Prophecy
Coal Corp.

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

## For the year ended December 31, 2013
## (Expressed in Canadian Dollars)

**CONTENTS**

This Management's Discussion and Analysis ("**MD&A**") of Prophecy Coal Corp. and its subsidiaries ("**Prophecy Coal**", or the "**Company**") provides analysis of the Company's financial results for the year ended December 31, 2013. The following information should be read in conjunction with the accompanying December 31, 2013 audited consolidated financial statements and the notes to those financial statements, prepared in accordance with International Financial Reporting Standards ("**IFRS**"), as issued by the International Accounting Standards Board, and the Company's Annual Information Form for the year ended December 31, 2013, all of which are available on the SEDAR website at www.sedar.com. Financial information is expressed in Canadian dollars, unless stated otherwise. This MD&A is current as of March 28, 2014, and was reviewed, approved, and authorized for issue by the Company's Board of Directors. This discussion is intended to supplement and complement Prophecy Coal's audited annual consolidated financial statements for the year ended December 31, 2013 and the notes thereto (the "**Annual Financial Statement**s"). Readers are cautioned that this MD&A contains "forward-looking statements" and that actual events may vary from management's expectations. Readers are encouraged to read the cautionary note contained herein regarding such forward-looking statements.

**Cautionary Note Regarding Forward-Looking Statements**

*This document contains forward-looking statements within the meaning of applicable Canadian securities legislation concerning anticipated developments in the Company's continuing and future operations in Mongolia, the adequacy of the Company's financial resources and financial projections. Such forward-looking statements include but are not limited to statements regarding the permitting, feasibility, plans for development and production of Prophecy Coal's Chandgana Power Plant, including finalizing of any power purchase agreement; the likelihood of securing project financing; estimated future coal production at the Ulaan Ovoo coal mineral property and the Chandgana coal mineral properties; and other information concerning possible or assumed future results of operations of Prophecy. See in particular, the section Select Financial and Operational Data under Part 3 – Business Overview and 2014 Outlook descriptions.*

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

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

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

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

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

## 1. INTRODUCTION

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

**General Corporate Information:**

At December 31, 2013 and March 28, 2014, Prophecy Coal had: (i) 248,373,819 and 249,387,569 common shares issued and outstanding, respectively; (ii) 31,565,550 and 22,053,750 share options for common shares outstanding, respectively; and (iii) 13,225,583 and 13,225,583 warrants for common shares outstanding, respectively.

**Share Information**

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

**Investor Information**

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

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(Expressed in Canadian Dollars)

### *Directors and Officers*

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

| Directors | Officers |
|---|---|
| John Lee, Executive Chairman | John Lee, Interim Chief Executive Officer |
| Harald Batista | Irina Plavutska, Chief Financial Officer |
| Chuluunbaatar Baz | Tony Wong, Corporate Secretary |
| Greg Hall | |
| ***Audit Committee*** | ***Corporate Governance and Compensation Committee*** |
| Greg Hall (Chair) | Greg Hall (Chair) |
| Harald Batista | Harald Batista |

### *Qualified Persons*

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

## 2. YEAR 2013 HIGHLIGHTS AND SIGNIFICANT EVENTS

The Company has resumed mining operations at its Ulaan Ovoo coal mine in Mongolia in late October 2013. Sales volume and revenue from coal sales increased to 125,000 tonnes and $3.3 million respectively in 2013 compared to 121,000 tonnes and $2.3 million in 2012. The Company also earned approximately $1.3 million in revenue from leasing and renting out its idle equipment and staff while mining operations were suspended during the year.

In 2013, the Company announced a change to its Board of Directors, accepting the resignation of Mr. Jivko Savov. The Company also announced senior management changes with the departure of Mr. Jeffrey Mason, former Chief Financial Officer and the appointment of Ms. Irina Plavutska as Chief Financial Officer and of Ms. Patricia Purdy as Corporate Secretary.

On January 25, 2013, Mr. John Lee transitioned from his role as Chief Executive Officer ("**CEO**") of the Company to Executive Chairman of the Board of Directors (the "**Board**") of the Company. To complement Mr. Lee in his role as Executive Chairman of the Board, the Company has initiated a search for a new CEO to carry out day-to-day management responsibilities as the Company transitions into an advanced developer of coal powered electrical generation. Mr. Lee continues to serve as Interim CEO until a new candidate has been identified and appointed.

- On March 1, 2013, the Company announced that pursuant to the July 16, 2012 credit agreement between Prophecy Coal and Waterton Global Value L.P. ("**Waterton**"), the expiry of the original purchase and sales agreement with Tethys Mining LLC constituted a default under the credit agreement. Waterton agreed to waive the default, subject to certain terms.

- On March 5, 2013, the Company announced that Prophecy Power Generation LLC ("**PPG**", wholly owned subsidiary of Prophecy) has been granted 532.4 hectares of land to be used for the Company's proposed Chandgana power plant construction (the "**Land Use Rights**"). With the Land Use Rights in place, Prophecy Power has issued a contract to Erchim Concern LLC to bring 4MW of temporary power to the Chandgana power plant site from a local 35kV power line.

- On April 12, 2013, the Company closed a first tranche of the private placement announced on February 7, 2013, with the issuance of 4,382,571 units of the Company, of which each unit consists of one common share and 0.75 common share purchase warrant at a purchase price of $0.14 per unit for aggregate consideration of $613,560. Each whole Warrant is exercisable into one common share of Prophecy at a price of $0.18, expiring two years from the date of issue. Finder's fees of 6% were paid in connection with a portion of the first tranche of the private placement. Each unit sold in the first tranche also included an adjustment warrant entitling the holder to acquire additional common shares of the Company.

- On June 6, 2013, the Company closed a second and final tranche of the private placement announced on February 7, 2013 with the issuance of 8,142,857 units of the Company for aggregate consideration of $1,140,000. Each unit consists of one common share and 0.75 of a common share of the Company purchase warrant at a purchase price of $0.14 per unit. Each whole warrant is exercisable for one common share of the Company at a price of $0.18, expiring two years from the date of issue. Each unit sold in the second tranche also included an adjustment warrant entitling the holder to acquire additional common shares of the Company.

- On May 17, 2013, the Company announced receipt of official correspondence from the Head of the Chandgana coal mine mouth power plant project (the "**Chandgana Power Plant**") working group (the "**Working Group**") designated by the Mongolian Ministry of Energy, outlining the terms of a tariff agreement reached by the Working Group and PPG, for the Chandgana Power Plant.

- On July 15, 2013 the Company amended the credit agreement with Waterton originally entered into on July 16, 2012 and amended on February 1, 2013 by a Waiver Agreement (such credit agreement as amended by the waiver agreement and the Amendment, the "**Amended Loan Agreement**"). Prophecy Coal agreed to and completed a partial pay down of the principal loan amount from $10 million to $6.5 million from restricted cash-on-hand amounting to $3.5 million and extended the maturity date from July 16, 2013 to October 31, 2013 on certain terms.

- In August 2013, the Company entered into binding sales contracts for transported coal with a number of buyers involving the sale of over 30,000 tonnes of coal per month. The Company also signed multiple offtake agreements with a number of buyers which will involve the sale of over 30,000 tonnes of coal per month directly from the Company's Ulaan Ovoo mine.

- October 2013, the Company announced that it has entered into an additional offtake agreement with a buyer for 30,000 tonnes of coal per month directly from the Ulaan Ovoo mine. The first sale occurred in November 2013.

- In October 2013, Prophecy Coal's wholly-owned Mongolian subsidiary, Red Hill Mongolia LLC arranged a line of credit for US$1,500,000 with the Trade and Development Bank. The line of credit has a 1.5 year term with the option of extending it, and bears interest at 15% per annum and a commitment rate of 2% per annum payable monthly. The funds will be used for working capital. The credit facility is collateralized by certain equipment and mineral and exploration licenses.

- On November 7, 2013, the Company sold 18,525,000 common shares of Wellgreen Platinum Ltd. ("**Wellgreen Platinum**") (formerly, Prophecy Platinum Corp.) previously owned by the Company in a private sale to arm's length purchasers for net proceeds of $7,500,000. Transaction fees of 5% were paid pursuant to purchase agreement.

- On November 8, 2013, the Company repaid the remaining balance of its secured debt facility with Waterton of $6,250,000 plus applicable fees and interest pursuant to the Amended Loan Agreement and has been provided with a release/discharge of security interests, charges, and pledges.

- During the year ended December 31, 2013, the Company granted 4,800,000 share purchase options to employees, directors, officers and consultants, with a weighted average exercise price of $0.12 and expiry dates ranging from March 4, 2018 to August 16, 2018.

*Subsequent to year end*

- The Company issued a second tranche of 1,013,750 bonus shares in the capital of the Company to certain employees, directors, officers, and service providers of the Company.
- The Company appointed Tony Wong as General Counsel and Corporate Secretary. Mr. Wong replaced Pat Purdy as Prophecy's Corporate Secretary.
- The Company granted 250,000, 5,550,000, and 500,000 share purchase options to the Company directors, officers, employees, and consultants at the exercise price of $0.08, $0.105, and $0.10 per share respectively. All of these options are exercisable for a period of five years.
- The Company announced the death of Company director Michael J. Deats.
- 1,056,800 share purchase options exercisable at $0.28 per share expired unexercised on January 23, 2014.
- 1,523,881 of Wellgreen Platinum's reserved common shares held in-trust were released back to the Company due to 670,000 Prophecy Coal options being forfeited on December 31, 2013 and 14,355,000 and 1,056,800 Prophecy Coal options forfeited and expiring respectively subsequent to year end.
- The Company sold its remaining 3,327,261 un-reserved common shares of Wellgreen Platinum in addition to 1,523,881 common shares released from trust for net proceeds of $4,203,638.

## 3. BUSINESS OVERVIEW

Prophecy Coal in its current form is primarily the product of an April 2010 business combination between Red Hill Energy Ltd. (at the time TSX.V-RH) and a company formed in 2006, Prophecy Resource Corp. ("**Old Prophecy Coal**"). Under that merger, Red Hill was the successor legal entity which is herein referred to as the "Corporation". Under that 2010 business combination Old Prophecy Coal was merged with a subsidiary of Red Hill.

Red Hill was incorporated on November 6, 1978 under the *Company Act* (British Columbia) under the name "Banbury Gold Mines Ltd." Banbury changed its name to "Enerwaste Minerals Corp." on December 17, 1993, Enerwaste changed its name to "Universal Gun-Loc Industries Ltd.". On April 24, 2002, Universal Gun-Loc changed its name to "UGL Enterprises Ltd." and to Red Hill Energy Inc on April 16, 2006. On May 10, 2005, the Corporation, as UGL, transitioned under the new (2004) *Business Corporations Act* (British Columbia) ("**BCBCA**") which is the corporate law statute which continues to govern the Corporation. On April 16, 2010, the Corporation (then Red Hill) changed its name to "Prophecy Resource Corp." in conjunction with the Red Hill merger. On June 13, 2011, the Corporation changed its name to "Prophecy Coal Corp." in connection with an asset spin-off to capitalize our controlled at that time, publicly traded Wellgreen Platinum.

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

### Mineral Properties

As of December 31, 2013, Prophecy Coal's primary mineral properties included: Ulaan Ovoo coal property (Mongolia), the Khavtgai Uul and Chandgana Tal coal deposits (Mongolia), collectively known as the "Chandgana Coal Properties", and the Khujirt-1 exploration license. The other properties of Prophecy Coal include the Okeover copper-molybdenum project (British Columbia, Canada), Kanichee property (Ontario, Canada), and the Titan iron-titanium project (Ontario, Canada).

***Ulaan Ovoo Coal Property - Operating Mine, Mongolia***

Prophecy Coal Corp. (Red Hill Energy Ltd. at the time) entered into a letter of intent, dated November 24, 2005, amended February 19, 2006, with Ochir LLC and a wholly owned subsidiary of Ochir LLC, both privately owned

Mongolian companies, which set out the terms to acquire a 100% interest in the Ulaan Ovoo Property. The purchase price for this 100% interest, together with all equipment, buildings and other facilities, assembled and constructed at the Ulaan Ovoo property was US$9,600,000. The purchase price has been paid in full by Prophecy Coal. Ochir LLC retained a 2% royalty on production from the licenses, which was subsequently assigned to a third party.

On November 15, 2006, Prophecy Coal 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 these licenses was US$400,000. Under the terms of the agreement the vendor retained a 2% net smelter return royalty on all five mineral licenses. On April 29, 2009, Prophecy Coal announced positive pre-feasibility study results for the Ulaan Ovoo property.

On March 11, 2010, Prophecy Coal entered into a royalty purchase agreement, dated for reference as 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 by consideration including US$130,000 and the issuance of 2,000,000 Prophecy Coal shares. This transaction was completed on April 30, 2010.

Establishment of the site at Ulaan Ovoo commenced on July 13, 2010. During October 2010, Prophecy Coal 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, after its capital, Ulaanbaatar. At the request of the Mongolian Ministry of Mineral Resources and Energy, Prophecy Coal commenced pre-commercial mining and trucked the first coal shipment to Sukhbaatar rail station, for transport to Darkhan power plant by rail.

On November 9, 2010, Prophecy Coal received the final permit to commence pre-commercial mining operations at the Ulaan Ovoo mine. On December 16, 2010, Prophecy Coal received an updated prefeasibility study (the "**PFS**") on the Ulaan Ovoo property. The focus of the Ulaan Ovoo PFS was for the development of low ash coal reserves in the form of a starter pit.

The estimated resources, reserves, coal quality, and other mine characteristics of the Ulaan Ovoo coal property were estimated by independent consultancies. The coal resources are presented in Table 1 and the coal reserves and mining characteristics for the starter pit area are presented in Table 2.

<u>Table 1. Coal resource detail of the Ulaan Ovoo property</u>

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

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

<u>Table 2. Coal reserve detail of the starter pit area of the Ulaan Ovoo property</u>

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

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

The Behre Dolbear & Company (USA), Inc. report ("**Scoping Study Ulaan-Ovoo Coal Deposit**") dated October 2006 was prepared by independent Qualified Person Mr. Gardar G. Dahl, Jr, P. Geo, a senior associate of Behre

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

**Select Financial and Operational Data:**

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. Transportation of coal inventory from these existing stockpiles commenced during November 2012 and continued to October 2013.

On December 31, 2012, the Company recorded a non-cash impairment write down of $47 million on the Ulaan Ovoo property, which was reflected on the consolidated statement of operations. The impairment charge reduced previously capitalized deferred exploration within property and equipment, to a balance of $2 million. As there were no benchmark or market changes from October 1, 2013 to December 31, 2013, the impaired value for Ulaan Ovoo within property and equipment, remains unchanged at a balance of $2 million. Costs in excess of the impaired value for the year ended December 31, 2013 totalled $2.36 million which is reflected on the consolidated statement of operations and comprehensive loss.

The mine restart plan commenced late October 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 an excavator, 5 dump trucks, tipper trucks and other ancillary equipment. In order to prepare for resuming operations, the Company installed significant water-pumping capacity and started to dewater the pit area, recalled leased out mining equipment, hired various staff, procured diesel, parts and other supplies and materials needed to bring the mine back into production. Key positions were filled included hiring a new mine manager, a transportation manager and engaged government advisors to manage and support the operations of the Ulaan Ovoo mine.

Operating costs incurred prior to restarting the Ulan Ovoo mine during the year totalled approximately US $3,898,000. The approximate amounts of significant items included are fuel of US $881,500, contract and consulting services of US $747,000 human resources of US $431,900 and parts and lubricants of US $137,000. Operating costs incurred once mining activities resumed totalled approximately US $2,072,500. Capital expenditures related to Ulan Ovoo totalled approximately US $512,000 for the year which included approximately US $175,000 in dewatering and power generation equipment to prepare the mine for resuming operations.

During the year the Company produced approximately 89,000 tonnes of coal. As of December 31, 2013, the coal stockpile balance was approximately 119,900 tonnes with a value of approximately $1.76 million.

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

Fresh coal deliveries from Ulan Ovoo started in November 2013 and over the course of the third quarter, the Company entered into binding coal sales contracts with a number of local buyers which involve the sale of approximately 10,000 tonnes of coal per month from the mine. The Company was also able to obtain binding contracts for coal sales delivered to Mongolian customers through Mongolia's Sukhbaatar rail station ("**Sukhbaatar**") totalling approximately 360,000 tonnes of coal annually. The buyers include cement plants, a metallurgical plant, a heat plant, chemical plants, a railway company and coal traders. The off-take quantities and variety of customers reflect the Company's significant efforts to drive higher margin sales while satisfying government power plant needs.

During the year the Company sold approximately 125,000 tonnes of coal with total sales revenue of approximately of $3.3 million. In addition, the Company earned approximately $1.3 million in revenue from leasing and renting out its idle equipment and staff while mining operations were suspended during the year. As the Company is in the pre-commercial production stages, proceeds from the sale of coal are not recorded as revenue but rather are offset against capitalized deferred exploration costs.

Since resuming operations, the Company has estimated it's average cash cost per tonne, including transportation and administration expenses at approximately US $29.50 per tonne and has experienced domestic average sales prices of approximately US $36 per tonne for coal with GCV greater than 5,000 kcal/kg. On the other hand, average sales prices for coal with GCV less than 5,000 kcal/kg was US $20.50 per tonne. However, approximately over sixty percent of the Company's sales in 2013 consisted of sales of coal with GCV greater than 5,000 kcal/kg.

Furthermore, domestic market prices for coal with GCV greater than 5,000 kcal/kg range from US $30 to US $50 per tonne, dependant on quantity and point of delivery. In addition, the Company's neighbouring market in the Russian regions realize sales prices for coal with GCV of 4,500 kcal/kg to 5,000 kcal/kg ranging from 1,800 to 2,200 Roubles per tonne (US $50 to US $60 per tonne), dependant on point of delivery.

***2014 Outlook***

Since resuming operations at Ulan Ovoo, management primarily works towards improving mining practices in the areas of safety, cost containment and coal quality improvement. With these mandates and since near surface oxidized coal was removed in 2011 and 2012, the Company has been able to consistently mine higher grade thermal coal with GCV greater than 5,000 kcal/kg. With consistent, effective and efficient mining practices, management expects that approximately ninety percent of the coal mined at Ulan Ovoo will be greater than 5,000 kcal/kg in 2014 as was projected in the Wardrop Pre-Feasibility Study. As such the Company is transitioning to supplying to a market for coal of GCV greater than 5,000 kcal/kg which realizes premium pricing, both in the Company's domestic and neighbouring market, Russia. On February 10, 2014, the Company sold and successfully delivered a coal shipment from Sukhbaatar rail station to a Russian customer. The coal was approximately 5,300kcal/kg GCV, 0.5% sulphur, and 5% ash.

The Company has only commenced penetrating the premium thermal coal market in this region and believes there is potential to further expand sales with minimal competition in northern Mongolia and its neighboring Russian region. Furthermore, during the year, the company invested in a coal screener to enable the provision of specific sizes of coal which realize premium pricing in all markets. In addition, subsequent to year end, the Company also invested in a coal dryer to support maintaining lower moisture levels in order to consistently produce coal with GCV greater than 5,000 kcal/kg to also support capturing greater market share where premium prices are realized. As such the Company is focusing its efforts on controlling its mining practices and marketing efforts to become primarily a provider of coal greater than 5,000 GCV where premium pricing can be obtained. Lower grades of coal will be used to produce briquettes and sold in the briquette market for higher prices accordingly.

During the end 2013 and the first quarter of 2014, management visited a number of potential industrial customers in the Republic of Buryatia, Russia to discuss their coal purchase needs and drafted proposals with the goal of establishing continuous coal shipments to Russia during 2014. The company is currently negotiating coal offtake agreements with these potential industrial customers in the Republic of Buryatia, Russia.

In addition, the Mongolia Ministry of Road and Transportation recently issued the terms of reference ("**TOR**") for the Zeltura Road feasibility study. After the TOR was issued, Prophecy contracted a consultant to prepare a feasibility study on upgrading the road from Ulaan Ovoo mine to the Zeltura border. Given that the mine is approximately 17km from the Zeltura border (as opposed to approximately 120km from the mine to Sukhbaatar), the re-opening of the Zeltura border crossing would reduce transportation costs and potentially further support increased coal sales to Russia. After the study is complete and if accepted by the Ministry of Road and Transportation (target May 2014), the road upgrade can begin. Concurrently, the Company is working with the Ministry of Finance and Mongolian Customs Office on creating a customs clearing zone at the Ulaan Ovoo mine site for Russian exports that would go through Zeltura. While the Company is pleased with the overall progress and appreciates the support from the Mongolian and Russian authorities, it cannot offer any certainty or a definitive time frame to start transporting coal to Russia through Zeltura.

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

***Chandgana Coal Properties, Mongolia***

The Chandgana properties consist of the Chandgana Tal ("**Tal**") and Khavtgai Uul ("**Khavtgai**") (formerly named Chandgana Khavtgai) properties which are within nine kilometres of each other in the Nyalga Coal Basin in east central Mongolia which is approximately 280 kilometres east of Ulaanbaatar. On November 22, 2006 Prophecy Coal (then Red Hill) entered into a letter agreement with a private Mongolian company that set out the terms to acquire a 100% interest in the Tal property. On August 7, 2007, Prophecy Coal (then Red Hill) entered into a letter agreement with another private Mongolian company that set out the terms to acquire a 100% interest in the Khavtgai property. Under the terms of the Chandgana Khavtgai agreement, Prophecy Coal paid a total of US $570,000. On February 8, 2011, Prophecy Coal received a full mining license from the Mineral Resources Authority of Mongolia for the Tal property. The license can be updated to allow mining of 3.5 million tonnes per year to meet the demand of the Chandgana power plant within 90 days.

During 2007 Prophecy Coal performed geologic mapping, drilling and geophysical surveys of the Tal and Khavtgai properties. During June, 2010, Prophecy Coal completed a 13 drill hole, 2,373 metre resource expansion drilling program on the Khavtgai property, including 1,070 metres of core drilling, and five lines of seismic geophysical survey for a total of 7.4 line kilometres. Prophecy completed a 15 drill hole program during June-July 2011 to better define the coal resource of the Tal licenses.

A NI 43-101 technical report ("**Technical Report on the Coal Resources of the Chandgana Tal Coal Project Khentii Aimag, Mongolia**") dated September 11, 2007 was prepared by independent Qualified Person Mr. Gardar G. Dahl, Jr, P. Geo, a senior associate of Behre Dolbear & Company (USA), Inc. (the "**Behre Dolbear Report**"). Prophecy Coal engaged Leighton Asia LLC to prepare a scoping level mine study for the Tal property which was completed during December 2011. Later a preliminary economic assessment ("**PEA**") was prepared by John T. Boyd Co. and received in November 2012 for the Tal licenses. A subsequent update to the PEA was prepared and submitted to regulators. However, as of the date of this MD&A, it has not yet been finalized for filing. An updated NI 43-101 technical report on the Khavtgai property ("**Updated Technical Report on the Coal Resources of the Chandgana Khavtgai Coal Resource Area, Khentii Aimag, Mongolia**") dated September 28, 2010 was completed by Christopher Kravits, LPG, CPG of Kravits Geological Services LLC (the "**Khavtgai Report**"). The Khavtgai Report updates the previous independent technical report on the Khavtgai property prepared by Mr. Kravits dated January 9, 2008. All the reports are filed on www.SEDAR.com. The resource and mining characteristics of the Chandgana Coal Properties are summarized in the following table:

Table 3. Coal resource details of the Chandgana Properties

| Property | Coal Resources (million tonnes) | | | Life of Mine (years) | Strip Ratio (Bcm/t) | Coal Quality (arb) | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Measured | Indicated | Total | | | Total Moisture (wt %) | Ash (wt %) | Gross Calorific Value (kcal/kg) | Total Sulfur (wt %) |
| Khavtgai | 509.3 | 538.8 | 1,048.1 | Not det | 2.2:1 | 36.5 | 10.1 | 3,636 | 0.6 |
| Tal | 124.4 | 0.0 | 124.4 | 35+ | 0.7:1 | 40.9 | 10.8 | 3,306 | 0.6 |
| Total/Weighted Avg | 633.7 | 538.8 | 1,172.5 | | 2.0:1 | 37.0 | 10.2 | 3,601 | 0.6 |

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

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

During the year 2013, Prophecy Coal incurred total costs of $1.35 million (2012 - $3.87 million) for the Chandgana Tal property (including power plant application costs) and $0.27 million (2012 - $0.48 million) for the Chandgana Khavtgai property.

***2014 Outlook***

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

During December 2011, Prophecy Power began seeking EPC contractors. Nine tenders were received by the submission deadline of May 1, 2012 in the first round. For the second round in July 2012, Prophecy Power requested more detailed tenders which resulted in the shortlisting of three EPC contractors based on completeness of the tenders, construction capability, equipment quality, time to deployment, and price.

During August 2012, Prophecy Power's technical team, led by VP Sharma, a consultant to Prophecy Coal, who has 30 years of experience with China Light and Power Group, met with those firms qualifying for the second round. The team discussed detailed owner technical specifications and requirements, Mongolian customs, transport and insurance, tax, permit, labor policies, and project timeline in order to facilitate preparation of final tenders. This resulted in three full and complete tenders that were received in late September 2012.

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

**2014 Outlook:** The Company actively pursues the remaining agreements, approvals and permits required to proceed with the development of the Chandgana Power Plant Project. Prophecy also continues to actively consider the project financing options which include either debt, equity or a combination thereof in addition to joint ventures with international power project developers.

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

Prophecy Coal has an 80% interest in the Titan iron-titanium property ("**Titan**") located in Ontario province, Canada. Prophecy Coal has done much exploration work including 22 kilometres of line cutting covering over 2.7 square kilometres in 100 metre intervals that extended the current surveyed grid west and southwest of the Titan property. A ground magnetometer survey was completed during the summer of 2010, the results of which expanded the extent of the magnetic anomaly associated with the Titan deposit. This work successfully demonstrated that exploration is warranted outside the previously known limits. Assessment work was completed during 2013 with a total cost of $25,620.

***2014 Outlook***

The Company will maintain its interest in Titan. Land taxes were paid in January 2014 and the required license maintenance work will be completed. The Company will continue monitoring commodity prices to consider the timing of possible development.

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

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

***2014 Outlook***

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

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

The 60% interest in Okeover"", a copper-molybdenum project in south-western British Columbia, Canada, 25 kilometres north of Powell River and 145 kilometres northwest of Vancouver, was acquired through the amalgamation between Red Hill and Prophecy Coal Holdings Inc. in April 2010. Exploration work completed to date suggests mineralization exists east, west and south of the known mineralized body. Further assessment costing $42,226 was completed during the year ended December 31, 2013. This work included 13.3 line kilometers of surveying and flagging to extend the grid of which 9.4 km the vegetation was cut and the soil sampled with a total 178 soil and 29 rock samples. The results of the work are being reviewed as of the date of this report.

***2014 Outlook***

The Company will maintain its interest in Okeover. The required license maintenance work will be completed. Line surveying and flagging is planned in the southern portion of the license hold and the Company will continue monitoring commodity prices to consider the timing of possible development.

(Expressed in Canadian Dollars)

## 4. SELECTED ANNUAL INFORMATION

| | Years ended December 31, | | |
|---|---|---|---|
| | 2013 | 2012 | 2011 |
| Loss before other items and future income tax recovery | $ (4,094,448) | $ (10,848,277) | $ (12,959,668) |
| Net loss for year | (23,296,154) | (61,389,108) | (9,773,768) |
| Comprehensive loss for year | (22,896,883) | (59,465,339) | (11,188,587) |
| Net loss for period attributable to: | | | |
| Owners of the Company | (23,296,154) | (56,876,372) | (7,137,313) |
| Non-controlling interest | - | (4,512,736) | (2,636,455) |
| | (23,296,154) | (61,389,108) | (9,773,768) |
| Comprehensive loss for period attributable to: | | | |
| Owners of the Company | (22,896,883) | (55,033,590) | (8,454,021) |
| Non-controlling interest | - | (4,431,749) | (2,734,566) |
| | (22,896,883) | (59,465,339) | (11,188,587) |
| Share Information: | | | |
| Net loss per share, basic and diluted attributable to: | | | |
| Owners of the Company | (0.10) | (0.26) | (0.04) |
| Non-controlling interest | - | (0.02) | (0.01) |
| Comprehensive loss per share, basic and diluted attributable to: | | | |
| Owners of the Company | (0.10) | (0.025) | (0.04) |
| Non-controlling interest | - | (0.02) | (0.01) |
| Weighted average number of common shares outstanding | 236,480,098 | 222,183,144 | 193,174,218 |
| Financial Position: | | | |
| Current assets | 8,568,387 | 10,294,682 | 9,034,824 |
| Property and equipment | 10,758,586 | 12,929,342 | 51,645,276 |
| Mineral properties | 15,053,773 | 13,387,882 | 62,169,481 |
| Total assets | 34,442,800 | 62,386,558 | 130,842,900 |
| Non-current liabilities | 761,477 | 1,247,363 | 257,355 |
| Dividends | $ - | $ - | $ - |

Explanation of loss variations from 2012 to 2013 are contained in the "Discussion of Operations" section of this MD&A.

The Company's total assets at December 31, 2013 were $34.4 million compared to $62.4 million at December 31, 2012 and $130.8 at December 31, 2011. The decrease in total assets in 2013 was mainly due to the disposal of its investment in associate and the sale of short term investments during the period.

The Company's non-current liabilities at December 31, 2013 were $.76 million compared to $1.25 million at December 31, 2012 and $0.26 million at December 31, 2011. The decrease in non-current liabilities in 2013 was primarily attributable to a decrease in the Company's deferred income tax liabilities as a result of the Company's decrease in ownership and cessation of significant influence over Wellgreen Platinum during the year.

## 5. SUMMARY OF QUARTERLY RESULTS

The following table summarizes selected financial information for the eight most recently completed quarters, prepared in accordance with IFRS:

(Expressed in Canadian Dollars)

| | 2013 | | | |
|---|---|---|---|---|
| | Dec-31 | Sep-30 | Jun-30 | Mar-31 |
| Operating expense | $ 225,160 | $ (2,731,414) | $ (793,281) | $ (794,913) |
| **Loss Before Other Items and Deferred Income Tax** | 225,160 | (2,731,414) | (793,281) | (794,913) |
| Other items | (11,997,195) | (2,568,853) | (2,771,104) | (2,817,654) |
| **Loss Before Deferred Income Tax** | (11,772,035) | (5,300,267) | (3,564,385) | (3,612,567) |
| Deferred income tax recovery | 953,100 | - | - | - |
| **Net Income (Loss) for Quarter** | (10,818,935) | (5,300,267) | (3,564,385) | (3,612,567) |
| Fair value gain (loss) on available-for-sale investments | 153,575 | (202,149) | (333,639) | 781,484 |
| **Comprehensive Income (Loss) for Quarter** | (10,665,360) | (5,502,416) | (3,898,023) | (2,831,082) |
| **Share Information** | | | | |
| Net Loss per share, basic and diluted attributable to | | | | |
| Owners of the Company | (0.04) | $ (0.02) | $ (0.02) | $ (0.02) |
| Comprehensive Loss per share, basic and diluted attributable to | | | | |
| Owners of the Company | (0.04) | (0.02) | (0.02) | (0.01) |
| Average number of common shares outstanding | | | | |
| for quarter, basic and diluted | 248,148,215 | 243,176,495 | 236,490,184 | 229,547,023 |

| | 2012 | | | |
|---|---|---|---|---|
| | Dec-31 | Sep-30 | Jun-30 | Mar-31 |
| Operating expense | $ (1,069,354) | $ (2,970,363) | $ (2,474,327) | $ (4,334,233) |
| **Loss Before Other Items and Deferred Income Tax** | (1,069,354) | (2,970,363) | (2,474,327) | (4,334,233) |
| Other items | (46,585,365) | (2,328,747) | 1,439,189 | (1,710,416) |
| **Loss Before Deferred Income Tax** | (47,654,718) | (5,299,110) | (1,035,138) | (6,044,649) |
| Deferred income tax recovery | (1,569,024) | 160,247 | (68,176) | 121,461 |
| **Net Loss for Quarter** | (49,223,742) | (5,138,863) | (1,103,314) | (5,923,188) |
| Fair value gain (loss) on available-for-sale investments | 2,476,797 | 688,744 | (2,114,759) | 872,987 |
| **Comprehensive Income (Loss) for Quarter** | (46,746,945) | (4,450,119) | (3,218,073) | (5,050,201) |
| **Net Income (Loss) for Quarter Attributable to:** | | | | |
| Owners of the Company | (48,831,202) | (3,242,577) | (289,024) | (4,513,569) |
| Non-controlling interest | (879,254) | (1,409,573) | (814,290) | (1,409,619) |
| | (49,710,456) | (4,652,150) | (1,103,314) | (5,923,188) |
| **Comprehensive Loss for Quarter Attributable to:** | | | | |
| Owners of the Company | (44,266,921) | (2,961,989) | (4,638,569) | (3,166,111) |
| Non-controlling interest | (804,911) | (1,647,892) | (94,856) | (1,884,090) |
| | $ (45,071,832) | $ (4,609,880) | $ (4,733,425) | $ (5,050,201) |
| **Share Information** | | | | |
| Net Loss per share, basic and diluted attributable to: | | | | |
| Owners of the Company | $ (0.22) | $ (0.01) | $ (0.00) | $ (0.02) |
| Non-controlling interest | (0.00) | (0.01) | (0.00) | (0.01) |
| Comprehensive Loss per share, basic and diluted attributable to: | | | | |
| Owners of the Company | (0.21) | (0.01) | (0.02) | (0.02) |
| Non-controlling interest | $ (0.00) | $ (0.01) | $ (0.00) | $ (0.01) |
| Average number of common shares outstanding | | | | |
| for quarter, basic and diluted | 228,379,503 | 227,407,328 | 225,071,203 | 199,587,605 |

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

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

(Expressed in Canadian Dollars)

## 6. DISCUSSION OF OPERATIONS

All of the information described below is accounted for in accordance with IFRS. The reader is encouraged to refer to Note 6 of Prophecy Coal's Annual Financial Statements for the year ended December 31, 2013 for Prophecy Coal's IFRS accounting policies. Certain prior period figures have been reclassified to conform to the current year's presentation. Such reclassification is for presentation purposes only and has no effect on previously reported results. For discussion on each project, the reader is encouraged to refer to the "Business Overview" section of this MD&A.

For the year ended December 31, 2013, Prophecy Coal incurred operating expenses of $4.1 million compared to $10.8 million incurred for the year ended December 31, 2012.

| Operating Expenses | | | | Year ended December 31, |
|---|---|---|---|---|
| | | 2013 | | 2012 |
| Advertising and promotion | $ | 132,779 | $ | 2,018,946 |
| Consulting and management fees | | 198,156 | | 877,343 |
| General and administrative expenses | | 1,366,239 | | 3,232,546 |
| Mine site expenses | | - | | 367,879 |
| Professional fees | | 974,010 | | 1,303,805 |
| Share-based payments | | 1,304,486 | | 2,650,632 |
| Travel and accommodation | | 118,778 | | 397,126 |
| | $ | 4,094,448 | $ | 10,848,277 |

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

The decrease by $6.75 million in operating expenses was mainly due to the following factors:

**Advertising and promotion** expense decreased in 2013 by $1.9 million of which $1.1 million was attributable to Wellgreen Platinum no longer being consolidated as at November 30, 2012. The decrease was also due to a reduction of promotional activities carried out by the Company during 2013;

**Consulting and management fees** include charges by Officers of the Company and its subsidiaries. In 2013, consulting and management fees decreased by $0.7 million of which $0.5 million was attributable to Wellgreen Platinum no longer being consolidated as at November 30 2012;

**General and administrative** consist of general office expenses and administrative services related to maintaining the Company's exchange listing and complying with securities regulations along with insurance, salaries and directors fees. General and administrative expenses decreased by $1.9 million most of which was attributable to Wellgreen Platinum no longer being consolidated as at November 30 2012;

**Professional fees** decreased by $0.3 million. The decrease was primarily due to the deconsolidation of Wellgreen Platinum on November 30, 2012 offset by an increase in the Company's audit expenses in 2013;

**Share-based payments** decreased by $1.35 million. The decrease was primarily attributable to Wellgreen Platinum no longer being consolidated as at November 30, 2012 offset by increase in share-based payments attributable to the Company's re-priced and re-issued share purchase options.

For the year ended December 31, 2013, Prophecy Coal incurred other expenses classified as "Other Items" amounting to $19.2 million compared to $50.5 million for the year ended December 31, 2012.

The decrease in other items by $31.3 million was mainly due to the following factors:

(Expressed in Canadian Dollars)

| Other Items | Year ended December 31, 2013 | 2012 |
|---|---|---|
| Costs in excess of impaired value | 2,356,443 | - |
| Deemed disposal loss of investment in associate | 1,264,472 | - |
| Finance and transaction costs | 765,000 | - |
| Flow through premium liability income | - | (201,914) |
| Foreign exchange (gain) loss | (251,254) | 272,456 |
| Gain on deconsolidation of subsidiary | - | (4,366,912) |
| (Gain) loss on sale of available-for-sale investments | (237,137) | 1,652,514 |
| Impairment write down on property and equipment | - | 47,063,713 |
| Impairment on available-for-sale investments | - | 2,639,572 |
| Interest expense | 2,314,438 | 1,145,031 |
| Interest income | (28,890) | (59,435) |
| Loss on debt settlement | 174,959 | - |
| Loss on disposal of equipment | - | 191,528 |
| Loss on disposal of investment in associate | 12,399,523 | - |
| Mineral property written down | - | 651,823 |
| Share of net loss of associate | 1,397,252 | 196,961 |
| Deferred income tax recovery | (953,100) | 1,355,492 |
| | $ 19,201,706 | $ 50,540,829 |

**Impairment write down on property and equipment**: On December 31, 2012, the Company recorded a non-cash impairment write down of $47.1 million, on its Ulaan Ovoo property. As there were no benchmark or market changes from January 1, 2013 to December 31, 2013, the impaired value for Ulaan Ovoo within property and equipment, remains unchanged at a balance of $2,000,000. The Company expensed Ulaan Ovoo property expenditures of $2.36 million incurred in the year ending December 31, 2013, as costs in excess of impaired value;

**Loss on disposal of investment in associate:** The Company recorded a loss on disposal of investment in associate of $12.4 million due to the decrease in the Company's ownership percentage in Wellgreen Platinum to 4.12% (excluding reserved held in trust shares Wellgreen Platinum shares);

**Interest expense**: The increase in interest expense was due to interest charges at a 25% effective interest rate on the original $10 million Waterton loan which matured on July 16 2013 along with interest charges at a 39% effective interest rate on the remaining extinguished balance of $6.25 million which was paid off on November 8, 2013;

**Deemed disposal loss of investment in associate**: The Company's ownership percentage in Wellgreen Platinum decreased as a result of a private placement of Wellgreen Platinum that the Company did not participate in during the year. As a result, the transaction triggered a deemed disposition for the Company creating a loss to be recognized for the year ended December 31, 2013;

**Share of net loss of associate:** The share of loss of an associate amount represents the Company's ownership interest applied to the net loss of Wellgreen Platinum for the year ended December 31, 2013.

**Deferred income tax recovery:** As a result of the Company's decrease in ownership and cessation of significant influence over Wellgreen Platinum during the year, the Company had a recovery in the current year of deferred income taxes payable that were recorded in prior periods.

## 7. FOURTH QUARTER

The following table summarize Prophecy Coal's consolidated results for the three months ended December 31, 2013 and 2012:

(Expressed in Canadian Dollars)

| Operating Expenses | | Three Months Ended December 31 | | |
|---|---|---|---|---|
| | | 2013 | | 2012 |
| Advertising and promotion | $ | 13,557 | $ | 218,508 |
| Consulting and management fees | | 100,503 | | (72,871) |
| General and administrative expenses | | 324,251 | | 1,054,532 |
| Mine site expenses | | - | | 309,406 |
| Professional fees | | 314,678 | | 417,764 |
| Share-based payments | | (1,036,813) | | (954,051) |
| Travel and accommodation | | 58,666 | | 96,066 |
| | $ | (225,158) | $ | 1,069,354 |

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

In the fourth quarter 2013, the Company's operating expenses decreased by $1.3 million compared to operating expenses for the fourth quarter in 2012 primarily due to the following:

**General and administrative expenses** decreased by $0.7 million primarily due to less salary and benefits expense as less personnel were on payroll during the fourth quarter 2013 compared to the fourth quarter of 2012.

**Mine site expenses** in 2012 were primarily attributable to Wellgreen Platinum.

**Consulting and management fees** include fees charged by officers of the Company and its subsidiaries. In the fourth quarter of 2013 consulting and management fees were $100,503 compared to a negative amount for the fourth quarter in 2012 due to an adjustment related to the capitalization of consulting and management fees paid to the Company's CEO related to the Company's Chandgana and Ulaan Ovoo properties.

**Share-based payments**: Due to the recalculation of the incremental fair value of re-priced and re-issued share purchase options, the Company had a negative balance of $1 million share-based payments in the fourth quarter of 2013. Due to a reclassification of share based payment expense related to a one time consultant during the fourth quarter of 2012, the Company had a negative balance of $0.95 million share-based payments in quarter four of 2012.

For the fourth quarter of 2013, the Company incurred other expenses classified as "Other Items" amounting to $11.0 million compared to $48.2 million for the fourth quarter of 2012.

(Expressed in Canadian Dollars)

| Other Items | | Three Months Ended December 31 2013 | | 2012 |
|---|---|---|---|---|
| Costs in excess of impaired value | $ | (1,066,843) | $ | - |
| Deemed disposal loss of investment in associate | | 142,143 | | - |
| Finance and transaction costs | | 375,000 | | - |
| Flow through premium liability income | | - | | (201,914) |
| Foreign exchange (gain) loss | | (12,084) | | 229,721 |
| Gain on deconsolidation of subsidiary | | - | | (4,366,912) |
| Gain on change in value of adjustment warrants | | 146,130 | | - |
| Gain on change in value of adjustment warrants | | - | | - |
| (Gain) loss on sale of available-for-sale investments | | (179,349) | | (67,500) |
| Impairment write down on property and equipment | | - | | 47,063,713 |
| Impairment on available-for-sale investments | | - | | 2,639,572 |
| Interest expense | | 144,254 | | 449,779 |
| Interest income | | (1,466) | | (10,428) |
| Loss on debt settlement | | 174,959 | | - |
| Loss on disposal of equipment | | - | | 191,528 |
| Loss on disposal of investment in associate | | 12,076,589 | | - |
| Mineral property written down | | - | | 460,843 |
| Share of net loss of associate | | 197,862 | | 196,961 |
| Deferred income tax recovery | | (953,100) | | 1,569,024 |
| | $ | 11,044,095 | $ | 48,154,387 |

**Finance and transaction costs:** The Company incurred finance and transaction costs related to the private sale of 18,525,000 common shares of Wellgreen Platinum for net proceeds of $7,500,000 with transaction fees of 5% were paid pursuant to purchase agreement. No such fees were paid in the comparative period.

**Loss on disposal of investment in associate:** The Company recorded a loss on disposal of investment in associate of $12.1 million due to the decrease in the Company's ownership percentage in Wellgreen Platinum during the year, the majority of which incurred during quarter four of 2013.

**Loss on debt settlemen**t: During quarter four of 2013, the Company settled a loan payable to a director of the Company by the issuance of common shares of the Company. The resulting effect of this non-monetary transaction was a $174,959 loss on settlement, of which did not occur in the comparative period.

**Deferred income tax recovery:** As a result of the Company's decrease in ownership and cessation of significant influence over Welgreen Platinum during the year, the Company had a recovery in the current year of deferred income taxes payable that were recorded in prior periods.

## 8. LIQUIDITY AND CAPITAL RESOURCES

### Working Capital

At December 31, 2013 Prophecy Coal had approximately $0.51 million comprised of cash and cash equivalents, representing a decrease of $0.26 million from the $0.77 million held at December 31, 2012. Working capital amounted to $6.1 million at December 31, 2013 compared to working capital of $0.1 million as at December 31 2012. The Company's working capital increased since the year ended December 31, 2012 as the Company paid off the $10 million Waterton Loan and recommenced operations at its Ulan Ovoo mine during quarter four of 2013.

As at the date of this report, the Company's working capital surplus is approximately $5 million. The Company has sufficient capital to fund its mining and exploration activities and to cover its administrative costs for 2014.

The Company raised $0.6 million in April 2013 and $1.1 million in June 2013 through a non-brokered private placement announced on February 7, 2013.

(Expressed in Canadian Dollars)

During the year ended December 31, 2013, the Company disposed of 19,840,827 Wellgreen Platinum shares for net proceeds of $7.8 million and a realized loss of $12.4 million recognized in the consolidated statement of operations and comprehensive loss. Transaction fees of $375,000 were incurred to facilitate the share sales. As a result, the Company's ownership percentage has been decreased to 4.12% (excluding reserved Wellgreen Platinum shares) or to 7% (including reserved Wellgreen Platinum shares) of the total issued and outstanding shares of Wellgreen Platinum, and, therefore, the Company ceased to have significant influence over Wellgreen Platinum. As of December 31, 2013 the Company holds 3.3 million of Wellgreen Platinum's issued and outstanding common shares. The closing price on December 31, 2013 as quoted on the Toronto Stock Venture Exchange was $0.69 per share for a total quoted amount of $2,295,810.

Subsequent to year end, the Company sold its remaining 3,327,261 common shares of Wellgreen Platinum in addition to 1,523,881 common shares released from trust for net proceeds of approximately $4.2 million.

During the year ended December 31, 2013, the Company disposed the remaining 31,409,385 shares of Victory Nickel for proceeds of $0.87 million and a realized gain of $0.24 million.

In November, 2013, the Company repaid the remaining balance of the Waterton Loan, plus applicable fees and interest totalling $7.0 million pursuant to the Amended Loan Agreement and has been provided with a release/discharge of security interests, charges, and pledges.

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

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

**Cash Flow Highlights**

| | | Year ended December 31, 2013 | | 2012 |
|---|---|---|---|---|
| Cash used in operating activities | $ | (3,191,812) | $ | (6,337,655) |
| Cash (used in) provided by investing activities | | 11,756,782 | | (26,094,880) |
| Cash (used in) provided by financing activities | | (8,825,805) | | 29,721,317 |
| Increase (decrease) in cash for period | | (260,835) | | (2,711,219) |
| Net foreign exchange difference | | - | | - |
| Cash balance, beginning of period | | 768,831 | | 3,480,050 |
| Cash balance, end of period | $ | 507,996 | $ | 768,831 |

**Operating activities:** Cash used in operating activities was $3.2 million during the year ended December 31, 2013 compared to cash used of $6.3 million during the same period of 2012. The decreased outflows in 2013 primarily related to a partial repayment of the Waterton Loan and reduced working capital requirements during the year.

**Investing activities:** Cash provided by investing activities was $11.8 million for the year ended December 31, 2013 compared to $26.1 million required cash for the year ended December 31, 2012. The Company received $7.8 million from the sale of its common shares of Wellgreen Platinum, $5.11 million from the release of restricted cash, and $0.87 million from the sale of its common shares of Victory Nickel. Cash used for property and equipment during the year ended December 31, 2013 was $0.7 million and the cash used for mineral property expenditures was $1.4 million.

**Financing activities:** A total of $8.8 million was used in financing activities during the year ended December 31, 2013 compared to $29.7 million cash received in the year ended December 31, 2012. The cash provided by financing activities was attributable to the net proceeds of $1.3 million received from the private placement completed during the year and $1.7 million in draws from the LOC facility. The Company fully paid out the $10 million Waterton Loan and related interest of $1.0 million during the year.

**Contractual Commitments**

Prophecy Coal's commitments related to mineral properties are disclosed in Note 15 to the Annual Financial Statements. Prophecy Coal's other commitments are disclosed in Note 28 to the Annual Financial Statements.

**Capital Risk Management**

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

The properties, to which Prophecy Coal currently has an interest in, are predominantly in the exploration stage; as such, Prophecy Coal is dependent on external financing to fund its activities. In order to carry out the planned exploration and development and pay for administrative costs, Prophecy Coal will spend its existing working capital and raise additional amounts as needed. There were no changes in managements approach to capital management during the year ended December 31, 2013. Neither Prophecy Coal nor its subsidiaries are subject to externally imposed capital requirements.

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

The Company expects to have sufficient liquidity and capital resources to be able to continue as a going concern until at least December 31, 2014 based on existing capital resources and estimated cash flows from mining operations (Note 1 to the Annual Financial Statements).

## 9. CONTINGENTIES

The Company accrues for liabilities when they are probable and the amount payable can be reasonably estimated. As at December 31, 2013 no contingent amounts have been accrued.

## 10. ENVIRONMENT

Prophecy Coal is subject to the Environmental Protection Law of Mongolia (the "**EPL**") and has the following duties with respect to environmental protection:

- To comply with the EPL and the decision of the government, local self-governing organizations, local governors and Mongolian state inspectors;
- To comply with environmental standards, limits, legislation and procedures and to supervise their implementation with their organization;
- To keep records on toxic substances, adverse impacts, and waste discharged into the environment; and
- To report on measures taken to reduce or eliminate toxic chemicals, adverse impacts, and waste.

In addition to those duties imposed on them by the EPL, mining license holders are required to prepare an initial environment impact assessment analysis before the mine comes into production. The mining license holders must also annually develop and implement an environmental protection plan (including reclamation measures) in co-operation with the Ministry of Nature, Environment and Tourism which should take into account the results of the environmental impact assessment.

Prophecy Coal received approval of its detailed Environmental Impact Assessment and Environmental Protection Plan from the Mongolian Ministry of Nature and Environment for mining operations at its Ulaan Ovoo mine in 2010. Prophecy Coal has implemented a number of internal policies to embrace responsibility for the impact of its business activities on the environment. By conducting studies, carefully designing mine plans, implementing pollution control recommendations from internal and external sources, monitoring the effects of mining on mining areas and carefully designing mine closure plans, Prophecy Coal seeks to minimize the impact of our activities on the environment.

Prophecy Coal established an environmental policy in 2008. The environmental policy affirms Prophecy Coal's commitment to environmental protection. Prophecy Coal monitors its operations to ensure that it complies with all applicable environmental requirements, and takes actions to prevent and correct problems if needed.

Closure and reclamation liability results from the development, construction and ordinary operation of mining property, plant and equipment and from environmental regulations set by regulatory authorities. The liability includes costs related to removal and/or demolition of mine equipment, buildings and other infrastructure, removing contaminated soil, protection of abandoned pits and re-vegetation.

At December 31, 2013, Prophecy Coal had a provision for closure and reclamation liability of $129,552 (December 31, 2012 - $294,263). The fair value of the closure and reclamation liability is estimated using a present value technique and is based on existing laws, contracts or other policies and current technology and conditions (Note 19 to the Annual Financial Statements).

## 11. RELATED PARTY DISCLOSURES

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

(a) The Cantech Capital Corporation, a private company owned by Donald Gee, former director of Wellgreen Platinum, provided consulting and management services.

(b) The Elysian Enterprises Inc., a private company owned by David Patterson, former director of Wellgreen Platinum, provided consulting and management services.

(c) Energy Investment Capital, a private company owned by Jivko Savov, former director of Prophecy Coal, provided consulting services to the Company.

(d) JWL Investment Corp., a private company owned by Joseph Li, former General Manager, Corporate Secretary and Director of Prophecy Coal and Wellgreen Platinum, provided management services to the Company.

(e) Linx Partners Ltd., a private company controlled by John Lee, Director, Interim CEO and Executive Chairman of Prophecy Coal, and a Director and former Chairman and CEO of Wellgreen Platinum, provides management and consulting services to the Company.

(f) MaKevCo Consulting Inc., a private company 50% owned by Greg Hall, Director of Prophecy Coal and former director of Wellgreen Platinum, provides consulting and management services to the Company.

(g) The Energy Gateway Ltd., a private company owned by former Director Paul Venter, provided consulting and management services.

On June 4, 2013, John Lee, the interim CEO, subscribed for 1,000,000 of the Company's common shares. In lieu of paying cash in the amount of $140,000 (1,000,000 shares at $0.14 per share), he transferred to the Company 202,989 common shares of Wellgreen Platinum (which were valued effective at $0.69 per share).

(Expressed in Canadian Dollars)

On July 12, 2013, Jeffrey Mason, former CFO, purchased 500,000 common shares of Wellgreen Platinum from the Company at $0.50 per share based on a 20% discount to the 5 day VWAP, as calculated on June 19, 2013. This purchase was made in accordance with his employment agreement with the Company. Proceeds of the sale totalled $250,000 which the Company used to partially repay the Waterton Loan in accordance with the Amended Loan Agreement. On October 8, 2013, the Company granted a severance payment of $98,250 to Mr. Mason by way of transferring 196,500 common shares of Wellgreen Platinum to Mr. Mason at a deemed price per share of $0.50.

On October 22, 2013, the Company entered into a one year loan agreement with Harald Batista, a director of the Company, in the amount of $200,000 with a stated interest rate of 8% per annum payable on the maturity date. The loan was subsequently settled on November 25, 2013 via the transfer of 493,827 common shares of Wellgreen Platinum from the Company to Mr. Batista at a deemed value per share of $0.405.

A summary of related party general and administrative expenses are as follows:

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Related parties | | 2013 | | 2012 |
| Cantech Capital Corp. (a) | $ | - | $ | 6,500 |
| Directors and officers | | 499,817 | | 400,418 |
| Elysian Enterprises Inc. (b) | | - | | 7,500 |
| Energy Investment Capital (c) | | - | | 39,852 |
| JWL Investments Corp. (d) | | - | | 284,500 |
| Linx Partners Ltd. (e) | | 525,012 | | 1,109,862 |
| MaKevCo Consulting Inc. (f) | | 142,200 | | 195,500 |
| The Energy Gateway (g) | | - | | 51,991 |
| | $ | 1,167,029 | $ | 2,096,123 |

*The Company's related party disclosure includes Wellgreen Platinum's related party transactions during the year ended December 31, 2013.*

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

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Related parties | | 2013 | | 2012 |
| Consulting and management fees | $ | 153,948 | $ | 787,534 |
| Directors' fees | | 246,010 | | 313,621 |
| Mineral properties | | 320,250 | | 701,109 |
| Property and equipment | | 162,750 | | 214,995 |
| Salaries and benefits | | 284,071 | | 78,864 |
| | $ | 1,167,029 | $ | 2,096,123 |

As at December 31, 2013, the amount included within accounts payable and accrued liabilities, which was due to related parties totalling $413,278 (December 31, 2012 – $53,334), consisted of amounts owing to directors for fees of 129,060, consulting fees of $84,072, and for managing the mineral properties and power plant project of $200,146.

**Other related party transactions**

Transactions between the Company and its subsidiaries are eliminated on consolidation; therefore, they are not disclosed as related party transactions.

Prophecy Coal shared administrative assistance, office space, and management with Wellgreen Platinum pursuant to a Service Agreement for 2012, consisting of fixed monthly fees of $40,000. Prophecy Coal recovers costs for services rendered to Wellgreen Platinum and expenses incurred on behalf of Wellgreen Platinum. As at December 31, 2013 an estimated amount of $78,364 was due from Wellgreen Platinum.

(Expressed in Canadian Dollars)

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

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

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Key Management Personnel | | 2013 | | 2012 |
| Salaries and short term benefits | $ | 811,323 | $ | 896,739 |
| Share-based payments | | 829,085 | | 324,624 |
| | $ | 1,640,408 | $ | 1,221,363 |

## 12. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Critical accounting estimates used in the preparation of the Annual Financial Statements include determining the carrying value of mineral properties exploration and evaluation projects and property and equipment, assessing the impairment of long-lived assets, determination of environmental obligation provision for closure and reclamation, determining deferred income taxes, and the valuation of share-based payments. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of Prophecy Coal's control.

Readers are encouraged to read the significant accounting policies and estimates as described in Prophecy Coal's Annual Financial Statements for the year ended December 31, 2013 (Note 5 to the Annual Financial Statements). Prophecy Coal's Annual Financial Statements have been prepared using the going concern assumption (Note 1 to the Annual Financial Statements).

**Significant accounting judgments and estimates**

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Areas requiring the use of estimates include the rates of amortization for property and equipment, the useful life and recoverability of long-lived assets, the recoverability of accounts receivable, determination of environmental obligation provision for closure and reclamation, accounts payable and accrued liabilities, the assumptions used in the determination of the fair value of financial instruments and share-based payments, and the determination of the recoverability of for deferred income tax assets. Prophecy Coal bases its estimates and assumptions on current and various other factors that it believes to be reasonable under the circumstances. Management believes the estimates are reasonable; however, actual results could differ from those estimates and could impact future results of operations and cash flows. See Note 5 to the Annual Financial Statements for further details.

(a) Same accounting policies as annual audited consolidated financial statements

Prophecy Coal followed the same accounting policies and methods of computation in the Annual Financial Statements for the year ended December 31, 2013 as followed in the consolidated financial statements for the year ended December 31, 2012.

(b) Basis of consolidation

The Annual Financial Statements include the accounts of Prophecy Coal and its controlled subsidiaries. All material intercompany balances and transactions have been eliminated. Details of Prophecy Coal's subsidiaries at the date of these MD&A:

(Expressed in Canadian Dollars)

| | Principal | Place of incorporation | Ownership |
|---|---|---|---|
| 0912603 B.C. Ltd. | Exploration/Development | Canada | 100% |
| 0912601 B.C. Ltd. | Exploration/Development | Canada | 100% |
| Chandgana Coal LLC | Exploration/Development | Mongolia | 100% |
| Prophecy Power Generation LLC | Exploration/Development | Mongolia | 100% |
| Red Hill Mongolia LLC | Exploration/Development | Mongolia | 100% |
| UGL Enterprises LLC | Inactive | Mongolia | 100% |
| 1420 PSR PTE. LTD | Holding | Singapore | 100% |

## 13. FINANCIAL INSTRUMENTS AND RELATED RISKS

The Board of Directors, through the Audit Committee is responsible for identifying the principal risks of Prophecy Coal and ensuring that risk management systems are implemented. Prophecy Coal manages its exposure to financial risks, including liquidity risk, foreign exchange rate risk, interest rate risk, and credit risk in accordance with its risk management framework. Prophecy Coal's Board of Directors reviews Prophecy Coal's policies on an ongoing basis.

**Financial Instruments** (Note 24 to the Annual Financial Statements)

The following table sets forth Prophecy Coal's financial assets that are measured at fair value on a recurring basis by level within the fair value hierarchy. As at December 31, 2013, those financial assets and liabilities are classified in their entirety based on the level of input that is significant to the fair value measurement.

| As at December 31, 2013 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Financial assets | | | | |
| Cash and cash equivalents | $ 507,996 | $ - | $ - | $ 507,996 |
| Receivables | 2,648,993 | - | - | 2,648,993 |
| Amount due from related party | 78,364 | - | - | 78,364 |
| Available-for-sale investments | 2,295,810 | - | - | 2,295,810 |
| | $ 5,531,163 | $ - | $ - | $ 5,531,163 |

**Related Risks**

Liquidity risk is the risk that an entity will be unable to meet its financial obligations as they fall due. The Company manages liquidity risk by preparing cash flow forecasts of upcoming cash requirements. The Company maintained sufficient cash, including short term investments, at December 31, 2013 in the amount of $5,507,996 (December 31, 2012 - $5,876,331) in order to meet short-term business requirements. At December 31, 2013, the Company had accounts payable and accrued liabilities $1,432,238 (December 31, 2012 - $766,209), which have contractual maturities of 90 days or less, and loan payable of $nil (December 31, 2012 - $9,392,170) which were due within one year in the comparative period. The Company had a current portion of $1,069,400 related to a line of credit (December 31, 2012 - $nil) as of December 31, 2013.

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

Market risk - The significant market risks to which Prophecy Coal is exposed are interest rate risk, foreign currency risk, and commodity and equity price risk.

(a) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Prophecy Coal's cash equivalents primarily include highly liquid investments that earn interest at market rates that are fixed to maturity or at variable interest rates. Due to the short-term nature of these financial instruments, fluctuations in market rates do not have a significant impact on the fair values or future cash flows of the financial instruments as of December 31, 2013. Prophecy Coal manages interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity.

(b) Foreign currency risk

Prophecy Coal is exposed to foreign currency risk to the extent that monetary assets and liabilities held by Prophecy Coal are not denominated in Canadian dollars. Prophecy Coal has exploration and development projects in Mongolia and undertakes transactions in various foreign currencies. Prophecy Coal is therefore exposed to foreign currency risk arising from transactions denominated in a foreign currency and the translation of financial instruments denominated in US dollars and Mongolia tugrug into its reporting currency, the Canadian dollar.

Net exposures as at December 31, 2013, with other variables unchanged, a 1% strengthening (weakening) of the Canadian dollar against the Mongolian tugrug would not have a material impact on earnings with other variables unchanged. A 1% strengthening (weakening) of the US dollar against the Canadian dollar would not have a material impact on net loss. Prophecy Coal currently does not use any foreign exchange contracts to hedge this currency risk.

(c) Commodity and equity price risk

The Company holds investments in available-for-sale that fluctuate in value based on market prices. Based upon the Company's investment position as at December 31, 2013, a 10% increase (decrease) in the market price of the available-for-sale investments held would have resulted in an increase (decrease) to comprehensive income (loss) of approximately $229,600 (December 31, 2012 - $62,800 million). Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company closely monitors commodity prices, individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company. Fluctuations in value may be significant.

## 14. RISKS AND UNCERTAINTIES

Readers should carefully consider the risks and uncertainties described in the Company's Annual Information Form for the year ended December 31, 2013 (the "**AIF**") "Risk Factors" page 44. The AIF is available under the Company's profile at www.SEDAR.com.

## 15. DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by Prophecy Coal in its annual filings, filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by Prophecy Coal in its annual filings, filings or other reports filed or submitted under securities legislation is accumulated and communicated to Prophecy Coal's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of Prophecy Coal's disclosure controls and procedures. As of December 31, 2013, the Chief Executive Officer and Chief Financial Officer have each concluded that Prophecy Coal's disclosure controls and procedures, as defined in NI 52-109 are effective to achieve the purpose for which they have been designed. The Company identified two material weaknesses in internal controls regarding 2012 annual reporting; being the consistent application of the Company's accounting policies and procedures during 2012 by its wholly owned Mongolian subsidiaries and accounting for non-cash stock based compensation, both of which were communicated to the audit committee and the board of directors. To mitigate these issues the Company hired an internal auditor in 2012 to report to the audit committee, increased accounting personnel and time in these two areas, and expanded the review diligence prior to the finalization of the year end consolidated financial statements. During 2013, the internal auditor was released and additional accounting and finance personnel were hired for various functions. The audit committee, accounting and finance team and management continue to expand the review diligence prior to the finalization of the year end consolidated financial statements and work towards enhancing the Company's practices and internal controls, in addition to refinements to the Whistle Blower and Code of Conduct policies.

Prophecy Coal's disclosure committee, is comprised of the Chief Executive Officer and senior members of management. The disclosure committee's responsibilities include determining whether information is material and ensuring the timely disclosure of material information in accordance with securities laws. The board of directors is responsible for reviewing the Company's disclosure policy, procedures and controls to ensure that it addresses the Company's principal business risks, and changes in operations or structure, and facilitates compliance with applicable legislative and regulatory reporting requirements.

### *Design of Internal Controls over Financial Reporting*

Prophecy Coal's internal controls over financial reporting include policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions, acquisition and disposition of assets and liabilities;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with IFRS and that receipts and expenditures are being made only in accordance with the authorization of management and directors of Prophecy Coal; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets, and incurrence of liabilities, that could have a material effect on the financial statements.

The Company's management are responsible for establishing and maintaining an adequate system of internal control over financial reporting. Any system of internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. There has not been any change in the Company's internal control over financial reporting that occurred during the Company's fourth fiscal quarter of 2013 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## 16. DISCLOSURE OF OUTSTANDING SHARE DATA

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

- 249,387,569 common shares outstanding with recorded value of $147,781,488;
- 22,053,750 stock options outstanding with a weighted average exercise price of $0.18. Each option is exercisable to purchase a common share of the Company at prices ranging from $0.08 to $0.67 and which expire between 2014 and 2019; and
- 13,225,583 share purchase warrants outstanding exercisable to purchase one common share of the Company at any time at a price of $0.18 and which expire between April and October 2015.

## 17. OFF-BALANCE SHEET ARRANGEMENTS

During the year ended December 31, 2013, Prophecy Coal was not a party to any off-balance-sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations, financial condition, revenues or expenses, liquidity, capital expenditures or capital resources of Prophecy Coal.

Prophecy
Coal Corp.

# Annual Consolidated Financial Statements
# For the years ended December 31, 2013 and 2012
**(Expressed in Canadian Dollars)**

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## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The annual audited consolidated financial statements (the "Annual Financial Statements"), the notes thereto, and other financial information contained in the accompanying Management's Discussion and Analysis ("MD&A") have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and are the responsibility of the management of Prophecy Coal Corp. The financial information presented elsewhere in the MD&A is consistent with the data that is contained in the Annual Financial Statements. The Annual Financial Statements, where necessary, include amounts which are based on the best estimates and judgment of management.

In order to discharge management's responsibility for the integrity of the Annual Financial Statements, the Company maintains a system of internal accounting controls. These controls are designed to provide reasonable assurance that the Company's assets are safeguarded, transactions are executed and recorded in accordance with management's authorization, proper records are maintained and relevant and reliable financial information is produced. These controls include maintaining quality standards in hiring and training of employees, policies and procedures manuals, a corporate code of conduct and ethics and ensuring that there is proper accountability for performance within appropriate and well-defined areas of responsibility. The system of internal controls is further supported by a compliance function, which is designed to ensure that we and our employees comply with securities legislation and conflict of interest rules.

The Board of Directors is responsible for overseeing management's performance of its responsibilities for financial reporting and internal control. The Audit Committee, which is composed of non-executive directors, meets with management as well as the external auditors to ensure that management is properly fulfilling its financial reporting responsibilities to the Board who approve the Annual Financial Statements. The external auditors have full and unrestricted access to the Audit Committee to discuss the scope of their audits and the adequacy of the system of internal controls, and to review financial reporting issues.

The external auditors, Davidson & Company LLP, have been appointed by the Company's shareholders to render their opinion on the Annual Financial Statements and their report is included herein.

| | |
|---|---|
| *"John Lee"* | "*Irina Plavutska*" |
| -------------------------------------- | ----------------------------------------- |
| John Lee, Interim Chief Executive Officer<br>Vancouver, British Columbia | Irina Plavutska, Chief Financial Officer |

March 28, 2014

# INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Prophecy Coal Corp.

We have audited the accompanying consolidated financial statements of Prophecy Coal Corp., which comprise the consolidated statements of financial position as at December 31, 2013 and the consolidated statements of operations and comprehensive loss, changes in equity, and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors' Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

***Opinion***

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Prophecy Coal Corp. as at December 31, 2013 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

***Other Matters***

The consolidated financial statements of Prophecy Coal Corp. for the year ended December 31, 2012 were audited by another auditor who expressed an unmodified opinion on those statements on April 2, 2013.

**"DAVIDSON & COMPANY LLP"**

Vancouver, Canada — Chartered Accountants

March 28, 2014

**PROPHECY COAL CORP.**
**Consolidated Statements of Financial Position**
(Expressed in Canadian Dollars)

| As at | Notes | | December 31 2013 | | December 31 2012 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Current assets** | | | | | |
| Cash and cash equivalents | 8 | $ | 507,996 | $ | 768,831 |
| Short term investments | 9 | | - | | 5,107,500 |
| Receivables | 10 | | 2,648,993 | | 456,035 |
| Amount due from related party | 25 | | 78,364 | | 82,500 |
| Prepaid expenses | 11 | | 1,278,914 | | 1,443,282 |
| Inventory | 12 | | 1,758,310 | | 2,436,534 |
| Available-for-sale-investments | 13 | | 2,295,810 | | - |
| | | | 8,568,387 | | 10,294,682 |
| **Non-current assets** | | | | | |
| Restricted cash equivalents | 8 | | 34,500 | | - |
| Reclamation deposits | | | 27,554 | | 27,554 |
| Available-for-sale-investments | 13 | | - | | 628,188 |
| Investment in associate | 13 | | - | | 25,118,910 |
| Property and equipment | 14 | | 10,758,586 | | 12,929,342 |
| Mineral properties | 15 | | 15,053,773 | | 13,387,882 |
| | | $ | 34,442,800 | $ | 62,386,558 |
| **Liabilities and Equity** | | | | | |
| **Current liabilities** | | | | | |
| Accounts payable & accrued liabilities | 16 | $ | 1,432,238 | $ | 766,209 |
| Loan payable | 17 | | - | | 9,392,170 |
| Line of credit facility, current portion | 18 | | 1,069,400 | | - |
| | | | 2,501,638 | | 10,158,379 |
| **Non-current liabilities** | | | | | |
| Provision for closure and reclamation | 19 | | 129,552 | | 294,263 |
| Line of credit facility | 18 | | 631,925 | | - |
| Deferred income tax | 20 | | - | | 953,100 |
| | | | 3,263,115 | | 11,405,742 |
| **Equity** | | | | | |
| Share capital | 21 | | 147,680,113 | | 145,796,591 |
| Reserves | | | 19,790,089 | | 18,577,859 |
| Accumulated other comprehensive gain | 13 | | 399,271 | | - |
| Deficit | | | (136,689,788) | | (113,393,634) |
| Equity attributable to owners of the Company | | | 31,179,685 | | 50,980,816 |
| Equity attributable to non-controlling interest | | | - | | - |
| **Total Equity** | | | 31,179,685 | | 50,980,816 |
| | | $ | 34,442,800 | $ | 62,386,558 |

Approved on behalf of the Board:

***"John Lee"*** ***"Greg Hall"***

John Lee, Director Greg Hall, Director

**Nature of operation and going concern** (Note 1)
**Commitments** (Note 28)
**Events after the reporting date** (Note 30)

See accompanying notes to the consolidated financial statements.

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

| | Notes | Year Ended December 31 2013 | 2012 |
|---|---|---|---|
| **General and Administrative Expenses** | | | |
| Advertising and promotion | | $ 132,779 | $ 2,018,946 |
| Consulting and management fees | | 198,156 | 877,343 |
| Depreciation | | 137,535 | 196,968 |
| Director fees | | 247,655 | 335,964 |
| Insurance | | 186,128 | 225,347 |
| Mine site expenses | | - | 367,879 |
| Office and administration | | 141,949 | 517,095 |
| Professional fees | | 974,010 | 1,303,805 |
| Salaries and benefits | | 531,355 | 1,725,900 |
| Share-based payments | 21 | 1,304,486 | 2,650,632 |
| Stock exchange and shareholder services | | 121,617 | 231,272 |
| Travel and accommodation | | 118,778 | 397,126 |
| **Loss Before Other Items and Deferred Income Tax Recovery** | | (4,094,448) | (10,848,277) |
| **Other Items** | | | |
| Costs in excess of impaired value | 14 | (2,356,443) | - |
| Deemed disposal loss of investment in associate | 13 | (1,264,472) | - |
| Finance and transaction costs | 17 | (765,000) | - |
| Flow through premium liability income | | - | 201,914 |
| Foreign exchange gain (loss) | | 251,254 | (272,456) |
| Gain on deconsolidation of subsidiary | | - | 4,366,912 |
| Gain (loss) on sale of available-for-sale investments | 13 | 237,137 | (1,652,514) |
| Impairment write down on property and equipment | | - | (47,063,713) |
| Impairment on available-for-sale investments | | - | (2,639,572) |
| Interest expense | 17 | (2,314,438) | (1,145,031) |
| Interest income | | 28,890 | 59,435 |
| Loss on debt settlement | 25 | (174,959) | - |
| Loss on disposal of equipment | | - | (191,528) |
| Loss on disposal of investment in associate | 13 | (12,399,523) | - |
| Mineral property written down | | - | (651,823) |
| Share of net loss of associate | 13 | (1,397,252) | (196,961) |
| | | (20,154,806) | (49,185,337) |
| **Loss Before Deferred Tax Recovery** | | (24,249,254) | (60,033,616) |
| Deferred income tax recovery (expense) | | 953,100 | (1,355,492) |
| **Net Loss for Year** | | (23,296,154) | (61,389,108) |
| Fair value gain on available-for-sale investments | 7 | 399,271 | 1,923,769 |
| **Comprehensive Loss for Year** | | $ (22,896,883) | $ (59,465,339) |
| Net loss for year attributable to: | | | |
| Owners of the Company | | $ (23,296,154) | $ (56,876,372) |
| Non-controlling interest | | - | (4,512,736) |
| | | $ (23,296,154) | $ (61,389,108) |
| Comprehensive loss for year attributable to: | | | |
| Owners of the Company | | $ (22,896,883) | $ (55,033,590) |
| Non-controlling interest | | - | (4,431,749) |
| | | $ (22,896,883) | $ (59,465,339) |
| **Loss Per Common Share,** basic and diluted | | $ (0.10) | $ (0.28) |
| **Weighted Average Number of Common Shares Outstanding** | | 236,480,098 | 222,183,144 |

See accompanying notes to the consolidated financial statements.

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

| | Numbers of shares | Share Capital | Reserves | Accumulated Other Comprehensive Gain (Loss) | Deficit | Equity attributable to owners of the Company | Non-controlling Interest | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2011** | 201,109,422 | $ 134,492,080 | $ 17,138,468 | $ (1,842,782) | $ (53,375,529) | $ 96,412,237 | $ 32,808,418 | $ 129,220,655 |
| Private placement, shares issued | 22,363,866 | 10,063,740 | - | - | - | 10,063,740 | - | 10,063,740 |
| Private placement, share issue costs | - | (774,549) | - | - | - | (774,549) | - | (774,549) |
| Shares issued as financing fees | 2,735,617 | 600,000 | - | - | - | 600,000 | - | 600,000 |
| Options exercised | 187,500 | 159,875 | (113,000) | - | - | 46,875 | - | 46,875 |
| Warrants exercised | 1,479,509 | 762,578 | (7,232) | - | - | 755,346 | - | 755,346 |
| Share-based payments | - | - | 905,229 | - | - | 905,229 | 1,984,365 | 2,889,594 |
| Share bonus to personnel | 525,042 | 78,857 | 74,363 | - | - | 153,220 | - | 153,220 |
| Warrant modification | - | - | 580,031 | - | (580,031) | - | - | - |
| Dilution and sale of interest in subsidiary | - | - | - | - | (2,561,702) | (2,561,702) | 20,250,321 | 17,688,619 |
| Loss for the year | - | - | - | - | (56,876,372) | (56,876,372) | (4,512,736) | (61,389,108) |
| Unrealized gain (loss) on available for-sale investments | - | - | - | (795,580) | - | (795,580) | 80,987 | (714,593) |
| Deferred income tax | - | 414,010 | - | - | - | 414,010 | - | 414,010 |
| Impairment of available-for-sale investments | - | - | - | 2,638,362 | - | 2,638,362 | - | 2,638,362 |
| De-consolidation of subsidiary | - | - | - | - | - | - | (50,611,355) | (50,611,355) |
| **Balance, December 31, 2012** | 228,400,956 | $ 145,796,591 | $ 18,577,859 | $ - | $ (113,393,634) | $ 50,980,816 | $ - | $ 50,980,816 |
| Private placement, shares issued | 12,525,428 | 1,753,560 | - | - | - | 1,753,560 | - | 1,753,560 |
| Private placement, share issue costs | - | (763,963) | - | - | - | (763,963) | - | (763,963) |
| Shares issued as financing fees | 2,000,000 | 280,000 | - | - | - | 280,000 | - | 280,000 |
| Warrants exercised | 4,175,143 | 438,390 | - | - | - | 438,390 | - | 438,390 |
| Share-based payments | - | - | 1,070,305 | - | - | 1,070,305 | - | 1,070,305 |
| Share bonus to personnel | 1,272,292 | 175,535 | 141,925 | - | - | 317,460 | - | 317,460 |
| Loss for the year | - | - | - | - | (23,296,154) | (23,296,154) | - | (23,296,154) |
| Fair value gain on available-for-sale-investments | - | - | - | 399,271 | - | 399,271 | - | 399,271 |
| **Balance, December 31, 2013** | 248,373,819 | $ 147,680,113 | $ 19,790,089 | $ 399,271 | $ (136,689,788) | $ 31,179,685 | $ - | $ 31,179,685 |

See accompanying notes to the consolidated financial statements.

**PROPHECY COAL CORP.**
**Consolidated Statements of Cash Flows**
(Expressed in Canadian Dollars)
**Supplemental cash flow information** (Note 27)

| | Year Ended December 31 2013 | 2012 |
|---|---|---|
| **Operating Activities** | | |
| Net loss for the year | $ (23,296,154) | $ (61,389,108) |
| Adjustments to reconcile net loss to net cash flows: | | |
| Depreciation and accretion | 137,535 | 203,806 |
| Deferred income tax | (953,100) | 1,355,492 |
| Share-based payments | 1,304,486 | 2,650,632 |
| Share of loss of an associate | 1,397,252 | 196,961 |
| Loss on disposal of investment in associate | 12,399,523 | - |
| Deemed loss on investment in associate | 1,264,472 | - |
| Unrealized gain on deconsolidation of subsidiary | - | (4,366,912) |
| Impairment write down on property and equipment | - | 47,063,713 |
| Costs in excess of impaired value | 2,356,443 | - |
| (Gain) loss on sale of available-for-sale investments | (237,137) | 1,652,514 |
| Impairment on available-for-sale investments | - | 2,639,572 |
| Mineral property write down | - | 651,823 |
| Interest costs | 2,314,438 | 1,145,031 |
| Finance and transaction costs | 390,000 | - |
| Interest income | (28,890) | (59,435) |
| Unrealized foreign exchange | 219 | - |
| | (2,950,913) | (8,255,910) |
| Working capital adjustments | | |
| Receivables | (1,509,084) | 2,703,925 |
| Prepaid expenses | 164,368 | (833,925) |
| Decrease in nventory | 678,224 | - |
| Accounts payable and accrued liabilities | 425,593 | 48,254 |
| | (240,899) | 1,918,254 |
| **Cash Used in Operating Activities** | (3,191,812) | (6,337,655) |
| **Investing Activities** | | |
| Restricted cash | (34,500) | - |
| Acquisition of property and equipment | (651,554) | (14,415,386) |
| Mineral property expenditures | (1,383,594) | (8,882,679) |
| Short term investment | 5,107,500 | (5,107,500) |
| Proceeds from disposal of investment in associate | 7,824,715 | - |
| Cash disposed on loss of control of subsidiary | - | (2,146,240) |
| Proceeds from sale of available-for-sale investments | 865,325 | 4,570,289 |
| Loss on disposal of equipment | - | (191,528) |
| Interest received from short term investment | 28,890 | 78,164 |
| **Cash (Used in) Provided by Investing Activities** | 11,756,782 | (26,094,880) |
| **Financing Activities** | | |
| Loan proceeds | - | 9,625,000 |
| Mongolian credit facility proceeds | 1,701,325 | - |
| Loan paid and fees | (10,398,936) | - |
| Restructuring fees | (390,000) | - |
| Interest paid | (1,026,181) | (656,736) |
| Shares issued, net of share issuance costs | 1,287,987 | 19,147,919 |
| Net proceeds from exercise of options | - | 298,876 |
| Net proceeds from exercise of warrants | - | 1,104,344 |
| Flow through premium liability income | - | 201,914 |
| **Cash (Used in) Provided by Financing Activities** | (8,825,805) | 29,721,317 |
| Net (Decrease) Increase in cash and cash equivalents | (260,835) | (2,711,219) |
| Cash and Cash Equivalents - beginning of year | 768,831 | 3,480,050 |
| Cash and Cash Equivalents - end of year | $ 507,996 | $ 768,831 |

See accompanying notes to the consolidated financial statements.

## 1. NATURE OF OPERATIONS AND GOING CONCERN

Prophecy Coal Corp. ("Prophecy Coal" or the "Company") is incorporated under the laws of the province of British Columbia, Canada and is engaged in exploring and developing coal properties and coal mine-mouth power projects in Mongolia. The Company maintains its head office at 2nd floor, 342 Water Street, Vancouver, B.C., Canada, V6B 1B6.

The business of mineral exploration involves a high degree of risk and there can be no assurance that the Company's current operations, including exploration programs, will result in profitable mining operations. The recoverability of the carrying value of mineral properties, and property and equipment interests and the Company's continued on going existence is dependent upon the preservation of its interest in the underlying properties, the discovery of economically recoverable reserves, the achievement of profitable operations, the ability of the Company to raise additional sources of funding, and/or, alternatively, upon the Company's ability to dispose of some or all of its interests on an advantageous basis.

It is indeterminate when and whether the Company can attain profitability and positive cash flow, obtain adequate additional financing, achieve stable profitable operations at the Ulaan Ovoo property, develop the Chandgana Power Plant project including coal feed, control costs of production, and receive the required market price levels for coal.

The Company has incurred significant losses and negative cash flow from operations in recent years. The Company was in pre-commercial production at its Ulaan Ovoo coal property ("Ulaan Ovoo") in Mongolia commencing in November 2010. In July 2012, the Company temporarily suspended pre-commercial production at Ulaan Ovoo to manage coal inventory and to maintain efficient working capital levels. The Company recommenced pre-commercial production at the end of October 2013.

In order to finance its business in 2013, the Company: 1) raised $1.7 million in a non-brokered private placement; 2) disposed 19.8 million Wellgreen Platinum Ltd. (formerly Prophecy Platinum Corp.) shares for net proceeds of $7.8 million (Note 13); 2) repaid a secured debt facility with Waterton Global Value LP ("Waterton") of $10 million plus applicable fees and interest (Note 17); and entered into a US $1.5 million line of credit facility with Trade and Development Bank in Mongolia (Note 18). Subsequent to year end, the Company sold its interest in Wellgreen Platinum's common shares for net proceeds of approximately $4.2 million (Note 30). The Company continues to minimize uncommitted capital expenditures and exploration expenditures in order to preserve its financial resources.

At December 31, 2013, Prophecy Coal had cash and cash equivalents of $0.51 million and working capital of $6.1 million. The net loss incurred for the year ended December 31, 2013 amounted to $23.3 million, and the cumulative deficit for the Company was $136.7 million, as at December 31, 2013.

Additional sources of funding, which may not be available at favourable terms, if at all, include: equity and debt financings; coal sales; equipment rentals; equity, debt or property level joint ventures with power project and coal property developers; and sales of interests in existing assets. In the event that the Company is not able to obtain adequate additional funding to continue as a going concern, material adjustment would be required to both the carrying value and classification of assets and liabilities on the statement of financial position.

## 1. NATURE OF OPERATIONS AND GOING CONCERN (cont'd...)

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

## 2. BASIS OF PRESENTATION

(a) Statement of compliance

These Annual Financial Statements have been prepared in accordance with International Financial Reporting Standards, ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The preparation of financial statements in compliance with IFRS requires the use of certain critical accounting estimates. It also requires the Company's management to exercise judgment in applying the Company's accounting policies. The areas where significant judgments and estimates have been made in preparing these Annual Financial Statements and their effect are disclosed in Note 5.

These Annual Financial Statements have been prepared on a historical cost basis, except for financial instruments classified as available-for-sale and fair value through profit or loss ("FVTPL"), which are stated at their fair values. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting except for cash flow information.

The accounting policies set out in Note 6 and have been applied consistently by the Company and its subsidiaries to all years presented.

(b) Approval of the financial statements

The Annual Consolidated Financial Statements were approved and authorized for issue by the Board of Directors on March 28, 2014.

(c) Functional Currency

The presentation currency is the Canadian dollar and the functional currency of the Company and its subsidiaries is the Canadian dollar, as this is the principal currency of the economic environment in which it operates.

(Expressed in Canadian Dollars)

## 3. BASIS OF CONSOLIDATION

a) Subsidiaries

The Annual Financial Statements comprise the financial statements of the Company and its wholly owned subsidiaries as at December 31, 2013. Subsidiaries are consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date when such control ceases. Effects of transactions between related companies are eliminated on consolidation. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company. Accounting policies of the subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

Prophecy Coal's subsidiaries at December 31, 2013 are as follows:

| | Principal | Place of incorporation | Ownership |
|---|---|---|---|
| 0912603 B.C. Ltd. | Exploration/Development | Canada | 100% |
| 0912601 B.C. Ltd. | Exploration/Development | Canada | 100% |
| Chandgana Coal LLC | Exploration/Development | Mongolia | 100% |
| Prophecy Power Generation LLC | Exploration/Development | Mongolia | 100% |
| Red Hill Mongolia LLC | Exploration/Development | Mongolia | 100% |
| UGL Enterprises LLC | Inactive | Mongolia | 100% |

## 4. CHANGES IN ACCOUNTING POLICIES

New Accounting Standards

IFRS 10 – *Consolidated Financial Statements* (“IFRS 10”)

IFRS 10 applied starting January 1, 2013. The Company reviewed its investment in Wellgreen Platinum Ltd. at January 1, 2013 and has concluded that that the adoption of IFRS 10 did not result in any change to the investment in an associate balance. The Company also applied the revisions to IAS 27 and IAS 28 and the application did not have a significant impact on the consolidated financial statements.

IFRS 11 – *Joint Arrangements* (“IFRS 11”)

IFRS 11 applied starting January 1, 2013. It does not have any impact on the consolidated financial statements.

IFRS 12 – *Disclosure of Interests in Other Entities* (“IFRS 12”)

IFRS 12 applied starting January 1, 2013. The requirement of IFRS 12 relates to disclosures only and is applicable for the first annual period after adoption. The Company included additional disclosures about interests in other entities in its Annual Financial Statements for the year ended December 31, 2013 (Note 13).

(Expressed in Canadian Dollars)

## 4. CHANGES IN ACCOUNTING POLICIES (cont'd...)

IFRS 13 - *Fair Value Measurement* (IFRS 13")

The Company adopted IFRS 13 with prospective application from January 1, 2013.

The adoption of IFRS 13 had immaterial effect on the Company's Annual Financial Statements for the year ended December 31, 2013. The Company has added additional disclosures on fair value measurement in Note 23.

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

As at December 31, 2013, the Company is not in the production stage. The Company is currently assessing the impact of adopting IFRIC 20 on its consolidated financial statements.

**Standards issued but not yet effective**

The standards and interpretations that are issued up to the date of issuance of the Company's financial statements, but were not effective during the year ended December 31, 2013, are disclosed below. The Company intends to adopt these standards, if applicable, when they become effective.

| | |
|---|---|
| IFRS 9 | Financial Instruments(iii) |
| IFRS 9, IFRS 7 and IAS 39 Amendments | Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39(iii) |
| IFRS 10, IFRS 12 and IAS 27 (2011) Amendments | Amendments to IFRS 10, IFRS 12 and IAS 27 (2011) – Investment Entities(i) |
| IAS 19 Amendments | Amendments to IAS 19 Employee Benefits – Defined Benefit Plans: Employee Contributions(ii) |
| IAS 32 Amendments | Amendments to IAS 32 Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities(i) |
| IAS 39 Amendments | Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting(i) |
| IFRIC 21 | Levies(i) |

(i) Effective for annual periods beginning on or after January 1, 2014.
(ii) Effective for annual periods beginning on or after July 1, 2014.
(iii) Mandatory effective date not yet determined.

The Company anticipates that the adoption of these standards and interpretations in future periods will have no material impact on the financial statements of the Company.

## 5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of a company's financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from these estimates.

### 5.1 Significant Judgments

The significant judgments that the Company's management has made in the process of applying the Company's accounting policies, apart from those involving estimation uncertainties (Annual financial statements 5.1.2), that have the most significant effect on the amounts recognized in the Annual Financial Statements include, but are not limited to:

a) Functional currency determination

The functional currency for each of the Company's subsidiaries and investment in an associate is the currency of the primary economic environment and the Company reconsiders the functional currency of its entities if there is a change in events and conditions which determined the primary economic environment.

b) Operating levels intended by management and valuation of property and equipment

Prior to reaching operating levels intended by management, costs incurred are capitalized as part of the costs of the related mineral property and proceeds from coal sales are offset against capitalized costs. Depletion of capitalized costs for a mineral property begins when operating levels intended by management have been reached. Management considers several factors in determining when a mineral property has reached the operating levels intended by management. The results of operations of the Company during the year ended December 31, 2013, presented in these Annual Financial Statements, have been impacted by management's determination that its Ulaan Ovoo mineral property, classified within property and equipment on the statement of financial position, did not reach the operating levels intended by management. The Company is unable to determine with certainty the extent of project changes and operational modifications that would be required to more fully realize on the potential value of the existing coal resources. The determined impaired value of $2 million for the Ulaan Ovoo property as at December 31, 2012, remains unchanged at December 31, 2013 (Note 14).

c) Economic recoverability and probability of future economic benefits of exploration, evaluation and development costs

Management has determined that exploratory drilling, evaluation, development and related costs incurred which have been capitalized are economically recoverable. Management uses several criteria in its assessments of economic recoverability and probability of future economic benefit including geologic and metallurgic information, history of conversion of mineral deposits to proven and probable reserves, scoping, prefeasibility and feasibility studies, assessable facilities, existing permits and life of mine plans.

## 5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS (cont'd...)

d) Impairment assessment of deferred exploration interests

The Company considers both external and internal sources of information in assessing whether there are any indications that mineral property interests are impaired. External sources of information the Company considers include changes in the market, economic and legal environment in which the Company operates that are not within its control and affect the recoverable amount of mineral property interest. Internal sources of information the Company considers include the manner in which mineral properties and plant and equipment are being used or are expected to be used and indications of economic performance of the assets. Management has determined that at December 31, 2013, there was no further impairment write down of the Ulaan Ovoo property and there was no impairment of the Company's other mineral property interests.

### 5.2 Estimates and Assumptions

The Company bases its estimates and assumptions on current and various other factors that it believes to be reasonable under the circumstances. Management believes the estimates are reasonable; however, actual results could differ from those estimates and could impact future results of operations and cash flows.

The areas which require management to make significant estimates and assumptions in determining carrying values include, but are not limited to:

a) Mineral reserves

The recoverability of the carrying value of the exploration and evaluation assets and mineral properties is dependent on successful development and commercial exploitation, or alternatively, sale of the respective areas of interest;

b) Depreciation

Significant judgment is involved in the determination of useful life and residual values for the computation of depreciation, depletion and amortization and no assurance can be given that actual useful lives and residual values will not differ significantly from current assumptions.

c) Impairment

The carrying value of property and equipment is reviewed each reporting period to determine whether there is any indication of impairment. If the carrying amount of an asset exceeds its recoverable amount, the asset is impaired and an impairment loss is recognized in the consolidated statement of operations. The assessment of fair values, including those of the cash generating units (the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflow from other assets or groups of assets) ("CGUs") for purposes of testing goodwill, require the use of estimates and assumptions for recoverable production, long-term commodity prices, discount rates, foreign exchange rates, future capital requirements and operating performance. Changes in any of the assumptions or estimates used in determining the fair value of goodwill or other assets could impact the impairment analysis.

## 5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS (cont'd...)

d) Inventories

Coal stockpiles are valued at the lower of production cost and net realizable value. The costs of inventories are determined on a weighted average basis. Production cost includes direct and indirect labour, operating materials and supplies, transportation costs, and an applicable portion of operating overhead, including depreciation and depletion. Net realizable value is the expected average selling price of the finished product less the costs to get the product into saleable form and to the selling location.

Stockpile tonnages are verified by periodic surveys.

The allocation of costs to stockpiles and in-process inventories and the determination of net realizable value involve the use of estimates. There can be no assurance that actual results will not differ significantly from estimates used in the determination of the carrying value of inventories.

e) Allowance for doubtful accounts, and the recoverability of receivables and prepaid expense amounts

Significant estimates are involved in the determination of recoverability of receivables and no assurance can be given that actual proceeds will not differ significantly from current estimations. Similarly, significant estimates are involved in the determination of the recoverability of services and/or goods related to the prepaid expense amounts, and actual results could differ significantly from current estimations.

f) Provision for closure and reclamation

The Company assesses its mineral properties' rehabilitation provision at each reporting date or when new material information becomes available. Exploration, development and mining activities are subject to various laws and regulations governing the protection of the environment. In general, these laws and regulations are continually changing and the Company has made, and intends to make in the future, expenditures to comply with such laws and regulations. Accounting for reclamation obligations requires management to make estimates of the future costs that the Company will incur to complete the reclamation work required to comply with existing laws and regulations at each location. Actual costs incurred may differ from those amounts estimated. Also, future changes to environmental laws and regulations could increase the extent of reclamation and remediation work required to be performed by the Company. Increases in future costs could materially impact the amounts charged to operations for reclamation and remediation. The provision represents management's best estimate of the present value of the future reclamation and remediation obligation. The actual future expenditures may differ from the amounts currently provided.

## 5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS (cont'd...)

g) Share-based payments

Management uses valuation techniques in measuring the fair value of share purchase options granted. The fair value is determined using the Black Scholes option pricing model which requires management to make certain estimates, judgement, and assumptions in relation to the expected life of the share purchase options and share purchase warrants, expected volatility, expected risk-free rate, and expected forfeiture rate. Changes to these assumptions could have a material impact on the Annual Financial Statements.

h) Contingencies

The assessment of contingencies involves the exercise of significant judgment and estimates of the outcome of future events. In assessing loss contingencies related to legal proceedings that are pending against the Company and that may result in regulatory or government actions that may negatively impact the Company’s business or operations, the Company and its legal counsel evaluate the perceived merits of the legal proceeding or unasserted claim or action as well as the perceived merits of the nature and amount of relief sought or expected to be sought, when determining the amount, if any, to recognize as a contingent liability or when assessing the impact on the carrying value of the Company’s assets. Contingent assets are not recognized in the Annual Financial Statements.

i) Deferred Tax Liability

Judgement is required to determine which types of arrangements are considered to be a tax on income in contrast to an operating cost. Judgement is also required in determining whether deferred tax liabilities are recognised in the statement of financial position. Deferred tax liabilities, including those arising from un-utilised tax gains, require management to assess the likelihood that the Company will generate sufficient taxable losses in future periods, in order to offset recognised deferred tax liabilities. Assumptions about the generation of future taxable losses depend on management’s estimates of future cash flows. These estimates of future taxable losses are based on forecast cash flows from operations (which are impacted by production and sales volumes, commodity prices, reserves, operating costs, closure and rehabilitation costs, capital expenditure, and other capital management transactions) and judgement about the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable losses differ significantly from estimates, the ability of the Company to offset the net deferred tax liabilities recorded at the reporting date could be impacted.

## 5. SIGNIFICANT JUDGMENTS, ESTIMATES AND ASSUMPTIONS (cont'd...)

j) Fair value measurement

The Company measures financial instruments at fair value at each reporting date. The fair values of financial instruments measured at amortised cost are disclosed in Note 23. Also, from time to time, the fair values of non-financial assets and liabilities are required to be determined, e.g., when the entity acquires a business, or where an entity measures the recoverable amount of an asset or cash-generating unit at fair value less costs of disposal. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. Changes in estimates and assumptions about these inputs could affect the reported fair value.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Loss of control of an entity

The loss of control of an entity while retaining a residual equity interest may be analyzed as the disposal of a controlling interest followed by the acquisition of a non-controlling interest. This process involves, as of the date when control is lost: (i) the recognition of a gain or loss on disposal, comprising a gain or loss resulting from the percentage ownership interest sold; and (ii) a gain or loss resulting from the re-measurement at fair value of the ownership interest retained in the entity. The other comprehensive income items are reclassified in the profit or loss resulting from the ownership interest disposed.

(b) Associates

Associates are entities, including unincorporated entities such as partnerships, over which the Company has significant influence and that are neither subsidiaries nor interests in joint ventures. Significant influence is the ability to participate in the financial and operating policy decisions of the investee without having control or joint control over those policies. In general, significant influence is presumed to exist when the Company has between 20% and 50% of voting power. Significant influence may also be evidenced by factors such as the Company’s representation on the board of directors, participation in policy-making of the investee, material transactions with the investee, interchange of managerial personnel, or the provision of essential technical information. Associates are equity accounted for from the effective date of commencement of significant influence to the date that the company ceases to have significant influence.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Results of associates are equity accounted for using the results of their most recent annual financial statements or interim financial statements, as applicable. Losses from associates are recognized in the consolidated financial statements until the interest in the associate is written down to $nil. Thereafter, losses are recognized only to the extent that the Company is committed to providing financial support to such associates.

The carrying value of the investment in an associate represents the cost of the investment, including goodwill, a share of the post-acquisition retained earnings and losses accumulated other comprehensive income ("AOCI") and any impairment losses. At the end of each reporting period, the Company assesses whether there is any objective evidence that its investments in associates are impaired.

(c) Cash equivalents

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

(d) Short term investment

Short-term investments consist of certificates of deposit and money market instruments, including cashable guaranteed investment certificates, bearer deposit notes and commercial paper with original terms of three months or more, but less than one year.

(e) Available-for-sale investments

Available-for-sale equity investments are recorded at fair value with unrealized gains and losses recorded in Other Comprehensive Income ("OCI"). Realized gains and losses are recorded in the consolidated statement of operations when investments are sold and are calculated using the weighted average carrying amount of securities sold.

(f) Impairment of financial assets

The Company assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of investments classified as available-for-sale, an evaluation is made as to whether a decline in fair value is significant or prolonged based on an analysis of indicators such as market price of the investment and significant adverse changes in the technological, market, economic or legal environment in which the investee operates.

If an available-for-sale financial asset is impaired, an amount equal to the difference between its carrying value and its current fair value is transferred from AOCI and recognized in the consolidated statement of operations. Reversals of impairment charges in respect of equity instruments classified as available-for-sale are not recognized in the consolidated statement of operations.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

(g) Mineral properties

Costs directly related to the exploration and evaluation of resource properties are capitalized to mineral properties once the legal rights to explore the resource properties are acquired or obtained. When the technical and commercial viability of a mineral resource have been demonstrated and a development decision has been made, the capitalized costs of the related property are transferred to property and equipment assets and depreciated using the units of production method on commencement of commercial production.

If it is determined that capitalized acquisition, exploration and evaluation costs are not recoverable, or the property is abandoned or management has determined an impairment in value, the property is written down to its recoverable amount. Mineral properties are reviewed for impairment when facts and circumstances suggest that the carrying amount may exceed its recoverable amount.

From time to time, the Company acquires or disposes of properties pursuant to the terms of option agreements. Options are exercisable entirely at the discretion of the optionee and, accordingly, are recorded as mineral property costs or recoveries when the payments are made or received. After costs are recovered, the balances of the payments received are recorded as a gain on option or disposition of mineral property.

(i) Title to mineral properties

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title, nor has the Company insured title. Property title may be subject to unregistered prior agreements and non-compliance with regulatory requirements.

(ii) Realization of mineral property assets

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

**6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (cont'd...)

(iii) Environmental

The Company is subject to the laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. The Company may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest. The Company conducts its mineral exploration activities in compliance with applicable environmental protection legislation. The Company is not aware of any existing environmental issues related to any of its current or former properties that may result in material liability to the Company.

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

(h) Property and equipment

(i) Development

When economically viable reserves have been determined and the decision to proceed with development has been approved, the expenditures related to development and construction are capitalized as construction-in-progress and, in addition, any pre-commercial production is also capitalized, all of which is classified as a component of property and equipment.

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

Road and bridges, classified within mine development and deferred exploration costs, are amortized on a declining balance basis at an annual rate of 20%.

(ii) Equipment

Equipment is stated at cost less accumulated depreciation and accumulated impairment losses, if any. The cost of an item of property and equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use, and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Depreciation of equipment is recorded on a declining-balance basis at the following annual rates, (excepting standby equipment at 50% of these rates):

| | |
|---|---|
| Computer equipment | 45% |
| Computer software | 100% |
| Exploration equipment | 20% |
| Furniture and equipment | 20% |
| Leasehold improvements | Straight line/5yrs |
| Mining equipment | 20% |
| Vehicles | 30% |

When parts of major components of equipment have different useful lives, they are accounted for as a separate item of equipment.

The cost of major overhauls of part of equipment is recognized in the carrying amount of the item if is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of equipment are recognized in profit or loss as incurred.

Leasehold improvements are amortized on a straight-line basis over the term of the lease. Additions during the year are amortized at one-half the annual rates.

(i) Impairment of non-current assets and Cash Generating Units (“CGU”)

At the end of each reporting period, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the CGU, where the recoverable amount of the CGU is the greater of the CGU’s fair value less costs to sell and its value in use to which the assets belong.

In assessing value in use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or CGU) is estimated to be less than its carrying amount, the carrying amount of the asset (or CGU) is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of comprehensive loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Each project or group of claims or licenses is treated as a CGU. The Company uses its best efforts to fully understand all of the aforementioned to make an informed decision based upon historical and current facts surrounding the projects. Discounted cash flow techniques often require management to make estimates and assumptions concerning reserves and expected future production revenues and expenses, which can vary from actual.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or CGU) in prior years.

(j) Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of that asset. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

Where funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs incurred. Where surplus funds are available for a short-term from funds borrowed specifically to finance a project, the income generated from the temporary investment of such amounts is also capitalized and deducted from the total capitalized borrowing cost. Where the funds used to finance a project are from part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of the Company during the period. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

(k) Foreign currency translation

Transactions in currencies other than the functional currency are recorded at the prevailing exchange rates on the dates of the transactions. At each financial position reporting date, monetary assets and liabilities denominated in foreign currencies are translated at the prevailing exchange rates at the date of the consolidated statement of financial position. Non-monetary items measured in terms of historical cost in a foreign currency are not retranslated.

Gains and losses arising from this translation are included in the determination of net loss for the year.

(l) Revenue recognition

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

Sales of coal are recognized when the risks and rewards of ownership pass to the customer and the price can be measured reliably. Sales contracts and revenue is recognized based on the terms of the contract. Revenue is measured at the fair value of the consideration received, excluding discounts and rebates. Royalties related to production are recorded in cost of sales.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Revenue from coal sales is credited against construction when generated during commissioning of the plant; to mineral properties or property and equipment when generated from pre-commercial production; and to operations when generated from commercial production.

(m) Unit offerings

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

(n) Inventories

Net realisable value tests are performed at each year end reporting date and represent the estimated future sales price of the product the entity expects to realise when the product is processed and sold, less estimated costs to complete production and bring the product to sale. This value is compared to the cost of producing coal, with the lower of the net realisable value or the cost being recorded.

Stockpiles are measured by estimating the number of tonnes added and removed from the stockpile. Stockpile tonnages are verified by periodic surveys.

(o) Share-based payments

The Company has a share purchase option plan that is described in Note 21. The Company accounts for share-based payments using a fair value based method with respect to all share-based payments to directors, officers, employees, and service providers. Share-based payments to employees are measured at the fair value of the instruments issued and amortized over the vesting periods. Share-based payments to non-employees are measured at the fair value of the goods or services received or if such fair value is not reliably measurable, at the fair value of the equity instruments issued. The fair value is recognized as an expense or capitalized to mineral properties or property and equipment with a corresponding increase in option reserve. This includes a forfeiture estimate, which is revised for actual forfeitures in subsequent periods.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of the options, measured immediately before and after the modification, is also charged to the consolidated statement of comprehensive income over the remaining vesting period.

Upon the exercise of the share purchase option, the consideration received and the related amount transferred from option reserve are recorded as share capital.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

(p) Loss per share

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

(q) Income taxes

The Company uses the asset and liability method to account for income taxes. Deferred income taxes are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax basis on the statement of financial position date. Deferred income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on deferred income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantively enacted. The amount of deferred income tax assets recognized is limited to the amount of the benefit that is probable upon recovery.

(r) Provision for closure and reclamation

The Company assesses its property, equipment and mineral property rehabilitation provision at each reporting date. Changes to estimated future costs are recognized in the statement of financial position by either increasing or decreasing the rehabilitation liability and asset to which it relates if the initial estimate was originally recognized as part of an asset measured in accordance with IAS 16 *Property, Plant and Equipment*.

The Company records the present value of estimated costs of legal and constructive obligations required to restore operations in the period in which the obligation is incurred. The nature of these restoration activities includes dismantling and removing structures; rehabilitating mineral properties; dismantling operating facilities; closure of plant and waste sites; and restoration, reclamation and vegetation of affected areas.

Present value is used where the effect of the time value of money is material. The related liability is adjusted each period for the unwinding of the discount rate and for changes in estimates, changes to the current market-based discount rate, and the amount or timing of the underlying cash flows needed to settle the obligation.

(s) Financial instruments

(i) Financial assets

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held-to-maturity, available-for-sale, loans and receivables or at fair value through profit or loss (“FVTPL”). This category comprises derivatives and financial assets acquired principally for the purpose of selling or repurchasing in the near term. They are carried at fair value with changes in fair value recognized in profit or loss.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

The Company's cash and cash equivalents, short-term investments and restricted cash equivalents are classified as FVTPL.

Loans and receivables: These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at amortized cost using the effective interest method less any provision for impairment.

The Company's receivables and amount due from related party are classified as loans and receivables.

Held-to-maturity investments: These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's Management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest method less any provision for impairment.

The Company does not have any held-to-maturity investments.

Available-for-sale: Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized in other comprehensive income. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from accumulated other comprehensive income and recognized in profit or loss.

The Company's investments are classified as available-for-sale.

All financial assets except those measured at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is objective evidence of impairment as a result of one or more events that have occurred after initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset or the group of financial assets.

Transactions costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

(ii) Financial liabilities

All financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or other financial liabilities. Financial liabilities classified as other financial liabilities are initially recognized at fair value less directly attributable transaction costs. The Company's accounts payable and accrued liabilities, loan payable and line of credit facility are classified as other financial liabilities.

Financial liabilities classified as FVTPL include financial liabilities held-for-trading and financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives are also classified as held-for-trading unless they are designated as effective hedging instruments. Fair value changes on financial liabilities classified as FVTPL are recognized through the statement of comprehensive income. The Company has no financial liabilities classified as FVTPL.

## 6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Please refer to Note 23 for relevant fair value measurement disclosures.

## 7. SEGMENTED INFORMATION

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

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

| | December 31, 2012 | | |
|---|---|---|---|
| | Canada | Mongolia | Total |
| Reclamation deposits | $ 6,500 | $ 21,054 | $ 27,554 |
| Property and equipment | 279,045 | 12,650,297 | 12,929,342 |
| Mineral properties | 2,159,765 | 11,228,117 | 13,387,882 |
| Investment in associate | 25,118,910 | - | 25,118,910 |
| | $ 27,564,220 | $ 23,899,468 | $ 51,463,688 |

## 8. CASH AND CASH EQUIVALENTS

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

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Cash | | |
| Denominated in Canadian dollars | $ 259,411 | $ 269,246 |
| Denominated in US dollars | 1,777 | 58,484 |
| Denominated in Mongolian tugriks | 246,808 | 441,056 |
| Cash equivalents | | |
| Denominated in Canadian dollars | - | 45 |
| | $ 507,996 | $ 768,831 |

### Restricted Cash Equivalents

A guaranteed investment certificate of $34,500 has been pledged as collateral for the Company's credit card.

## 9. SHORT TERM INVESTMENTS

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Short Term Investments | | |
| Denominated in Canadian dollars | $ - | $ 5,107,500 |
| | $ - | $ 5,107,500 |

## 10. RECEIVABLES

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Current assets | | |
| VAT/HST recoverable | $ 1,838,683 | $ 104,515 |
| Trade receivable | 679,738 | 351,520 |
| Other receivable | 130,572 | - |
| | $ 2,648,993 | $ 456,035 |

Trade receivables are non-interest-bearing and are generally on terms of 30 to 90 days. The Company anticipates full recovery of its outstanding trade and other receivables, net of any allowances.

During the year ended December 31, 2013, the Company became obligated to record VAT receipts and expenditures. As of December 31, 2013, the Company was in the process of filing applicable documents to Mongolian tax authorities. The Company expects to receive these funds as either a credit to VAT payable in future periods, a credit to other Mongolian federal or state taxes payable in future periods or a lump sum cash refund during fiscal 2014.

## 11. PREPAID EXPENSES

Prepaid expenses correspond to expenses paid during the year that relate to the subsequent year are as follows:

| | December 31, 2013 | December 31, 2012 |
|---|---|---|
| Advertising and promotion | $ 2,902 | $ 63,694 |
| Mining and exploration | 251,255 | 607,524 |
| General | 113,946 | 242,824 |
| Insurance | 11,825 | 49,243 |
| Mine maintenance | - | 117,156 |
| Capital expenses | 335,657 | - |
| Power plant application | 398,650 | - |
| Environmental and taxes | 46,904 | - |
| Road and bridge repair | - | 279,999 |
| Lisitng fees | 15,715 | 14,891 |
| Transportation and fuel | 32,094 | 11,726 |
| Rent | 69,966 | 56,225 |
| | $ 1,278,914 | $ 1,443,282 |

(Expressed in Canadian Dollars)

## 11. PREPAID EXPENSES (cont'd...)

The Company anticipates full recovery of its outstanding prepaid expense amounts in the form of goods and services, net of any allowances.

## 12. INVENTORY

| | | December 31, 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Coal Inventory | $ | 1,758,310 | $ | 2,436,534 |
| | $ | 1,758,310 | $ | 2,436,534 |

## 13. AVAILABLE FOR SALE INVESTMENTS

a) Current Assets

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

As of December 31, 2013 the Company holds 3,327,261 (December 31, 2012 – 22,013,799) or 4.12% (excluding reserved Wellgreen Platinum shares) or 7% (including reserved Wellgreen Platinum shares) of Wellgreen Platinum's issued and outstanding common shares. The closing price on December 31, 2013 as quoted on the Toronto Stock Venture Exchange was $0.69 per share for a total quoted amount of $2,295,810.

The Company's activity in it's available-for-sale investment for the year ending December 31, 2013 and December 31, 2012 was as follows:

| | | December 31 , 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Investment in Wellgreen Platinum Ltd. | | | | |
| Opening balance | $ | 25,118,910 | $ | - |
| Initial recognition | | - | | 25,315,871 |
| Deemed disposal loss of associate | | (1,264,472) | | - |
| Share of net loss of associate | | (1,397,252) | | (196,961) |
| Acquisitions (Note 25) | | 140,000 | | - |
| Disposals to market | | (625,222) | | - |
| Settlement of debt | | (474,699) | | - |
| Private sale | | (19,596,976) | | - |
| Fair value loss on available-for-sale investments of an associate | | (3,750) | | - |
| Net gain/(loss) transferred to equity | | 399,271 | | - |
| | $ | 2,295,810 | $ | 25,118,910 |

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

For the period from January 1, 2012 to November 30, 2012, the Company's Annual Financial Statements included the consolidation of Wellgreen Platinum as it had the power to control the financial performance and operating parameters of Wellgreen Platinum. On November 30, 2012, it was determined that Prophecy Coal's control changed to significant influence over Wellgreen Platinum due to the culmination of a series of events including: the appointment of Wellgreen Platinum's new senior executive management not common to both companies; election of a majority of the Board of Directors not common to both companies; a reduction in shared management and administrative functions between the companies; and the reduction of Prophecy Coal's equity ownership interest from 44.4%, as at the time of acquisition in June 2011, to 32.6% as at November 30, 2012. As a result of the change from control to significant influence over Wellgreen Platinum, in accordance with IAS 27 – Consolidated and Separate Financial Statements, the Company has:

- Derecognized the assets and liabilities of Wellgreen Platinum at their carrying amounts of $74,479,915 and of $2,919,601 respectively;
- Derecognized non-controlling interest in Wellgreen Platinum of $50,611,355;
- Reclassified other comprehensive loss of $19,375, in relation to Wellgreen Platinum, to Statement of Operations and Comprehensive Loss;
- Recognized the investment retained in Wellgreen Platinum at its fair value of $25,315,871; and
- Recognized the difference as a gain on deconsolidation of subsidiary of $4,366,912 in the statement of operations and comprehensive loss for the year ended December 31, 2012 attributable to the Company upon the change from control to significant influence over Wellgreen Platinum.

On June 20, 2013, Wellgreen Platinum completed a private placement that the Company did not participate in. As a result, the Company's ownership in Wellgreen Platinum decreased. IAS 28 dictates that a reduction in the investor's ownership must be recorded as a deemed disposal. As such, for the year ending December 31, 2013 a deemed disposal loss of $1,264,472 (December 31, 2012 - $NIL) was recorded.

During the year ended December 31, 2013, the Company disposed 19,840,827 Wellgreen Platinum shares for net proceeds of $7,824,715 and a realized loss of $12,399,523 recognized in the consolidated statement of operations and comprehensive loss. Transaction fees of $375,000 were incurred to facilitate the share sales. As a result, the Company's ownership percentage has been decreased to 4.95% (excluding reserved Wellgreen Platinum shares) or to 7.95% (including reserved Wellgreen Platinum shares) of the total issued and outstanding shares of Wellgreen Platinum. Therefore, the Company ceased to have significant influence over Wellgreen Platinum. As of November 7, 2013, the Company has reclassified its investment in Wellgreen Platinum from "investment in associate" to an "available-for-sale investment" and, in accordance with IAS 39, discontinued the use of equity method accounting. The Company has measured the retained interest at fair value.

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

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

In July 2013, 951,300 of Wellgreen Platinum's reserved held in-trust shares were released back to the Company due to 9,230,749 Prophecy Coal warrants expiring and 808,514 Prophecy Coal options being cancelled or forfeited. At December 31, 2013 Prophecy Coal held, reserved in-trust, 2,316,634 (December 31, 2012 - 3,267,934) Wellgreen Platinum shares contingent on exercise of these June 9, 2011 Options and Warrants.

b) Non-current Assets

Available-for-sale investment consisted of an investment in common shares of Victory Nickel Inc., and had no fixed maturity date or coupon rate. The fair value of the available-for-sale investment was determined directly by reference to published price quotations in an active market. At December 31 2013, the Company owned Nil% (December 31, 2012 - 7.9% or $628,188, with a quoted price of $.02 per share) of Victory Nickel's issued and outstanding common shares.

In May 2010, the Company purchased 36,615,385 common shares in Victory Nickel Inc ("Victory Nickel"), which represented approximately a 9.8% equity interest in Victory Nickel, for $3,808,001.

At December 31, 2012, due to the prolonged decline in value of Victory Nickel shares, the Company recognized an impairment loss of $2,639,572, which represented the difference between the acquisition cost and its fair market value at December 31, 2012, in the consolidated statement of operations.

During the year ended December 31 2012, the Company disposed of 5,206,300 Victory Nickel shares bringing the new equity interest to 7.9%. Proceeds of $201,620 were received and a realized loss of $332,589 was incurred.

During the year ended December 31, 2013, the Company disposed the remaining 31,409,385 shares of Victory Nickel for proceeds of $865,325 and a realized gain of $237,137.

(Expressed in Canadian Dollars)

## 14. PROPERTY AND EQUIPMENT

| | Computer Equipment | Furniture & Equipment | Vehicles | Computer Software | Leasehold Improvements | Ulaan Ovoo Mining Equipment | Ulaan Ovoo Deferred Exploration | Exploration Equipment | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | | |
| Balance, December 31, 2011 | $ 144,445 | $ 224,564 | $ 772,111 | $ 234,068 | $ 172,818 | $ 14,248,586 | $ 38,338,876 | $ 28,299 | $ 54,163,767 |
| Additions | | | | | | | | | |
| Assets acquired | 33,319 | 153,137 | 14,835 | 21,726 | - | 210,526 | 15,705,544 | 330,590 | 16,469,678 |
| Sale of coal | - | - | - | - | - | - | (2,325,623) | - | (2,325,623) |
| Disposals | - | - | - | - | - | - | - | - | - |
| Impairment | - | - | - | - | - | - | (49,718,797) | - | (49,718,797) |
| Deconsolidation of subsidiary (note 3 & 15) | (1,572) | - | - | (59,087) | - | - | - | (358,889) | (419,548) |
| Balance, December 31, 2012 | $ 176,192 | $ 377,701 | $ 786,946 | $ 196,707 | $ 172,818 | $ 14,459,112 | $ 2,000,000 | $ - | $ 18,169,478 |
| **Accumulated amortization** | | | | | | | | | |
| Balance, December 31, 2011 | 49,226 | 82,448 | 137,315 | 82,456 | 23,582 | 2,125,913 | - | 17,551 | 2,518,491 |
| Amortization for the year | 32,583 | 53,003 | 151,173 | 84,026 | 34,563 | 2,431,190 | 2,655,084 | 61,313 | 5,502,935 |
| Impairment | - | - | - | - | - | - | (2,655,084) | - | (2,655,084) |
| Deconsolidation of subsidiary (note 3 & 15) | (1,294) | - | - | (46,049) | - | - | - | (78,864) | (126,206) |
| Balance, December 31, 2012 | $ 80,515 | $ 135,451 | $ 288,488 | $ 120,433 | $ 58,145 | $ 4,557,103 | $ - | $ - | $ 5,240,136 |
| **Carrying amounts** | | | | | | | | | |
| At December 31, 2012 | $ 95,678 | $ 242,250 | $ 498,459 | $ 76,274 | $ 114,673 | $ 9,902,009 | $ 2,000,000 | $ - | $ 12,929,342 |

*Prior to December 1, 2012, Wellgreen Platinum's net assets and operations were consolidated into the financial statements of Prophecy Coal. Thereafter the value of those amounts was reflected as an Investment in Associate using the equity accounting method (Note 13).*

(Expressed in Canadian Dollars)

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

| | Computer Equipment | Furniture & Equipment | Vehicles | Computer Software | Leasehold Improvements | Ulaan Ovoo Mining Equipment | Ulaan Ovoo Deferred Exploration | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| Balance, December 31, 2012 | $ 176,192 | $ 377,701 | $ 786,946 | $ 196,707 | $ 172,818 | $ 14,459,112 | $ 2,000,000 | $ 18,169,476 |
| Additions | | | | | | | | |
| Assets acquired | - | - | 11,653 | - | - | 612,388 | 7,980,277 | 8,604,317 |
| Disposals | (4,642) | (5,156) | - | (153) | - | - | - | (9,951) |
| Sale of coal | - | - | - | - | - | - | (3,253,283) | (3,253,283) |
| Equipment rental revenue | - | - | - | - | - | - | (1,338,003) | (1,338,003) |
| Costs in excess of impaired value | - | - | - | - | - | - | (3,388,991) | (3,388,991) |
| Balance, December 31, 2013 | $ 171,550 | $ 372,545 | $ 798,599 | $ 196,554 | $ 172,818 | $ 15,071,500 | $ 2,000,000 | $ 18,783,566 |
| **Accumulated depreciation** | | | | | | | | |
| Balance, December 31, 2012 | 80,515 | 135,451 | 288,488 | 120,433 | 58,145 | 4,557,103 | - | 5,240,135 |
| Depreciation for period | 19,357 | 38,564 | 116,099 | 10,895 | 34,564 | 2,565,366 | 1,032,548 | 3,817,392 |
| Costs in excess of impaired value | - | - | - | - | - | - | (1,032,548) | (1,032,548) |
| Balance, December 31, 2013 | $ 99,872 | $ 174,015 | $ 404,587 | $ 131,328 | $ 92,709 | $ 7,122,469 | $ - | $ 8,024,980 |
| **Carrying amount** | | | | | | | | |
| At December 31, 2012 | $ 95,677 | $ 242,250 | $ 498,458 | $ 76,274 | $ 114,673 | $ 9,902,009 | $ 2,000,000 | $ 12,929,342 |
| At December 31, 2013 | $ 71,678 | $ 198,530 | $ 394,012 | $ 65,226 | $ 80,109 | $ 7,949,031 | $ 2,000,000 | $ 10,758,586 |

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

### Ulaan Ovoo Property

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

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

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

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

### Costs in excess of impaired value and impairment write down of Ulaan Ovoo property

During the year ended December 31, 2013, the Company incurred expenditures on the Ulaan Ovoo property, classified as costs in excess of impaired value, amounting to $2,356,443 which is reflected on the consolidated statement of operations and comprehensive loss. As there were no benchmark or market changes from January 1, 2013 to December 31, 2013, the impaired value for Ulaan Ovoo within property and equipment, remains unchanged at a balance of $2,000,000.

Pre-commercial operations for the period from commencement in November 2010 until December 31, 2013, along with project exploration and development costs were capitalized within the category Ulaan Ovoo deferred exploration costs within property and equipment. Modest coal sales revenue and associated costs to deliver the coal during the fiscal 2013 have been recorded against deferred exploration, within property and equipment. The ending coal stockpile inventory value at December 31, 2013 was $1.76 million ($2.4 million at December 31, 2012) (Note 12). During the year ending December 31, 2013, the Company rented out part of its equipment fleet for revenue proceeds of $1.34 million.

(Expressed in Canadian Dollars)

## 15. MINERAL PROPERTIES

| | Chandgana Tal | Chandgana Khavtgai | Titan | Okeover, others | Ilch Khujirt | Lynn Lake | Wellgreen | Burwash |
|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2011** | $ 4,752,701 | $ 2,124,768 | $ 738,649 | $ 1,366,912 | $ - | $ 32,760,807 | $ 17,603,145 | $ 1,883,050 |
| 2012 Additions: | | | | | | | | |
| Acquisition cost | - | - | - | - | - | 1,450,000 | - | - |
| Deferred exploration costs: | | | | | | | | |
| Application | 2,493,956 | - | 11,979 | 14,056 | - | 28,474 | 3,987 | - |
| Consulting | 1,186,558 | 475,464 | - | 20,373 | 190,980 | - | 2,124,984 | - |
| Drilling | - | - | - | - | - | - | 3,945,131 | - |
| Personnel | 70,341 | - | - | - | - | 11,157 | 516,454 | - |
| Recovery | - | - | - | - | - | (50,851) | - | - |
| Camp and general | 120,574 | 3,754 | - | 7,797 | - | 11,291 | 1,839,816 | 16,744 |
| Impairment | - | - | - | - | (190,980) | - | - | - |
| | 3,871,429 | 479,218 | 11,979 | 42,226 | - | 1,450,070 | 8,430,372 | 16,744 |
| Deconsolidation of subsidiary (note 13) | - | - | - | - | - | (34,210,877) | (26,033,517) | (1,899,794) |
| **Balance, December 31, 2012** | **$ 8,624,130** | **$ 2,603,986** | **$ 750,628** | **$ 1,409,138** | **$ -** | **$ -** | **$ -** | **$ -** |

| | Cerro Chato and others | Las Aguilas | Shakespeare | Baldwin and option | Shining Tree | Stumpy Bay Option | Fox Mountain | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2011** | $ 707,450 | $ 231,999 | $ - | $ - | $ - | $ - | $ - | $ 62,169,481 |
| 2012 Additions: | | | | | | | | |
| Acquisition cost | - | 198,255 | 5,989,350 | 477,114 | 442,873 | 318,811 | 109,373 | 8,985,776 |
| Deferred exploration costs: | | | | | | | | |
| Application | - | 22,361 | - | - | - | - | - | 2,574,812 |
| Consulting | 40,256 | - | - | - | - | - | - | 4,038,615 |
| Drilling | - | - | - | - | - | - | - | 3,945,131 |
| Personnel | - | - | - | - | - | - | - | 597,952 |
| Recovery | - | 8,228 | - | - | - | - | - | (42,623) |
| Camp and general | 803 | - | - | - | - | - | - | 2,000,780 |
| Impairment | - | (460,843) | - | - | - | - | - | (651,823) |
| | 41,059 - | 231,999 | 5,989,350 | 477,114 | 442,873 | 318,811 | 109,373 | 12,462,843 |
| Deconsolidation of subsidiary (note 13) | (748,509) | - | (5,989,350) | (477,114) | (442,873) | (318,811) | (109,373) | (70,230,218) |
| **Balance, December 31, 2012** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ 13,387,882** |

(Expressed in Canadian Dollars)

## 15. MINERAL PROPERTIES (cont'd...)

*Prior to December 1, 2012, Wellgreen Platinum's net assets and operations were consolidated into the financial statements of Prophecy Coal. Thereafter the value of those amounts was reflected as an Investment in Associate using the equity accounting method (Note 13).*

| | Chandgana Tal | Chandgana Khavtgai | Titan | Okeover, others | Total |
|---|---|---|---|---|---|
| **Balance, December 31, 2012** | $ 8,624,130 | $ 2,603,986 | $ 750,628 | $ 1,409,138 | $ 13,387,882 |
| *2013 Additions:* | | | | | |
| Acquisition cost | - | - | - | - | - |
| Deferred exploration costs: | | | | | |
| Licenses, leases, and power plant application | 792,392 | 161,225 | - | 4,853 | 958,470 |
| Geological core, engineering, and consulting | 271,683 | 515 | - | 30,580 | 302,778 |
| Camp and general | 285,967 | 110,081 | - | 8,595 | 404,643 |
| | 1,350,042 | 271,821 | - | 44,028 | 1,665,891 |
| **Balance, December 31, 2013** | $ 9,974,172 | $ 2,875,807 | $ 750,628 | $ 1,453,166 | $ 15,053,773 |

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

a) Chandgana Tal Property, Mongolia

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

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

b) Chandgana Khavtgai Property, Mongolia

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

c) Titan property, Ontario, Canada

The Company has an 80% interest in the Titan property, a vanadium-titanium-iron project located in Ontario, Canada.

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

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

d) Okeover property, British Columbia, Canada

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

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

(Expressed in Canadian Dollars)

## 16. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

| | | December 31, 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Trade accounts payable | $ | 992,253 | $ | 487,497 |
| Accrued liabilities | | 439,985 | | 278,712 |
| | $ | 1,432,238 | $ | 766,209 |

## 17. LOAN PAYABLE

The outstanding balance of the loans payable as at December 31, 2013 is summarized as follows:

| | | December 31, 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Waterton loan payable | $ | - | $ | 9,392,170 |
| | $ | - | $ | 9,392,170 |

On June 18, 2012, Prophecy Coal entered into a Sale and Purchase Agreement (the “Tugalgatai Agreement”) to acquire assets in Mongolia relating to certain Tugalgatai coal exploration property licenses from Tethys Mining LLC ("Tethys"), subject to approval from the Minerals Resource Authority of Mongolia to have such exploration licenses transferred to Prophecy Coal.

In order to purchase the Tethys property, in July 2012, the Company arranged a secured debt facility of $10,000,000 (the “Loan”) with Waterton. The Loan had a one year term, due on July 16, 2013, and bore interest at 14% per annum payable monthly with an effective interest rate of 25%. In connection with the Loan, a structuring fee of 2.5% ($250,000) was paid to Waterton in cash and legal fees of $189,805 were incurred. Pursuant to the terms of the Loan, Prophecy Coal issued (for a value of $600,000) 2,735,617 common shares of Prophecy Coal on closing of the Loan on July 16, 2012.

As at December 31, 2012, Prophecy Coal had outstanding $10,000,000 of the Loan, which was callable at the option of Waterton in the case of the termination of the Tugalgatai Agreement. Such termination occurred in October 2012 as the initial long stop date for approval of the licence transfers by Minerals Resource Authority of Mongolia had elapsed. Under the Credit Agreement, the expiry of the original purchase and sales agreement with Tethys constituted a default.

In February 2013 Waterton agreed to waive the default, subject to certain conditions which have been met and were as follows: a) setting aside $3.5 million in escrow, b) issuing 2 million common shares to Waterton; and c) pledging additional security to Waterton in the form of 5,535,000 remaining free trading Wellgreen Platinum common shares.

## 17. LOAN PAYABLE (cont'd....)

In July, 2013 the Company further amended the Senior Secured Credit Agreement with Waterton ("Amended Loan Agreement"). Prophecy Coal agreed to and completed a partial pay down of the principal loan amount from $10 million to $6.5 million (the "Loan") from cash in escrow (see (a) above) amounting to $3.5 million and extending the maturity date from July 16, 2013 to October 31, 2013. As consideration for entering into the Amendment, the Company paid Waterton $390,000 restructuring fees.

As additional consideration, the Amendment also provided that each prepayment and repayment in full or in part of the principal amount outstanding under the Amended Loan Agreement was to be increased as follows:

(i) if such payment is of the entire outstanding principal amount of the Loan, the Company shall pay to Waterton an amount in cash equal to the quotient of the entire amount outstanding under the Loan and the applicable Discount Metric (as set out below); and

(ii) if such payment is a partial payment of the outstanding amount of the Loan, Prophecy Coal shall pay Waterton an amount in cash equal to the quotient of the partial payment amount and the applicable Discount Metric (the Company paid $250,000 on July 12, 2013);

(iii) where "Discount Metric" means (i) 1.00 from the date of the Amendment up to and including August 16, 2013;(ii) 0.98 from August 17, 2013 up to and including August 31, 2013; (iii) 0.96 for the calendar month of September, 2013; and (iv) 0.94 for the calendar month of October, 2013.

IAS 39 (IFRS 9 - *Financial Instruments* ("IFRS 9")) requires that if the net present value of the cash flows under the new terms of (including any fees paid net of any fees received) discounted at the original effective interest rate is at least 10% different from the discounted present value of the remaining cash flows of the original debt instrument, the change in the loan modification should be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

The Company determined that, the net present value of the modified loan (discounted at the effective interest rate of 25% of the original loan) was 11% different from that of the original loan, so the modification is required to be treated as an extinguishment under IAS 39 (IFRS 9) and, therefore, the Company recognised the modified loan at fair value and amortized using its own effective interest rate of 38.5%, not that applicable to the original loan. Accordingly to IAS 39 (IFRS 9) if an exchange of debt instruments or modification of terms is accounted for as an extinguishment of the original debt, any costs or fees incurred to be recognised in the statement of operations. As such, for the year ended December 31, 2013, finance costs of $390,000 representing restructuring fees were expensed. For the year ended December 31, 2013, the Company recorded an interest expense of $2,314,438 and interest paid of $1,026,181.

In November, 2013, the Company repaid the remaining balance of Waterton Loan, plus applicable fees and interest totalling $7,039,005 pursuant to the Amended Loan Agreement and has been provided with a release/discharge of security interests, charges, and pledges.

## 18. LINE OF CREDIT FACILITY

In October 2013, Prophecy Coal's wholly-owned Mongolian subsidiary, Red Hill Mongolia LLC ("Red Hill") arranged a line of credit for US $1,500,000 ("LOC") with the Trade and Development Bank. The line of credit has a 1.5 year term, with the option of extending it, and bears interest at 15% per annum and a commitment rate of 2% per annum payable monthly. The funds will be

(Expressed in Canadian Dollars)

## 18. LINE OF CREDIT FACILITY (cont'd...)

used for working capital. The credit facility is collateralized by certain equipment and mineral and exploration licences.

Pursuant the LOC agreement, Red Hill shall pay a fixed amount of US $125,000 monthly against the principal starting May 2014. As at December 31, 2013, Red Hill had drawn down $1,701,325 of the LOC. Accordingly, the Company classified $1,069,400 as current portion of the LOC on its statement of financial position. For the year ended December 31, 2013, Red Hill recorded an interest expense of $42,900, interest paid of $25,979, and interest payable of $19,960.

## 19. PROVISION OF CLOSURE AND RECLAMATION

| | | December 31, 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Balance, beginning of year | $ | 294,263 | $ | 257,356 |
| Additions (reductions) | | (193,460) | | 30,069 |
| Accretion | | 28,749 | | 6,838 |
| Balance, end of year | $ | 129,552 | $ | 294,263 |

The Company's closure and reclamation costs consists of costs accrued based on the current best estimate of mine closure and reclamation activities that will be required at the Ulaan Ovoo site upon completion of mining activity. These activities include costs for earthworks, including land re-contouring and re-vegetation, water treatment and demolition. The Company's provision for future site closure and reclamation costs is based on the level of known disturbance at the reporting date, known legal requirements and estimates prepared by a third party specialist. It is not currently possible to estimate the impact on operating results, if any, of future legislative or regulatory developments.

Management used a risk-free interest rate of 2.77% and a risk premium of 7% in preparing the Company's provision for closure and reclamation. Although the ultimate amount of reclamation costs to be incurred cannot be predicted with certainty, the total undiscounted amount of estimated cash flows required to settle the Company's estimated obligations is $2,000,000 over the next 10.7 years. The cash expenditures are expected to occur over a period of time extending several years after the projected mine closure of the mineral properties. The decrease from the prior year is due to revised figures used to calculate the volume of the disturbed pit area relative to the prior year.

## 20. DEFERRED INCOME TAXES

Prophecy Coal's operations are, in part, subject to foreign tax laws where interpretations, regulations and legislation are complex and continually changing. As a result, there are usually some tax matters in question that may, upon resolution in the future, result in adjustments to the amount of deferred income tax assets and liabilities, and those adjustments may be material to the Company's financial position and results of operations.

(Expressed in Canadian Dollars)

## 20. DEFERRED INCOME TAXES (cont'd...)

A reconciliation of income tax at the statutory tax rate with the reported taxes is as follows:

| | 2013 | 2012 |
|---|---|---|
| Earnings (loss) for the year | $ (24,249,254) | $ (60,033,616) |
| Expected income tax (recovery) | $ (6,244,000) | $ (15,008,404) |
| Change in statutory, foreign tax, foreign exchange rates and other | (41,100) | (189,283) |
| Permanent Difference | 5,160,000 | (75,226) |
| Accounting impairment | - | 13,806,185 |
| Change in estimate | - | 300,586 |
| Deconsolidation of associate | - | 1,340,485 |
| Impact of flow through share | - | 292,775 |
| Share issue cost | (84,000) | - |
| Adjustment to prior years provision versus statutory tax returns and expiry of non-capital losses | (518,000) | - |
| Change in unrecognized deductible temporary differences | 774,000 | 888,374 |
| **Total income tax expense (recovery)** | **$ (953,100)** | **$ 1,355,492** |

The Canadian income tax rate declined/increased during the year due to changes in the law that reduced/increased corporate income tax rates in Canada/British Columbia.

| | 2013 | 2012 |
|---|---|---|
| Deferred Tax Assets (liabilities) | | |
| Share issue costs | - | 414,010 |
| Allowable capital losses | - | 58,350 |
| Property and equipment | - | 112,804 |
| Investment in associate | (298,000) | (2,425,232) |
| Asset retirement obligation | - | 77,000 |
| Non-capital losses | 298,000 | 809,968 |
| **Net deferred tax liability** | **$ -** | **$ (953,100)** |

Significant components of deductible and taxable temporary differences, unused tax losses and unused tax credits that have not been included on the consolidated statements of financial position are as follows:

| | 2013 | Expiry dates | 2012 | Expiry dates |
|---|---|---|---|---|
| Share issue costs | $ 1,531,000 | 2034 to 2037 | $ - | |
| Allowable Capital losses | $ 538,000 | No expiry | $ - | |
| Non-Capital losses | $ 8,524,000 | 2030 to 2033 | $ 3,239,872 | 2029 to 2032 |
| Property and equipment | $ 995,000 | No expiry | $ 451,216 | No expiry |
| Exploration and evaluation assets | $ 104,000 | No expiry | $ 294,264 | No expiry |
| Investment tax credits | $ 22,000 | 2029 | $ - | |
| Available for sale investments - OCI | $ - | No expiry | $ 1,319,196 | No expiry |
| Asset retirement obligation | $ 294,000 | No expiry | $ - | |

## 21. SHARE CAPITAL

(a) Authorized

The authorized share capital consists of an unlimited number of common shares without par value. There are no authorized preferred shares. At December 31, 2013, the Company had 248,373,819 (December 31, 2011 – 228,400,956) common shares issued and outstanding.

(b) Equity issuances

During the year ended December 31, 2013, Prophecy Coal had the following common share capital transactions:

(i) On March 15, 2013, Prophecy Coal issued 2,000,000 shares to Waterton at a value of $0.14 per share, amounting to $280,000, as a financing fee pursuant to $10 million loan and related waiver discussed in Note 17.

(ii) On April 12, 2013, the Company closed the first tranche of a non-brokered private placement announced on February 7, 2013 (the "Private Placement"), issuing 4,382,571 units (each a "Unit") of the Company, of which each Unit consists of one common share (a "Share") and 0.75 common share purchase warrant (a "Warrant"), at a purchase price of $0.14 per Unit for aggregate consideration of $613,560. Each whole Warrant is exercisable into one common share of Prophecy at a price of $0.18, expiring two years from the date of issue. Each Unit sold in the first tranche also included, subject to shareholder approval, which was obtained at the AGM on July 30, 2013, an adjustment warrant ("Adjustment Warrant") entitling the holder to acquire additional common shares of the Company. Finder's fees of 6% were paid in connection with a portion of the first tranche of the private placement.

(iii) On June 6, 2013, the Company closed a second and final tranche of the Private Placement with the issuance of 8,142,857 units (each a "Unit") of the Company for aggregate consideration of $1,140,000. Each Unit consists of one common share and 0.75 of a common share purchase Warrant at a purchase price of $0.14 per Unit. Each whole Warrant is exercisable for one common share of Prophecy at a price of $0.18, expiring two years from the date of issue. Each Unit sold in the second tranche also included an adjustment warrant entitling the holder to acquire additional common shares of the Company. Finder's fees of 6% were paid on the second tranche of the Private Placement.

The Company amended the first and second tranche of the Private Placement to include an additional Adjustment Warrant in each Unit sold in the Private Placement. Each Adjustment Warrant may be exercised for no additional consideration for a period of 12 months following the closing of the final tranche of the private placement, for a fraction of a common share of Prophecy. The fraction will be calculated by first dividing the Unit subscription price of $0.14 by the market price (subject to a floor market price of $0.105) at the time of exercise, then subtracting one (1) from that resulting number to determine the fraction. Market price is defined as the 20 day moving average price for the Company's common shares. The Adjustment Warrants must be exercised in their entirety and may not be exercised in part, and the holder of Adjustment Warrants may not sell any securities of the Company within 20 days prior to exercise. Adjustment Warrants may also only be exercised to the extent that the holder continues to hold the shares and warrants comprising the Units of which the Adjustment Warrants were attached.

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

A total of 12,525,428 Adjustment warrants were issued and subsequently exercised resulting in the Company issuing 4,175,143 common shares on October 4, 2013.

(iv) On January 24, 2013, the Board of Directors approved the grant of 2,027,500 bonus shares to employees, consultants and directors. Pursuant to shareholder approval granted at the Company's 2013 Annual General Meeting held on July 30, 2013, the Company issued a first tranche of 1,013,750 Prophecy Coal common shares on October 4, 2013. On July 3, 2013, the Company issued 258,542 common shares as the second tranche of 2011 stock bonus. As at December 31, 2013, the Company recorded $317,460 stock bonus expense.

During the year ended December 31, 2012, Prophecy Coal had the following common share capital transactions:

(i) Prophecy Coal issued 187,500 and 1,479,509 shares on the exercise of options and warrants, respectively, for total proceeds of $922,453.

(ii) On January 2, 2012, the Company granted 868,583 bonus shares to employees, consultants and directors, subject to the following terms: 50% escrowed for 9 months, and 50% escrowed for 18 months from the grant date. This share bonus grant was approved at the Company's Annual General Meeting on June 11, 2012. As at December 31, 2012, Prophecy Coal had released 525,042 bonus shares.

(iii) On March 8, 2012, the Company closed a non-brokered private placement of 22,363,866 shares at a price of $0.45 per share for gross proceeds of $10,063,740. Finders' fees of 6% of the gross proceeds were paid on certain portions of the placement totalling $466,064. All shares issued were subject to a four-month hold period that expired on July 9, 2012, and

(iv) On July 16, 2012, Prophecy Coal issued 2,735,617 shares to Waterton at a value of $0.20 per share as a financing fee pursuant to a $10 million Loan, (Annual financial statements 20).

(c) Share purchase options

During the year ended December 31, 2013, the Company replaced its 2012 fixed share purchase option plan with a rolling share purchase option plan (the "2013 Plan") permitting the reserve for issuance of options exercisable for 20% of the Company's common shares issued and outstanding at the date of grant. The exercise price of options granted under the 2013 Plan is a price not less than the volume weighted average trading price of the common shares on the TSX during the five trading days immediately preceding the date of grant. The provisions of the 2013 Plan dealing with the expiry date and vesting of options provide an allowable exercise period of options granted under the 2013 Plan, unless otherwise fixed by the Board, of up to ten years from the date the option is granted, subject to any accelerated termination. Options granted under the 2013 Plan vest and become exercisable at 12.5% per quarter over two years, unless determined otherwise by the Board.

(Expressed in Canadian Dollars)

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

During the year ended December 31, 2012, the Company granted 10,835,000 share purchase options to directors, officers, employees and consultants at exercise prices ranging from $0.17 to $0.49 and expiry dates ranging from January 9, 2017 to November 5, 2017. Of these 15,850,000 options that were granted for the 2012 fiscal year-to-date, 5,315,000 were re-granted options as described below.

On June 18, 2012, further to the voluntary forfeiture of share purchase options held by certain directors, officers, employees and consultants with expiry dates on June 13, 2016, August 30, 2016, January 9, 2017, February 3, 2017, and March 22, 2017 at exercise prices ranging from $0.425 to $0.77, the Company granted 5,315,000 new share purchase options to such individuals with an expiry date of June 18, 2017 at an exercise price of $0.28 per share subject to a two year vesting schedule whereby 50% of the options granted vest at the end of the each of the first and second years. The re-issuing of these options had been approved by the TSX, but they had not been approved by the shareholders until July 30, 2013 AGM.

On June 18, 2012, the Company amended the exercise price of 18,358,050 options that had previously been granted to directors, officers, employees and consultants with expiry dates ranging from January 23, 2014 to February 14, 2016 by reducing the exercise prices (which ranged from $0.38 to $0.93) to $0.28, subject to TSX and shareholder approval. There were no changes to the expiry dates and vesting periods of these options. The re-pricing of these options had been approved by the TSX but they had not been approved by the shareholders until July 30, 2013 AGM.

Consequently the incremental fair value of $508,725 of these options was determined using the Black- Scholes option pricing model using the weighted average assumptions as follows: risk free rate – 2.48%, expected life – 2.2 years, expected volatility – 86.79%, dividend yield - 0%, and a stock price of $0.14.

During the year ended December 31, 2013, the Company granted 4,800,000 share purchase options to employees, directors, officers and consultants, with a weighted average exercise price of $0.12 and expiry dates ranging from March 4, 2018 to August 16, 2018.

The following is a summary of the changes in Prophecy Coal's share purchase options from December 31, 2011 to December 31, 2013:

| | Number of Options | | Weighted Average Exercise Price |
|---|---|---|---|
| Outstanding, December 31, 2011 | 24,493,050 | $ | 0.70 |
| Granted | 10,835,000 | $ | 0.27 |
| Exercised | (187,500) | $ | 0.25 |
| Forfeited | (1,830,000) | $ | 0.61 |
| Cancelled | (825,000) | $ | 0.26 |
| Outstanding, December 31, 2012 | 32,485,550 | $ | 0.57 |
| Granted | 4,800,000 | $ | 0.12 |
| Cancelled | (5,720,000) | $ | 0.20 |
| Outstanding, December 31, 2013 | 31,565,550 | $ | 0.26 |
| Options exercisable on December 31, 2012 | 21,366,383 | $ | 0.73 |
| Options exercisable on December 31, 2013 | 24,199,717 | $ | 0.24 |

(Expressed in Canadian Dollars)

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

As of December 31, 2013, the following Prophecy Coal share purchase options were outstanding:

| December 31, 2013 | | Expiry | At December 31, 2013 | |
|---|---|---|---|---|
| Exercise Price | Options Outstanding | Date | Exercisable | Unvested |
| $0.12 | 3,900,000 | August 15, 2018 | 487,500 | 3,412,500 |
| $0.13 | 250,000 | July 22, 2018 | 31,250 | 218,750 |
| $0.14 | - | November 2, 2017 | - | - |
| $0.15 | - | November 5, 2017 | - | - |
| $0.18 | 375,000 | September 24, 2017 | 187,500 | 187,500 |
| $0.18 | 230,000 | August 16, 2017 | 115,000 | 115,000 |
| $0.18 | 3,804,167 | August 22, 2017 | 1,902,084 | 1,902,083 |
| $0.18 | - | September 20, 2017 | - | - |
| $0.25 | 975,000 | October 29, 2014 | 975,000 | - |
| $0.25 | 10,000 | June 1, 2017 | 5,000 | 5,000 |
| $0.28 | 3,050,000 | June 18, 2017 | 1,525,000 | 1,525,000 |
| $0.28 | 200,000 | November 30, 2014 | 200,000 | - |
| $0.28 | 1,056,800 | January 23, 2014 | 1,056,800 | - |
| $0.28 | 281,250 | January 29, 2015 | 281,250 | - |
| $0.40 | 100,000 | January 29, 2015 | 100,000 | - |
| $0.43 | - | January 9, 2017 | - | - |
| $0.49 | - | March 22, 2017 | - | - |
| $0.28 | 525,000 | September 21, 2015 | 525,000 | - |
| $0.54 | 125,000 | September 21, 2015 | 125,000 | - |
| $0.28 | 350,000 | March 10, 2015 | 350,000 | - |
| $0.28 | 175,000 | July 17, 2014 | 175,000 | - |
| $0.28 | 65,000 | September 21, 2014 | 65,000 | - |
| $0.63 | - | June 13, 2016 | - | - |
| $0.28 | 1,340,000 | May 10, 2015 | 1,340,000 | - |
| $0.67 | 262,500 | May 10, 2015 | 262,500 | - |
| $0.28 | 75,000 | October 15, 2015 | 75,000 | - |
| $0.67 | 100,000 | October 15, 2015 | 100,000 | - |
| $0.28 | 2,050,000 | December 24, 2015 | 2,050,000 | - |
| $0.77 | - | August 30, 2016 | - | - |
| $0.28 | 9,000,000 | December 10, 2015 | 9,000,000 | - |
| $0.80 | 400,000 | April 30, 2015 | 400,000 | - |
| $0.28 | 75,000 | April 30, 2015 | 75,000 | - |
| $0.28 | 100,000 | September 23, 2015 | 100,000 | - |
| $0.28 | 120,000 | January 4, 2016 | 120,000 | - |
| $0.28 | 2,270,833 | December 24, 2015 | 2,270,833 | - |
| $0.28 | 50,000 | January 6, 2016 | 50,000 | - |
| $0.28 | 100,000 | February 14, 2016 | 100,000 | - |
| $1.03 | 150,000 | March 24, 2015 | 150,000 | - |
| | 31,565,550 | | 24,199,717 | 7,365,833 |

(Expressed in Canadian Dollars)

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

At December 31, 2013, the Company had 24,199,717 exercisable share purchase options outstanding (2012 – 21,366,383).

Share-based payment expenses resulting from stock options are amortized over the corresponding vesting periods. During the year ended December 31, 2013, the share-based payment expenses were calculated using the following weighted average assumptions:

| | Year ended December 31, | |
|---|---|---|
| | 2013 | 2012* |
| Risk-free interest rate | 1.85% | 1.35% |
| Expected life of options in years | 5 years | 4 years |
| Expected volatility | 74.6% | 75.0% |
| Expected dividend yield | Nil | Nil |

The expected volatility used in the Black-Scholes option pricing model is based on the historical volatility of the Company's shares. The weighted average fair-value of options granted during the year ended December 31, 2013 was $0.07 (December 31, 2012 - $0.05).

Share-based payments charged to operations and assets were allocated between capitalization as property and equipment for Ulaan Ovoo and other deferred mineral properties, and general and administrative expenses. For the year ended December 31, 2013 and 2012, share-based payments were recorded as follows:

| | Year Ended December 31, 2013 | 2012 |
|---|---|---|
| Consolidated Statement of Operations | | |
| Share based payments, Prophecy Coal | $ 1,304,486 | $ 666,268 |
| Share based payments, Wellgreen Platinum* | - | 1,984,364 |
| | 1,304,486 | 2,650,632 |
| Consolidated Statement of Financial Position | | |
| Ulaan Ovoo exploration | 68,487 | 170,731 |
| Power Plant application | 14,792 | 16,580 |
| | 83,279 | 187,311 |
| Total share-based payments | $ 1,387,765 | $ 2,837,943 |

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

(Expressed in Canadian Dollars)

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

(d) Share purchase warrants

The following is a summary of the changes in Prophecy Coal's warrants and adjustment warrants from December 31, 2011 to December 31, 2013:

| | Number of Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 31, 2011 | 11,834,769 | $ 0.72 |
| Exercised | (1,479,509) | $ 0.51 |
| Expired | (15,334) | $ 0.49 |
| Outstanding, December 31, 2012 | 10,339,926 | $ 0.57 |
| Issued | 9,394,072 | $ 0.18 |
| Expired | (6,508,415) | $ 0.80 |
| Outstanding, December 31, 2013 | 13,225,583 | $ 0.18 |

| | Number of Adjustment Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, January 1, 2013 | - | - |
| Issued adjustment warrants | 12,525,428 | ** |
| Exercised | (12,525,428) | - |
| Outstanding, December 31, 2013 | - | - |

*** Adjustment warrants see Note 21 b (ii, iii)*

The value of adjustment warrants of $438,390 was charged to share capital reducing the proceeds from the private placement.

On October 4, 2013, all adjustment warrants pursuant to adjustment warrant terms described in Note 21 have been exercised at no consideration. The Company issued 4,175,143 common shares pursuant to the exercise of 12,525,420 warrants and derecognized the corresponding amount from the liability.

As of December 31, 2013 and December 31, 2012, the following Prophecy Coal warrants were outstanding:

| Exercise price | Number of Warrants At December 31, 2013 | At December 31, 2012 | Expiry date |
|---|---|---|---|
| $0.80 | - | 2,653,967 | March 23, 2013 |
| $0.77 | - | 551,968 | March 31, 2013 |
| $0.80 | - | 2,964,730 | March 31, 2013 |
| $0.80 | - | 337,750 | April 21, 2013 |
| $0.18 | 3,286,929 | - | April 11, 2015 |
| $0.18 | 6,107,143 | - | June 4, 2015 |
| $0.18 | 3,831,511 | 3,831,511 | October 28, 2015 |
| | 13,225,583 | 10,339,926 | |

## 22. CAPITAL RISK MANAGEMENT

Management considers its capital structure to consist of share capital, share purchase options and warrants. Prophecy Coal manages its capital structure and makes adjustments to it, based on the funds available to, and required by, Prophecy Coal, in order to support the acquisition, exploration and development of mineral properties. The Board of Directors does not establish quantitative returns on capital criteria for management. In order to facilitate the management of its capital requirement, the Company prepares annual expenditure budgets that are updated as necessary depending on various factors. The annual and updated budgets are approved by the Board of Directors.

The properties to which Prophecy Coal currently has an interest in, are predominantly in the exploration stage; as such, Prophecy Coal is dependent on external financing to fund its activities. In order to carry out the planned exploration and development and pay for administrative costs, Prophecy Coal will spend its existing working capital and raise additional amounts as needed. There were no changes in managements approach to capital management during the year ended December 31, 2013. Neither Prophecy Coal nor its subsidiaries are subject to externally imposed capital requirements.

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

The Company expects to have sufficient liquidity and capital resources to be able to continue as a going concern until at least December 31, 2014 based on existing capital resources and estimated cash flows from pre-commercial mining operations (Note 1).

## 23. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

### Fair Value

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

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

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

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

(Expressed in Canadian Dollars)

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

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

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

| As at December 31, 2012 | | Level 1 | | Level 2 | | Level 3 | | Total |
|---|---|---|---|---|---|---|---|---|
| Financial assets | | | | | | | | |
| Cash and cash equivalents | $ | 768,831 | $ | - | $ | - | $ | 768,831 |
| Short term investment | $ | 5,107,500 | | - | | - | | 5,107,500 |
| Available-for-sale investments | $ | 628,188 | | - | | - | | 628,188 |
| | $ | 6,504,519 | $ | - | $ | - | $ | 6,504,519 |

The Company considers that the carrying amount of all its financial assets and financial liabilities measure at amortized cost approximates their fair value. The Company does not offset financial assets with financial liabilities. There were no transfers between Level 1, 2 and 3 for the year ended December 31, 2013.

Valuation Techniques

Available-for-sale investments

The fair value of available-for-sale investments is determined based on the closing price of each investment at the date of the statement of financial position. The closing price is a quoted market price obtained from the exchange that is the principal active market for the particular security, and therefore available-for-sale investment are classified within Level 1 of the fair value hierarchy. The fair value of the Company's investment in the shares of Wellgreen Platinum is determined using this methodology.

(Expressed in Canadian Dollars)

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

**Categories of financial instruments**

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

| | As at December 31, 2013 | As at December 31, 2012 |
|---|---|---|
| Fair value through profit or loss | | |
| Cash and cash equivalents | $ 507,996 | $ 768,831 |
| Restricted cash equivalents | 34,500 | - |
| Short term investment | - | 5,107,500 |
| Loans and receivables | | |
| Trade receivable | 679,738 | 351,520 |
| Due from related party | 2,069,255 | 104,515 |
| Available-for-sale investments | | |
| Investment in Victory Nickel | - | 628,188 |
| Investment in Wellgreen Platinum | 2,295,810 | - |
| | $ 5,587,299 | $ 6,960,554 |

| | | |
|---|---|---|
| Other financial liabilities | | |
| Accounts payable and accrued liabilities | $ 1,432,238 | $ 766,209 |
| Loan payable | - | 9,392,170 |
| Line of credit facility | 1,132,592 | - |
| | $ 2,564,830 | $ 10,158,379 |

## 24. FINANCIAL RISK MANAGEMENT DISCLOSURES

(a) Liquidity risk

Liquidity risk is the risk that an entity will be unable to meet its financial obligations as they fall due. The Company manages liquidity risk by preparing cash flow forecasts of upcoming cash requirements. The Company maintained sufficient cash and cash equivalents, and short term investments and available-for-sale investments, at December 31, 2013 in the amount of $2,803,806 (December 31, 2012 - $5,876,331), in order to meet short-term business requirements. At December 31, 2013, the Company had accounts payable and accrued liabilities $1,432,238 (December 31, 2012 - $766,209), which have contractual maturities of 90 days or less and short-term line of credit payments of $1,069,400.

The Company has a planning and budgeting process in place by which it anticipates and determines the funds required to support normal operation requirements as well as the growth and development of its mineral property interests. The Company coordinates this planning and budgeting process with its financing activities through the capital management process in normal circumstances.

(Expressed in Canadian Dollars)

## 24. FINANCIAL RISK MANAGEMENT DISCLOSURES (cont'd...)

The following table details the Company's current and expected remaining contractual maturities for its financial liabilities with agreed repayment periods. The table is based on the undiscounted cash flows of financial liabilities.

| | 0 to 6 months | 6 to 12 months | Total |
|---|---|---|---|
| As at December 31, 2013 | | | |
| Trade accounts payable | $ 992,253 | $ - | $ 992,253 |
| Line of credit facility, current portion | 267,350 | 802,050 | 1,069,400 |
| | $ 1,259,603 | $ 802,050 | $ 2,061,653 |
| As at December 31, 2012 | | | |
| Trade accounts payable | $ 487,497 | $ - | $ 487,497 |
| Loans payable | - | 10,000,000 | 10,000,000 |
| | $ 487,497 | $ 10,000,000 | $ 10,487,497 |

The Company attempts to manage liquidity risk by maintaining sufficient cash and cash equivalents and short-term investment balances. Liquidity requirements are managed based on expected cash flow to ensure there is sufficient capital to meet short-term obligations. The Company ensures, as far as reasonably possible, that it will have sufficient capital in order to meet short term business requirements, after taking into account cash flows from operations and the Company's holdings of cash and cash equivalents. The Company believes that these sources will be sufficient to cover the likely short term cash requirements.

Additional sources of funding, which may not be available on favourable terms, if at all, include: share equity and debt financings; coal sales from stockpiled inventory; equity, debt or property level joint ventures with power project and coal property developers; and sale of interests in existing assets. In the event that the Company is not able to obtain adequate additional funding to continue as a going concern, material adjustment would be required to both the carrying value and classification of assets and liabilities on the statement of financial position (Note 1).

(b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risk primarily associated to cash and cash equivalents and receivables, net of allowances (50% for receivables over 90 days and 15% for receivables over 60 days). The Company manages credit risk, in respect of cash and cash equivalents, by purchasing highly liquid, short-term investment-grade securities held at a major Canadian financial institution. The significant concentration of credit risk is situated in Mongolia. The carrying amount of assets included on the statements of financial position represents the maximum credit exposure.

(c) Market risk

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

## 24. FINANCIAL RISK MANAGEMENT DISCLOSURES (cont'd...)

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Company's cash equivalents primarily include highly liquid investments that earn interest at market rates that are fixed to maturity or at variable interest rates. The Company also drew down US $1,500,000 on its credit facility bearing an annual coupon rate of 15%, with monthly interest payments. Due to the short-term nature of these financial instruments, and that the Company's line of credit beers interest at fixed rate, fluctuations in market rates do not have a significant impact on the fair values or future cash flows of the financial instruments as of December 31, 2013. The Company manages interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity.

(ii) Foreign currency risk

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

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

Based on the above, net exposures as at December 31, 2013, with other variables unchanged, a 1% (December 31, 2012 - 1%) strengthening (weakening) of the Canadian dollar against the Mongolian tugrik would not have a material impact on earnings with other variables unchanged. A 1% (December 31, 2011 - 1%) strengthening (weakening) of the US dollar against the Canadian dollar would not have a material impact on net loss. The Company currently does not use any foreign exchange contracts to hedge this currency risk.

(iii) Commodity and equity price risk

The Company holds investments in available-for-sale that fluctuate in value based on market prices. Based upon the Company's investment position as at December 31, 2013, a 10% increase (decrease) in the market price of the available-for-sale investments held would have resulted in an increase (decrease) to comprehensive income (loss) of approximately $229,600 (December 31, 2012 - $62,800). Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company closely monitors commodity prices, individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company. Fluctuations in value may be significant.

## 25. RELATED PARTY DISCLOSURES

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

(a) The Cantech Capital Corporation, a private company owned by Donald Gee, former director of Wellgreen Platinum, provided consulting and management services.

(b) The Elysian Enterprises Inc., a private company owned by David Patterson, former director of Wellgreen Platinum, provided consulting and management services.

(c) Energy Investment Capital, a private company owned by Jivko Savov, former director of Prophecy Coal, provided consulting services to the Company.

(d) JWL Investment Corp., a private company owned by Joseph Li, former General Manager, Corporate Secretary and Director of Prophecy Coal and Wellgreen Platinum, provided management services to the Company.

(e) Linx Partners Ltd., a private company controlled by John Lee, Director, Interim CEO and Executive Chairman of Prophecy Coal, and a Director and former Chairman and CEO of Wellgreen Platinum, provides management and consulting services to the Company.

(f) MaKevCo Consulting Inc., a private company 50% owned by Greg Hall, Director of Prophecy Coal and former director of Wellgreen Platinum, provides consulting and management services to the Company.

(g) The Energy Gateway Ltd., a private company owned by former Director Paul Venter, provided consulting and management services.

On June 4, 2013, John Lee, interim CEO, subscribed for 1,000,000 of the Company's common shares. In lieu of paying cash in the amount of $140,000 (1,000,000 shares at $0.14 per share), he transferred to the Company 202,989 common shares of Wellgreen Platinum (which were valued effective at $0.69 per share).

On July 12, 2013, Jeffrey Mason, the former CFO, purchased 500,000 common shares of Wellgreen Platinum from the Company at $0.50 per share based on a 20% discount to the 5 day VWAP, as calculated on June 19, 2013. This purchase was made in accordance with his employment agreement with the Company. Proceeds of the sale totalled $250,000 which the Company used to partially repay the Waterton Loan in accordance with the Amended Loan Agreement. On October 8, 2013, the Company granted a severance payment of $98,250 to Mr. Mason by way of transferring 196,500 common shares of Wellgreen Platinum to Mr. Mason at a value of $0.50 per share.

On October 22, 2013, the Company entered into a one year loan agreement with Harald Batista, a director of the Company, in the amount of $200,000 with a stated interest at 8% per annum payable on the maturity date. The loan has been subsequently settled via the transfer of 493,827 common shares of Wellgreen Platinum registered in the Company's name to Mr. Batista on November 25, 2013 at a value of $0.405 per share.

(Expressed in Canadian Dollars)

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

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

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Related parties | | 2013 | | 2012 |
| Cantech Capital Corp. (a) | $ | - | $ | 6,500 |
| Directors and officers | | 499,817 | | 400,418 |
| Elysian Enterprises Inc. (b) | | - | | 7,500 |
| Energy Investment Capital (c) | | - | | 39,852 |
| JWL Investments Corp. (d) | | - | | 284,500 |
| Linx Partners Ltd. (e) | | 525,012 | | 1,109,862 |
| MaKevCo Consulting Inc. (f) | | 142,200 | | 195,500 |
| The Energy Gateway (g) | | - | | 51,991 |
| | $ | 1,167,029 | $ | 2,096,123 |

*The Company's related party disclosure includes Wellgreen Platinum's related party transactions during the year ended December 31, 2012.*

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

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Related parties | | 2013 | | 2012 |
| Consulting and management fees | $ | 153,948 | $ | 787,534 |
| Directors' fees | | 246,010 | | 313,621 |
| Mineral properties | | 320,250 | | 701,109 |
| Property and equipment | | 162,750 | | 214,995 |
| Salaries and benefits | | 284,071 | | 78,864 |
| | $ | 1,167,029 | $ | 2,096,123 |

As at December 31, 2013, the amount included within accounts payable and accrued liabilities, which was due to related parties totalling $413,278 (December 31, 2012 – $53,334), consisted of amounts owing to directors for fees of $129,060, consulting fees of $84,072, and for managing the mineral properties and power plant project of $200,146.

Transactions between the Company and its subsidiaries are eliminated on consolidation; therefore, they are not disclosed as related party transactions.

Prophecy Coal shared administrative assistance, office space, and management with Wellgreen Platinum pursuant to a Service Agreement for 2012, consisting of fixed monthly fees of $40,000. Prophecy Coal recovers costs for services rendered to Wellgreen Platinum and expenses incurred on behalf of Wellgreen Platinum. As at December 31, 2013 an estimated amount of $78,364 was due from Wellgreen Platinum.

(Expressed in Canadian Dollars)

## 26. KEY MANAGEMENT PERSONNEL COMPENSATION

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

| | | Year Ended December 31, | | |
|---|---|---|---|---|
| Key Management Personnel | | 2013 | | 2012 |
| Salaries and short term benefits | $ | 811,321 | $ | 896,739 |
| Share-based payments | | 829,085 | | 324,624 |
| | $ | 1,640,406 | $ | 1,221,363 |

## 27. SUPPLEMENTAL CASH FLOW INFORMATION

| | | Year ended December 31, 2013 | | 2012 |
|---|---|---|---|---|
| Supplementary information | | | | |
| Interest paid | $ | 1,052,160 | $ | 656,736 |
| Non-Cash Financing and Investing Activities | | | | |
| Shares issued as financing fees | $ | 280,000 | $ | 600,000 |
| Shares issued as bonus shares | $ | 175,535 | $ | 78,857 |
| Shares issued in exchange for Wellgreen shares | $ | 140,000 | $ | - |
| Non-cash disposition of Wellgreen shares to settle debt | $ | 474,699 | $ | - |
| Revision in provision for closure and reclamation | $ | (193,460) | $ | - |
| Capitalized depreciation of fixed assets | $ | 3,708,606 | $ | 5,043,167 |
| Property & equipment expenditures included in accounts payable | $ | 615,090 | $ | 167,460 |
| Mineral property expenditures included in accounts payable | $ | 269,171 | $ | 1,666 |
| Share-based payments capitalized in property and equipment | $ | 68,487 | $ | 170,731 |
| Share-based payments capitalized in mineral properties | $ | 14,792 | $ | 16,580 |

## 28. COMMITMENTS

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

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

| Line of credit facility re-payment commitments | | |
|---|---|---|
| Year | | Amount |
| 2014 | $ | 1,069,400 |
| 2015 | | 631,925 |
| | $ | 1,701,325 |

## 27. CONTINGENCIES

The Company accrues for liabilities when they are probable and the amount payable can be reasonably estimated. As at December 31, 2013 no contingent amounts have been accrued.

## 28. EVENTS AFTER THE REPORTING DATE

The following events occurred subsequent to December 31, 2013:

a) The Company issued a second tranche of 1,013,750 common shares as bonus shares to directors, officers, employees and service providers of the Company.

b) The Company granted 250,000, 5,550,000, and 500,000 share purchase options to directors, officers, employees, and consultants of the Company at the exercise price of $0.08, $0.105, and $0.10 per share respectively. All these options are exercisable for a period of five years.

c) 1,056,800 share purchase options exercisable at $0.28 per share expired unexercised on January 23, 2014.

d) 1,523,881 of Wellgreen Platinum's reserved held in-trust shares were released back to the Company due to 670,000 Prophecy Coal options being forfeited on December 31, 2013 and 14,355,000 and 1,056,800 Prophecy Coal options forfeited and expiring respectively subsequent to year-end.

e) The Company sold its remaining 3,327,261 Wellgreen Platinum's common shares and its 1,523,881 common shares released from reserve of Wellgreen Platinum after year end for net proceeds of approximately $4,203,638.