on the southeast side of the Nyalga Basin Fault Zone. The former Nyalga Basin Fault is now considered to be a fault zone with a central horst.

The drill hole spacing placed all of coal resources in the measured and indicated assurance-of-existence categories. Analyses confirmed the coal to be a moderate grade, low rank thermal coal. Cores allowed visual characterisation of rock properties and provided samples for assay. The overburden and interburden rocks and the coal are weak being poorly to moderately lithified but with few fractures. Finally, the drilling mapped a 33.0 to 42.5 metres thick moderately artesian sandstone aquifer between the B and E Coal Seams.

The 2011 drilling did not encounter coal east of the Nyalga Basin Fault. The 2015 drilling confirmed the coal seam subcrop to be outside the northwest portion of the license but definition of possible faults was inconclusive.

### *Sampling & Analysis*

In planning the 2007 exploration, exposures in the nearby Chandgana Coal mine were considered. These exposures suggested that at least one of the coal seams should be very thick, low rank and dip at a low angle to the southeast. Thus, having a thick stratiform deposit and considering that the exploration is the first in the resource area, the approach used was to obtain samples that gave a reliable gross estimate of coal quality. To meet this goal, sampling was planned to: (i) obtain samples at widely spaced locations; (ii) sample the full thickness of the coal seam; (iii) determine the limit of weathered coal; and (iv) ensure the samples are representative of the grade and rank of the coal. The desire to obtain samples at widely spaced locations complimented the desire to place as much of the resource in the higher assurance-of-existence categories as possible.

Drilling and trenching were then considered most appropriate for obtaining samples. Large diameter HQ drill cores were obtained using a three-metre core barrel. Only the B Coal Seam was cored because the existence of the upper coal seams was not known. The full thickness of the B Coal Seam was cored where possible. Unfortunately, in some cases a portion of the top of the coal seam was rotary drilled before changing to the core drilling string because the structure of the coal seam was not known.

A similar sampling approach was used for the 2010 drilling. But the stratigraphically higher coal seams were core drilled in two drill holes besides the B Coal Seam. Since the structure of the coal seam was known fairly well, core was obtained from all of the targeted coal seams but one where the upper few metres were rotary drilled. The representativeness of the core samples obtained during the 2007 and 2010 drilling was enhanced in several ways. These included: (i) selecting large diameter core to increase core recovery; (ii) core drilling on a 24 hour schedule to increase core recovery; and (iii) using inert drilling fluids when possible to reduce core contamination.

Trenching with an excavator was primarily done to locate the B Coal Seam subcrop, but secondarily to obtain samples to be assayed. The portion of the coal seam exposed in Trenches C and D were sampled. The representativeness of the trench samples was enhanced by obtaining large samples and placing the sample in plastic bags as soon as possible to preserve in-situ moisture.

The sampling of cores during the 2011 and 2015 drilling followed the same methods. Sampling was started and completed as soon as possible after lithologic descriptions and photographs were done. The sampling method followed that of ASTM D 5192 where practical. Sample treatment methods included rinsing the core of contaminants and allowing sufficient time for the free water to drain from the core to enhance sample representativeness. Sample preservation included placing the core in 6 mil plastic sleeves to minimize moisture loss then placement on wooden core boxes for protection. The samples were removed from the core tray in lengths up to 1 metre depending on the thickness of partings and the beginning and end of core runs.

### *Security of Samples*

All the drill core and trench samples were prepared and assayed in accordance to ASTM, ISO, or Australian Standards (AS) procedures in the coal laboratories of SGS-CSTC Standard Technical Services Co., Ltd.

These laboratories are located in Ulaanbaatar, Mongolia (SGS Mongolia), the test centre in Tianjin, China (SGS Mineral Fuels), and the geochemical and ores laboratory in Tianjin, China (SGS Geochemical and Ores). Sample preservation, security and tracking was established and well maintained from the drill site to reporting of the results for the 2007, 2010, 2011 and 2015 drilling.

Sample security was ensured from the drill site to the assay report. A chain of custody form was completed by Mr. Robeck for the 2007 samples and by Mr. Kravits for the 2010 and 2011 samples that gives sufficient information to identify the samples and describes the analyses required. The chain of custody accompanied the samples during shipment from the drill site to the laboratory and was signed by all parties involved in the transport of the samples and SGS Mongolia upon receipt. All the samples were shipped under Red Hill or Prophecy control directly to SGS Mongolia. Upon delivery, the samples were jointly inventoried by a Prophecy representative and SGS staff before SGS signed for receipt of the samples. The signed sample chains of custody are on file at Prophecy's Ulaanbaatar office. SGS Mongolia then entered the sample information into their laboratory information management system (LIMS) which generated unique laboratory identification numbers. Sample preparation and laboratory worksheets are then prepared by the LIMS to track each sample to the final report. The laboratory managers review the sample tracking while the samples are in process and review the final assay reports to ensure the correct sample identifying information accompanies the correct assays (Murray, 2007 and Rao, 2010). This responsibility is part of the laboratory accreditation which for the 2007 samples was validated by ISO (Murray, 2007). No assay results were found to have been misidentified.

Once in the custody of SGS, the samples were sealed and stored in a secure lockable location to prevent tampering. The storage conditions are controlled to protect the samples from heat, light and humidity (Rao, 2010). No samples were lost, stolen or tampered with during any of the drilling.

None of the samples were handled by Mr. Robeck, Mr. Kravits, or any contractors, employees, officers or directors of Red Hill or Prophecy after receipt by SGS and none of these parties were involved in preparation or assay of the samples.

#### *Data Verification*

Each type of data was reviewed to verify that it represents the location, depth and/or other descriptive information of its source. The quality of the data was then assessed by a review for accuracy and errors. The methods used vary according to the type of data and were performed using practices common in the coal industry or the industry that produces such data.

The topographic data and the map produced from this data were verified by Mr. Kravits during the site inspection and with information obtained during the inspection. This was done by comparing the coordinates and elevation of the drill holes, trenches, and license corners determined with a handheld GPS receiver to the coordinates and elevations on the geologic map.

The stratigraphic data obtained from the 2007 and 2010 drill holes were verified by Mr. Kravits in two ways. These included comparison of the identification, location, and other information of the 2007 drill holes in the stratigraphic database to the information on the geophysical and lithologic log headers and the information obtained during the site inspection and comparison of the interpreted and correlated geophysical logs by Mr. Kravits to those of Mr. Robeck. For the 2010 drill holes this was not necessary because Prophecy geologists and Mr. Kravits located the drill holes with a GPS receiver prior to drilling and the completed drill hole was surveyed by Oyu Survey LLC (Oyu Survey, 2010). The GPS coordinates and surface elevation were placed on the geophysical log headers to better tie the log to the drill hole.

The trench data were verified against observations made and coordinates obtained by Mr. Kravits during the site visit and notes made and pictures obtained by Mr. Robeck during the trenching. The geophysical data were verified by comparison of the contractor supplied coordinates of their activities to evidences of their activity and coordinates obtained by Oyu Survey or Mr. Kravits.

The 2007 and 2010 assay data were verified by comparison of the descriptive information (drill hole number, depth interval, sample number, and lithology) and assay results accompanying the quality data to that of the same information on the core log and chain of custody and the recorded lithology. Transcribed data were reviewed twice for errors. The stratigraphic and assay data from drilling and trenching conducted during the 2011-2015 period were verified in a similar manner.

#### *Future Exploration and Development*

Further exploration, analyses and tests are recommended to better understand the geology in the western portion of the license, map the coal seams above the B Coal Seam and better characterize the quality and utilization characteristics of the coal. This includes reprocessing of the acquired seismic data, rotary and core drilling, bulk sampling and more thorough and detailed analyses and tests of core samples and a bulk sample.

Coal from the Khavtgai Uul Property is intended by the Company to supplement the Chandgana Tal coal that would fuel the Chandgana Power Plant Project to be located adjacent to that property. The Mongolian government is supportive of the Chandgana Power Plant Project and has issued a construction license to the Company. The large coal resource from Khavtgai Uul could fuel a larger energy project or supply a coal-to-liquids facility.

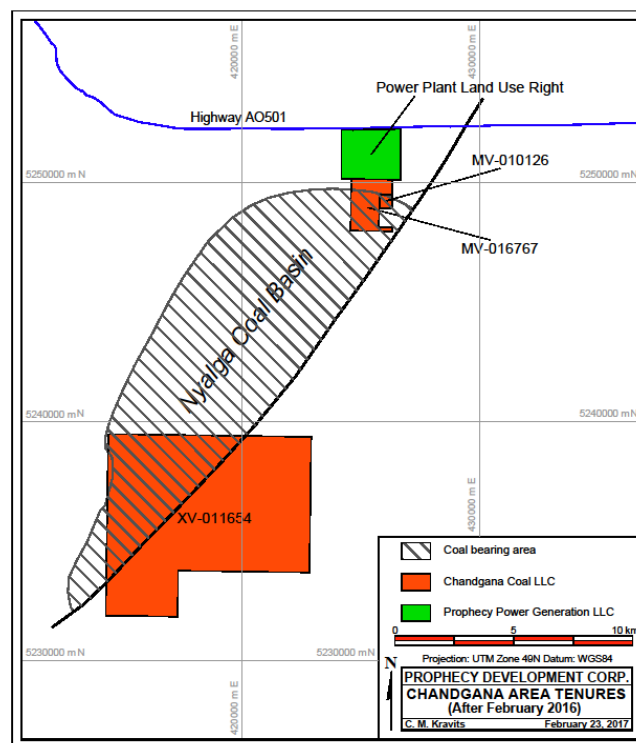
#### **Project Risks and Mitigation**

The major risks to developing the Khavtgai Uul project include decrease in global and regional commodity demand or price, decrease in domestic demand or price, the inability to obtain financing, adverse political and social changes, and technical risks. Global and regional commodity demand and price trends present an indirect risk to the project in that they influence domestic coal demand and prices. Domestic demand and price trends present a direct risk because government control to varying degrees of certain coal producers and consumers and support of prices and costs favor these entities and maintain lower prices. Four outside factors have recently decreased these demand and price trend risks. The recent global and regional increase in demand has nearly doubled the benchmark price of thermal and metallurgical coal. The new Mongolian government administration is continuing with privatisation of state-owned entities as part of its program to transition to an open market economy. The new administration has stated that one of its goals is to improve and increase infrastructure, which includes electrical power generation capacity and reduction of imported electrical power. Fourth, the domestic demand for electrical power currently exceeds generation capacity and is projected to exceed capacity into the future despite new capacity brought on line and in construction. The Company's intent to use the coal as a supplement to Chandgana Tal coal to fuel the Chandgana Power Plant Project or a larger plant, possibly including coal conversion considering the renewed interest in this use further decrease the demand risk. Mitigation of decreases in domestic coal prices is by two sources. The characteristics of the deposit including a thick coal seam with few thin partings and low strip ratio, which Chandgana Tal is one of a very few in Mongolia to the best of the Company's knowledge, will make for a low mining cost. In addition, the Company intends to mine at the lowest cost possible by accessing local skilled staff, scheduling relative to seasonal weather patterns, adopting best industry practices where practical, and use of other management and operational policies. The inability to obtain financing has largely been mitigated by the successful pursuit of equity investors and various forms of financing. Adverse political and social changes are considered to be much less of a risk now because the new administration has started to become much more supportive of mining and foreign investment by taking definite actions including effecting change in and passing new regulation addressing these areas. The Company also diligently promotes the project to national and local government leaders. There are technical risks which can be mitigated so that they do not become major hindrances or fatal flaws to the project. The available information suggests groundwater may hinder mining and so be a risk to the project. The Company considers this risk to be easily mitigated by a detailed hydrologic study and above pit and in pit dewatering and proper highwall design, as is commonly practiced at similar mines. The low competency and fracturing of the overburden rocks could reduce highwall stability and become a risk to the project. Mitigation can bring this risk to an acceptable level by a detailed geotechnical study and above pit dewatering and proper highwall design, as is done at similar mines.

During 2016 the Company completed license maintenance activities including payment of fees, annual reports preparation and submittal, exploration and adjusted the area of the license.

The Company completed exploration drilling which satisfied the exploration expenditure required by regulation. Two holes were drilled the results of which largely confirmed the known geology and provided more information for resource estimation and mine planning. The license maintenance fees were paid and the exploration report was prepared and submitted to the Mineral Resource and Petroleum Authority. Preparations were started to convert the license to a mining license in order to retain the tenure because the license is nearing the end of its term as an exploration license. Tenders were received from consultants to complete the full scope of work and the contract is expected to be awarded and work to start by the end of March 2017.

The license was adjusted during 2016 to remove the area of an ephemeral lake at the request of the Ministry of Mining and the Ministry of Environment. The adjustment had no effect on the coal resource or mineability. The new license area is shown in Figure 11.



**Figure 11**

### Activities During 2017

The required annual exploration was completed on the Khavtgai Uul exploration license which by government decree in early 2015, extended the term from 9 years to 12 years. The Khavtgai Uul license thus has one remaining year as an exploration license before it must either be converted to a mining license or relinquished. Exploration licenses grant as a right, access to the license area.

During 2017, preparatory work to convert the Khavtgai Uul exploration license to a mining license was completed. The Company engaged a contractor to prepare the required documents to convert the license to a mining license under which the right to explore is permanent. In 2017, as preparatory work to convert the Khavtgai Uul exploration license to a mining license, necessary laboratory analysis work was done such as coal chemical, mineral and element analysis of duplicates of coal samples taken as a result of drilling work in past years as well as radiation analysis of coal ash. Geological and exploration work report for

2017 was delivered to the Geological Division of Mineral Resources and Petroleum Authority of Mongolia (former Mineral Resources Authority of Mongolia “**MRAM**”). Based on previous years of work a report of the reserves of the licensed area was prepared, and an official letter to have an expert appointed were submitted to the Mineral Resources Professional Council in January 2018.

### **Planned Activities**

The activities planned for 2018 include continuation of work to convert the license to a mining license.

### **Chandgana Tal Property**

#### **Project Description and Location**

The Chandgana Tal Property consists of mining licenses MV-016767 and MV-010126. The licenses are held by Chandgana Coal and are found in the northeast portion of the Nyalga Coal Basin. The licenses are located 285 kilometres east of Ulaanbaatar in Moron soum (sub-province) of Khentii aimag (province), Mongolia. There are coal mining licenses adjacent to the property that are held by Tugalgatai Mining LLC, a subsidiary of Cosmo LLC and Berkh Uul LLC. The project area has a continental climate with short warm summers and longer cold winters and is generally favourable for development of the coal resource.

The property is located in the Nyalga Depression within the Khentii Zone of the Khangai-Khentii fold system and is part of the Shorvogo Steppe physiographic province along the northern margin of the Gobi Desert. The topography is relatively featureless with a mean surface elevation of 1,142 metres.

The coal seams belong to the Early Cretaceous age Zuunbayan Formation and are part of the northern end of the headwall portion of a faulted syncline. The coal seams subcrop in the northern portion of the license and dip approximately 4.5° to the south and southwest. The resource area is bounded to the southeast by the Nyalga Basin Fault Zone.

#### **Accessibility, Climate, Local Resources, Infrastructure and Physiography**

##### *Accessibility*

Access to the Chandgana Tal licenses is possible by ground vehicle and helicopter or possibly small airplane. Ground vehicles may enter the resource area by driving the Ulaanbaatar-Ondorhaan highway (A0501) 290 kilometres east then turning south on any of several unpaved roads and driving 2 kilometres south to the resource area. The highway is an all-weather road capable of supporting truck traffic. The unpaved roads on the resource area are generally in good condition and drivable throughout the year. However, the dirt roads can only support truck traffic when dry and only on certain sections. Helicopters may fly to the resource area and land almost anywhere. Small airplanes may also fly to the resource area but landing and take-off is only possible on several stretches of unpaved road. The elevation is not too great for helicopters or small planes although winds may be an issue at certain times of the year.

There is no access by railroad or water. The nearest railroad spurs end at Bor-Ondor, 118 kilometres south and the Baganuur Coal Mine, 134 kilometres west of the Chandgana Tal licenses and adjacent to the Ulaanbaatar-Ondorhaan highway. The Herlen River is the closest major river and is not navigable.

##### *Climate and Vegetation*

The resource area has a continental climate with warm and dry but short summers and cold and dry winters. The area is generally windy with wind direction from the northwest or northeast at speeds of 4-7 m/sec but reaching 20 m/sec in the spring. The warmest temperatures are during June to July with highs around 40° C and the coldest during December to January with lows around -30° C. Snow accumulation averages 10 cm in flat areas but may drift to 1 metre deep. The annual precipitation varies from 10 to 50 cm.

The surface is predominantly grass-covered although there are some low shrubs on the hills. There are no forested areas in or near the resource area.

#### *Local Resources*

Surface water is not readily available in the resource area. The nearest flowing water is the Herlen River located 30 kilometres to the southeast. Otherwise, surface water may only be available from dry stream courses and ephemeral lakes during the summer wet season. There are no lakes or reservoirs. Groundwater appears to be available because the 2007 and 2011 exploration drilling encountered water in the drill holes and the water level in the abandoned mine pit remains relatively constant. The size and production capacity of the aquifer has not been evaluated.

#### *Infrastructure and Population Centres*

The only infrastructure within or nearby the Chandgana Tal Property is the Ulaanbaatar-Ondorhaan highway (A0501), a 110 kV power transmission line to the south, a 35 kV distribution line to the Chandgana Coal mine, and cellular phone coverage. The highway is located 3 kilometres north and is a paved all-weather highway. There are no water or natural gas pipelines, telephone lines, canals, or water retention structures within or nearby the resource area.

#### *Physiography*

The property is located within an intermontane valley between the Nyalga Depression to the southwest and the Shorvogo Basin to the northeast. The Khentii Mountain Range is northwest and the Hongor Mountains are southeast of the resource area. The physiography of the property consists of a broad flat with low hills to the northwest and east. Otherwise, there are no prominent physiographic features. The drainage bottoms are 1 to 5 metres below the adjacent surface and are usually dry. The bottoms of the ephemeral lakes are 0.5 to 4 metres below the adjacent surface.

The surface elevations of the resource area vary from 1,129 metres to 1,164 metres making for a relief of approximately 35 metres. The low flat areas average 1,135 metres and the hills 1,152 metres in elevation.

#### *History*

Mining license MV-016767 was originally granted as an exploration licenses to Belchir LLC and was issued on March 19, 2004. No previous licenses are known. The license was transferred to Tugrug Nuurn Energy LLC and registered by the head of the Office of Geological and Mining Cadastre in his decision no. 444 of 2005. The exploration license was later transferred to Coal Khentii LLC and registered by the head of the Office of Geological and Mining Cadastre in his decision no. 318 of 2006. Red Hill acquired this license in 2006 with government approval. The license was converted to a mining license January 27, 2011.

Mining license MV-010126 was granted to Tugrug Nuurn Energy LLC with the right to mine on July 8, 2005. The exploration license was later transferred to Coal Khentii LLC and registered by the head of the Office of Geological and Mining Cadastre in his decision no. 318 of 2006. Red Hill acquired this license in 2006 with government approval.

There has been previous exploration for coal within and near the licenses. The former Soviet government performed survey work during 1926 to describe the coal deposit and during 1958 to assess the resource of radioactive elements. The Soviet government further explored for coal by drilling and trenching in 1962 and drilling in 1980. Red Hill explored the Chandgana Tal coal licenses during the summer of 2007 by drilling 8 drill holes and again during 2011 by drilling 15 drill holes. Tethys Mining LLC conducted coal exploration on their licenses (now held by Cosmo LLC) contiguous to Prophecy's license during the years 2007 through 2012. There is previous mining on the Chandgana Tal Property and current mining on the adjacent license owned by Berkh-Uul.



## **Geology**

### *Geological Setting*

The property is located in the Nyalga Basin which is a portion of the Khentii Zone of the Khangai-Khentii fold system. The Khangai-Khentii fold system is a series of folded Silurian to Cretaceous age sedimentary rocks found in eastern Mongolia.

### *Surficial Deposits and Sedimentary Rocks*

Surficial materials include surface deposits and sedimentary rocks. Surface deposits appear to be Holocene in age and include alluvium, colluvium and playa deposits and are up to 70 metres thick. Sedimentary rocks are found in small areas at the surface but comprise all the subsurface rocks. These rocks range in age from Silurian to Tertiary and include nonmarine sand, clay, conglomerate, sandstone, siltstone, claystone, shale, and coal. A minimum thickness of 3,350 metres of sedimentary rocks is known.

### *Property Geology*

Unconsolidated Holocene age sediments are found at the surface and no bedrock is exposed. The rocks found immediately below the surficial deposits belong to the nonmarine Early Cretaceous Zuunbayan Formation. The coal resource is found in the Zuunbayan Formation. Igneous dikes and sills have not been found to cut the Zuunbayan Formation.

### *Structural Geology*

The coal resources are found within the northern end of the Nyalga Basin. The basin appears to be a faulted syncline though seismic surveys suggest the coal-bearing rocks continue on the southeast side of the Nyalga Basin Fault Zone. The basin then may extend farther to the southeast than has been considered before. The coal seams subcrop along the western margin of the syncline, strike from N 20° to 65°E, and dip approximately 4.5° to the southeast. The wide variation in strike may be a result of faulting but cannot be proven with the information available. Resistivity-IP and seismic lines across the former Nyalga Basin Fault indicate a horst exists at this location. The former Nyalga Basin Fault is the northwest normal fault bounding the horst while another normal fault about 570 metres southeast bounds the horst on the other side. These two faults and possible smaller faults indicated by the seismic survey lines justified renaming the area the Nyalga Basin Fault Zone. The location of the fault zone is also partly supported by the change in lithology of float material, drilling results, apparent slight topographic expression and azimuth of topographic contours, and the change in lithology of the portion of the Zuunbayan Formation penetrated in drill holes on either side of the fault. Displacement along both faults is approximately 300 metres at their north and south ends but appears to decrease at the middle. At this time the Nyalga Basin Fault Zone is considered to have a tectonic origin based on the type of deformation and observations from drill core which also agrees with the structural history of the area. Mass wasting that may affect the reliability of the coal resource estimate or impact coal recoverability has not been found.

The drilling of 2007 and especially later during 2011 provided the most reliable information including depth and thickness of coal seams and core samples. This allowed better mapping of the extent, elevation and thickness of the coal seams and better estimation of coal quality. The S2 Coal Seam is found throughout the property and is thick but locally thins. The elevation of the coal seams generally decreases to the southwest.

### *Exploration*

The goals of this exploration were to obtain more information on the depth, thickness, and grade of the coal seams and locate the geologic limits of the resource more accurately. The exploration concept was that commonly used for relatively low dipping stratiform deposits where exploration was planned and executed to obtain information on depth, thickness, continuity, and quality of the resource. This information was obtained by trenching and drilling. Four shallow trenches were excavated in 2009. During 2011, Prophecy

completed 15 drill holes from which the coal seams were sampled in detail. This exploration supplemented that completed in 2007, which included remote imagery interpretation, surface mapping, trenching, and drilling. The new information made for a much more accurate resource estimate, enabled more accurate mapping of the geologic limits of the resource area, and made for better estimation of coal quality.

*Mineralization*

The S2 coal seam contains most of the coal resources found within the licenses. Other thinner coal seams comprise smaller portions of the resource and most are mineable based on thickness. The S2 Coal Seam is found throughout the property, has an average resource thickness of 40.7 metres and locally exceeds 60 metres thick including several, mostly thin partings (Figure 12). Depth to the top of the S Coal Seam increases to over 60 m at the southwest corner of the license.



**Figure 12**

Other coal seams are found above and below the S2 Coal Seam. These coal seams have a thinner resource thickness (0 to 12.0 metres) and are less extensive yet contain mineable resources. The coal seams are black, friable, readily slake and have poor competency. The partings are poorly indurated and have a moderate slake potential. The overburden is also poorly indurated with a moderate slake potential but contains few structural discontinuities. The coal seams are moderate grade low rank thermal coals. The weighted average in-place assay (as-received basis) of the S2 Coal Seam within the resource area is 40.9% moisture, 10.8% ash, 3,306 kcal/kg heating value, and 0.6% sulphur (Table 18). Their agglutinating properties have not been assayed, but the coals are expected to be non-agglutinating. The apparent ASTM rank of the coal is lignite A based on the moist, mineral matter-free gross calorific value of core sample assays.

**Table 18. Chandgana Tal Weighted Average S2 Coal Seam Quality**

Parameter	Short Proximate Analysis <sup>1</sup>			Total Sulphur (wt. %)
	Moisture (wt. %)	Ash (wt. %)	Heating Value (kcal/kg)	
	40.9	10.80	3,306	0.6

**Note:**

(1) As-received basis

*Drilling*

For the 2007 drilling, Landdrill International Inc. of Ulaanbaatar, Mongolia, was contracted to drill the holes and used a truck-mounted Longyear Model 44 rig. The procedure was to: (i) drill with a 132 mm (HWT) full face PDC bit and set conductor casing; (ii) drill the overburden to core point with a 96 mm (HQ) full face PDC bit using polymer as a medium; and (iii) core from core point to total depth with an HQ-3 core drilling string. Coring was done using HQ rods behind a 96 mm OD diamond core bit with inert polymer as a medium. Wireline coring methods were used with a sleeved 3 metre core barrel assembly. All drilling was done on a 24-hour schedule. The drilling method, drilling procedures, and size of core obtained is considered appropriate for the logistics of the area, goals of the drilling, and type of analyses desired.

The drill holes were distributed about the licenses. The drill holes penetrated nearly the full thickness of the upper member of the Zuunbayan Formation. The drill hole locations and elevations were obtained by ground survey methods using a theodolite.

Drill cuttings were collected at one metre intervals, described and the lithologic information logged onto forms. The drill core was described in white light and ultraviolet light, the information logged on forms at a scale of 3 cm=0.5 m, and the core photographed with a digital camera. The core information logged includes lithology, rock mechanics, and sampled intervals. Other information was noted during drilling and logging including water and gas encountered and unusual drilling conditions. After completion of the core logging, the core was sampled, placed in plastic sleeves, and the samples noted on the core log. The lithology and rock mechanics information are considered to be logged in acceptable detail.

After reaching total depth, the drill holes in the resource area were geophysically logged. Some of these were logged through the core rods if the hole was not stable. The logging suite included gamma, spontaneous potential, gamma-gamma density, single point resistivity, and caliper. Printed field copies at a scale of 1 cm=2 metres and LAS electronic files of the logs were provided to Red Hill.

Upon completion of logging the drill holes were plugged with bentonite chips and capped with 2 to 5 metres of cement. The conductor casing was pulled from some of the drill holes. A marker with drill hole identification information was placed in the top of the cement.

The 2011 drilling was performed by Best Drilling Inc. of Ulaanbaatar, Mongolia using a skid-mounted Longyear Model 44 rig. The drilling procedure was the same as that used in 2007. The drilling method, drilling procedures, and size of core obtained is considered appropriate for the logistics of the area, goals of the drilling, and type of analyses desired. Geologic data and samples were obtained using the same methods practised during the 2007 drilling. The lithology and rock mechanics information are considered to be logged in acceptable detail. Geophysical logging was performed similar to that performed in 2007 with the exception that spontaneous potential was not logged, otherwise natural gamma, gamma-gamma density, single point resistivity, and caliper were logged.

### *Summary and Interpretation of Results*

Accurate measurements of the depth and thickness of all the coal seams are now available and the closer spacing between drill holes allows all the coal seams to be correlated more reliably. The S4 Coal Seam is the stratigraphically lowest coal seam followed, in ascending order by the S3, S2, and S1 coal seams. The combined S2 Coal Seam is the thickest ranging from 15 to 50 metres thick and has the greatest areal extent. All the coal seams contain partings.

The attitude of the rocks and location of faulting is known better. The rocks gently dip to the southwest but the dip becomes nearly vertical at the reverse faults. The location of the northern fault is known more accurately.

### *Sampling and Analysis*

In planning the 2007 exploration, exposures in the nearby Chandgana Coal mine were considered. These exposures suggested that at least one of the coal seams should be very thick, low rank and dip at a low angle to the southeast. Thus, having a thick stratiform deposit and considering that the exploration is the first in the resource area, the approach used was to obtain samples that gave a reliable gross estimate of coal quality. To meet this goal, sampling was planned to: (i) obtain samples at widely spaced locations; (ii) sample the full thickness of the coal seam; (iii) determine the limit of weathered coal; and (iv) ensure the samples are representative of the grade and rank of the coal. The desire to obtain samples at widely spaced locations complimented the desire to place as much of the resource in the higher assurance-of-existence categories as possible.

Drilling and trenching were then considered most appropriate for obtaining samples. Large diameter HQ drill cores were obtained using a three metre core barrel. Only the S2 Coal Seam was cored because the

existence of the upper coal seams was not known. The full thickness of the S2 Coal Seam was cored where possible. Unfortunately, in some cases a portion of the top of the coal seam was rotary drilled before changing to the core drilling string because the structure of the coal seam was not known.

Trenching with an excavator was primarily done to locate the S2 Coal Seam subcrop, but secondarily to obtain samples to be assayed. The portion of the coal seam exposed in trenches were sampled. The representativeness of the trench samples was enhanced by obtaining large samples and placing the sample in plastic bags as soon as possible to preserve in-situ moisture.

The sampling of cores during the 2007 and 2011 drilling followed the same methods. Sampling was started and completed as soon as possible after lithologic descriptions and photographs were done. The sampling method followed that of ASTM D 5192 where practical. Sample treatment methods included rinsing the core of contaminants and allowing sufficient time for the free water to drain from the core to enhance sample representativeness. Sample preservation included placing the core in 6 mil plastic sleeves to minimize moisture loss then placement on wooden core boxes for protection. The samples were removed from the core tray in lengths up to one metre depending on the thickness of partings and the beginning and end of core runs.

#### *Security of Samples*

All the drill core and trench samples were prepared and assayed in accordance to ASTM, ISO, or AS procedures in the coal laboratories of SGS Mongolia, SGS Mineral Fuels and SGS Geochemical and Ores. Sample preservation, security and tracking was established and well maintained from the drill site to reporting of the results for the 2007 and 2011 drilling.

Sample security was ensured from the drill site to the assay report. A chain of custody form was completed by Mr. Robeck for the 2007 samples and by Prophecy's senior geologist for the 2011 samples that gives sufficient information to identify the samples and describes the analyses required. The chain of custody accompanied the samples during shipment from the drill site to the laboratory and was signed by all parties involved in the transport of the samples and SGS Mongolia upon receipt. All the samples were shipped under Red Hill or Prophecy control directly to SGS Mongolia. Upon delivery, the samples were jointly inventoried by a Prophecy representative and SGS staff before SGS signed for receipt of the samples. The signed sample chains of custody are on file at Prophecy's Ulaanbaatar office. SGS Mongolia then entered the sample information into their LIMS which generated unique laboratory identification numbers. Sample preparation and laboratory worksheets are then prepared by the LIMS to track each sample to the final report. The laboratory managers review the sample tracking while the samples are in process and review the final assay reports to ensure the correct sample identifying information accompanies the correct assays. No assay results were found to have been misidentified.

None of the samples were handled by Mr. Robeck, Mr. Kravits, or any contractors, employees, officers or directors of Red Hill or Prophecy after receipt by SGS and none of these parties were involved in preparation or assay of the samples.

#### *Data Verification*

Data was reviewed to verify that it represents the location, depth and/or other descriptive information of its source. The quality of the data was then assessed by a review for accuracy and errors. The methods used vary according to the type of data and were performed using practices common in the coal industry or the industry that produces such data.

The 2007 and 2011 assay data were verified by comparison of the descriptive information (drill hole number, depth interval, sample number, and lithology) and assay results accompanying the quality data to that of the same information on the core log and chain of custody and the recorded lithology. Transcribed data were reviewed twice for errors.

### *Future Exploration and Development*

Further exploration, analyses and tests are recommended to better understand the geology in the northern portion of the license, map depth of weathered coal, map the coal seams above the S2 Coal Seam and better characterize the quality and utilization characteristics of the coal.

The Chandgana Tal Property has been mined previously and occasionally during the Company's tenure to meet local demand. The Company decided not to mine during the 2016-2017 heating season because of insufficient demand.

A dry lake was determined by the Ministry of Environment to overlap onto one of the Chandgana Tal licenses as determined under the Long Named Law but the overlap was resolved without loss to the Company. The Khavtgai Uul Property has never been mined. The Ministry of Environment determined that a dry lake overlapped the Khavtgai Uul license as defined under the Long Named Law. This was resolved by removing the lake area from the license while not affecting the coal resource and mineability. The Company will continue to monitor the developments and ensure that it follows the necessary steps in the Amended Law on Implementation to secure its operations and licenses and is fully compliant with Mongolian law.

### **Project Risks and Mitigation**

The major risks to developing the Chandgana Tal project are mostly similar to those for Khavtgai Uul and include decrease in global and regional commodity demand or price, decrease in domestic demand or price, the inability to obtain financing, adverse political and social changes and technical risks. Global and regional commodity demand and price trends present an indirect risk to the project in that they influence domestic coal demand and prices. Domestic demand and price trends present a direct risk because government control to varying degrees of certain coal producers and consumers and support of prices and costs favor government-controlled entities and maintain lower prices. Four outside factors have recently decreased these demand and price trend risks. The recent global and regional increase in demand has nearly doubled the benchmark price of thermal and metallurgical coal. The new Mongolian government administration is continuing with privatization of state-owned entities as part of its program to transition to an open market economy. The new administration has stated that one of its goals is to improve and increase infrastructure, which includes electrical power generation capacity and reduction of imported electrical power. Finally, the domestic demand for electrical power currently exceeds generation capacity and is projected to exceed capacity into the future despite recent additions to capacity and in construction. Mitigation of decreases in domestic coal prices is by two sources. The characteristics of the deposit including a thick coal seam with few thin partings and low strip ratio, which Chandgana Tal is one of a very few in Mongolia to the best of the Company's knowledge, will make for a low mining cost. In addition, the Company intends to mine at the lowest cost possible by accessing local skilled staff, scheduling relative to seasonal weather patterns, adopting best industry practices where practical, and use of other management and operational policies. The inability to obtain financing has largely been mitigated by the successful pursuit of equity investors and various forms of financing. Adverse political and social changes are considered to be much less of a risk now because the new administration has started to become much more supportive of mining and foreign investment by taking definite actions including effecting change in and passing new regulation addressing these areas. The Company also diligently promotes the project to national and local government leaders. There are technical risks which can be mitigated so that they do not become major hindrances or fatal flaws to the project. The available information suggests groundwater may hinder mining and so be a risk to the project. The Company considers this risk to be easily mitigated by a detailed hydrologic study and above pit and in pit dewatering and proper highwall design, as is commonly practiced at similar mines. The low competency and fracturing of the overburden rocks could reduce highwall stability and become a risk to the project. Mitigation can bring this risk to an acceptable level by a detailed geotechnical study and above pit dewatering and proper highwall design, as is done at similar mines.

## Activities During 2017

During 2017, activities for the Chandgana Tal project included payment of license fees and environmental sampling and reporting. No exploration was completed on the Chandgana Tal licenses. The Company assessed the local market for coal and found there was not sufficient demand to warrant mining during the 2017-2018 heating season. Thus, the annual mining and environmental plans were not filed.

## Planned Activities

For the Chandgana Tal project, the Company intends to discuss the need to update the detailed environmental impact assessment (“DEIA”) and mining feasibility study with the relevant ministries.

## Impairment Analysis

During the year ended December 31, 2017, the Company determined there were several indicators of potential impairment of the carrying value of the Chandgana Properties including the Chandgana Power Plant Project application. The indicators of potential impairment were as follows:

- (a) decreased coal demand from local customers;
- (b) no positive decision from the Mongolian Government to construct the Chandgana Power Plant Project;
- (c) no further exploration for evaluation in the area planned; and
- (d) change in the Company’s primary business focus to the Gibellini Project.

As result, in accordance with *IFRS 6, Exploration for and Evaluation of Mineral Resources* and *IAS 36, Impairment of Assets*, at December 31, 2017, the Company assessed the recoverable amount of the Chandgana Project deferred exploration costs and determined that its value in use is \$nil. As at December 31, 2017, the recoverable amount of \$nil resulted in an impairment charge of \$14,733,067 against the value of the deferred exploration costs, which was reflected on the consolidated statement of operations.

## 5.6 Chandgana Power Plant Project

The Company is developing the coal-fired Chandgana Power Plant Project which includes the building of a 600 MW (4X150 MW) coal fired mine-mouth power plant, Chandgana coal mine and transmission lines. The power plant will be built in two phases. Phase one is proposed to be 300 MW (2 x 150MW) and phase two is proposed to be 300 MW (2 x 150MW). The location is 300 km east of the capital city Ulaanbaatar and 55 km west of Undurkhaan city (Figure 13). The proposed power plant will be situated on a land use right located north and adjacent to the Chandgana Tal licenses in Murun Soum, Khentii Province in Central Mongolia (Figure 11) at an average elevation of 1,250 m. The available infrastructure is good with paved highway bordering the site, a rail terminal 155 km west, and communications.

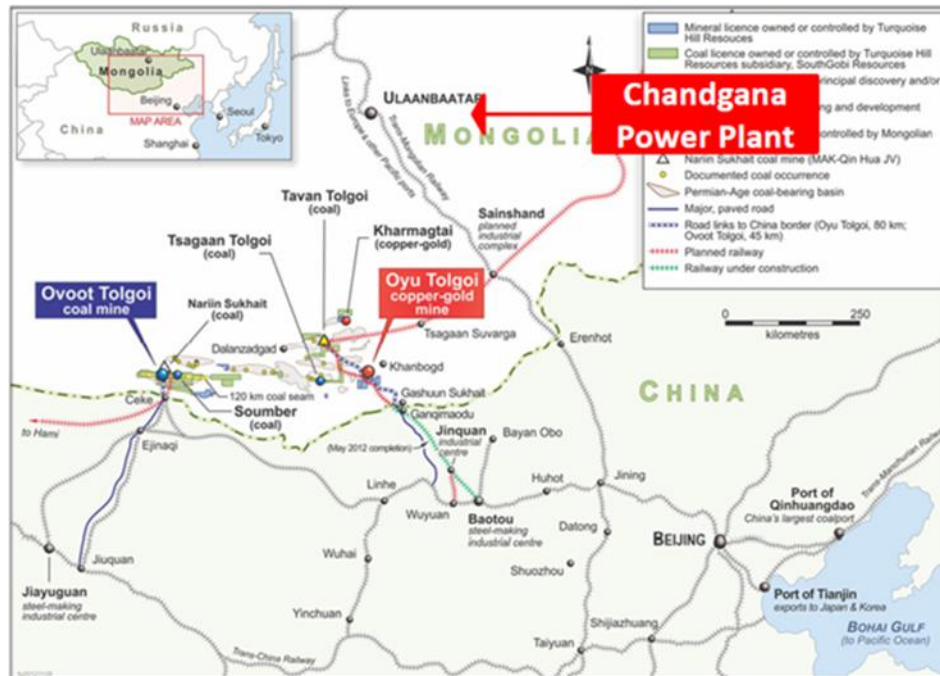


Figure 13

In November 2010, the Company received a DEIA pertaining to the construction of a pit-mouth 600MW coal fired power plant on the Chandgana Tal Property, which DEIA has been approved by the Mongolian Ministry of Nature and the Environment. The DEIA was prepared for Prophecy by an independent Mongolian environmental consulting firm. The DEIA considers social and labour issues, climate and environmental circumstances representative of the proposed power plant. The approved study concluded that there are no major impediments to the project and provided recommendations on best practices for conservation of the environment and the community.

In February 2011, Prophecy received the full mining license from the Mineral Resources Authority of Mongolia for the Chandgana Tal Property. On November 21, 2011, the Company's wholly-owned Mongolian subsidiary, Prophecy Power Generation LLC ("**Prophecy Power**", and formerly East Energy Development LLC), received a construction license from the Mongolian Energy Regulatory Authority to construct a 600 MW power plant at Chandgana Tal. In May 2012, the Company entered into a Cooperation Covenant Agreement with the Mongolian Energy Regulatory Authority to bring the Chandgana Power Plant Project online by 2016. Prophecy engaged Leighton Asia LLC to prepare a scoping level mine study for the Chandgana Tal Property which was completed in December 2011. Prophecy has also received a mining permit to mine coal on the licenses and can receive approval of a modification to mine up to 3.5 million tonnes per year within approximately 90 days.

In March 2013, Prophecy Power was granted 532.4 hectares of land (land use right) to be used for siting the proposed Chandgana Power Plant Project. A news release issued by Prophecy on March 5, 2013 provides further information and can be found under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) or posted on the Company's website.

Prophecy has been in on-going discussions with the Mongolian government to finalize a Power Purchase Agreement ("**PPA**") that will enable Prophecy to seek project financing and begin construction. Prophecy has also had discussions with the Ministry of Natural Resources and Energy ("**NETGCO**") (now Ministry of Energy) to discuss technical and commercial issues. On September 6, 2012, Prophecy Power formally submitted its PPA proposal to NETGCO. The proposed PPA details the terms under which Prophecy Power would be prepared to supply power to NETGCO. In May 2013, the Company received official correspondence from the NETGCO outlining the terms of a Tariff Agreement, as described above in the PPA, reached between the NETGCO and Prophecy Power. A news release issued by Prophecy on May

17, 2013 provides further information and can be found under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) or posted on the Company's website.

On June 5, 2013, Prophecy Power and Chandgana Coal executed a Coal Supply Agreement. The Coal Supply Agreement calls for Chandgana Coal to supply 3.6 million tonnes of coal per year to Prophecy Power for 25 years. The initial coal price is USD17.70 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.

In July 2013, the Company applied for a concession with the Ministry of Economic Development (the "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 the MOED, or the PPA with the Ministry of Energy.

In February 2014, the Chandgana Power Plant Project was approved by the Mongolian Government under amendment to Resolution #317 to be included in the list of concession projects. Prophecy met numerous times with the MOED in 2014 to discuss the Chandgana Power Plant Project Concession Agreement, with the issue centered on whether a public tender is required or whether the project can be qualified under the direct negotiation frame work given that Prophecy Power is already in possession of several unique non-transferrable essential elements to the project such as construction license and land use rights. In June 2014, the MOED announced a tender for the Chandgana Power Plant Project and the Baganuur to Ondurkhan to Choibalsan Overhead Transmission Lines project with the projects' technical and financial proposal submission deadline set of August 20, 2014. The Company submitted the projects' technical and financial proposals to the MOED on August 20, 2014. The Chandgana Power Plant Project tender concluded in September 2014, with no winning bid because no bidder submitted the required USD1.6 million bank guarantee.

In October 2014, Prophecy Power received an official invitation letter (#7/2055) from the MOED to directly negotiate the conditions of the Chandgana Power Plant Project Concession Agreement on an exclusive basis under the Mongolian Concession Law Article 15. Upon request by the MOED, Prophecy Power submitted a full set of revised agreements (key ones including): a Feasibility Study, Concession Agreement, PPA, Tariff Proposal, Coal Supply Agreement, EPC Proposal, EPC Contract, Bank Term Sheet, Equity Investor MOUs, Land Use Permit) totaling well over 1,000 pages for review.

In December 2014, with a new Mongolian Government in place, the Concession department was transferred from the MOED to the Ministry of Industry. In late January 2015, Prophecy Power representatives met with the Minister of Industry, who committed to fast-track a list of advanced and qualified concession projects to signing of Concession Agreements, including one for the Chandgana Power Plant Project, in the coming Spring session.

Any power plant development would be subject to large financing requirements (in the magnitude of an estimated USD800 million) as well as technical studies to confirm the technical and economic feasibility of a power plant supplied by Chandgana Tal coal to produce the power and secure a long-term power purchase contract for the plant's electrical power output.

In February 2015, PPG was notified that a working group was appointed to work on the power concession projects. During the year, the Company met with the government appointed working group and revised the Concession Agreement following their recommendations. Discussions with investors continued including discussions for funding of some required studies.



On December 18, 2015, the Company signed an EPC Agreement, Equity Investment Agreement, and Share Purchase Agreement with SEPCO2 to invest in, and build the Chandgana Power Plant Project.

#### *EPC Agreement*

The EPC Agreement is the result of over one year of investigative and research work conducted by both the Company and SEPCO2 according to the set of detailed Owner's Technical Specifications & Requirements considering operating variables such as: coal quality and supply, operating temperatures, auxiliary heat consumption, water consumption, environmental limits and power output, and incorporated detailed cost and performance optimization considerations including shortest transportation routes by most cost-effective transportation carrier, and offers from insurance providers and local construction material and fuel suppliers.

#### *Share Purchase Agreement and Equity Investment Agreement*

The Company has agreed to transfer Common shares representing a 5% ownership interest in the capital of PPG (the "**Subject Shares**") to SEPCO2, in consideration for SEPCO2 preparing and delivering any remaining engineering or design studies required by either the Mongolian government or investors to proceed to project financial close. Upon SEPCO2 acquiring the Subject Shares from Prophecy, SEPCO2 has agreed to contribute to the overall expenses of PPG based on SEPCO2's pro rata equity share interest. Such expenses may be offset against the fees payable by PPG to SEPCO2 in relation to the Chandgana Power Plant Project under any EPC Services Agreement entered into by PPG or Prophecy and SEPCO2 or its affiliates or associates. Conditions precedent to the Equity Investment Agreement and Share Purchase Agreement include the parties having obtained all necessary prior approval of relevant authorities.

#### *Project Financing and Financial Close*

The total capital investment necessary to complete the Chandgana Power Plant Project is expected to be approximately USD1 billion. The proposed investment for Phase 1 (150MW x2) is estimated to be USD600 million. Phase 1 is to be completed within 3 years from the start of construction.

SEPCO2 has extensive international project financing experience for power plant projects in developing countries in the Middle East and Africa, and has expressed confidence in arranging debt financing for the Chandgana Power Plant Project. In 2014, SEPCO2 provided Prophecy with a bank financing term sheet for the project which needs to be renewed for 2016, based on a 12-year term with 85% of the total value of the EPC Agreement advanced at the London Interbank Offered Rate (LIBOR) + 5%.

In parallel, the Company expects to partner with the overseas investment subsidiary of the world's largest coal-fired power generation group (the "**Strategic Partner**") to jointly invest in the Chandgana Power Plant Project. In May 2015, the Strategic Partner signed an Exclusivity Agreement with Prophecy whereby the Strategic Partner agreed to focus its development and construction activities in Mongolia solely on the Chandgana Power Plant Project for the remainder of 2015.

On December 22, 2015, the Company announced the signing of a non-binding Joint Development Agreement with the Strategic Partner to invest in the Chandgana Power Plant Project. Under the Joint Development Agreement, the companies will create a consortium, whereby the Strategic Partner will provide legal, financial and technical experts to assist the Company to negotiate and finalize the Concession Agreement ("**CA**"), PPA and Tariff Agreement with the relevant Mongolian Ministries and Agencies. Upon satisfactorily completing these agreements, the Parties intend to enter into an investment arrangement that will result in the Strategic Partner owning a minimum 51% stake in the Chandgana Power Plant Project.

## **Project Risks and Mitigation**

The major risks to developing the Chandgana Power Plant Project include control or decrease in domestic price, the inability to obtain financing, adverse political and social changes and technical risks. Control or decrease in price present a direct risk because government control to varying degrees of certain power plants and support of prices and costs tend to maintain lower prices. Outside factors have recently decreased these demand and price trend risks. The new Mongolian government administration is continuing with privatisation of state-owned entities as part of its program to transition to an open market economy. The domestic demand for electrical power has leveled somewhat yet still exceed generation capacity and is projected to exceed capacity into the future despite new capacity recently brought on line and in construction. The inability to obtain financing has largely been mitigated by the successful pursuit of equity investors and various forms of financing. Adverse political and social changes are considered to be much less of a risk now because the new administration has started to become much more supportive of foreign investment by taking definite actions including effecting change in and passing new regulation addressing this. The Company also diligently promotes the project to national and local government leaders. There are technical risks which can be mitigated so that they do not become major hindrances or fatal flaws to the project. Operation of a coal-fired thermal electrical generation plant can be difficult in a cold arid environment. This has been mitigated by a power plant design that uses insulated air cooled condensers to control the cooling rate, sourcing water from the adjacent open pit mine, and a closed water system to maximise water use.

During 2016, activities by the Company included land use right maintenance, continued pursuit to conclude the remaining agreements and continued pursuit of financing. The land use right fee was paid to maintain the Company's tenure. Concerning the remaining required agreements, in light of the government's new development plan, Company officials met with several officials of the newly-elected government and submitted documents, including its development and investment proposal with a letter requesting that the Chandgana Power Plant Project be included in the 2016-2020 strategy plan of the Ministry of Energy. Also, several meetings were held with government officials and negotiations concluded to develop a strategy and put it in place to push the Chandgana Power Plant Project and to expedite negotiations for the Concession and Power Purchase Agreements. Prophecy continued engaging in discussions with large-scale Asian strategic power producers who have expressed interest in investing in the Chandgana Power Plant Project. The Company started work to renew the power plant DEIA and to renew the power plant construction license.

### **Activities During 2017**

During 2017, discussions with Mongolian authorities on the PPA and other documents related to the Chandgana Power Plant Project continued. Other activity included discussions with potential financial partners in the Chandgana Power Plant Project and renewal of the DEIA for the power plant and the construction license. However, negotiation with the government to discuss the conditions for a Concession Agreement have been delayed because of the government's recent policy to limit implementation of coal-fired energy projects due to the deterioration in Mongolia's economic situation and period of reduction in energy consumption growth since 2015.

### **Planned Activities**

For 2018, the Company intends to continue with its 2017 activities. The Company also plans discussion with the relevant ministries concerning renewal of the DEIA and power plant construction license during 2018.

## **6. RISK FACTORS**

The Company is in the business of acquiring, exploring and developing mineral properties, and is exposed to a number of risks and uncertainties, including but not limited to, those listed below that are common to

other junior mineral exploration and development companies in the same business.

### **History of Net Losses; No Foreseeable Positive Cash Flow**

The Company has not received any material revenue or net profit to date from the exploitation activities on its Ulaan Ovoo Property. Exploration and development of mineral properties requires large amounts of capital and usually results in accounting losses for many years before profitability is achieved, if ever. The Company has incurred losses and negative operating cash flow during its most recently completed financial year and for the current financial year to date. The Company believes that commercial mining activity is warranted on its Gibellini and Pulacayo Projects and its Ulaan Ovoo Property. Activities to prepare the Chandgana Power Plant Project for commercial operation are warranted which if started, would later warrant commercial activity of the Chandgana Tal mine. Even if the Company undertakes further development activity on any of its properties, there is no certainty that the Company will produce revenue, operate profitably or provide a return on investment in the future.

The exploration of the Company's properties depends on the Company's ability to obtain additional required financing. There is no assurance that the Company will be successful in obtaining the required financing, which could cause it to postpone its exploration plans or result in the loss or substantial dilution of its interest in its properties.

### **Exploration, Development and Production Risks**

The exploration for and development of minerals involves significant risks, which even a combination of careful evaluation, experience and knowledge may not eliminate. Few properties which are explored are ultimately developed into producing mines. There can be no guarantee that the estimates of quantities and qualities of minerals disclosed will be economically recoverable. With all mining operations there is uncertainty and, therefore, risk associated with operating parameters and costs resulting from the scaling up of extraction methods tested in pilot conditions. Mineral exploration is speculative in nature and there can be no assurance that any minerals discovered will result in an increase in the Company's resource base.

The Company's operations are subject to all of the hazards and risks normally encountered in the exploration, development and production of minerals. These include unusual and unexpected geological formations, rock falls, seismic activity, flooding and other conditions involved in the extraction of material, any of which could result in damage to, or destruction of, mines and other producing facilities, damage to life or property, environmental damage and possible legal liability. Although precautions to minimize risk will be taken, operations are subject to hazards that may result in environmental pollution and consequent liability that could have a material adverse impact on the business, operations and financial performance of the Company.

Substantial expenditures are required to establish ore reserves through drilling, to develop metallurgical processes to extract the metal from the ore and, in the case of new properties, to develop the mining and processing facilities and infrastructure at any site chosen for mining. Although substantial benefits may be derived from the discovery of a major mineralized deposit, no assurance can be given that minerals will be discovered in sufficient quantities to justify commercial operations or that funds required for development can be obtained on a timely basis. The economics of developing vanadium, silver, coal and other mineral properties is affected by many factors including the cost of operations, variations in the grade of ore mined, fluctuations in metal markets, costs of processing equipment and such other factors as government regulations, including regulations relating to royalties, allowable production, importing and exporting of minerals and environmental protection. The remoteness and restrictions on access of properties in which Prophecy has an interest will have an adverse effect on profitability as a result of higher infrastructure costs. There are also physical risks to the exploration personnel working in the terrain in which Prophecy's properties are located, often in poor climate conditions.

The long-term commercial success of Prophecy depends on its ability to find, acquire, develop and commercially produce vanadium, silver, coal and other minerals. No assurance can be given that Prophecy

will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Prophecy may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

### **No History of Profitable Mineral Production**

The Company has no history of profitably commercially producing coal or metals from its mineral exploration properties and there can be no assurance that it will successfully establish mining operations or profitably produce coal or base or precious metals.

None of the Company's properties, other than the Ulaan Ovoo Property, are currently under development. The future development of any property found to be economically feasible will require the construction and operation of mines, processing plants and related infrastructure. As a result, the Company is subject to all of the risks associated with establishing new mining operations and business enterprises, including:

- the timing and cost of the construction of mining and processing facilities;
- the availability and costs of skilled labour and mining equipment;
- the availability and cost of appropriate smelting and/or refining arrangements;
- the need to obtain necessary environmental and other governmental approvals and permits and the timing of those approvals and permits; and
- the availability of funds to finance construction and development activities.

The costs, timing and complexities of mine construction and development are increased by the remote location of the Company's mining properties. It is common in new mining operations to experience unexpected problems and delays during development, construction and mine start-up. In addition, delays in the commencement of mineral production often occur. Accordingly, there are no assurances that the Company's activities will successfully establish mining operations, result in profitable operations or that coal or metals will be produced at any of its properties.

### **Commencing Mine Development Activities without a Feasibility Study**

The Company commenced mining development activities on the Ulaan Ovoo Property without having completed a feasibility study on the Ulaan Ovoo Property. There are certain risks and uncertainties associated with commencing production without a feasibility study. The property may lack some information concerning geological, engineering, legal, operating, economic, social, environmental, and other relevant factors which may be required to serve as a reasonable basis for a financial institution to finance the development of the deposit for mineral production. Additionally, the outcome of the feasibility study may not be positive or optimal for the production scale being initiated.

### **Mineral Resources and Reserves**

Apart from the Ulaan Ovoo and the Pulacayo Project properties, all of the properties in which the Company holds an interest are considered to be in the exploration or development stage only and do not contain a known body of commercial minerals. The figures for the Company's resources and reserves are estimates based on interpretation and assumptions and may yield less mineral production under actual operating conditions than is currently estimated. Unless otherwise indicated, mineralization figures presented in this AIF and in the Company's other filings with securities regulatory authorities, press releases and other public statements that may be made from time to time are based upon estimates made by the Company's personnel and independent geologists. These estimates may be imprecise because they are based upon geological and engineering interpretation and statistical inferences drawn from drilling and sample analysis, stated operating conditions, and mineral processing tests, which may prove to be unreliable. There can be no assurance that:

- these estimates will be accurate;
- resource or other mineralization figures will be accurate; or
- the resource or mineralization could be mined or processed profitably.

Because the Company has not commenced production at any of its properties, other than Ulaan Ovoo, and has not defined or delineated any proven or probable reserves on any of its properties, other than Ulaan Ovoo and Pulacayo, mineralization estimates for Prophecy's properties may require adjustments including possible downward revisions based upon further exploration or development work, actual production experience, or current costs and sales prices. In addition, the quality of coal or grade of ore ultimately mined, if any, may differ from that indicated by drilling and beneficiation testing results. There can be no assurance that the type and amount of minerals recovered in laboratory analyses and small-scale beneficiation tests will be duplicated in large-scale tests under on-site conditions or in production scale.

The resource and reserve estimates contained in this AIF and in the documents incorporated herein by reference have been determined and valued based on assumed future prices, cut-off grades and operating costs that may prove to be inaccurate. Extended declines in market prices for vanadium, silver, other metals or coal may render portions of Prophecy's mineralization uneconomic and result in reduced reported mineralization. Any material reductions in estimates of mineralization, or of Prophecy's ability to extract this mineralization, could have a material adverse effect on Prophecy's results of operations or financial condition.

The Company had only established the presence of proven or probable reserves at its Ulaan Ovoo and Pulacayo Project properties. There can be no assurance that subsequent testing or future studies will establish proven or probable reserves at any of Prophecy's other properties. The failure to establish proven or probable reserves could restrict Prophecy's ability to successfully implement its strategies for long-term growth.

### **Capital Costs, Operating Costs, Production and Economic Returns**

Actual capital costs, operating costs, production and economic returns may differ significantly from those the Company has anticipated and there are no assurances that any future development activities will result in profitable mining operations. The capital costs required to take the Company's projects into production may be significantly higher than anticipated.

None of the Company's mineral properties, including the Ulaan Ovoo Property, have sufficient operating history upon which the Company can base estimates of future operating costs. Any potential decisions about the possible development of these and other mineral properties would ultimately be based upon feasibility studies which may, or may not be undertaken. Feasibility studies derive estimates of cash operating costs based upon, among other things:

- anticipated tonnage, grades and metallurgical characteristics of the ore or quality of the coal to be mined and/or processed;
- anticipated recovery rates of metals from the ore;
- cash operating costs of comparable facilities and equipment; and
- anticipated climatic conditions.

Cash operating costs, production and economic returns, and other estimates contained in studies or estimates, if prepared or the Company, may differ significantly from those anticipated by the Company's

current studies and estimates, and there can be no assurance that Prophecy's actual operating costs will not be higher than currently anticipated.

### **Foreign Operations and Political Conditions**

Certain of the Company's current principal exploration properties are located in Bolivia and Mongolia. In these countries, their operations may be exposed to various levels of political, economic, and other risks and uncertainties. These risks and uncertainties include, but are not limited to political and bureaucratic corruption and uncertainty, terrorism; hostage taking; military repression; fluctuations in currency exchange rates; high rates of inflation; labour unrest; the risks of civil unrest; expropriation and nationalization; renegotiation or nullification of existing concessions, licenses, permits and contracts; illegal mining; changes in taxation policies; restrictions on foreign exchange and repatriation; and changing political conditions, currency controls, and governmental regulations that favour or require the awarding of contracts to local contractors, or require foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction.

Future political and economic conditions may result in a government adopting different policies with respect to foreign development and ownership of mineral resources. Any changes in policy may result in changes in laws affecting ownership of assets, foreign investment, taxation, rates of exchange, resource sales, environmental protection, labour relations, price controls, repatriation of income, and return of capital which may affect both the ability of the Company to undertake exploration and development activities in respect of future properties in the manner currently contemplated, as well as its ability to continue to explore, develop, and operate those properties to which it has rights relating to exploration, development, and operations.

### **Legal and Political Risk**

Any changes in regulations or shifts in political attitudes in Mongolia are beyond the control of the Company and may adversely affect its business, financial condition and prospects. The Mongolian legal system shares several of the qualitative characteristics typically found in a developing country and many of its laws, particularly with respect to matters of environment and taxation, are still evolving. A transaction or business structure that would likely be regarded under a more established legal system as appropriate and relatively straightforward might be regarded in Mongolia as outside the scope of existing Mongolian law, regulation or legal precedent. As the legal framework in Mongolia is in many instances based on recent political reforms or newly enacted legislation which may not be consistent with long-standing conventions and customs, certain business arrangements or structures and certain tax planning mechanisms may carry significant risks. In particular, when business objectives and practicalities dictate the use of arrangements and structures that, while not necessarily contrary to settled Mongolian law, are sufficiently novel within a Mongolian legal context, it is possible that such arrangements may be invalidated.

The legal system in Mongolia has inherent uncertainties that could limit the legal protections available to the Company, which include: (i) inconsistencies between laws; (ii) limited judicial and administrative guidance on interpreting Mongolian legislation; (iii) substantial gaps in the regulatory structure due to delay or absence of implementing regulations; (iv) the lack of established interpretations of new principles of Mongolian legislation, particularly those relating to business, corporate and securities laws; (v) a lack of judicial independence from political, social and commercial forces; and (vi) bankruptcy procedures that are not well developed and are subject to abuse. The Mongolian judicial system has relative little experience in enforcing the laws and regulations that currently exist, leading to a degree of uncertainty as to the outcome of any litigation, it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction.

In addition, while legislation has been enacted to protect private property against expropriation and nationalisation, due to the lack of experience in enforcing these provisions and political factors, these protections may not be enforced in the event of an attempted expropriation or nationalisation. Whether legitimate or not, expropriation or nationalisation of any of the Company's assets, or portions thereof, potentially without adequate or any compensation, could materially and adversely affect its business and

results of operations. In addition, there can be no assurance that neighbouring countries' political and economic policies in relation to Mongolia will not have adverse economic effects on the Company's business, including its ability to transport and sell its product and access construction labour, supplies and materials.

The Bolivian government adopted a new constitution (the "NCPE") in early 2009 which increased state control over key economic sectors, including mining. The NCPE provides that all minerals, among all natural resources, belong to the Bolivian people who are represented by the Government. Such entity is the only one capable of managing all minerals throughout the production chain. Consequently, only the Bolivian Central Government possesses the authority to grant mining rights. Bolivian President Evo Morales signed a new law increasing the state's expropriation powers over the mining sector: the Law of Mining Rights. It was specifically drafted to target mines deemed by the state as unproductive, inactive or idle. The Government has assigned responsibility for determining whether a concession is idle to the Vice Ministry of Regulation, Auditing and Mining Policy. Mining areas occupied by cooperatives or local groups will not be regarded as idle. There have been recent actions by the government of Bolivia to ease concerns of foreign exploration and mining investors. As reported in *Mining Journal*, "At a UK-Bolivia trade and investment forum in London this week, Félix César Navarro, minister of mining and metallurgy, talked of new safeguards for foreign investors looking to put cash into the country. New contracts governing exploration, mining and processing were currently going through Bolivia's congress that would give foreign investors the legal security they need to invest in the country, he said" (*report by Mining Journal June 10, 2016*). Company officials also met with Minister Navarro in March, October and November 2016. During the meeting in March at the 2016 PDAC convention, Minister Navarro expressed his full support for the start-up and development of the Pulacayo mine. During the October 9 meeting, Minister Navarro stated that "the aim of the recent mining regulation is to support the investors and ensure the inclusion of cooperative labour in their projects". At the November 9 meeting, Minister Navarro stated: "Both, public and private mining sectors will try to attract foreign investment disclosing and sharing their experience with investors from several parts of the world." The Company also assisted in coordinating and preparing for his participation in the 2017 PDAC convention. The reader is referred to Prophecy's news release dated November 10, 2016, filed under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com) and posted on the Company's website, for more information. The Company considers its investment in the Pulacayo Project to be safe. However, the Company cannot provide any assurance that its operations at the Pulacayo Project will not be affected by changes in the political environment of Bolivia.

### **Local Laws**

Recent and future amendments to Mongolian laws could adversely affect the Company's mining rights in the Ulaan Ovoo Project or its other projects, or make it more difficult and/or expensive to develop such projects and carry out mining.

The Government of Mongolia has in the past, expressed its desire to foster, and has to date protected the development of, an enabling environment for foreign direct investment. However, there are political constituencies within Mongolia that have espoused ideas which would not be regarded by the international mining industry as conducive to foreign investment if they were to become law or official government policy. There can be no assurance that future political and economic conditions in Mongolia will not result in the Mongolian Government adopting different policies in relation to foreign development and ownership of mineral resources. Any such changes in government or policy may result in changes in laws affecting ownership of assets, environmental protection, labour relations, repatriation of income, return of capital, investment agreements, income tax laws, royalty regulation, government incentive and other areas, each of which may materially and adversely affect the Company's ability to undertake exploration and development activities in the manner currently contemplated.

In 2006, the Mongolian Government enacted a new minerals law. The 2006 Minerals Law, which preserves, to a limited extent, some of the substance of the former minerals legislation of 1997 minerals legislation, was drafted with the assistance of legal experts in the area of mining legislation and was widely regarded as progressive, internally consistent and effective legislation. However, the 2006 Minerals Law contains new provisions that have increased the potential for political interference and weakened the rights and

security of title holders of mineral tenures in Mongolia. Certain provisions of the 2006 Minerals Law are ambiguous and it is unclear how they will be interpreted and applied in practice. Examples of such provisions include those relating to the designation of a mineral deposit as a Mineral Deposit of Strategic Importance. The Mongolian Government could determine that any one or more of the Company's projects in Mongolia is a Mineral Deposit of Strategic Importance.

On July 16, 2009, Parliament enacted a new law (the "**Prohibition Law**") that prohibits minerals exploration and mining in areas such as headwaters of rivers and lakes, forest areas as defined in the Forest Law of Mongolia and areas adjacent to rivers and lakes as defined in the Law on Water of Mongolia. Pursuant to the Prohibition Law, the Mongolian government was instructed to define the boundaries of the areas in which exploration and mining would be prohibited. New exploration licenses and mining licenses overlapping the defined prohibited areas will not be granted and previously granted licenses that overlap the defined prohibited areas will be terminated within five months following the adoption of the law. The Prohibition Law provides that affected licence holders shall be compensated, but there are no specifics as to the way such compensation will be determined.

The MRAM has prepared a draft list of licenses that overlap with the prohibited areas described in the Prohibition Law. Six of the Company's exploration licenses included on MRAM's draft list of licenses may be included on the final list published by the Mongolian Government. This could potentially affect the status of those licenses. Specifically, on July 16, 2010, the Company received a notice from MRAM of the potential revocation of these licenses. However, on October 12, 2010, the Company received a further notice from MRAM invalidating its prior notice of potential revocation.

On November 18, 2010 the Mongolian Government announced its intention to initiate the revocation of licenses under the Prohibition Law on a staged basis, beginning with the revocation of 254 mineral licenses. None of the licenses held by the Company is on this list.

Lastly, any restrictions imposed, or Mongolian Government charges levied or raised (including royalty fees), under Mongolian law for the export of coal could harm the Company's competitiveness.

In Bolivia, recent and anticipated changes to mining laws and policies and mining taxes, and expected changes in governmental regulation or governmental actions may adversely affect the Company. On May 28, 2014, Law 535 of Mining and Metallurgy (the "**New Mining Law**") was adopted and placed into effect. Pursuant to the New Mining Law, the Company must develop its mining activities to comply with the economic and social function, which means observing the sustainability of the mining activities, work creation, respecting the rights of its mining workers, and ensuring the payment of mining patents and the continuity of existing activities.

The Framework Law on Mother Earth and Integral Development for Living Well, in effect since October 15, 2012, prioritizes the importance of nature to the Bolivian people and could have significant consequences to the country's mining industry. This law established 11 new rights for "mother earth" including the right to life and to exist; the right to continue vital cycle and processes free from human alteration; the right to pure water and clean air; the right to balance; the right not to be polluted; and the right to not have cellular structure modified or genetically altered. At present, it is unclear how this new law will affect exploration companies with projects in the area or how the law will be enforced.

In the past, the Government of Bolivia has nationalized the assets of certain companies in various industries

### **Permits and Licenses**

The Company's activities are subject to government approvals, various laws governing prospecting, development, land resumptions, production taxes, labour standards and occupational health, mine safety, toxic substances and other matters, including issues affecting local native populations. Although the Company believes that its activities are currently carried out in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail production or development.



Amendments to current laws and regulations governing operations and activities of exploration and mining, or more stringent implementation thereof, could have a material adverse impact on the business, operations and financial performance of the Company. Further, the mining licenses and permits issued in respect of its projects may be subject to conditions which, if not satisfied, may lead to the revocation of such licenses. In the event of revocation, the value of the Company's investments in such projects may decline.

In the United States, the tenures are in the form of claims where exploration and development rights are retained so long as annual maintenance fees are paid and certain forms filed. The maintenance fees may be substantial with a large number of claims and the fees are adjusted periodically. Diligent periodic assessment of the resource and development value of claims by the claimant is required.

In Mongolia, the Company's exploration licences are subject to periodic renewal and may only be renewed a limited number of times for a limited period of time. While the Company anticipates that renewals will be issued as and when they are sought, there is no assurance that such renewals will be given as a matter of course and there is no assurance that new conditions will not be imposed in connection therewith. The Company's business objectives may also be impeded by the costs of holding and/or renewing the exploration licences in Mongolia. Licence fees for exploration licences increase substantially upon the passage of time from the original issuance of each individual exploration licence. The Company needs to assess continually the mineral potential of each exploration licence, particularly at the time of renewal, to determine if the costs of maintaining the exploration licences are justified by the exploration results to date, and may elect to let some of its exploration licences lapse.

Furthermore, the Company will require mining licences and permits to mine in order to conduct mining operations in Mongolia. There can be no assurance; however, that such licences and permits will be obtained on terms favourable to it or at all for the Company's future intended mining and/or exploration targets in Mongolia.

In Bolivia, the New Mining Law introduced a more protectionist approach to the management of natural resources, particularly to the use of surface and land. The New Mining Law can be summarized as the transition from a concession system to a contract-based system. Under the New Mining Law, participants are granted mining rights through mining contracts. These contracts provide participants with the right to perform any of the recognised activities within the industry, but only for a limited period of time and without granting any sort of ownership rights over surface or land.

In addition to the execution of mining contracts, the New Mining Law provides that participants may be granted a special license. The main difference between executing a mining contract and obtaining a licence is that in the first case a participant may be granted rights to perform all activities within the productive chain, whereas in the second case they are only granted the right to perform one of such activities. These recent and anticipated changes to mining laws and policies may adversely affect the Company.

### **Chandgana Power Plant Project Challenges**

The Company has been in discussions with the Mongolian government to finalize the PPA that will enable the Company to seek project financing and begin construction of a power plant at Chandgana. The Company has also had discussions with other Mongolian ministries concerning technical and commercial issues relating to the Chandgana Power Plant Project. On September 6, 2012, Prophecy Power, formally submitted its PPA proposal to NETGCO. The proposed PPA details the terms under which Prophecy Power would be prepared to supply power to NETGCO.

In addition to entering into a PAA and obtaining all required licences and permits for the construction and operation of the Chandgana Power Plant Project, any power plant development would be subject to large financing requirements (in the magnitude of an estimated USD1 billion) as well as technical studies to confirm the technical and economic feasibility of a power plant supplied by Chandgana Tal coal to produce the power and secure a long-term power purchase contract for the proposed plant's electrical power output. There can be no assurance that such financing can be obtained on favourable terms or at all, or that such technical studies will yield positive results. Prophecy also does not have experience constructing or

operating coal fired power plants or qualified personnel to do so, and will have to employ such personnel or rely on contractors or potential partners to supply such expertise.

### **Title to Mineral Properties**

Title to mineral properties, as well as the location of boundaries on the grounds may be disputed. Moreover, additional amounts may be required to be paid to surface right owners in connection with any mining development. At all of such properties where there are current or planned exploration activities, the Company believes that it has either contractual, statutory, or common law rights to make such use of the surface as is reasonably necessary in connection with those activities. Although the Company believes it has taken reasonable measures to ensure proper title to its properties, there is no guarantee that title to its properties will not be challenged or impaired. Successful challenges to the title of the Company's properties could impair the development of operations on those properties.

### **Environmental Risks**

All phases of the mining business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions, and state and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills and releases or emissions of various substances produced in association with mining operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. Environmental assessments of proposed projects carry a heightened degree of responsibility for companies and directors, officers and employees. The cost of compliance with changes in governmental regulations has a potential to reduce the profitability of operations.

Failure to comply with applicable laws, regulations, and permitting requirements may result in enforcement actions thereunder, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in mining operations may be required to compensate those suffering loss or damage by reason of the mining activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations and, in particular, environmental laws.

Amendments to current laws, regulations and permits governing operations and activities of mining companies, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in capital expenditures, production costs or reduction in levels of production at producing properties, or require abandonment or delays in the development of new mining properties.

### **Competition**

The mining industry in general is intensely competitive and there is no assurance that, even if commercial quantities of ore are discovered, a ready market will exist for the sale of same. Marketability of natural resources which may be discovered by the Company will be affected by numerous factors beyond its control, such as market fluctuations, the proximity and capacity of natural resource markets and processing equipment, government regulations including regulations relating to prices, royalties, land tenure, land use, importing and exporting of minerals and environmental protection. The exact effect of such factors cannot be predicted but they may result in the Company not receiving an adequate return on its capital.

### **Lack of Infrastructure**

The Company has projects located in remote areas which currently lack or do not have sufficient basic infrastructure, including sources of electric power, water, housing, food and transport necessary to develop

and operate a major mining project. Infrastructure is at or within 7 miles of the Gibellini Project. While the Company has established limited infrastructure necessary to conduct its exploration and development activities at the Ulaan Ovoo Mine, infrastructure is not fully established. Most infrastructure must be developed for the Chandgana Project in Mongolia. For the Pulacayo Project most infrastructure is in place. Lack of availability of the means and inputs necessary to establish such infrastructure may adversely affect mining feasibility. Establishing such infrastructure will, in any event, require significant financing, identification of adequate sources of raw materials and supplies and necessary approvals from national and regional governments.

### **Key Personnel**

The Company depends on a number of key personnel, including its directors and executive officers, the loss of any one of whom could have an adverse effect on the Company's operations. The Company has employment and consulting contracts with several key personnel and does not have key man life insurance.

The Company's ability to manage growth effectively will require it to continue to implement and improve management systems and to recruit and train new employees. The Company cannot assure that it will be successful in attracting and retaining skilled and experienced personnel.

### **Uninsured Risks**

The Company's business is subject to a number of risks and hazards, including adverse environmental conditions, industrial accidents, labour disputes, unusual or unexpected geological conditions, ground or slope failures, cave-ins, changes in the regulatory environment and natural phenomena such as inclement weather conditions, floods and earthquakes. Such occurrences could result in damage to mineral properties or production facilities, personal injury or death, environmental damage to the Company's properties or the properties of others, delays in development or mining, monetary losses and possible legal liability.

Although the Company maintains insurance to protect against certain risks in amounts that it considers reasonable, its insurance will not cover all the potential risks associated with its operations. The Company may also be unable to maintain insurance to cover these risks at economically feasible premiums. Insurance coverage may not continue to be available or may not be adequate to cover any resulting liability. Moreover, insurance against risks such as environmental pollution or other hazards as a result of exploration and production is not generally available to the Company or to other companies in the mining industry on acceptable terms. The Company may also become subject to liability for pollution or other hazards which may not be insured against or which the Company may elect not to insure against because of premium costs or other reasons. Losses from these events may cause the Company to incur significant costs that could have a material adverse effect upon its financial performance, results of operations and business outlook.

### **Fluctuating Market Prices**

The Company's revenues, if any, are expected to be in large part derived from the mining and sale of coal, silver and other minerals. The prices of those commodities has fluctuated widely, particularly in recent years, and are affected by numerous factors beyond the Company's control including international economic and political trends, expectations of inflation, currency exchange fluctuations, interest rates, global or regional consumption patterns, speculative activities and increased production due to new mine developments and improved mining and production methods.

The price of coal and silver may have a significant influence on the market price of the Shares and the value of the Company's mineral properties. Mineral prices fluctuate widely and are affected by numerous factors beyond the control of the Company. The level of interest rates, the rate of inflation, the world supply of mineral commodities and the stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns, monetary systems and political developments. The price of mineral commodities has fluctuated widely in

recent years, and future price declines could cause commercial production to be impracticable, thereby having a material adverse effect on the Company's business, financial condition and result of operations.

### **Reliance on Contractors**

The Company will be heavily reliant upon its contractors during the development of large scale projects. Companies are often measured and evaluated by the behaviour and performance of their representatives, including in large part their contractors. The Company works hard to build in controls and mechanisms to choose and retain employees and contractors with similar values as the Company; however, these controls may not always be effective. Sound judgment, safe work practices and ethical behaviour is expected from the Company's contractors both on and off-site. Any work disruptions, labour disputes, regulatory breach or irresponsible behaviour of the Company's contractors could reflect poorly on the Company and could lead to loss of social license, delays in production and schedule, unsafe work practices and accidents and reputational harm.

### **Additional Financing**

The Company estimates that its current financial resources are insufficient to undertake presently planned exploration and development programs. Further exploration on and development and construction of the Company's mineral properties may require additional capital. One source of future funds presently available to the Company is through the sale of equity capital. There is no assurance that this source will continue to be available as required or at all. If it is available, future equity financings may result in substantial dilution to shareholders. Another alternative for the financing of further exploration and/or development would be the offering by the Company of an interest in its mineral properties to be earned by another party or parties carrying out further exploration or development thereof. There can be no assurance that the Company will be able to conclude any such agreements on favourable terms or at all.

Any failure of the Company to obtain the required financing on acceptable terms could have a material adverse effect on the Company's financial condition, results of operations and liquidity and may require the Company to cancel or postpone planned capital investments.

### **Foreign Exchange**

Prophecy will transact business in a number of currencies including U.S., Bolivian and Mongolian currencies. Fluctuations in exchange rates may have a significant effect on the cash flows of the Company. Future changes in exchange rates could materially affect the Prophecy's results in either a positive or negative direction. Prophecy does not currently engage in foreign currency hedging activities.

### **Anti-Corruption Legislation**

Prophecy is subject to anti-corruption legislation including the *Corruption of Foreign Public Officials Act* (Canada) and other similar acts (collectively "**Anti-Corruption Legislation**"), which prohibit Prophecy or any officer, director, employee or agent of Prophecy or any stockholder of Prophecy acting on its behalf from paying, offering to pay or authorizing the payment of anything of value to any foreign government official, government staff member, political party or political candidate in an attempt to obtain or retain business or to otherwise influence a person working in an office capacity. The Anti-Corruption Legislation also requires public companies to make and keep books and records that accurately and fairly reflect their transactions and to devise and maintain an adequate system of internal accounting controls. Prophecy's international activities create the risk of unauthorized payments or offers of payments by its employees, consultants or agents, even though they may not always be subject to its control. The Company has policies and procedures in place that strictly prohibits these practices by its employees and agents. However, the Company's existing safeguards and any future improvements may prove to be less than effective, and its employees, consultants and agents may engage in conduct for which the Company may be held responsible. Any failure by the Company to adopt appropriate compliance procedures and to ensure that its employees and agents comply with Anti-Corruption Legislation and applicable laws and regulations in

foreign jurisdictions could result in substantial penalties or restrictions on its ability to conduct its business, which may have a material adverse impact of the Company or its share price.

### **Recent Global Financial Conditions**

Access to financing has been negatively impacted by many factors as a result of the global financial crisis. This may impact the Company's ability to obtain debt or equity financing in the future on terms favourable to the Company and its ability to attain strategic partnerships or enter into joint venture arrangements which may further negatively impact the timeline for commencement of commercial production. Additionally, global economic conditions may cause decreases in asset values that are deemed to be other than temporary, which may result in impairment losses. If such volatility and market turmoil continue, the Company's business and financial condition could be adversely impacted.

### **Dividends**

To date, the Company has not paid any dividends on its outstanding Shares and this is unlikely to occur in the foreseeable future. Any decision to pay dividends on the Prophecy Shares will be made by its Corporate Governance and Compensation Committee (the "CGCC") on the basis of its earnings, financial requirements and other conditions.

### **Insurance Against All Risks**

Prophecy's insurance will not cover all the potential risks associated with a mining company's operations. Prophecy may also be unable to maintain insurance to cover these risks at economically feasible premiums. Insurance coverage may not continue to be available or may not be adequate to cover any resulting liability. Moreover, insurance against risks such as environmental pollution or other hazards as a result of exploration and production is not generally available to Prophecy or to other companies in the mining industry on acceptable terms. Prophecy might also become subject to liability for pollution or other hazards which may not be insured against or which Prophecy may elect not to insure against because of premium costs or other reasons. Losses from these events may cause Prophecy to incur significant costs that could have a material adverse effect upon its financial condition and results of operations.

### **Conflicts of Interest**

Conflicts of interest may arise as a result of the directors, officers and promoters of the Company also holding positions as directors and/or officers of other companies. Some of those persons who will be directors and officers of the Company have and will continue to be engaged in the identification and evaluation of assets and businesses and companies on their own behalf and on behalf of other companies, and situations may arise where the directors and officers will be in direct competition with Prophecy. Such conflicts, if any, will be subject to the procedures and remedies under the BCBCA.

### **Information Systems and Cyber-Security**

The Company relies on information technology ("IT") systems and networks in its operations which are provided and maintained by third-party contractors. The availability, capacity, reliability and security of these IT systems could be subject to network disruptions caused by a variety of malicious sources, including computer viruses, security breaches, cyber-attacks and theft, as well as network and/or hardware disruptions resulting from unexpected failures such as human error, software or hardware defects, natural disasters, fire, flood or power loss. The Company's operations also depend on the timely maintenance, upgrade and replacement of networks, equipment, IT systems and software, as well as pre-emptive expenses to mitigate the risks of failures.

The ability of the IT function to support the Company's business in the event of any such failure and the ability to recover key systems from unexpected interruptions cannot be fully tested. There is a risk that if such an event were to occur, the Company's response may not be adequate to immediately address all of the potential repercussions of the incident. In the event of a disaster affecting the Company's head office,

key systems may be unavailable for a number of days, leading to inability to perform some business processes in a timely manner. The failure of Prophecy's IT systems or a component thereof could, depending on the nature, materially impact the Company's financial condition, results of operations, reputation and share price.

Unauthorized access to Prophecy's IT systems as a result of cyber-attacks could lead to exposure, corruption or loss of confidential information, and disruption to the Company's communications, operations, business activities or its competitive position. Further, disruption of critical IT services, or breaches of information security, could expose the Company to financial losses and regulatory or legal action. The Company's risk and exposure to these matters cannot be fully mitigated because of, among other things, the evolving nature of these threats. As a result, cyber-security and the continued development and enhancement of controls, processes and practices designed to protect systems, computers, software, data and networks from attack, damage or unauthorized access remain a priority.

The Company applies technical and process controls in line with industry-accepted standards to protect information, assets and systems. Although these measures are robust, they cannot possibly prevent all types of cyber-threat. There is no assurance that the Company will not suffer losses associated with cyber-security breaches in the future, and it may be required to expend significant additional resources to investigate, mitigate and remediate any potential vulnerabilities. As cyber-threats continue to evolve, the Company may be required to expend additional resources to continue to modify or enhance protective measures or to investigate and remediate any security vulnerabilities.

## 7. DIVIDENDS

The Company has not paid any dividends on its Shares and it is not contemplated that the Company will pay any dividends in the immediate or foreseeable future. It is the Company's intention to use all available cash flow to finance further operations and exploration of its resource properties. Holders of Prophecy Shares will be entitled to receive dividends, if, as and when declared by the Company's board of directors out of profits, capital or otherwise.

There are no restrictions that could prevent the Company from paying dividends on the Shares except that the Company may not pay dividends if that payment would render it insolvent.

## 8. DESCRIPTION OF CAPITAL STRUCTURE

### 8.1 General Description of Capital Structure

The authorized capital of Prophecy consists of an unlimited number of Shares without par value. As of the date of this AIF, there are 7,472,179 Prophecy Shares issued and outstanding. The holders of Prophecy Shares are entitled to vote at all meetings of shareholders of Prophecy, to receive dividends if, as and when declared by the Board and to participate rateably in any distribution of property or assets upon the liquidation, winding-up or other dissolution of Prophecy. The Shares carry no pre-emptive rights, conversion or exchange rights, redemption, retraction, repurchase, sinking fund or purchase fund provisions. There are no provisions requiring the holders of the Shares to contribute additional capital and there are no restrictions on the issuance of additional securities by Prophecy. There are no restrictions on the repurchase or redemption of the Shares by the Company except to the extent that any such repurchase or redemption would render Prophecy insolvent pursuant to the BCBCA.

As of the date hereof, the Company also has stock options ("**Options**") outstanding to purchase up to 844,834 Shares with each Option exercisable to purchase one Prophecy Share at exercise prices ranging from \$2 to \$13 and having expiry dates ranging from July 2018 to February 2023.

As of the date hereof, the Company has Share purchase warrants outstanding to purchase up to 2,620,203 Shares with each share purchase warrant exercisable to purchase one Prophecy Share at exercise prices ranging from \$4 to \$7 and having expiry dates ranging from May 2020 to June 2022.

## Share-Based Compensation Plan

The Company has adopted a 20% fixed share-based compensation plan, as amended (the “**Share-Based Compensation Plan**”). The purpose of the Share-Based Compensation Plan is to allow the Company to grant Options, bonus shares and stock appreciation rights (collectively, the “**Awards**”) to directors, officers, employees and consultants, as additional compensation, and as an opportunity to participate in the success of Prophecy. The granting of Awards is intended to align the interests of such persons with that of the Company’s Shareholders.

Options are exercisable for up to 10 years or as determined by the CGCC and are required to have exercise prices equal to or greater than the Market Price (as defined by the stock exchange on which the Shares are principally listed for trading and based on the volume weighted average trading price of the Shares as reported on such exchange for the five trading days immediately preceding the day that Options are granted). Any Options granted under the Share-Based Compensation Plan vest at 12.5% per quarter over a two-year period unless determined otherwise by the CGCC. In addition, the CGCC may accelerate the vesting date, permit the conditional exercise of Options, amend or modify the terms of the Options, or terminate Options.

Pursuant to the Share-Based Compensation Plan, the CGCC may from time to time authorize the issuance of Awards to directors, officers, employees and consultants of Prophecy or employees of companies providing management or consulting services to Prophecy. The maximum number of Shares which may be reserved for issuance under the Share-Based Compensation Plan is the equivalent of 1,077,849.

## 9. MARKET FOR SECURITIES

### 9.1 Trading Price and Volume

The Company’s Shares trade on the TSX under the symbol “PCY”. Prior to October 19, 2011, the Shares traded on the TSX Venture Exchange. The following table shows the high and low trading prices and average daily trading volume of the Shares of the Company on the TSX and for the periods listed in Table 19 below.

**Table 19. Recent Prophecy Share Price and Volume**

<b>Month</b>	<b>High (\$)</b>	<b>Low (\$)</b>	<b>Volume</b>
March 2018 <sup>(1)</sup>	3.40	2.50	245,802
February 2018	3.54	2.75	150,148
January 2018	4.39	3.30	213,953
December 2017	4.70	3.86	67,948
November 2017	4.95	4.40	68,112
October 2017	5.00	4.02	149,515
September 2017	4.36	3.40	307,274
August 2017	3.66	3.00	160,330
July 2017	3.26	2.75	76,838
June 2017	3.75	3.06	103,139
May 2017	3.53	2.99	91,571
April 2016	3.87	3.21	56,626
March 2017	4.99	3.50	126,155
February 2017	5.58	4.07	118,193
January 2017	7.19	4.10	187,045

**Note:**

(1) Up to and including March 29, 2018.

## 9.2 Prior Sales of Unlisted Securities

The Company has no class of securities that is outstanding but not listed or quoted on a market place.

## 9.3 Escrowed Securities

As of the date of this AIF, “nil” Shares of the Company are being held in escrow.

## 10. DIRECTORS AND OFFICERS

### 10.1 Name, Occupation and Security Holding

Table 20 sets forth the names and residencies of all directors and executive officers of the Company, the positions and offices with the Company held by such persons and their principal occupations. As of the date of this AIF, the directors and executive officers of the Company, as a group, beneficially own, or control or direct, directly or indirectly approximately 18.88% of the Shares.

**Table 20. Directors and Executive Officers Information**

<b>Name, Jurisdiction of Residence, Offices</b>	<b>Principal Occupation During Last Five Years<sup>(3)</sup></b>	<b>Director/Officer Since</b>	<b>Number of Common Shares Beneficially Owned, Controlled or Directed, Directly or Indirectly<sup>(5)</sup></b>
John Lee Taipei, Taiwan, Interim CEO, Executive Chairman and Director	President of Mau Capital Management LLC (private investor relations firm) from July, 2004 to present; CEO of Prophecy Development Corp. from October, 2009 to November, 2012; Interim CEO of Prophecy Development Corp. from November, 2012 to present; Chairman of Prophecy Development Corp. from June, 2011 to January, 2013; Executive Chairman of Prophecy Development Corp. from January, 2013 to present	June 13, 2011 (Director of Pre-amalgamated company <sup>(4)</sup> since October 21, 2009)	1,210,730
D. Greg Hall North Vancouver, BC, Director <sup>(1)(2)</sup>	President of Water Street Assets Inc. from September 2013 to present; Advisor to Market One Media Group Inc. from September 2013 to present; Director of Montan Mining Corp. from September 2016 to present; Secretary and Director, of Makevco Consulting Inc. (private consulting company), from March, 2000 to present	June 13, 2011 (Director of Pre-amalgamated company <sup>(4)</sup> since October 21, 2009)	22,457



Name, Jurisdiction of Residence, Offices	Principal Occupation During Last Five Years <sup>(3)</sup>	Director/Officer Since	Number of Common Shares Beneficially Owned, Controlled or Directed, Directly or Indirectly <sup>(5)</sup>
Harald Batista Los Altos Hills, California, Director <sup>(1)(2)</sup>	Co-Founder, and consultant at Bayesco from August, 2012 to present; Power Messaging Coach at Corporate Visions Inc. from July, 2008 to present	July 27, 2012 (Special Advisor to Pre-amalgamated company <sup>(4)</sup> since January 5, 2010)	31,242
Masa Igata New Territories, Hong Kong, Director <sup>(1)(2)</sup>	Founder and CEO of Frontier Securities, (foreign investment bank in Mongolia) from March, 2007 to present	April 23, 2014	86,068 <sup>(6)</sup>
Irina Plavutska Port Coquitlam, BC, Chief Financial Officer	Controller, at Prophecy Development Corp. from August, 2010 to August, 2011; Interim CFO of Prophecy Development Corp. from August, 2011 to November, 2012; Controller at Prophecy Development Corp. from November, 2012 to September 9, 2013; CFO of Prophecy Development Corp. from September, 2013 to present	September 11, 2013	Nil
Tony Wong Vancouver, BC, Corporate Secretary	Lawyer (sole practitioner) from June, 2011 to January, 2014; General Counsel & Corporate Secretary of Prophecy Development Corp. from February, 2014 to present	February 3, 2014	36,918
Bekzod Kasimov La Paz, Bolivia Vice-President, Business Development	Business Development Manager of Prophecy Development Corp. from September, 2012 to June, 2015; Vice-President, Operations of Prophecy Development Corp. from June, 2015 to January, 2018; Vice-President, Business Development of Prophecy Development Corp. from February, 2018 to present	June 22, 2015	23,071
Danniel Oosterman Newmarket, ON Vice-President, Exploration	President & CEO of Canstar Resources Inc. from March, 2013 to December, 2017; Vice-President, Exploration of Prophecy Development Corp. from February, 2018 to present	February 20, 2018	371

**Notes:**

- (1) Member of the Audit Committee.
- (2) Member of the Corporate Governance and Compensation Committee.
- (3) The information as to principal occupation, business or employment and Shares beneficially owned or controlled is not within the knowledge of the management of Prophecy and has been furnished by the respective individuals.

*Each director or officer has held the same or similar principal occupation with the organization indicated or a predecessor thereof for the last five years.*

- (4) *Northern Platinum Ltd., Prophecy Holdings Inc. and Prophecy Resource Corp. were amalgamated on June 13, 2011 as one company under the name "Prophecy Resource Corp." Prophecy Resource Corp. changed its name to "Prophecy Coal Corp." on June 14, 2011. Prophecy Coal Corp. changed its name to "Prophecy Development Corp." on January 5, 2015.*
- (5) *The approximate number of Shares in all circumstances beneficially owned directly or indirectly, or over which control or direction is exercised by each director or officer as at the date hereof is based on information furnished by the named persons.*
- (6) *These Shares are held by Sophir Asia Limited, a private company wholly owned and controlled by Mr. Igata.*

## **11. PROMOTERS**

Other than its directors and officers, there is no person who is or who has been within the two years immediately preceding the date of this AIF, a promoter of Prophecy as defined under applicable Canadian securities laws.

## **12. LEGAL PROCEEDINGS**

Other than as disclosed below, the Company has not been a defendant in any potentially material legal proceedings or regulatory actions during this fiscal year. The Company accrues for liabilities when it is probable and the amount can be reasonably estimated.

### **Red Hill Mongolia Tax Claim**

During the year ended December 31, 2014, Red Hill was issued a letter from the Sukhbaatar District Tax Division notifying it of the results of the Sukhbaatar District Tax Division's VAT inspection of Red Hill's 2009-2013 tax imposition and payments that resulted in validating VAT credit of only MNT235,718,533 from Red Hill's claimed VAT credit of MNT2,654,175,507. Red Hill disagreed with the Sukhbaatar District Tax Division's findings as the tax assessment appeared to the Company to be unfounded. The Company disputed the Sukhbaatar District Tax Division's assessment and submitted a complaint to the Capital City Tax Tribunal.

On March 24, 2015, the Capital City Tax Tribunal resolved to refer the matter back to the Sukhbaatar District Tax Division for revision and separation of the action between confirmation of Red Hill's VAT credit, and the imposition of the penalty/deduction for the tax assessment. The Sukhbaatar District Tax Division appealed the Capital City Tax Tribunal's resolution to the General Tax Tribunal office, but was denied on June 4, 2015 on procedural grounds. As a result, the Sukhbaatar District Tax Division implemented the Capital City Tax Tribunal's resolution on June 25, 2015, finding: (1) with respect to confirmation of Red Hill's VAT credit, that after inspection the amount was to be MNT235,718,533; and (2) with respect to the imposition of the penalty/deduction for the tax assessment, that no penalty was to be issued but that Red Hill's loss to be depreciated and reported to be MNT1,396,668,549 in 2010 and MNT4,462,083,700 in 2011.

The Company continued to dispute the Sukhbaatar District Tax Division's assessment and delivered a complaint to Capital City Tax Tribunal on July 24, 2015.

At this time, there is no change in the VAT claim. Red Hill submitted a complaint concerning the long delay to the General Tax office and the Ministry of Finance. Following the submittal, the City tax tribunal officer informed Red Hill that a hearing would be scheduled soon.

Red Hill is working with its external legal counsel to provide additional documents to the City tax tribunal before the hearing to solidify its case.

## **ASC Bolivia Tax Claim**

In connection with the transaction with Apogee, Prophecy agreed to assume within certain limitations all liabilities, including legal and tax liabilities associated with the Apogee Subsidiaries and the Pulacayo Project. During Apogee's financial year ended June 30, 2014, it received notice from the Servicio de Impuestos Nacionales, the national tax authority in Bolivia alleging that the Company's wholly owned subsidiary ASC owes approximately Bs42,000,000 (\$7,541,016) of taxes, interest and penalties relating to a historical tax liability which occurred in 2004, prior to Apogee acquiring the subsidiary in 2011. Apogee disclosed that it was not aware of this historical liability, originally assessed by the tax authority at an amount equivalent to approximately \$760,000 in 2004, and believes this notice was improperly provided. The Company continued to dispute the assessment and hired local legal counsel to pursue an appeal of the tax authority's assessment on both substantive and procedural grounds.

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

## **13. INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS**

Except as otherwise disclosed in this AIF the Company is not aware of any material interest, direct or indirect, of any director or executive officer of the Company, any person or company beneficially owning or controlling, directly or indirectly, more than 10% of the Shares of the Company or any associate or affiliate of any such person in any transaction entered into by the Company in the most recently completed financial years that has materially affected or is reasonably expected to materially affect the Company.

## **14. REGISTRAR AND TRANSFER AGENT**

The Registrar and Transfer Agent for the Company is Computershare Trust Company of Canada, of 3rd Floor, 510 Burrard Street, Vancouver, British Columbia, V6C 3B9.

## **15. MATERIAL CONTRACTS**

Except for contracts entered into in the ordinary course of business, the only contracts entered into by the Company within the financial year ended December 31, 2017 and immediately prior to the date of this AIF that can reasonably be regarded as presently material to the Company are:

- (a) the Mineral Lease Agreement dated June 22, 2017 between Prophecy and Janelle Dietrich, concerning the lease by the Company of those mining claims which constitute the Gibellini group of claims;
- (b) the Mineral Lease Agreement dated July 10, 2017 among Prophecy, Richard A. McKay, Nancy M. Minoletti and Pamela S. Scutt, concerning the lease by the Company of those mining claims which constitute the Louie Hill group of claims; and
- (c) the Share Purchase Agreement dated February 7, 2018 among Prophecy, Medalist Capital Ltd. and 631208 B.C. Ltd., concerning the indirect acquisition of 105 unpatented lode mining claims located adjacent to the existing Gibellini Project through the acquisition of 1104002 B.C. Ltd and its subsidiary, VC Exploration (US) Inc.

The material contracts specified above, which are required to be filed, are available under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com).

## 16. INTERESTS OF EXPERTS

Prophecy retained Mercator to prepare an updated independent NI 43-101 report on the Pulacayo Project. The Pulacayo Report is referenced in Section 1.5 - *Documents Incorporated by Reference* of this AIF.

Prophecy retained Mine Development Associates to prepare an independent NI 43-101 report on the Titan Project. The Titan Technical Report is reference in Section 1.5 – *Documents Incorporated by Reference* of this AIF.

Prophecy retained Amec E&C to prepare an independent NI 43-101 report on the Gibellini Project. The Gibellini Technical Report is reference in Section 1.5 – *Documents Incorporated by Reference* of this AIF.

Davidson & Company LLP, Chartered Accountants prepared the auditor's report for the audited annual financial statements of Prophecy for the year ended December 31, 2017. Davidson & Company LLP is an independent auditor in accordance with the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia.

To the best knowledge of the Company, none of the above mentioned experts or their respective associates or affiliates, beneficially owns, directly or indirectly, any securities of Prophecy, has received or will receive any direct or indirect interests in the property of Prophecy or is expected to be elected, appointed or employed as a director, officer or employee of Prophecy or any associate or affiliate thereof.

## 17. ADDITIONAL INFORMATION

Additional information relating to the Company:

- (a) may be found under the Company's SEDAR profile at [www.SEDAR.com](http://www.SEDAR.com);
- (b) including directors and officers remuneration and indebtedness, principal holders of the Company's securities and securities authorized for issuance under equity compensation plans is contained in the Information Circular for the Company's most recent annual meeting of shareholders; and
- (c) is provided in the Company's financial statements and management discussion and analysis for its most recently completed financial year.

## 18. CORPORATE GOVERNANCE

### 18.01 Audit Committee

The Company has an Audit Committee comprised of directors D. Greg Hall (Chair), Harald Batista and Masa Igata, each of whom is an independent director and financially literate within the meaning of National Instrument 52-110 *Audit Committees*.

The education and experience of each member of the Audit Committee relevant to the performance of his responsibilities as an Audit Committee member is as follows:

**D. Greg Hall** – Mr. Hall is a seasoned financial market professional with over 25 years' of experience as a broker, senior executive officer and founder of a number of successful brokerage firms. Mr. Hall has also had extensive experience as a board member and executive director for a number of Canadian and United States public and private companies. He is a graduate of the SME Board program at the Rotman School of Management, University of Toronto, and a member of the Institute of Corporate Directors.

**Harald Batista** – Mr. Batista is an accomplished entrepreneur with over two decades of international sales and marketing experience. He holds an MBA degree from Santa Clara University in California.

**Masa Igata** – Mr. Igata has more than 25 years’ experience working in Asian financial markets and is the founder and CEO of Frontier Securities, the first foreign investment bank in Mongolia. Previously, he was Managing Director at Nikko Citigroup with a leading role in Japanese equity sales and investor relations. Mr. Igata now focuses primarily on advising resource companies in Mongolia. Mr. Igata received his Graduate of Law from Kyoto University and is a member of the Securities Analysts Association of Japan and Mongolian Stock Exchange.

The Audit Committee’s mandate and responsibilities are detailed in its charter, a copy of which is attached as Appendix “A” hereto.

#### Pre-Approval Policies and Procedures

Under Section 1(a)(iv) of the Audit Committee Charter, the Audit Committee shall approve in advance all audit and permitted non-audit services provided by the Company’s external auditors. However, the Audit Committee has not adopted any specific policies or procedures for the engagement of non-audit services.

#### External Auditor Service Fees (By Category)

The aggregate fees billed by the Company’s external auditors in each of the last two fiscal years for audit fees are shown in Table 21 below:

**Table 21. Auditor Information**

<b>Financial Year Ending</b>	<b>Audit Fees<sup>(1)</sup></b>	<b>Audit Related Fees<sup>(2)</sup></b>	<b>Tax Fees<sup>(3)</sup></b>	<b>All Other Fees<sup>(4)</sup></b>
December 31, 2017	\$100,000	\$20,000	\$15,000	\$0
December 31, 2016	\$104,000	\$0	\$15,000	\$0

**Notes:**

- (1) **“Audit Fees”** include fees necessary to perform the annual audit and quarterly reviews of the Company’s financial statements and includes the fees of the Company’s auditor, Davidson & Company LLP for 2017 and 2016. Audit fees also include fees for review of tax provisions and for accounting consultations on matters reflected in the financial statements. Audit Fees also include audit or other attest services required by legislation or regulation, such as comfort letters, consents, reviews of securities filings and statutory audits.
- (2) **“Audit-Related Fees”** include services that are traditionally performed by the auditor. These audit-related services include employee benefit audits, due diligence assistance, accounting consultations on proposed transactions, internal control reviews and audit or attest services not required by legislation or regulation.
- (3) **“Tax Fees”** include fees for all tax services other than those included in **“Audit Fees”** and **“Audit-Related Fees”**. This category includes fees for tax compliance, tax planning and tax advice. Tax planning and tax advice includes assistance with tax audits and appeals, tax advice related to mergers and acquisitions, and requests for rulings or technical advice from tax authorities.
- (4) **“All Other Fees”** include all other non-audit service.

## 18.02 Corporate Governance and Compensation Committee

The Company has a Corporate Governance and Compensation Committee comprised of directors D. Greg Hall (Chair), Harald Batista and Masa Igata, each of whom is an independent director within the meaning of National Instrument 52-110 *Audit Committees*.

## APPENDIX "A"

### AUDIT COMMITTEE CHARTER

#### 1. PURPOSE: RESPONSIBILITIES AND AUTHORITY

The Audit Committee (the "**Audit Committee**" or "**Committee**") shall carry out its responsibilities under applicable laws, regulations and stock exchange requirements with respect to the employment, compensation and oversight of the Company's independent auditor, and other matters under the authority of the Committee. The Committee also shall assist the Board of Directors (the "**Board**") in carrying out its oversight responsibilities relating to the Company's financial, accounting and reporting processes, the Company's system of internal accounting and financial controls, the Company's compliance with related legal and regulatory requirements, and the fairness of transactions between the Company and related parties. In furtherance of this purpose, the Committee shall have the following responsibilities and authority:

(a) **Relationship with Independent Auditor.**

- (i) Subject to the laws of British Columbia as to the role of the Shareholders in the appointment of independent auditors, the Committee shall have the sole authority to appoint or replace the independent auditor.
- (ii) The Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work.
- (iii) The independent auditor shall report directly to the Committee.
- (iv) The Committee shall approve in advance all audit and permitted non-audit services of the independent auditor, including the terms of the engagements and the fees payable; provided that the Committee Chair may approve services to be performed by the independent auditors and the fee therefore between Committee meetings if the amount of the fee does not exceed \$20,000, provided that any such approval shall be reported to the Committee at the next meeting thereof. The Committee may delegate to the Chief Financial Officer ("**CFO**") or a subcommittee the authority to grant pre-approvals of audit and permitted non-audit services, provided that the decision of the CFO or any such subcommittee shall be presented to the full Committee at its next scheduled meeting.
- (v) At least annually, the Committee shall review and evaluate the experience and qualifications of the lead partner and senior members of the independent auditor team.
- (vi) At least annually, the Committee shall obtain and review a report from the independent auditor regarding:
  - (A) the independent auditor's internal quality-control procedures;
  - (B) any material issues raised by the most recent internal quality-control review, or peer review, of the auditor, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the firm;
  - (C) any steps taken to deal with any such issues; and
  - (D) all relationships between the independent auditor and the Company.

(vii) At least annually, the Committee shall evaluate the qualifications, performance and independence of the independent auditor, including considering whether the auditor's quality controls are adequate and the provision of permitted non-audit services is compatible with maintaining the auditor's independence.

(viii) The Committee shall ensure the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit, the concurring partner responsible for reviewing the audit, and other audit partners as required by law.

(ix) The Committee shall consider whether, in order to assure continuing auditor independence, it is appropriate to adopt a policy of rotating the independent auditing firm on a regular basis.

(x) The Committee shall recommend to the Board policies for the Company's hiring of employees or former employees of the independent auditor who were engaged on the Company's account or participated in any capacity in the audit of the Company.

**(b) Financial Statement and Disclosure Review.**

(i) The Committee shall review and discuss with management and the independent auditor the annual audited financial statements, including disclosures made in management's discussion and analysis, and recommend to the Board whether the audited financial statements should be filed with applicable securities regulatory authorities and included in the Company's annual reports.

(ii) The Committee shall review and discuss with management (and, to the extent the Committee deems it necessary or appropriate, the independent auditor) the Company's quarterly financial statements, including disclosures made in management's discussion and analysis, and recommend to the Board whether such financial statements should be filed with applicable securities regulatory authorities.

(iii) The Committee shall review and discuss with management and the independent auditor significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements, including the independent auditor's assessment of the quality of the Company's accounting principles, any significant changes in the Company's selection or application of accounting principles, any major issues as to the adequacy of the Company's internal controls over financial reporting and any special steps adopted in light of material control deficiencies.

(iv) At least annually and prior to the publication of annual audited financial statements, the Committee shall review and discuss with management and the independent auditor a report from the independent auditor on:

(A) all critical accounting policies and practices used by the Company;

(B) all alternative accounting treatments of financial information that have been discussed with management since the prior report, ramifications of the use of such alternative disclosures and treatments, the treatment preferred by the independent auditor, and an explanation of why the independent auditor's preferred method was not adopted; and

(C) other material written communications between the independent auditor and management since the prior report, such as any management letter or schedule of unadjusted differences, the development, selection and disclosure of critical accounting estimates, and analyses of the effect of alternative assumptions, estimates or IFRS methods on the Company's financial statements.

(v) Prior to their filing or issuance, the Committee shall review the Company's Annual Information Form including the use of "pro forma" or "adjusted" non-IFRS information.

(vi) The Committee shall review and discuss with management the financial information and earnings guidance provided to analysts and rating agencies. Such discussion may be specific or it may be in general regarding the types of information to be disclosed and the types of presentations to be made.

(c) **Conduct of the Annual Audit.** The Committee shall oversee the annual audit, and in the course of such oversight the Committee shall have the following responsibilities and authority:

(i) The Committee Chair shall meet with the independent auditor prior to the audit to discuss the planning and conduct of the annual audit, and shall meet with the independent auditor as may be necessary or appropriate in connection with the audit.

(ii) The Committee shall ascertain that the independent auditor is registered and in good standing with the Canadian Public Accounting Board and the Public Company Accounting Oversight Board and that the independent auditor satisfies all applicable Canadian independence standards and Independence Standards Board Standard No. 1. The Committee shall obtain from the auditor a written statement delineating all relationships between the auditor and the Company as per ISB Standard 1, and review relationships that may impact the objectivity and independence of the auditor.

(iii) The Committee shall discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit.

(iv) The Committee shall make such inquiries to the management and the independent auditor as they deem necessary or appropriate to satisfy themselves regarding the efficacy of the Company's financial and internal controls and procedures and the auditing process.

(d) **Compliance and Oversight.**

(i) The Committee shall meet periodically with management and the independent auditor in separate executive sessions. The Committee may also, to the extent it deems necessary or appropriate, meet with the Company's investment bankers and financial analysts who follow the Company.

(ii) The Committee shall discuss with management and the independent auditor the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.

(iii) The Committee shall discuss with management the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.

(iv) At least annually and prior to the filing of the Annual Information Form ("**AIF**"), the Committee shall review with management and the independent auditor the disclosure controls and procedures and confirm that the Company (with CEO and CFO participation) has evaluated the effectiveness of the design and operation of the controls within 90 days prior to the date of filing of the AIF. The Committee also shall review with management and the independent auditor any deficiencies in the design and operation of internal controls and significant deficiencies or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.

(v) At least annually and prior to the filing of the AIF, the Committee shall review with management and the independent auditor management's internal control report and assessment of the internal controls and procedures, and the independent auditor's report on and assessment of the internal controls and procedures.



(vi) The Committee shall establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

(vii) The Committee shall discuss with management and the independent auditor any correspondence with regulators or governmental agencies and any employee complaints or reports which raise material issues regarding the Company's financial statements or accounting policies.

(viii) The Committee shall oversee the preparation of all reports required under applicable laws, regulations and stock exchange requirements.

(ix) The Committee shall exercise oversight with respect to anti-fraud programs and controls.

**(e) Related Party Transactions.**

(i) The Committee shall review for fairness to the Company proposed transactions, contracts and other arrangements between the Company and its subsidiaries and any related party or affiliate, and make recommendations to the Board whether any such transactions, contracts and other arrangements should be approved or continued. The foregoing shall not include any compensation payable pursuant to any plan, program, contract or arrangement subject to the authority of the Company's Corporate Governance and Compensation Committee.

(ii) As used herein, the term "related party" means any officer or director of the Company or any subsidiary, or any shareholder holding a greater than 10% direct or indirect financial or voting interest in the Company, and the term "affiliate" means any person, whether acting alone or in concert with others, that has the power to exercise a controlling influence over the Company and its subsidiaries.

**(f) Additional Duties.** The Committee shall perform the following additional duties:

(i) The Committee shall review and make recommendations to the full Board of Directors regarding transactions of a fundamental nature such as amalgamations, mergers and material acquisitions and dispositions.

(ii) The Committee shall review and make recommendations to the full Board regarding proposed new business activities that require an allocation of resources in excess of C\$200,000.

(iii) The Committee shall review and make recommendations to the full Board regarding any proposed material change to a business or strategic plan that has been previously approved by the Board.

(iv) To the extent not otherwise provided in this Charter, the Committee shall review disclosure of financial information and other documents required by law to be approved by the Board before release to the public.

(v) The Committee shall oversee the Company's risk assessment and risk management policies, and regularly review the top risks identified and the policies and practices adopted by the Company to mitigate those risks.

(vi) The Committee shall review and approve hedging, investment and dividend policies.

(vii) The Committee shall review the appointment of senior financial personnel and make recommendations to the Board regarding the appointment of the Chief Financial Officer.

(viii) The Audit Committee shall recommend to the Corporate Governance and Compensation Committee the qualifications and criteria for membership on the Committee.

## 2. STRUCTURE AND MEMBERSHIP

(a) **Number and qualification.** The Committee shall consist of three persons unless the Board should from time to time otherwise determine. All members of the Committee shall meet the experience and financial literacy requirements of National Instrument NI 52-110 and the rules of the Toronto Stock Exchange.

(b) **Selection and Removal.** Members of the Committee shall be appointed by the Board. The Board may remove or replace members of the Committee at any time with or without cause.

(c) **Independence.** All of the members of the Committee shall be “independent” as required for audit committees by National Instrument NI 52-110 and the rules of the Toronto Stock Exchange.

(d) **Chair.** The Board will appoint a Chair of the Committee.

(e) **Compensation.** The compensation of the Committee shall be as determined by the Board.

(f) **Term.** Members of the Committee shall be appointed for one-year terms. Each member shall serve until his or her replacement is appointed, or until he or she resigns or is removed from the Board or the Committee.

## 3. PROCEDURES AND ADMINISTRATION

(a) **Meetings.** The Committee shall meet as often as it deems necessary in order to perform its responsibilities. The Committee shall keep minutes of its meetings and any other records as it deems appropriate.

(b) **Subcommittees.** The Committee may form and delegate authority to one or more subcommittees, consisting of at least one member, as it deems appropriate from time to time under the circumstances.

(c) **Reports to the Board.** The Committee shall report (orally or otherwise) regularly to the Board following meetings of the Committee with respect to such matters as are relevant to the Committee’s discharge of its responsibilities, and shall report in writing on request of the Executive Chairman.

(d) **Charter.** The Committee shall, at least annually, review and reassess the adequacy of this Charter and recommend any proposed changes to the Board for approval.

(e) **Independent Advisors.** The Committee shall have the authority to engage such independent legal and other advisors as it deems necessary or appropriate to carry out its responsibilities. Such independent advisors may be regular advisors to the Company. The Committee is empowered, without further action by the Board, to cause the Company to pay appropriate compensation to advisors engaged by the Committee.

(f) **Investigations.** The Committee shall have the authority to conduct or authorize investigations into any matters within the scope of its responsibilities as it deems appropriate, including the authority to request any Officer or other person to meet with the Committee and to access all Company records.

## 4. ADDITIONAL POWERS

The Committee shall have such other duties as may be delegated from time to time by the Board.

## 5. LIMITATION OF COMMITTEE’S ROLE

While the Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Committee to plan or conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with IFRS and applicable rules and regulations. These are the responsibilities of management and the independent auditor.

## **6. COMMITTEE MEMBER INDEPENDENCE AND FINANCIAL LITERACY REQUIREMENTS**

### **A. Independence**

See *Appendix 2 - Director Independence Standards of the Company's Corporate Governance Policies and Procedures Manual*.

### **B. Financial Literacy Requirements**

#### **NI 52-110**

Section 3.1(4) states that each audit committee member must be financially literate.

Section 1.6 defines the meaning of financial literacy as follows:

"For the purposes of this Instrument, an individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements."