



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

**ANNUAL INFORMATION FORM
FOR THE FINANCIAL YEAR ENDED DECEMBER 31, 2014**

March 31, 2015

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1. GENERAL

1.1 Forward-Looking Statements

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

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

Examples of Forward-Looking Statements in this AIF

Such forward-looking statements include but are not limited to statements regarding the permitting, feasibility, plans for development and production of the Chandgana Power Plant (as hereinafter defined), 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; development of the Pulacayo Project (as hereinafter defined) and other information concerning possible or assumed future results of operations of Prophecy. See in particular, portions of Part 3.1 – *Three Year Corporate Development History – Summary of Three Principal Mineral Projects* and Part 4 – *Description of the Business*.

Material Assumptions

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

Material Risks

Numerous factors could cause Prophecy’s actual results to differ materially from those expressed or implied in the forward-looking statements including the following risks and uncertainties, which are discussed in greater detail under Part 6 – *Risk Factors* in this AIF: the Company’s history of net losses and lack of foreseeable cash flow; exploration, development and production risks, including risks related to the development of its Ulaan Ovoo coal property; Prophecy not having a history of profitable mineral production; commencing mine development without a feasibility study; the uncertainty of mineral resource and mineral reserve estimates; the capital and operating costs required to bring Prophecy’s projects into

production and the resulting economic returns from its projects; foreign operations and political conditions, including the legal and political risks of operating in Mongolia and Bolivia, which are developing countries and being subject to their local laws; the availability and timeliness of various government approvals and licenses; the feasibility, funding and development of the Chandgana Power Plant and Pulacayo Project; protecting title to the Company's mineral properties; environmental risks; the competitive nature of the mining business; lack of infrastructure; Prophecy's reliance on key personnel; uninsured risks; commodity price fluctuations; reliance on contractors; Prophecy's need for substantial additional funding and the risk of not securing such funding on reasonable terms or at all; foreign exchange risk; anti-corruption legislation; recent global financial conditions; the payment of dividends; 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 AIF should not be considered as a representation by Prophecy or any other person that Prophecy's objectives or plans will be achieved.

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

The information in this AIF is for the fiscal year ended December 31, 2014 but is current as of March 31, 2015 unless otherwise stated or clear from the context.

1.2 Accounting Principles

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

1.3 Currency

Unless otherwise indicated all references to "dollar" or "\$" are to Canadian dollars and all references to "US dollars" or "US \$" are to United States of America dollars.

	Year ended December 31,		
	2014	2013	2012
High	\$1.1656	\$1.0166	\$1.0418
Low	1.0639	0.9336	0.9710
Average	1.1046	0.9711	0.9996
Closing	1.1627	0.9015	0.9949

On March 31, 2015, the Bank of Canada noon mid-market rate of exchange was US \$1.2683 dollars to \$1.00.

1.4 Documents Incorporated by Reference

The following documents are incorporated by reference into this AIF:

- (a) "Updated Technical Report on the Coal Resources of the Chandgana Khavtgai Coal Resource Area, Khentii Aimag, Mongolia" dated September 28, 2010 that fulfills the disclosure requirements

of NI 43-101, prepared by Christopher M. Kravits, CPG, LPG of Kravits Geological Services, LLC (the "**Chandgana Technical Report**"), who was at the time an independent Qualified Person under NI 43-101 but has since become non-independent by virtue of the fact that the Company has become his primary client;

- (b) "Ulaan Ovoo – Pre-Feasibility Study" dated December 10, 2010 that fulfills the disclosure requirements of NI 43-101, prepared by John Sampson, B.Sc. (Hons) and Brian Saul P. Eng. of Wardrop Engineering Inc. ("**Wardrop**") (the "**Ulaan Ovoo Technical Report**" or "**Ulaan Ovoo PFS**"), who is an independent Qualified Person under National Instrument 43-101 – *Standard of Disclosure for Mineral Properties* ("**NI 43-101**");
- (c) Material Change Report dated July 16, 2012 disclosing the entering into of a Senior Secured Credit Agreement between Prophecy and Waterton Global Value, L.P. ("**Waterton**");
- (d) "Technical Report Coal Resources and Preliminary Economic Assessment - Coal Mine Component, Chandgana Tal Coal Project, Khentii Province, Mongolia" (the "**PEA**") dated November 30, 2012 and prepared by John T. Boyd Co. (USA). The lead Qualified Person for the report is Thaddeus J. Sobek, who is an independent Qualified Person under NI 43-101;
- (e) "NI 43-101 Technical Report Pulacayo Project Feasibility Study" (the "**Pulacayo FS**") dated January 17, 2013, that fulfills the disclosure requirements of NI 43-101 prepared by Ryan Illingworth, Michael Cullen, Peter Webster, Eugene Puritch, Jim Porter, Graeme Farr and Mark Smith.
- (f) Material Change Report dated February 25, 2013 disclosing the initiation of a non-brokered private placement and current number of units subscribed for thereunder (the "**Private Placement for Units**");
- (g) Material Change Report dated March 1, 2013 disclosing the waiver of default under the Senior Secured Credit Agreement due to the expiry of the original Purchase and Sales Agreement with Tethys Mining LLC ("**Tethys**");
- (h) Material Change Report dated March 11, 2013 disclosing the grant of land use rights to Prophecy's 100%-owned subsidiary Prophecy Power Generation LLC ("**Prophecy Power**") for the proposed Chandgana Power Plant (as hereinafter defined);
- (i) Material Change Report dated May 17, 2013 disclosing the entering into of a 25-year Tariff Agreement for the Chandgana Power Plant project;
- (j) Coal Supply Agreement dated June 5, 2013 between Chandgana Coal LLC ("**Chandgana Coal**") and Prophecy Power (the "**CSA**");
- (k) Material Change Report dated June 7, 2013 disclosing the closing of the final tranche of the Private Placement for Units;
- (l) Material Change Report dated June 24, 2013 disclosing an update on the Ulaan Ovoo mine;
- (m) Material Change Report dated July 15, 2013 disclosing the entering into of an Amendment to the Senior Secured Credit Agreement between Prophecy and Waterton;
- (n) Material Change Report dated October 17, 2013 disclosing the acceptance of an offer to purchase shares in Wellgreen Platinum Ltd. (formerly Prophecy Platinum Corp.) ("**Wellgreen Platinum**");
- (o) Material Change Report dated October 24, 2013 disclosing the acceptance of an offer to purchase additional shares in Wellgreen Platinum;

- (p) “Technical Report Coal Resources and Preliminary Economic Assessment - Coal Mine Component, Chandgana Tal Coal Project, Khentii Province, Mongolia” (the “**Revised PEA**”) reissued February, 2014, that fulfills the disclosure requirements of NI 43-101, filed on SEDAR on April 3, 2014 and prepared by John T. Boyd Co. (USA). The lead Qualified Person for the report is Thaddeus J. Sobek, who is an independent Qualified Person under NI 43-101;
- (q) Material Change Report dated August 18, 2014 disclosing the entering into binding agreements with Cosmo Coal LLC (“**Cosmo**”) to consolidate Chandgana Coal with Tugalgtai Mining LLC.
- (r) Material Change Report dated September 19, 2014 disclosing the approval of the Company’s General Development Plan for the Zeltura border port in Selenge province, Mongolia;
- (s) Material Change Report dated November 5, 2014 disclosing the entering into of a definitive Share Purchase Agreement with Apogee Silver Ltd. (“**Apogee**”) to acquire the Pulacayo Project (as hereinafter defined);
- (t) Material Change Report dated December 8, 2014, disclosing the undertaking of a non-brokered private placement and number of Shares (as hereinafter defined) subscribed for thereunder; and
- (u) Business Acquisition Report dated March 18, 2015 disclosing the acquisition of Bolivian and Cayman subsidiaries.

The above documents except the Pulacayo FS are available for review under the Company’s SEDAR profile at www.SEDAR.com.

The Pulacayo FS is available for review under Apogee’s SEDAR profile at www.SEDAR.com.

2. CORPORATE STRUCTURE

2.1 Name, Address and Incorporation

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

Prophecy is a reporting issuer in the provinces of British Columbia, Alberta, and Ontario. The Company’s common shares (the “**Shares**” or “**Prophecy Shares**”) are listed for trading on: (i) the Toronto Stock Exchange under the symbol “PCY”, (ii) the OTC-QX under the symbol “PRPCF”, and (iii) on the Frankfurt Stock Exchange under the symbol “1P2”.

Prophecy’s head and registered offices are located at 342 Water Street, 2nd Floor, Vancouver, British Columbia, V6B 1B6. The Company’s website is www.prophecydev.com.

Prophecy, in its current form, is primarily the product of an April 2010 business combination between Red Hill Energy Inc. (at the time, TSX.V-RH) and a company formed in 2006, Prophecy Resource Corp. Red Hill Energy Inc. was incorporated on November 6, 1978 under the *Corporations Act* (British Columbia) under the name “Banbury Gold Mines Ltd.” Banbury changed its name to “Enerwaste Minerals Corp.” on July 3, 1992 and to “Universal Gun-Loc Industries Ltd.” on December 17, 1993. On April 24, 2002, Universal Gun-Loc changed its name to “UGL Enterprises Ltd.” and to “Red Hill Energy Inc.” on May 29, 2006. On May 10, 2005, the Company, as UGL, transitioned under the new (2002) *Business Corporations Act* (British Columbia) (“**BCBCA**”) which is the corporate law statute as amended, which continues to govern the Company.

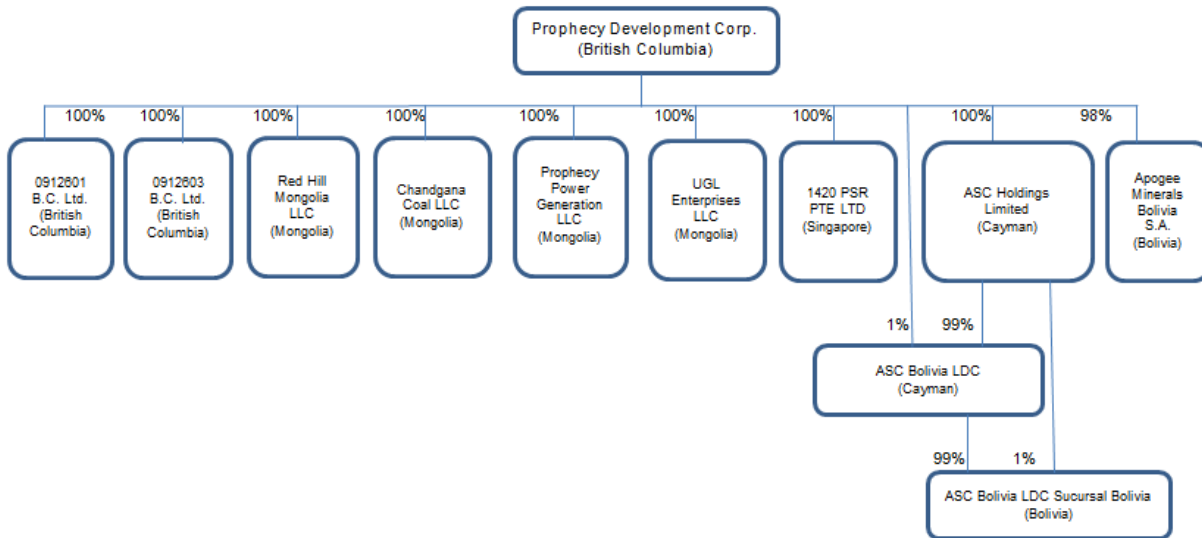
On April 16, 2010, the Company (then Red Hill Energy Inc.) changed its name to “Prophecy Resource Corp.” in conjunction with the Red Hill Energy Inc. merger. On June 13, 2011, the Company changed its name to “Prophecy Coal Corp.” in connection with its amalgamation with Northern Platinum Ltd. and Prophecy Holdings Inc. and an asset spin-off to capitalize the Company’s controlled (at that time),

affiliate, publicly traded Wellgreen Platinum. On January 5, 2015 the Company changed its name to “Prophecy Development Corp.” in connection with an acquisition of assets primarily located in Bolivia and to better reflect its various interests in its current mining and energy projects in Mongolia, Bolivia and Canada.

2.2 Inter-Corporate Relationships

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

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



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

- | | |
|----------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Red Hill Mongolia LLC | - 100% interest in the Ulaan Ovoo coal property (the “ Ulaan Ovoo Property ”) located in Selenge province, Mongolia. |
| Chandgana Coal LLC | - 100% interest in the Chandgana Tal coal property (the “ Chandgana Tal Property ”) and Khavtgai Uul coal property (the “ Khavtgai Uul Property ”) (together, the “ Chandgana Properties ”) located in Khentii Aimag province, Mongolia. |
| Prophecy Power Generation LLC | - Holds the licence for the Chandgana Coal-Fired Mine Mouth Power Plant 600MW project planned in central Mongolia (the “ Chandgana Power Plant ”). |
| 912601 B.C. Ltd. | - 80% interest in the Titan vanadium-titanium-iron property located in Ontario, Canada and 60% interest in the Okeover copper-molybdenum property located in British Columbia, Canada. |
| ASC Bolivia LDC Sucursal Bolivia | - Holds the mining joint venture interest in the Pulacayo Paca silver-lead-zinc property (the “ Pulacayo Project ”) located in southwestern Bolivia. |

3. GENERAL DEVELOPMENT OF THE BUSINESS

3.1 Three Year History

2012

- On June 18, 2012, the Company signed a Sale and Purchase Agreement with Tethys to acquire assets relating to the Tugalgtai coal exploration licenses in Mongolia (the “**Tugalgtai Licenses**”). The terms of the agreement included a US\$10 million upfront payment and an 8.5% royalty on future coal sales from both the Chandgana Properties and Tugalgtai Licenses (the “**Tugalgtai Agreement**”).
- On July 16, 2012, Prophecy secured a \$10 million debt facility (the “**Loan**”) with Waterton. The funds were borrowed to help finance the purchase of the Tugalgtai Licenses from Tethys, and for general working capital purposes. The Loan had a one year term, due July 16, 2013, and bears interest at 14% per annum. A structuring fee of 2.5% in cash plus a bonus for a fair value of \$600,000 was paid through the issuance to Waterton of 2,735,617 of the Company's Shares.
- In August, 2012, the Company temporarily suspended its coal mining operations at Ulaan Ovoo mine in an effort to save costs because at that time, the Company had sufficient inventory to meet anticipated coal demand through the balance of 2012.
- On September 6, 2012, the Company submitted a Power Purchase Agreement (“**PPA**”) proposal to the Mongolian Government.
- On October 15, 2012, Prophecy's wholly-owned subsidiary Prophecy Power started conducting final evaluation of three tenders from Engineering, Procurement and Construction firms to build the proposed Chandgana Power Plant in Mongolia.
- On November 2, 2012, the Company received the Chandgana Preliminary Economic Assessment report on its Chandgana Tal coal mining licenses, which was prepared by John T. Boyd Co. (USA) (“**Boyd**”).
- On November 2, 2012, the Company

postponed its purchase of coal assets from Tethys. The escrow funds, net of costs, amounting to US\$9.9 million was returned to the Company on termination of the original Tugalgtai Agreement, which occurred due to the elapsing of the initial long stop date for approval of the licences transfer by the Minerals Resource Authority of Mongolia.

- On December 31, 2012, the Company recorded a non-cash impairment write down of \$47,063,173 on the Ulaan Ovoo Property, which is reflected on the consolidated statement of operations. The impairment charge reduces previously capitalized deferred exploration within property and equipment, to a balance of \$2 million.
- In 2013, the Company announced a change to its Board of Directors, accepting the resignation of Mr. Paul Venter and Mr. Paul McKenzie. The Company also announced senior management changes with the departure of Mr. Joseph Li, former General Manager and Corporate Secretary and director of the Company and the appointment of Mr. Jeffrey Mason as Chief Financial Officer, Mr. Samir Patel as Corporate Secretary, and Mr. Robert Bruggeman as Vice President of Corporate Development.

2013

- On March 1, 2013, the Company announced that pursuant to the July 16, 2012 credit agreement between the Company and Waterton, the expiry of the original purchase and sales agreement with Tethys constituted a default under the credit agreement. Waterton agreed to waive the default, subject to the Company completing (which it has) the following: setting aside \$3.5 million in escrow for the purchase of the Tugalgtai Licenses; issuing 2 million Shares to Waterton; and pledging additional security to Waterton in the form of 5,535,000 remaining free trading Wellgreen Platinum common shares held by the Company.
- On March 5, 2013, the Company announced that Prophecy Power has been granted 532.4 hectares of land to be used for the proposed

Chandgana Power Plant construction.

- On April 12, 2013, the Company closed the first tranche of the Private Placement for Units, issuing 4,382,571 units (each a “Unit”) of the Company, of which each Unit consisted 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.
- On June 6, 2013, the Company closed the second and final tranche of the Private Placement for Units with the issuance of 8,142,857 Units of the Company for aggregate consideration of \$1,140,000. Each whole Warrant is exercisable for one common share of Prophecy at a price of \$0.18, expiring two years from the date of issuance.
- On May 17, 2013, the Company announced receipt of official correspondence from the Head of the Chandgana coal mine mouth power plant project designated by the Mongolian Ministry of Energy, outlining the terms of a tariff agreement reached by the Working Group and Prophecy Power, for the Chandgana Power Plant.
- On July 15, 2013 the Company amended the credit agreement with Waterton (the “**Amended Loan Agreement**”). The Company 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 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 with the Trade and Development Bank. The line of credit had 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 are to 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 in a private sale for net proceeds of \$7,500,000. Transaction fees of 5% were paid

pursuant to the purchase agreement. 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.

- 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, Mr. Samir Patel, former Corporate Secretary, Mr. Robert Bruggeman, former Vice President of Corporate Development and the appointment of Ms. Irina Plavutska as Chief Financial Officer and of Ms. Patricia Purdy as Corporate Secretary.

2014

- On June 30, 2014, Red Hill amended the line of credit agreement by extending the maturity date by four months.
- On August 18, 2014, the Company announced that it entered into binding agreements with Cosmo to:
 - 1) Consolidate the assets of the Company’s wholly-owned subsidiary, Chandgana Coal with the assets of Tugalgatai Mining LLC, which is a wholly-owned subsidiary of Cosmo, into: Chandgana Tugalgatai Coal LLC, a newly-incorporated Mongolian company, of which the Company will own 51% and Cosmo will own 49%.
 - 2) Transfer, for nominal consideration, 34% of the issued and outstanding shares of Prophecy Power to Cosmo.
 - 3) Accept Cosmo’s nomination of one new member to Prophecy’s Board of Directors.
- On September 19, 2014, the Company announced the approval of the Company’s General Development Plan for the Zeltura border port in Selenge province by the Border Ports National Council of Mongolia.
- On December 8, 2014, the Company announced a \$3,596,000 private placement with TBF Capital Management Group (HK) Limited (“**TBF**”) at a price of \$0.058 per share. Upon closing of the private placement, TBF will own approximately 19.24% of the Company’s

outstanding Shares, calculated on a non-diluted basis. TBF will be entitled to maintain its proportionate ownership percentage pursuant to certain rights granted by the Company under the terms of the subscription agreement between the parties (the “**Subscription Agreement**”).

Pursuant to the terms of the Subscription Agreement, TBF shall be entitled to nominate one member to the Company’s Board of Directors for as long as TBF maintains at least a 10% share ownership in the Company, calculated on a non-diluted basis, and the Company has agreed to reimburse TBF’s costs in relation to the transaction up to 5% of the total proceeds of the Placement.

- In 2014, the Company announced changes to its Board of Directors, accepting the resignation of Mr. Chuluunbaatar Baz and the death of Mr. Michael Deats and appointment of Mr. Masa Igata to its Board of Directors. The Company also announced senior management changes with the departure of Ms. Patricia Purdy, former Corporate Secretary, and the appointment of Mr. Tony Wong as General Counsel and Corporate Secretary.

2015 to date

- On January 5, 2015, the Company announced that it changed its name to “Prophecy Development Corp.”
- On January 20, 2015, the Company announced the approval by the Ministry of Roads and Transportation of Mongolia of the Road Feasibility Study for the construction of a

17 km road to connect Ulaan Ovoo mine to the Zeltura Russian border.

- On February 6, 2015, the Company entered into the following agreements with TBF further to the private placement:

1) Amended and Restated Subscription Agreement to among other things, restructure the closing of the private placement to take place in two tranches. 2) Voting Agreement whereby for two years, among other things, TBF agrees not to sell their Shares or vote against Company management with respect to certain governance matters. 3) Escrow Agreement with respect to the subscription funds.

- On March 12, 2015, the Company into a revolving credit facility agreement with Linx Partners Ltd. (a personal holding company wholly-owned and controlled by the Company’s Interim CEO, John Lee) in order to meet interim working capital requirements to fund the Company’s business operations and financial commitments. A maximum principal amount of CAD\$1.5 million is available for advance to the Company under the credit facility agreement, which will be in place for a term of one year, with an option to extend the credit facility agreement for any number of subsequent one-year terms. The credit facility agreement bears an interest rate of 18% per year, and is secured by a promissory note and general security agreement.
- On March 20, 2015, the TSX’s deadline to close the private placement with TBF expired without the transaction having closed.

3.2 Significant Acquisitions

On January 2, 2015, the Company acquired Apogee Minerals Bolivia S.A., ASC Holdings Limited and ASC Bolivia LDC (which hold ASC Bolivia LDC Sucursal Bolivia, the holder of Apogee’s mining joint venture interest in the Pulacayo Project) (collectively, the “**Apogee Subsidiaries**”), (the “**Pulacayo Acquisition**”).

Pursuant to the terms of the Pulacayo Acquisition, in consideration, the Company paid Apogee \$250,000 and issued to Apogee 60 million Prophecy Shares (the “**Consideration Shares**”). The Consideration Shares have been deposited into escrow pursuant to an escrow agreement, which allows for the release of the Consideration Shares over time, when the Company’s Shares trading on the Toronto Stock Exchange (the “**TSX**”) reach certain price levels or in the face of certain major triggering events. The Company also agreed to assume all liabilities of the Apogee Subsidiaries. The escrow agreement also provides for a standstill on the voting of the Consideration Shares while they are held in escrow, and to

not vote the released Consideration Shares against the Company's management so long as Prophecy continues to be engaged in its current business.

Following the Pulacayo Acquisition, the Company changed its name to "Prophecy Development Corp." The Pulacayo Acquisition represented a "significant acquisition" of a business for Prophecy within the meaning of National Instrument 51-102 – *Continuous Disclosure Obligations*. As a result, Prophecy is required under National Instrument 51-102 – *Continuous Disclosure Obligations* to incorporate by reference into this AIF, certain additional disclosure contained in Form 51-102F4 – *Business Acquisition Report*. A Business Acquisition Report dated March 18, 2015 was filed with respect to the Pulacayo Acquisition, which report is incorporated by reference herein and available under the Company's SEDAR profile at www.SEDAR.com.

4. DESCRIPTION OF THE BUSINESS

4.1 General

Prophecy is engaged in exploring and developing mining properties and energy projects in Canada, Mongolia and Bolivia. The Company's principal assets are its 100% interest in mining licenses in the Ulaan Ovoo Property and Chandgana Properties in Mongolia, which have been estimated to host some 1.4 billion tons of measured and indicated high grade subbituminous B rank (ASTM) coal resources, and its mining joint venture interest in the Pulacayo Project. The Company is also developing the Chandgana Power Plant in Mongolia.

The Company is focusing on building a successful and profitable intermediate development company. The Company's strategy is to actively pursue growth opportunities by secure financing, further improving operational efficiencies and reduce costs, delivering value through marketing and coal processing, and developing the Chandgana Power Plant. The Pulacayo Project is the most significant project acquisition in the Company's history and the Company intends to explore and develop this silver district to its full potential.

Market and Marketing

Prophecy's principal product is subbituminous B rank (ASTM) thermal coal from the Ulaan Ovoo deposit which is currently being developed and is in the pre-commercial production stage. The low calorific value of subbituminous coal results in a much lower price than for anthracite or coking coal. Subbituminous coal is usually not shipped long distances as the cost of doing so is prohibitive vis-à-vis its sales value. Its best use is in local thermal applications including making steam for electrical power generation.

The Company delivered coal from its Ulan Ovoo mine to Mongolian and Russian customers through Mongolia's Sukhbaatar rail station that total approximately 533,390 tonnes to date. The buyers include cement plants, a metallurgical plant, a heat plant, chemical plants, a railway company, an aviation plan and coal traders. The variety of customers reflects the Company's significant efforts to drive higher margin sales while satisfying government power plant needs.

Competitive Conditions

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

International coal pricing is generally established in US dollars and the competitive positioning between producers can be significantly affected by fluctuations in exchange rates. The competitiveness of coal producers is significantly determined by the quality of the deposit, production costs and transportation costs relative to other producers. Such costs are largely influenced by the location and nature of coal

deposits, mining and processing costs, transportation and port costs, currency exchange rates, operating and management skills, and differing taxation systems between countries.

Components

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

Mining Cycles

The mining business is subject to mineral price cycles. Since Prophecy's mining and exploration business is substantially in the development stage, Prophecy is not currently directly affected by changes in commodity demand and prices. Prophecy's ability to fund ongoing exploration is affected by the availability of financing which is, in turn, affected by prices of commodities, the strength of the economy and other general economic factors.

Economic Dependence

Prophecy's business is not substantially dependent on any one contract such as a property option agreement or a contract to sell the major part of its output. It is not expected that Prophecy's business will be affected in the current financial year by the renegotiation or termination of contracts or sub-contracts although it continues to seek Mongolian export related approvals in connection with its Ulaan Ovoo production in order to sell output into the higher priced Russian market.

Environmental Protection

All aspects of Prophecy's field operations are subject to environmental regulations and generally require approval by appropriate regulatory authorities prior to commencement and continuous monitoring. Any failure to comply could result in fines and penalties. Should any projects advance to the production stage, in addition to Ulan Ovoo, more time and money would be involved in satisfying environmental protection requirements.

Employees

As of December 31, 2014, Prophecy had four employees in Canada, 91 employees and 10 contractors or consultants in Mongolia. Prophecy utilizes consultants and contractors to carry on many of its activities. As Prophecy expands its activities, it is probable that it will hire additional employees and engage additional contractors or consultants.

Foreign Operations

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

Bankruptcy and Similar Procedures

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

Reorganization

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

Social and Environmental Policies

Prophecy established an environmental policy in 2008. The environmental policy affirms Prophecy's commitment to environmental protection. Prophecy monitors its operations to ensure that it complies with all applicable environmental requirements, and takes actions to prevent and correct problems if needed. Prophecy's management, with the assistance of its contractors and advisors, ensures its ongoing compliance with local environmental and other laws in the jurisdictions in which it does business.

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

5. MINERAL PROJECTS

The information in this section of this AIF has been extracted fully or where appropriate in part, from the Ulaan Ovoo Technical Report, Chandgana Technical Report and Pulacayo FS, as applicable. New information is provided where appropriate. Portions of the following excerpts are based on the assumptions, qualifications and procedures set forth in the respective technical reports which are not fully described herein. For a complete description of assumptions, qualifications and procedures associated with the information contained in each technical report, reference should be made to the full text of each technical report available under Prophecy's or Apogee's SEDAR profile, as applicable, at www.SEDAR.com.

5.1 Ulaan Ovoo Property

Ulaan Ovoo Property – Summary Operational Statistics

Prophecy (Red Hill Energy Inc. at the time) entered into a letter of intent, dated November 24, 2005, as amended February 19, 2006, with Ochir LLC and a wholly owned subsidiary of Ochir LLC, both privately owned Mongolian companies that set out the terms to acquire a 100% interest in the Ulaan Ovoo Property. The purchase price for the 100% interest, together with all equipment, buildings and other facilities, assembled and constructed at the Ulaan Ovoo Property was US \$9,600,000. The purchase price has been paid in full by the Company. Ochir LLC retained a 2% royalty on production from licenses, which was subsequently assigned to a third party.

On November 15, 2006, the Company entered into an agreement with a private Mongolian company to purchase 100% of the title and interest in five mineral licenses including licenses that are contiguous and entirely surrounding the Ulaan Ovoo Property. The aggregate purchase price for the licenses was US \$400,000. Under the terms of the agreement the vendor retained a 2% net smelter return royalty on the five newly acquired licenses. On April 29, 2009, Prophecy announced positive pre-feasibility study results for the Ulaan Ovoo Property.

On March 11, 2010, the Company entered into a royalty purchase agreement, dated for reference March 5, 2010, with Dunview Services Limited, a private British Virgin Islands company holding a 2% royalty on production from the licenses of the Ulaan Ovoo Property, to acquire such royalty in full in exchange for

US \$130,000 and the issuance of 2,000,000 Prophecy Shares. This transaction was completed on April 30, 2010.

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

On November 9, 2010, Prophecy received the final permit to commence mining operations at the Ulaan Ovoo Property and an official mine opening ceremony was held on November 20, 2010. On December 16, 2010, Prophecy received an updated prefeasibility study on the Ulaan Ovoo Property which is incorporated by reference into this AIF. The focus of the Ulaan Ovoo PFS was for the development of low ash coal reserves in the form of a starter pit.

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

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

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

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

Summary of operational results at Ulaan Ovoo mine

	Topsoil/overburden removed, m3	Coal produced, t	Coal sold, t	Revenue, US \$	Average Price, US \$/t
2010	1,011,274	70,678	19,396	274,649	14
2011	1,601,416	205,241	127,271	2,578,084	20
2012	770,315	165,712	131,719	2,511,446	19
2013	190,571	89,085	124,848	3,621,639	29
2014	321,097	151,395	130,145	3,998,566	31

Since November 2010, the Company has removed and stockpiled approximately 3.9 million bank cubic metres of topsoil, overburden and waste and produced 653,280 tonnes of thermal coal of different grades from the Ulaan Ovoo Property. Of this, the Company sold 533,393 tonnes for a total of US \$13 million.

As of December 31, 2014, the coal stockpile balance was approximately 115,000 tonnes with a value of approximately \$1.5 million.

During 2014, the Company has estimated its average cash cost per tonne, including transportation and administration expenses, at approximately US \$35.36 (2013 - US \$29.50) per tonne and has experienced domestic average sales prices of approximately US \$32 (2013 -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 \$24.85 per tonne (2013 - \$20.50 per tonne). However, approximately over 58% of the Company's sales in 2014 consisted of sales of coal with GCV greater than 5,000 kcal/kg (2013 – 60%). Furthermore, domestic market prices for coal with GCV greater than 5,000 kcal/kg range from \$30 to \$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 4500 kcal/kg to 5,000 kcal/kg ranging from 1,800 to 2,200 Rubles per tonne (US \$50 to US \$60 per tonne), dependant on point of delivery.

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

The Company continues to evaluate project operating optimization alternatives for the Ulaan Ovoo Property, in addition to investigating potential strategic partner and joint venture arrangements, sale of part or whole of the project, and coal marketing arrangements both domestically and potentially to access higher international coal market prices. However, Prophecy is unable to determine with certainty, how long coal markets will remain depressed, and when, if at all, access to Russian coal markets will be opened, nor the extent of project changes and operational modifications that would be required to more fully realize, beyond its pre-commercial operating history, on the potential value of the existing NI 43-101 coal reserve estimates per the Ulaan Ovoo PFS and per the NI 43-101 coal resources as determined by the 2007 Behre Dolbear report.

Property Location, Ownership

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

Figure 1 Location of Ulaan Ovoo Coal Project



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

Accessibility, Climate, Local Resources, Infrastructure and Physiography

Property Access

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

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

Climate

The Ulaan Ovoo Property has a sharply continental climate with predominately hot summers and cold winters. The area is hot and relatively rainy in summer, with highest temperatures of 35° to 40 degrees

Celsius (°C) in June and July and cold in the winter, with lowest temperatures in the range of minus (-) 35° to -40°C in December and January. Annual precipitation fluctuates between 100 millimetres (mm) and 500 mm and most (60% to 70%) of it falls as rain in August. Maximum snow depths may reach up to 2m where drifted but averages 10 centimetres (cm) to 20 cm where not drifted. Wind usually blows from northwest to southeast with an average speed of 14 kilometres per hour (km/h) to 24 km/h.

Local Resources & Regional Infrastructure

The Ulaan Ovoo Property is located within the territory of Tushig soum (sub-province) of Selenge aimag (province) and the nearest settlement to the deposit is the soum's central village, also called Tushig, located approximately 7 km to the southeast of the project area. The soum borders the state of Buryatia of Russia to the north, Bugat soum of Bulgan aimag to the west and Tsagaannuur soum of Selenge aimag to the east and south. Tushig soum has a territory of 276 square kilometres (km²) and a population of 7,500.

Physiography

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

Mountainous parts of the region have taiga-like forests of conifer and deciduous trees. The southern aspects of the hills in the area tend to be relatively treeless. Braided stream deposits covered with a mixture of small trees and bushes form the Zelter River valley flood plain. The north half of the coal deposit area is treeless and the south half is covered by willows and birch. Fertile soil is up to 4 m thick at the flood plain of the river valley and 20 cm to 30 cm on the adjacent hillsides.

History

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

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

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

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

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

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

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

History of Geological Exploration Work

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

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

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

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

History of Production

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

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

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

Geology

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

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

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

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

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

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

A high angle reverse fault trends northwest-southeast through the centre of the deposit and divides it into north and south (S) blocks. Throw on the fault is 10 m - 20 m and the downthrown side is the north. A moderate (20° - 30°), southward dipping coal subcrop on the north side of the deposit. Igneous activity is evidenced by the 137 m of horizontally-bedded basalt. Eleven holes were drilled by Red Hill in 2006.

Exploration

During 2006 Red Hill conducted an exploration drill programme which undertook the drilling of 11 drill holes from surface identifying the presence and delineation of the coal seams present at the site. This exploration programme formed the basis of the Behre Dolbear report supported by non-compliant data gathered during the period from the early 1970's up to 1992. This data was collected by a Russian entity in control of the project at that time.

In April 2010 the Company merged with Red Hill as described in section 3.1 and therefore assumed control of the permits and licences under the auspices of Red Hill. During 2010 Red Hill drilled one drill hole to obtain samples for grade control and marketing efforts. During 2011 Red Hill drilled nine drill holes to obtain grade control information and rock mechanics data.

Mineralization

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

Mod Coal Seam (formerly Coal Seam 1): This seam is the lower of the two main coal sequences. It merges with the upper and thicker Gol Coal Seam in the north-eastern part of the area and splits to the southwest. It is well developed in the western part of the syncline. Its thickness ranges from 2.0 m to 7.5 m and thins in the south-western part of the deposit. The seam contains up to three partings with thicknesses of 0.56 m to 0.77 m. In the area where it is best developed, the Mod Coal seam is separated from the Gol Coal Seam by a sandstone parting which may exceed 30 m in thickness.

Gol Coal Seam (formerly Coal Seam II): This is the uppermost of the two main coal seams. Because of limited drilling south of the Central fault, it had previously only been clearly defined in the northern half of the syncline. It has relatively consistent thickness in the northern half of the deposit, ranging from 29.8 m to 63.9 m. In the west, the Gol Seam splits into two major sub-seams and its aggregate thickness diminishes where it splits. Further to the west sub-seam the lower split further subdivides into two smaller sub-seams. The Gol seam may contain as many as 11 partings. These partings consist mainly of clayey rocks and coal-bearing mudstone with a thickness of 0.15 m to 1.0 m. With proper design, the

thickest of these partings can be removed during the mining process. Consequently, the partings will not represent a serious diminution of coal quality if properly handled.

Several thin coal beds are encountered to the west of the syncline, in the lower part of the middle member of the Sharyn Gol formation (J2-3 chg). Their thickness ranges between 0.9 m and 2.0 m. The extent of these thin seams is not known at this time, but they do not add materially to the coal resource base of the deposit. The cross sections shown in Section 7.0 show the style of splitting of the coal seams across the deposit area.

To date, the following four studies have been completed on the Ulaan Ovoo Property: Russian study completed in 1995; Mongolian University study completed in 1992-1995; Behre Dolbear study completed in 2006; and Minarco study completed in 2009. Each of these studies has produced its own coal seam nomenclature system, as well as criteria for applying nomenclature criteria. In order to not further confuse this issue, it was decided to use the nomenclature developed by Minarco in their 2009 NI-43-101 report.

Drilling

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

Sampling & Analysis

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

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

Security of Samples

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

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

All lab analysis was conducted following ASTM standard procedures by SGS Laboratories in Denver, Colorado and all lab duplicate samples are stored there. All non-lab core is stored in wooden boxes in a secure warehouse on site. All sampling handling used chains of custody to monitor the distribution of the samples.

Data Verification

In March 2010, Wardrop verified the data as part of a study to estimate the reserves and economics of a starter pit. They reviewed the available Ulaan Ovoo digital data, visiting the Ulaan Ovoo Property and conducted meetings with Red Hill's geological staff and decided that the following data from the Minarco 2009 study was acceptable and would be used: drill hole data from the 2006 programme; coal seam nomenclature and correlations; gridded surfaces for coal seams and partings; central, east, south and west faults; coal outcrop, burned coal (clinker) area coal resource classification criteria; and the coal resource area. The coal seam correlations developed by the Minarco 2009 study were correct and the coal resources reported in the Behre Dolbear 2006 and Minarco 2009 reports were considered valid.

Mining

A recommendation was made for the coal deposit to be mined by open pit methods.

A mining contractor was to mine 250,000 tonnes (t) of product coal in 2010 and 1.1 million (M) t of product coal in 2011. It was assumed that the contractor would operate the owner's mining equipment in year 2011 on a fee basis. Mining has been done by an owner-operated mining team starting in year 2012.

Contract mining was completed using an 85 t backhoe loading 50 t capacity haul trucks. Since the initial mining was near the surface, the use of drilling and blasting methods was not employed. Use of a contractor allowed for sufficient time to purchase, manufacture and ship the owner-operated mining fleet to site in 2011 for operation in 2012.

The proposed "owner-operated" mining methodology is to employ conventional drill and blast techniques, using a rotary drill capable of drilling the blast holes in a single pass. A high mining recovery is anticipated. Dilution and losses of 0.10 m and 0.25 m per contact or parting respectively have been factored into the recovered tonnage figures. Loading and hauling will use 11.5 cubic metre (m³) front end loaders, with 90.9 t rigid frame dump trucks. Track dozers are being used to clean coal-waste interfaces and thus minimise the losses and dilution.

A fleet of support and maintenance equipment has been included to maximise availability. Considerable emphasis has been placed on good design and construction of mine haul roads and other infrastructure to ensure high productivity. Emphasis is being placed on training the local labour force for the unskilled and semi-skilled jobs. The majority of the managerial, technical and skilled staff are either ex-patriots or from other regions of Mongolia. Sites adequate for the disposal of waste rock and a suitable stockpile area for the high ash coal exist within the property in the immediate area of the open pit.

Mineral Reserves

The material captured within the Mineral Reserve has been categorised as 100% Measured material. The reserve estimation only includes coal contained within the G3, G2, G1a, G1b, G1c, G1d coal seams as set out as the nomenclature for the Gol coal seam.

The other seams present at the Ulaan Ovoo Property do not fall within the pit design and are therefore excluded from the Mineral Reserve estimate. Further exclusions from the Mineral Reserve estimation are any coal occurrences to the south of a 200 m "No Mining Limit" from the northern banks of the Zelter River. Therefore it could be said that the Mineral Reserve estimate considers only the first phase of the project development of the Mineral resources contained in the Ulaan Ovoo Property.

Losses and dilution factors have been applied globally to the partings and the separate coal seams to derive a final Mineral Reserve. The block model created in SURPAC® was prepared and exported for use with the Whittle Optimiser software. The resultant pit shells that were created in Whittle formed the basis of the pit design which was conducted using the GEMS software package. The pit design took account of the assumed slope angles and ramp angles as recommended by the MUST “Summary of Feasibility Study for the Development of Ulaan Ovoo Bituminous Coal Deposit” (2004) conducted on behalf of Red Hill.

Once completed, the phased pit designs were imported into SURPAC and reported from the original block model to derive the in-situ reserves by seam. This data was then compiled in Microsoft Excel to derive a total in-situ reserve estimate. The losses and dilution parameters were applied to the in-situ reserves and the resultant changes can be seen in Table 1.

Table 1
Ulaan Ovoo Coal Reserve Statement

Coal Reserve Statement Description	Amount
Product Coal (kt)	20,724
Waste (kBCM)	37,268
Stripping Ratio (BCM:t)	1.8
Ash Content (%)	11.3
Calorific Value (kcal/kg)	5,040
Moisture (%)	21.7
Mine Life (years)	10.7
Process Rate (kt/a)	2,000

Note: BCM – Bank Cubic Metre

*Coal qualities are stated on an “as-received” basis.

The reserve extraction is considered to be 98.6% as a ratio of In-situ reserve to Saleable Product. The In-situ Reserve calculations were validated by internal checks as part of the Wardrop internal quality control system. A further 720,000 t of High Ash coal will be stockpiled and washed at a later time but cannot be considered within this reserve estimate because it has been assumed that there are no wash plant facilities available on site.

The resource extraction is considered to be 10.7% as a ratio of Saleable Product to Measured & Indicated Mineral Resource. This illustrates the phased approach of Resource Development that has been considered in this study. It is recommended for further project development that more drilling is carried out North and South of the River Zelter and a separate more detailed analysis is carried out to include the engineering and costs to divert the river in order to include more of the Mineral Resource in a more detailed reserve estimate.

The estimated reserve and other mine characteristics are shown in Table 1.

Coal product tonnages and qualities stated in Table 1 are stated on a Run-of-Mine (ROM) basis and take into account mining loss and rock dilution at coal/rock interfaces. The total proven Mineral Reserve Estimate is 20.7 Mt of Product (Low Ash) Coal.

As there is no coal beneficiation to be undertaken, any high ash coal is to be stockpiled so that it will be available if a wash-plant is built in the future. In general the product coal is G3, G2, G1a, G1b, G1c and G1d. The “Mod” or M series of seams are high ash and are not recovered. Opportunity exists to recover these seams if a wash-plant is constructed at some point in the future.

The southern edge of the pit is defined by the location of the Zelter River plain. Construction of a capital intensive river diversion, water cut-off wall and flood containment berm will be required to prevent water inflow into the pit if the river valley is encroached by the pit limit.

Environmental

Wardrop has not been requested to perform any evaluation or review of the environmental assessments or permits as part of this report. However a detailed Environmental Impact Assessment has been completed and approved by the Mongolian Government in 2008 and an Annual Environmental Protection Plan for 2010 has also been approved by the Mongolian Ministry of Environmental Protection.

Prophecy has supplied Wardrop with details of additional environmental and mining permits approved by the Mongolian authorities. These include the mine plan approval, land use permission, water utilisation permission, emergency response plan, border zone permission and road repair permit. An amount of US \$2 M has been included in the financial evaluation for mine reclamation.

Cost Estimates

Operating

The operating cost estimate is summarised in Table 2.

**Table 2
Ulaan Ovoo Operating Cost Estimate**

Area	Unit Cost (US \$/ Product Coal)
Coal Mining	9.40
On-Site Coal Handling	0.35
Administration & Overhead	0.48
Total	10.23

The above unit operating cost is the average for life-of-mine including contractor and owner-operated mining. Contractor costs include equipment lease costs.

Capital

Table 3 outlines the estimated initial project capital cost by category. Mobile equipment fleet includes the main production equipment such as loaders, blast-hole drills and haulage trucks as well as support ancillary equipment. Site infrastructure costs include site earthworks, buildings, and services such as water, electrical and sewage. Road transport includes road and bridge refurbishment and road haulage fleet. Project indirect cost includes engineering, procurement, construction and management (EPCM), freight, equipment spares and first fills. Owner's costs include land acquisition and head office costs.

**Table 3
Ulaan Ovoo Capital; Initial Capital Summary**

Area	Unit Cost (US \$ M)
Mobile Equipment Fleet	32.3
Site Infrastructure	7.0
Project Indirect	6.4
Owners Cost	0.3
Road Transport	15.5
Reclamation	0.3
Subtotal	61.8
Working Capital	4.0
Contingency	3.9
Total	69.7

Sustaining capital is listed in Table 4. Sustaining capital is for replacement of major mining equipment at the end of life. This includes loaders, haul trucks, dozers and graders. An annual value of US \$500,000 per year has been applied for sustaining capital site infrastructure.

Table 4
Capital; Sustaining Capital Summary

Area	Unit Cost (US \$ M)
Mobile Equipment Fleet	14.0
Site Infrastructure	4.5
Total	18.5

Financial Analysis

A financial evaluation of the Ulaan Ovoo Property was prepared by Wardrop based on a post-tax financial model. For the 10.7 year mine life the following pre-tax financial parameters were calculated: a 25.5% Internal Rate of Return (IRR); 4.5 years payback on US \$85.9 M capital and US \$71.0 M Net Present Value (NPV) at 10% discount value.

Sensitivity analyses were carried out to evaluate the project economics with plus 30%, minus 30% the base case coal price.

Table 5
Ulaan Ovoo Coal Price Scenarios

Scenario	Coal (US \$ /t)
Minus 30%	28.0
Minus 20%	32.0
Minus 10%	36.0
Base Case	40.0
Plus 10%	44.0
Plus 20%	48.0
Plus 30%	52.0

The post-tax financial model was established on a 100% equity basis, excluding debt financing and loan interest charges. The financial outcomes have been tabulated for NPV, IRR and pay back of capital. Discount rates of 10% were applied to all cases identified by coal price scenario. The results are presented in Table 6.

Table 6
Ulaan Ovoo Summary of Post-Tax NPV, IRR, and Payback

Scenario	NPV 10 (US \$ M)	IRR (%)	Payback (Yrs)
Minus 30%	-62.28	-4.4	13.1
Minus 20%	-17.82	6.1	10.7
Minus 10%	26.58	15.8	7.0
Base Case	70.98	25.5	4.5
Plus 10%	115.38	35.7	3.6
Plus 20%	159.77	46.8	3.1
Plus 30%	204.17	59.2	2.7

Conclusions

The financial evaluation indicates that the project should be economically viable given the coal pricing assumption of US \$40 per product tonne sold at the Russia/Mongolia border port of Naushki. To date the

Company's revenue from coal has come from sales prices of less than half to two thirds that figure. Viability of the deposit is contingent on being able to market the Ulaan Ovoo coal at higher prices such as into Russia where these prices can be obtained.

Project Risks and Mitigation

There are a number of project risks which have been mitigated where possible. The regional coal market has been difficult to penetrate and yet earn an acceptable margin on the coal. Though a number of coal contracts have been signed for Ulaan Ovoo coal only a handful are for substantial volumes or have reasonable margins. The market is not fully open where an independent producer has an equal opportunity to compete. Transportation is not always available at the time, in the capacity, or at the cost desired. These risks have been mitigated to some degree by decreasing mining, overhead, and transportation costs which recently appear to have made other markets available. Most recently receivable amounts from the large utility customers have become overdue. The decreased revenues forced temporarily idling the mine.

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

Groundwater inflow to the pit, especially where recharged by the Zelter River is a risk to mining operations. Pumping water from the mine pit has stopped production at times. Larger capacity pumps were purchased which have partially mitigated this risk. The May 2009 Minarco report recommended construction of a dike to divert the north meander of the Zelter River away from the mine. During 2011 dewater wells were proposed and budgeted to reduce the water inflow. The dewater wells were installed during 2012 and reduced water inflow into the mine.

5.2 Chandgana Properties

The Chandgana Properties consist of the Chandgana Tal Property and Khavtgai Uul Property (formerly named Chandgana Khavtgai) exploration and mining licenses, located in the Nyalga coal basin, approximately 280 km east of Ulaanbaatar, and are nine kilometres apart. On November 22, 2006 Prophecy (then Red Hill Energy Inc.) entered into a letter agreement with a private Mongolian company that set out the terms to acquire a 100% interest in the Chandgana Tal Property. On August 7, 2007, Prophecy (then Red Hill Energy Inc.) entered into a letter agreement with another private Mongolian company that set out the terms to acquire a 100% interest in the property known as Chandgana Khavtgai. Under the terms of the Chandgana Khavtgai agreement, Prophecy paid a total of US \$570,000.

Khavtgai Uul Property

Project Description and Location

The Khavtgai Uul Property Minerals Exploration License held by Chandgana Coal LLC, a subsidiary of Prophecy is one of the Chandgana Properties and is found in the southwest portion of the Nyalga Coal Basin. The license is located 295 kilometres east of Ulaanbaatar in Moron soum (sub-province) of Khentii aimag (province), Mongolia. The coal-bearing portion comprises approximately 1,636 hectares. Adjacent licenses include a coal exploration license held by Adamas Mining LLC to the southwest and coal mining licenses held by Cosmo. The resource area has a continental climate with short warm summers and longer cold winters and is generally favourable for development of the coal resource.

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

The coal seams belong to the Early Cretaceous age Zuunbayan Formation and are part of the southern end of the headwall portion of a faulted syncline. The coal seams subcrop at and just west of the western border of the license and dip approximately 4.5° to the southeast. The resource area is bounded to the southeast by the Nyalga Basin Fault Zone.

Accessibility, Climate, Local Resources, Infrastructure and Physiography

Accessibility

Access to the Khavtgai Uul Property is possible by ground vehicle and helicopter or possibly small airplane. Ground vehicles may enter the resource area by driving the Ulaanbaatar-Ondorhaan highway (A0501) 295 kilometres east then turning south on any of several unpaved roads and driving 16 kilometres to the resource area. The highway is an all-weather road capable of supporting truck traffic. The unpaved roads on the resource area are generally in good condition and drivable throughout the year. However, the dirt roads can only support truck traffic when dry and only on certain sections. Helicopters may fly to the resource area and land almost anywhere. Small airplanes may also fly to the resource area but landing and take-off is only possible on several stretches of unpaved road. The elevation is not too great for helicopters or small planes although winds may be an issue at certain times of the year.

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

Climate and Vegetation

The resource area has a continental climate with warm and dry but short summers and cold and dry winters. The area is generally windy with wind direction from the northwest or northeast at speeds of 4-7 m/sec but reaching 20 m/sec in the spring. The warmest temperatures are during June to July with highs around 40° C and the coldest during December to January with lows around -30° C. Snow accumulation averages 10 cm in flat areas but may drift to 1 metre deep. The annual precipitation varies from 10 to 50 cm and most falls as rain in August (Behre Dolbear, 2007).

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

Local Resources

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

Infrastructure and Population Centres

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

Physiography

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

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

History

The Khavtgai Uul Minerals Exploration License was originally granted to Deej Bayalag LLC and issued on April 7, 2007 under registration number 9011039094. No previous licenses are known. The second year license fee was paid on May 22, 2007. The license was transferred to Red Hill on October 12, 2007, under registration number 90190101078 with no change in the size or boundaries. The license was readjusted to decrease its size on April 8, 2009 and it now has an expiration date of April 7, 2012. The holder (issue) of the readjusted license is Chandgana Coal, a subsidiary of Prophecy.

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

Geological Setting

The resource area is located in the Nyalga Basin which is a portion of the Khentii Zone of the Khangai-Khentii fold system. The Khangai-Khentii fold system is a series of folded Silurian to Cretaceous age sedimentary rocks found in eastern Mongolia (Behre Dolbear, 2007).

Surficial Deposits and Sedimentary Rocks

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

Resource Area Geology

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

Structural Geology

The coal resources are found within the southern end of the Nyalga Basin. The basin appears to be a faulted syncline though seismic surveys suggest the coal-bearing rocks continue on the southeast side of the Nyalga Basin Fault Zone. The basin then may extend farther to the southeast than has been considered before. The coal seams subcrop along the western margin of the syncline, strike from N 20° to 65°E, and dip approximately 45° to the southeast. The wide variation in strike may be a result of faulting but cannot be proven with the information available. Resistivity-IP and seismic lines across the former Nyalga Basin Fault indicate a horst exists at this location. The former Nyalga Basin Fault is the northwest normal fault bounding the horst while another normal fault about 570 metres southeast bounds the horst on the other side. These two faults and possible smaller faults indicated by the seismic survey lines justified renaming the area the Nyalga Basin Fault Zone. The location of the fault zone is also partly supported by the change in lithology of float material, drilling results, apparent slight topographic expression and azimuth of topographic contours, and the change in lithology of the portion of the Zuunbayan Formation penetrated in drill holes on either side of the fault. Displacement along both faults is approximately 300 metres at their north and south ends but appears to decrease at the middle. At this time the Nyalga Basin Fault Zone is considered to have a tectonic origin based on the type of deformation and observations from drill core which also agrees with the structural history of the area. Mass wasting that may affect the reliability of the coal resource estimate or impact coal recoverability has not been found.

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

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

Exploration

Subsequent to the 2008 technical report much more exploration has been completed. The goals of this exploration were to place all of the resource in the measured and indicated assurance of existence categories, obtain more information on the depth, thickness, and grade of the coal seams, and locate the geologic limits of the resource more accurately. The exploration concept was that commonly used for relatively low dipping stratiform deposits where exploration was planned and executed to obtain information on depth, thickness, continuity, and quality of the resource. This information was obtained by surface mapping, trenching, drilling and geophysical methods. Two shallow trenches were excavated in 2009 for a total length of 189 metres. Approximately 15.7 kilometres of resistivity-induced polarization and 15.7 kilometres of magnetometer lines were run across the Nyalga Basin Fault in 2008. During 2010 Prophecy completed 13 drill holes and ran 11.3 kilometres of reflection seismic lines and 27.8 kilometres of magnetometer lines. This exploration supplemented that completed in 2007 which included remote imagery interpretation, surface mapping, trenching, and seven core drill holes. The new information has placed all of the resource in the measured and indicated assurance of existence categories, enabled more accurate mapping of the geologic limits of the resource area, and made for better characterization of the geology and estimation of coal resources and quality. Three drill holes were drilled during 2011. These drill holes helped to better define the coal seam subcrop and possible faulting. Trenching was performed during 2012 also to better define the coal seam subcrop and possible faulting. No development work or operations are active in the resource area.

Mineralization

Nine coal seams that contain coal resources are found in the resource area. The B Coal Seam contains 80% of the resource, followed by the F Coal Seam (8%) and E Coal Seam (7%) with the remaining coal seams containing smaller portions. The B Coal Seam is found throughout the resource area, has an average resource thickness of 34.2 metres and range from 6.2 to 60.5 metres thick including several, mostly thin partings. The known depth to the B Coal Seam varies from 27.7 to 266.8 metres but is probably even shallower in the northwest corner of the license. Other coal seams (formerly the Upper Coal Seams) are found above the B Coal Seam. These coal seams have a thinner resource thickness (0 to 16.0 metres) and are less extensive yet contain significant resources also. The coal seams are black, friable, readily slake and have poor competency. The partings are poorly indurated and have a moderate slake potential. The overburden is also poorly indurated with a moderate slake potential but contains few structural discontinuities. The coal seams are moderate grade low rank thermal coals. The thickness-weighted average in-place assay (as-received basis) of the sampled coal seams (A, B and C Coal Seam) within the resource area is 36.5% moisture, 10.1% ash, 3,636 kcal/kg heating value, and 0.6% sulphur. Their agglutinating properties have not been assayed, but the coals are expected to be non-agglutinating. The apparent ASTM rank of the coal is between Subbituminous C and B based on the moist, mineral matter-free gross calorific value of core sample assays.

Table 8

Weighted Average A, B and C Coal Seam Quality				
(as-received basis)				
Parameter	Moisture (wt. %)	Ash (wt. %)	Heating Value (kcal/kg)	Total Sulphur (wt. %)
	36.54	10.10	3,636	0.59

Drilling

For the 2007 drilling, Landdrill International Inc. of Ulaanbaatar, Mongolia, was contracted to drill the holes and used a truck-mounted Longyear Model 44 rig. The procedure was to (1) drill with a 132 mm (HWT) full face PDC bit and set conductor casing, (2) drill the overburden to core point with a 96 mm (HQ) full face PDC bit using polymer as a medium, and (3) core from core point to total depth with an HQ-3 core drilling string. Coring was done using HQ rods behind a 96 mm OD diamond core bit with inert polymer as a medium. Wireline coring methods were used with a sleeved 3 metre core barrel assembly. All drilling was done on a 24-hour schedule. The drilling method, drilling procedures, and size of core obtained is considered appropriate for the logistics of the area, goals of the drilling, and type of analyses desired.

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

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

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

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

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

Best Drilling performed the 2011 drilling and followed similar procedures as those in 2010. Geologic data and samples were obtained using methods similar to those of 2010 and the information logged in acceptable detail. This drilling did not change the amount or reliability of the resource estimate or the mineability of the resource.

Summary and Interpretation of Results

The drilling provided the most reliable data to characterise the geology of the resource area, estimate resources and estimate coal quality. The drilling - (1) provided more information on the areal extent and thickness of the coal seams, (2) further defined the structural geology, (3) confirmed the presence of a significant coal resource, (4) placed all of the resource in the measured and indicated assurance-of-existence categories, (5) better defined the geologic boundaries of the resource, (6) better characterized the type, grade and rank of the coal seams, and (7) gave indications of groundwater and mining conditions.

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

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

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

The 2011 drilling confirmed the subcrop to be outside the license as described in 2010. The location of possible faults was inconclusive.

Sampling & Analysis

In planning the 2007 exploration, exposures in the nearby Chandgana Coal Mine were considered. These exposures suggested that at least one of the coal seams should be very thick, low rank and dip at a low angle to the southeast. Thus, having a thick stratiform deposit and considering that the exploration is the first in the resource area, the approach used was to obtain samples that gave a reliable gross estimate of coal quality. To meet this goal, sampling was planned to (1) obtain samples at widely spaced locations, (2) sample the full thickness of the coal seam, (3) determine the limit of weathered coal, and (4) ensure the samples are representative of the grade and rank of the coal. The desire to obtain samples at widely spaced locations complimented the desire to place as much of the resource in the higher assurance-of-existence categories as possible.

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

A similar sampling approach was used for the 2010 drilling. But the stratigraphically higher coal seams were core drilled in two drill holes besides the B Coal Seam. Since the structure of the coal seam was known fairly well core was obtained from all of the targeted coal seams but one where the upper few metres were rotary drilled. The representativeness of the core samples obtained during the 2007 and 2010 drilling was enhanced in several ways. These included (1) selecting large diameter core to increase core recovery, (2) core drilling on a 24 hour schedule to increase core recovery, and (3) using inert drilling fluids when possible to reduce core contamination. The core sampled (including core loss) intervals and analysed intervals are indicated relative to the entire coal seam thickness in Figures 5 and 6.

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

The sampling of cores during the 2007, 2010 and 2011 drilling followed the same methods. Sampling was started and completed as soon as possible after lithologic descriptions and photographs were done. The sampling method followed that of ASTM D 5192 where practical. Sample treatment methods included rinsing the core of contaminants and allowing sufficient time for the free water to drain from the core to enhance sample representativeness. Sample preservation included placing the core in 6 mil plastic sleeves to minimize moisture loss then placement on wooden core boxes for protection. The samples were removed from the core tray in lengths up to 1metre depending on the thickness of partings and the beginning and end of core runs.

Security of Samples

All the drill core and trench samples were prepared and assayed in accordance to ASTM International (ASTM), International Organization for Standardization (ISO), or Australian Standards (AS) procedures in the coal laboratories of SGS-CSTC Standard Technical Services Co., Ltd. These laboratories are located in Ulaanbaatar, Mongolia (SGS Mongolia), the test centre in Tianjin, China (SGS Mineral Fuels), and the geochemical and ores laboratory in Tianjin, China (SGS Geochemical and Ores). Sample preservation, security and tracking was established and well maintained from the drill site to reporting of the results for the 2007, 2010, and 2011 drilling.

Sample security was ensured from the drill site to the assay report. A chain of custody form was completed by Mr. Robeck for the 2007 samples and by Mr. Kravits for the 2010 and 2011 samples that

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

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

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

Data Verification

There are five types of data used in this updated technical report: topographic data, stratigraphic data, trench data, geophysical data and assay data. Each type of data was reviewed to verify that it represents the location, depth and/or other descriptive information of its source. The quality of the data was then assessed by a review for accuracy and errors. The methods used vary according to the type of data and were performed using practices common in the coal industry or the industry that produces such data.

The topographic data and the map produced from this data were verified by Mr. Kravits during the site inspection and with information obtained during the inspection (Kravits Geological Services, 2007). This was done by comparing the coordinates and elevation of the drill holes, trenches, and license corners determined with a handheld GPS receiver to the coordinates and elevations on the geologic map.

The stratigraphic data obtained from the 2010 and 2011 drill holes were verified by Mr. Kravits in two ways. These included comparison of the identification, location, and other information of the 2007 drill holes in the stratigraphic database to the information on the geophysical and lithologic log headers and the information obtained during the site inspection and comparison of the interpreted and correlated geophysical logs by Mr. Kravits to those of Mr. Robeck. For the 2010 drill holes this was not necessary because Prophecy geologists and Mr. Kravits located the drill holes with a GPS receiver prior to drilling and the completed drill hole was surveyed by Oyu Survey LLC (Oyu Survey, 2010). The GPS coordinates and surface elevation were placed on the geophysical log headers to better tie the log to the drill hole.

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

The 2010 and 2011 assay data were verified by comparison of the descriptive information (drill hole number, depth interval, sample number, and lithology) and assay results accompanying the quality data to that of the same information on the core log and chain of custody and the recorded lithology. Transcribed data were reviewed twice for errors.

Mineral Resources and Reserves

The total coal resource within the resource area is 1,048.1 million tonnes of which 509.3 million tonnes are in the measured and 538.8 million tonnes are in the indicated assurance of existence categories. All the coal resources fall within the measured and indicated categories, there is none in the inferred category. The in-place strip ratio averages 2.2:1 over the resource area and varies from a minimum of 0.2:1 at the northwest corner of the license to a maximum of 5.3:1 to the north.

Table 9
Chandgana Coal Seam Resources

Coal Seam	Assurance-of-Existence Category		Total
	Measured	Indicated	
I Coal Seam	0.2	0.1	0.3
H Coal Seam	3.1	4.6	7.7
G Coal Seam	3.9	5.4	9.4
F Coal Seam	41.8	41.0	82.8
E Coal Seam	35.8	39.2	75.0
D Coal Seam	3.2	2.4	5.7
C Coal Seam	15.8	13.7	29.5
B Coal Seam	403.5	430.7	834.3
A Coal Seam	1.9	1.5	3.4
Subtotal	509.3	538.8	1,048.1
Total Measured and Indicated	1,048.1		

Resources are in millions of tonnes

The Khavtgai Uul Property 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.

Future Exploration and Development

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

The Company plans to use the coal from the Chandgana Tal Property to fuel a mine-mouth power plant that would be located adjacent to the property. The Mongolian government is supportive of this project and has issued a conditional permit to the Company. Coal from the Khavtgai Uul Property is intended by the Company to supplement the Chandgana Tal coal and possibly fuel a larger energy project at the location.

Chandgana Tal Property

Project Description and Location

The Chandgana Tal Property consists of mining licenses MV-016767 and MV-010126. The licenses are held by Chandgana Coal, a subsidiary of Prophecy and are found in the northeast portion of the Nyalga Coal Basin. The licenses are located 285 kilometres east of Ulaanbaatar in Moron soum (sub-province) of Khentii aimag (province), Mongolia. There are coal mining licenses adjacent to the property that are

held by Cosmo. The project area has a continental climate with short warm summers and longer cold winters and is generally favourable for development of the coal resource.

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

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

Accessibility, Climate, Local Resources, Infrastructure and Physiography

Accessibility

Access to the Chandgana Tal licenses is possible by ground vehicle and helicopter or possibly small airplane. Ground vehicles may enter the resource area by driving the Ulaanbaatar-Ondorhaan highway (A0501) 290 kilometres east then turning south on any of several unpaved roads and driving 16 kilometres to the resource area. The highway is an all-weather road capable of supporting truck traffic. The unpaved roads on the resource area are generally in good condition and drivable throughout the year. However, the dirt roads can only support truck traffic when dry and only on certain sections. Helicopters may fly to the resource area and land almost anywhere. Small airplanes may also fly to the resource area but landing and take-off is only possible on several stretches of unpaved road. The elevation is not too great for helicopters or small planes although winds may be an issue at certain times of the year.

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

Climate and Vegetation

The resource area has a continental climate with warm and dry but short summers and cold and dry winters. The area is generally windy with wind direction from the northwest or northeast at speeds of 4-7 m/sec but reaching 20 m/sec in the spring. The warmest temperatures are during June to July with highs around 40° C and the coldest during December to January with lows around -30° C. Snow accumulation averages 10 cm in flat areas but may drift to 1 metre deep. The annual precipitation varies from 10 to 50 cm and most falls as rain in August (Behre Dolbear, 2007).

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

Local Resources

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

Infrastructure and Population Centres

The only infrastructure within or nearby the Chandgana Tal Property is the Ulaanbaatar-Ondorhaan highway (A0501), a 110 kV power transmission line to the south, a 35 kV distribution line to the Chandgana Coal Mine, and cellular phone coverage. The highway is located 3 kilometres north and is a

paved all-weather highway. There are no water or natural gas pipelines, telephone lines, canals, or water retention structures within or nearby the resource area.

Physiography

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

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

History

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

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

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

Geological Setting

The property is located in the Nyalga Basin which is a portion of the Khentii Zone of the Khangai-Khentii fold system. The Khangai-Khentii fold system is a series of folded Silurian to Cretaceous age sedimentary rocks found in eastern Mongolia (Behre Dolbear, 2007).

Surficial Deposits and Sedimentary Rocks

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

Property Geology

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

Structural Geology

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

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

Exploration

Subsequent to the 2007 technical report much more exploration has been completed. The goals of this exploration were to obtain more information on the depth, thickness, and grade of the coal seams and locate the geologic limits of the resource more accurately. The exploration concept was that commonly used for relatively low dipping stratiform deposits where exploration was planned and executed to obtain information on depth, thickness, continuity, and quality of the resource. This information was obtained by trenching and drilling. Four shallow trenches were excavated in 2009. During 2011 Prophecy completed 15 drill holes from which the coal seams were sampled in detail. This exploration supplemented that completed in 2007 which included remote imagery interpretation, surface mapping, trenching, and drilling. The new information made for a much more accurate resource estimate, enabled more accurate mapping of the geologic limits of the resource area, and made for better estimation of coal quality.

Mineralization

The S2 coal seam contains most of the coal resources found within the licenses (Boyd, 2011). Other thinner coal seams comprise smaller portions of the resource and most are mineable based on thickness. The S2 Coal Seam is found throughout the property, has an average resource thickness of 40.7 metres and locally exceeds 60 metres thick including several, mostly thin partings. Depth to the top of the S Coal Seam increases to over 60 m at the southwest corner of the license. Other coal seams are found above and below the S2 Coal Seam. These coal seams have a thinner resource thickness (0 to 12.0 metres) and are less extensive yet contain mineable resources. The coal seams are black, friable, readily slake

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

Table 10

Weighted Average S2 Coal Seam Quality				
(as-received basis)				
Parameter	Moisture (wt. %)	Ash (wt. %)	Heating Value (kcal/kg)	Total Sulphur (wt. %)
	40.9	10.80	3,306	0.6

Drilling

For the 2007 drilling, Landrill International Inc. of Ulaanbaatar, Mongolia, was contracted to drill the holes and used a truck-mounted Longyear Model 44 rig. The procedure was to (1) drill with a 132 mm (HWT) full face PDC bit and set conductor casing, (2) drill the overburden to core point with a 96 mm (HQ) full face PDC bit using polymer as a medium, and (3) core from core point to total depth with an HQ-3 core drilling string. Coring was done using HQ rods behind a 96 mm OD diamond core bit with inert polymer as a medium. Wireline coring methods were used with a sleeved 3 metre core barrel assembly. All drilling was done on a 24-hour schedule. The drilling method, drilling procedures, and size of core obtained is considered appropriate for the logistics of the area, goals of the drilling, and type of analyses desired.

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

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

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

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

The 2011 drilling was performed by Best Drilling Inc. of Ulaanbaatar, Mongolia using a skid-mounted Longyear Model 44 rig. The drilling procedure was the same as that used in 2007. The drilling method, drilling procedures, and size of core obtained is considered appropriate for the logistics of the area, goals of the drilling, and type of analyses desired. Geologic data and samples were obtained using the same methods practised during the 2007 drilling. The lithology and rock mechanics information are considered

to be logged in acceptable detail. Geophysical logging was performed similar to that performed in 2007 with one exception. The exception is that spontaneous potential was not logged, otherwise natural gamma, gamma-gamma density, single point resistivity, and caliper were logged.

Summary and Interpretation of Results

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

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

Sampling & Analysis

In planning the 2007 exploration, exposures in the nearby Chandgana Coal Mine were considered. These exposures suggested that at least one of the coal seams should be very thick, low rank and dip at a low angle to the southeast. Thus, having a thick stratiform deposit and considering that the exploration is the first in the resource area, the approach used was to obtain samples that gave a reliable gross estimate of coal quality. To meet this goal, sampling was planned to (1) obtain samples at widely spaced locations, (2) sample the full thickness of the coal seam, (3) determine the limit of weathered coal, and (4) ensure the samples are representative of the grade and rank of the coal. The desire to obtain samples at widely spaced locations complimented the desire to place as much of the resource in the higher assurance-of-existence categories as possible.

Drilling and trenching were then considered most appropriate for obtaining samples. Large diameter HQ drill cores were obtained using a three metre core barrel. Only the S2 Coal Seam was cored because the existence of the upper coal seams was not known. The full thickness of the S2 Coal Seam was cored where possible. Unfortunately, in some cases a portion of the top of the coal seam was rotary drilled before changing to the core drilling string because the structure of the coal seam was not known.

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

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

Security of Samples

All the drill core and trench samples were prepared and assayed in accordance to ASTM International (ASTM), International Organization for Standardization (ISO), or Australian Standards (AS) procedures in the coal laboratories of SGS-CSTC Standard Technical Services Co., Ltd. These laboratories are located in Ulaanbaatar, Mongolia (SGS Mongolia), the test centre in Tianjin, China (SGS Mineral Fuels), and the geochemical and ores laboratory in Tianjin, China (SGS Geochemical and Ores). Sample preservation,

security and tracking was established and well maintained from the drill site to reporting of the results for the 2007 and 2011 drilling.

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

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

Data Verification

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

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

Mineral Resources and Reserves

The total coal resource within the resource area is 124.4 million tonnes of which all is in the measured assurance of existence category. Since all the coal resources fall within the measured and indicated categories, there is none in the inferred category. The in-place strip ratio averages 0.7:1 over the resource area.

**Table 11
Chandgana**

COAL SEAM RESOURCES			
Coal Seam	Assurance-of-Existence Category		Total
	Measured	Indicated	
S2 Coal Seam	124.4	0.0	124.4
Total Measured and Indicated	124.4		

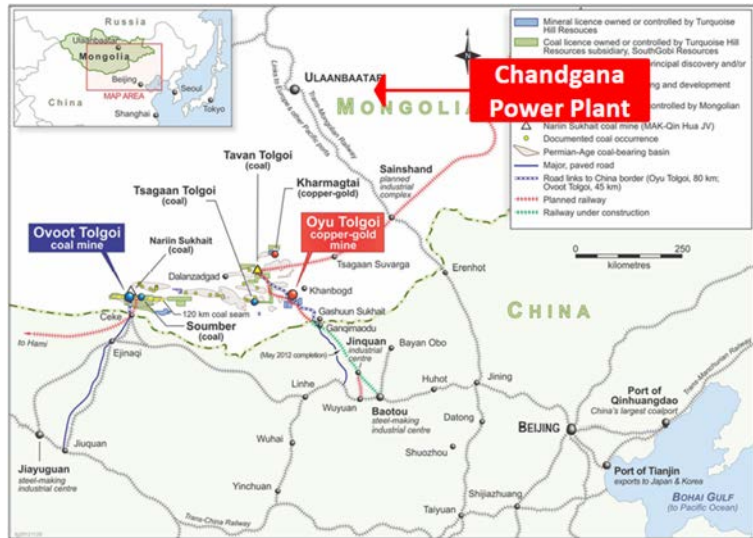
Resources are in millions of tonnes

Future Exploration and Development

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

Chandgana Power Plant

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



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

In February 2011, Prophecy received the full mining license from the Mineral Resources Authority of Mongolia for the Chandgana Tal Property. On November 21, 2011, the Company’s wholly-owned Mongolian subsidiary, Prophecy Power (formerly East Energy Development LLC), received a construction license from the Mongolian Energy Regulatory Authority to construct a 600 MW power plant at Chandgana Tal. In May 2012, the Company entered into a Cooperation Covenant agreement with the Mongolian Energy Regulatory Authority to bring the Chandgana power project online by 2016. Prophecy engaged Leighton Asia LLC to prepare a scoping level mine study for the Chandgana Tal Property which was completed in December 2011. A preliminary economic assessment was later prepared by Boyd and received November 2012 for the Chandgana Tal licenses. The preliminary economic assessment was revised then reissued February 2014 and filed under the Company’s SEDAR profile in April 2014. Prophecy has also received a mining permit to mine coal on the licenses and can receive approval of a modification to mine up to 3.5 million tonnes per year within approximately 90 days.

In March 2013, Prophecy Power was granted 532.4 hectares of land to be used for siting the proposed Chandgana Power Plant. A news release issued by Prophecy on March 5, 2013 provides further information and can be found under the Company’s SEDAR profile at www.SEDAR.com.

Prophecy has been in on-going discussions with the Mongolian government to finalize a Power Purchase Agreement (“**PPA**”) that will enable Prophecy to seek project financing and begin construction. Prophecy has also had discussions with the Ministry of Natural Resources and Energy (“**NETGCO**”) (now Ministry of Energy) to discuss technical and commercial issues. On September 6, 2012, Prophecy Power formally submitted its PPA proposal to NETGCO. The proposed PPA details the terms under which Prophecy Power would be prepared to supply power to NETGCO. In May 2013 the Company received official correspondence from the NETGCO outlining the terms of a tariff agreement, as described above in the PPA, reached between the NETGCO and Prophecy Power. A news release issued by Prophecy on May 17, 2013 provides further information and can be found under the Company's SEDAR profile at www.SEDAR.com.

On June 5, 2013 Prophecy Power and Chandgana Coal executed a coal supply agreement (“**CSA**”). The CSA calls for Chandgana Coal to supply 3.6 million tonnes of coal per year to Prophecy Power for 25 years. The initial coal price is 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.

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

In February 2014, the Chandgana Power Plant was approved by the Mongolian Government under amendment to Resolution #317 to be included in the list of concession projects. Prophecy met numerous times with the MOED in 2014 to discuss the Chandgana Power Plant concession agreement, with the issue centered on whether a public tender is required or whether the project can be qualified under the direct negotiation frame work given that Prophecy Power is already in possession of several unique non-transferrable essential elements to the project such as construction license and land use rights. In June 2014, the MOED announced a tender for the Chandgana Power Plant project and the Baganuur to Onderkhan to Choibalsan Overhead Transmission Lines project with the projects' technical and financial proposal submission deadline set of August 20, 2014. The Company submitted the projects' technical and financial proposals to the MOED on August 20, 2014. The Chandgana Power Plant tender concluded in September 2014, with no winning bid because no bidder submitted the required USD\$1.6 million dollar bank guarantee.

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

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

In February 2015, Prophecy Power was notified that a working group was appointed to work on the power concession projects.

Any power plant development would be subject to large financing requirements (in the magnitude of an estimated \$800 million) as well as technical studies to confirm the technical and economic feasibility of a power plant supplied by Chandgana Tal coal to produce the power and secure a long-term power purchase contract for the plant's electrical power output.

5.3 Pulacayo Project

The reader is referred to the feasibility study prepared by TWP Sudamérica S. A. titled "Pulacayo Project-Feasibility Study" effective date January 17, 2013 for further detail on the Pulacayo Project. The Pulacayo FS was prepared assuming a 1,000 ton per day mine and mill (concentrator) will be constructed and operated by the owner and the concentrate will be sold to a smelter. More current information is provided where possible. The Pulacayo Project consists of many contiguous licenses forming one property within which are located the Pulacayo, Paca, Pero and other mineral deposits. Previously the property has been called the 'Pulacayo property' but 'Pulacayo Project' is used in this AIF because it better reflects the size, multi-deposit nature, and development of the property.

Property Location

The Pulacayo Project is located 18 km northeast of the city of Uyuni (Canton of Pulacayo, Quijarro Province) in the Department of Potosí in south western Bolivia, 460 km south east of the capital city, La Paz, and 130 km south west of Potosí, the department capital (Figure 1). The project coordinates are 740 450 m East and 7 744 695 m North WGS84 Zone 19, south datum, and at an elevation of 4,305 m ASL.

Figure 1



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

Accessibility, Climate, Local Resources, Infrastructure and Physiography

Project Access

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

Climate

Pulacayo has a semi-arid climate, with annual rainfall of approximately 100 mm. During winter minimum temperatures reach the -20° to -25° C range and summer maximums in the 18 to 20°C range. The rainy period lasts from November to March corresponding with the southern hemisphere's summer season.

Potosí receives regular snowfalls, typically between February and April at the end of the rainy season. On the Altiplano and in higher altitude areas, sub-zero temperatures are frequent at night throughout the year.

Infrastructure and Local Resources

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

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

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

Physiography

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

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

Property

Ownership of the Pulacayo Project properties is effected by option and joint venture agreements. Apogee Minerals Ltd. (renamed "Apogee Silver Ltd." in March 2011) controlled 100% of the Pulacayo deposit through an agreement with Golden Minerals Company ("**GMC**"), the successor of Apex Silver Company before its acquisition by Prophecy. GMC's former Bolivian subsidiary, ASC Bolivia LDC Sucursal Bolivia ("**ASC**"), holds the mining rights to the concessions through a series of option and lease agreements with the Pulacayo Mining Cooperative and COMIBOL, the state mining corporation of Bolivia. On 21 January 2011, Apogee entered into a definitive agreement with GMC to acquire all of the issued share capital of ASC, which holds a 100% interest in the Pulacayo Project. Pursuant to the agreement, Apogee acquired all of the issued and outstanding shares of the subsidiary from GMC in consideration for common shares of the company upon closing of the transaction, and an additional block of common shares and a cash fee eighteen (18) months following closing of the transaction. Prophecy Coal Corp. (predecessor to Prophecy) completed purchase of the Apogee Subsidiaries and thus Apogee's interest in the mining joint venture in January 2015 (see Prophecy news release dated January 2, 2015). Figure 2 shows the distribution of Prophecy licenses on the property.

The property is comprised of contiguous licenses granting the right to explore and mine that total 22,828 hectares. The licenses form two groups; the largest centered over the town of Pulacayo and includes the extent of the Tajo Vein System, potential mineralized areas including Pero, Paca, Paca Mayu, the tailings piles, and areas for future surface facilities. A smaller group of licenses is located approximately 5 km southeast.

History of Production

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

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

Geology

In south western Bolivia, the Andes Mountains consist of three contiguous provinces, which are, from west to east, the Cordillera Occidental, the Altiplano, and the Cordillera Oriental. The basement beneath the area, which is as thick as 70 km, is believed to be similar to the rocks exposed immediately to the east, in the Cordillera Oriental, where a Phanerozoic-age fold and thrust belt consists largely of Paleozoic and Mesozoic-age marine shales and sandstones. Deposited mostly on Precambrian basement, the rocks of the Cordillera Oriental were deformed during at least three mountain-building cycles. The Altiplano is a series of high basins located between mountain ranges that formed apparently in response to folding and thrusting. Its formation involved the eastward underthrusting of the basement rocks of the Cordillera Occidental, concurrent with the westward overthrusting of the sedimentary rocks of the Cordillera Oriental. These thrusts resulted in continental foreland basins that received as much as 15,000 m of sediment and interlayered volcanic rocks during the Cenozoic. Igneous activity accompanying early Andean deformation was primarily focused further west, in Chile. During the main pulse of Andean deformation a number of volcano-plutonic complexes were emplaced at several localities on the Altiplano, particularly along its eastern margin with the Cordillera Oriental and to the south. During glacial time, most of the Altiplano was covered by large glacial lakes of which the great salars of Uyuni and Coipasa are remnants. The Cordillera Occidental consists of late Miocene to Recent volcanic rocks, both lava flows and ash flow tuffs that have erupted in response to the subduction of the Nazca plate beneath the continent of South America. This underthrusting continues, and many of the volcanoes that form the crest of the Andes and mark the international border with Chile are presently active.

Exploration

Modern era exploration in the project area included surface mapping and drilling by ASC and topographic mapping, surface mapping, geophysical surveying and drilling by Apogee.

ASC performed preliminary geologic mapping during 2003. They completed exploration drilling using diamond coring method between July 2002 and November 2002, February 2003, and September 2003. The drilling information is summarized in Table 1. These drilling programs outlined disseminated, veinlet and stock work style mineralization occurring between previously mined high grade veins.

Table 1

SUMMARY OF MODERN ERA DRILLING				
Party	Period	Number of Drill Holes	Meters of Drilling	Drilling From
ASC	Jul – Nov 2002	14	3,905	11 surface 3 underground
	Feb 2003	2	554	0 surface 2 underground
	Sep – Oct 2003	8	1,302	6 surface 2 underground
Total		24	5,761	17 surface 7 underground
Apogee	Feb – Jun 2006	19	4,418	15 surface 4 underground
	Nov 2007	14	3,745	14 surface 0 underground
	Jan – May 2008	54	14,096	46 surface 8 underground
	Jun 2009	49	12,756	26 surface 23 underground
	Nov 2010 – Dec 2011	45	29,936	45 surface 0 underground
	Aug 2011 – Jun 2012	34	3,166	0 surface 34 underground
Total		215	68,117	146 surface 69 underground
Grand Total		239	73,878	163 surface 76 underground

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

Following the acquisition of the Pulacayo Project, Apogee initiated a diamond core exploration drill program that consisted of 19 holes. During 2007-2008 Apogee focused on the Paca deposit and completed 68 drill holes in two programs with 14 completed during November 2007 and 54 holes completed during 2008. Subsequent drilling occurred during June 2009, between November 2010 and December 2011, and between August 2011 and June 2012. The drilling information is summarized in Table 1. Overall core recovery reported by Apogee exceeds 90% in most cases though proximity to old

mine workings reduces the recovery potential due to associated bedrock instability. Particular attention was paid to the planning and documentation of drill holes. Planning is based on the logging and interpretation of geological cross sections generated by Apogee staff geologists. Drillhole coordinates are established from digital maps and surface drill hole collars are located on the ground by field geologists using a hand-held GPS receiver. The completed drill hole is later surveyed by company surveyors. Drill hole azimuth and inclination are established using a compass and clinometer. Collar coordinates for underground drilling are established by company surveyors and hole azimuth and inclination are set by transit. Downhole deviation is determined for both surface and underground holes at approximately 50 m intervals using down hole survey tools.

Mineralization

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

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

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

As referenced by Pressacco et al. (2010) the Pulacayo deposit is considered an example of a sub-volcanic epithermal mineralization system showing well developed vertical metal zonation. The TVS is the main mineralized vein and stock work system at the Pulacayo Project. The east-west striking faults are interpreted to have acted as a conduit system for mineralizing fluids, with sulphide precipitation in open spaces to form veins and along fractures or by replacement to form zones of disseminated mineralization.

Changes in temperature, pressure and the chemical state between the wall rock and fluid are thought to have influenced the style and intensity of mineralization. The high grade parts of the TVS were historically mined as single 1 m to 3 m wide veins but it transitions into zones of complex quartz-sulphide or sulphide vein arrays that occur over widths ranging from less than a meter up to 120 m. Mineralization of economic interest at Pulacayo is predominantly comprised of sphalerite, galena and tetrahedrite in sulphide-rich veins that are accompanied by locally abundant quartz, barite and pyrite with disseminated sphalerite, galena and tetrahedrite in the wallrock between the veins. To date, the TVS system has been continuously proven by mining and/or surface exposure along a strike length of 2,700 m and to a vertical depth of 1,000 m below surface, is open in both strike and dip components, and locally reaches approximately 120 m of mineralized width.

Sampling

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

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

Security of Samples

Apogee staff was responsible for transport of core boxes by pick-up truck from drill sites to the company's locked and secure core storage and logging facility located in the town of Pulacayo. The secured 6 mil plastic sample bags are grouped in batches of 6 to 10 samples and secured in a larger plastic mesh bag in preparation for shipment to the ALS Chemex (ALS) preparation laboratory located in Oruro, Bolivia. All bagged samples remained in a locked storage facility until shipment to the laboratory. Samples are transported from the core storage area to the ALS facility by either Apogee personnel or a reputable commercial carrier. Sample shipment forms are used to list all samples in each shipment and laboratory personnel crosscheck samples received against this list and report any irregularities by fax or email to

Apogee. Apogee has not encountered any substantial issues with respect to sample processing, delivery or security for the Pulacayo drilling programs. The transport and security of samples pertinent to the ASC drilling were confirmed by Apogee staff familiar with the ASC program to be generally similar to those employed by Apogee.

Sample Preparation, Analysis and Quality Assurance/Quality Control

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

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

QAQC procedures pertinent to the ASC 2002-2003 drilling programs were not documented. However, the first drilling program carried out by Apogee in 2006 was intended to confirm earlier ASC analytical data. Full QAQC protocols instituted by Apogee were applied to this program and results of the Apogee re-drill program correlate well with those of ASC suggesting that acceptable standards were being met by ASC.

Data Verification

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

6.2.1@ software for such errors as sample record duplications, end of hole errors, survey and collar file inconsistencies and some potential lithocode file errors. The digital review and import of the manually checked datasets through Surpac provided a validated Microsoft Access® database that is considered to be acceptable for resource estimation.

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

Mineral Processing and Metallurgical Testing

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

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

Universidad Técnica de Oruro (UTO) conducted a metallurgical test program during 2009 on three samples comprising comminution (only Bond Ball Work Index), open circuit flotation tests (OCT), locked cycle flotation tests (LCT), OCT tailings (non-float) size by size analyses, and OCT tailings (non-float) sedimentation tests. Clay mineralogy studies were not carried out to determine the presence of clays that may produce very fine slimes though during the test work, slimes were produced affecting the flotation performance, settling of tailings, and flotation pulp rheology. The samples were drill cores composited to represent a higher grade, a medium grade, and a lower grade. Comminution was evaluated using the Bond Ball Mill Work Index (BWI) test and categorized the samples as medium to hard. Abrasion index, crushing work index, and rod work index tests were not performed. Specific gravity tests were performed. Flotation test work focused on lead and silver recovery using both batch open circuit and closed circuit flotation tests. Locked cycle tests of the high grade sample indicated that conventional selective lead-silver and zinc-silver flotation techniques recovered 56% of the silver in the lead concentrate and 27% of

the silver in the zinc concentrate with lead recovery of 79% and zinc recovery of 81%. Silver grades were 6,620 g/t in the lead concentrate and 2,010 g/t in the zinc concentrate. Locked cycle flotation (LCT) test results of the medium grade sample indicated that it is possible to recover almost 34% of the silver in the lead concentrate and 50% of the silver in the zinc concentrate, with lead and zinc grades at 51% and 58%, lead and zinc recoveries at 74% and 83%, and silver grades at 6,220 g/t and 2,990 g/t. Locked cycle flotation (LCT) test results of the low grade sample indicated that it is possible to recover almost 30% of the silver in the lead concentrate and 21% of the silver in the zinc concentrate, with lead and zinc grades at 51% and 58%, lead and zinc recoveries at 74% and 83%, and silver grades at 6,220 g/t and 2,990 g/t, respectively. The results seem to be reasonable and in accordance with expectations from the mineralogy of the ore. These results constitute the design basis for the flow sheet. Full open-circuit tests (OCT) of sulphide minerals flotation were conducted initially on each sample as a proof of concept of the overall circuit and to establish a workable set of flotation conditions and reagents. These tests demonstrated that sulphide flotation to saleable lead and zinc concentrates at acceptable (for batch tests) recoveries was possible.

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

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

exploratory test indicated that silver recovery to bulk concentrate is about 72%, while the lead and zinc recoveries are approximately 66% and 78% respectively. The floating fraction accounted for about 13%, the slimes fraction 18%, and the rest is lost as final tailings. Lead and silver losses are up to 23% and 13%, respectively. The open batch flotation tests indicated that lead recovery is in between of 48% and 54%, while zinc recovery is in the range from 50.1% to 72%. Total silver recovery to both lead and zinc concentrates is between 30% and 68%. Lead concentrate grades range from 33.5% to 59%, zinc concentrate grades range from 49% and 55%. Similarly, silver grades in both concentrates range from 9,875 g/t to 15,333 g/t. A single locked cycle test (LCT), a repetitive batch used to simulate a continuous circuit where all the intermediate material added to the appropriate location in the flowsheet, was conducted to produce a metallurgical projection of the sample tested and to assess if the flowsheet and reagent suite is stable. A good locked cycle test typically achieves steady state over the last three cycles. Steady state implies both stability and mass conservation. Stability implies constancy. It was not indicated whether the test reached stability or whether mass conservation was achieved. Assuming that steady state was reached, the results indicated that lead and zinc recoveries were 60.1% and 76.5%, respectively. Lead concentrate assayed 11,114 g/t Ag, 49.1% Pb and 4.81% Zn. Additionally, the metal values in the zinc concentrate were 2,220 g/t Ag, 2.29% Pb and 48.6% Zn. Concentrates account for about 2.9% w/w of the feed (0.81% lead and 2.1% zinc). Silver metal loss in the slimes is as high as in the tailings. Lead and silver losses in the final tails are 23.1% and 9.12% respectively. The PORCO flowsheet is basically a bulk flotation followed by lead and zinc flotation, this processing route should be carried out at high pH (12.2) intended to depress pyrite at the outset. However, the Pulacayo ore did not respond well mainly because of lead and silver selectivity issues and high consumption of acid (H₂SO₄) to drop the pH to a level suitable for lead flotation after the bulk stage.

Maelgwyn Mineral Services Africa (MMSA) carried out laboratory flotation optimization test work on ore samples from the Pulacayo Project during 2012. The objectives of the work were to – (1) test the flotation conditions supplied by Apogee on the core samples to determine the metal recoveries and grades achievable by differential flotation of the Pb and Zn minerals, (2) to optimize the flotation conditions for effective differential of the Pb and Zn minerals and to achieve saleable grades of Pb and Zn concentrates, and (3) to perform locked cycle testing of the optimized flotation conditions using selected variability core samples. Laboratory rod milling curves were produced for all the samples and found that the milling times required for the samples indicated a high degree of variability in hardness between the sample types. Flotation tests included 65 open circuit flotation tests (exploratory test work) and four locked cycle flotation tests. In summary the locked cycle tests yielded Pb concentrates of 55-69% Pb at recoveries between 88% and 93% and Zn concentrates of 37% to 56% Zn at recoveries of 79% to 90% with a large variation in head grade from 1.5% Pb to 4.3% Pb. The silver recoveries ranged between 68% and 94% with a variation in head grade of between 136 g/t Ag and 375 g/t Ag.

The test mining between November 2011 and May 2013 produced 12,550 tons of ore that were used in a toll milling program to evaluate ore processing. The ore was hauled by truck to four concentrators – Tatasi, Fedecomín, La Estrella, and Zabaleta. The Zabaleta concentrator attained the best recoveries for which the results are presented in Table 2.

Table 2

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

Mining

Mineralization is found from the surface to at least 1,000 m depth thus both surface and underground mining methods are likely. It is envisioned that surface mining will recover the oxidized ore and some sulphide ore to an elevation of 4,159 m above sea level. At this elevation a 15 m crown pillar will be left below which underground mining methods will start.

No surface mining method has been proposed or a mine plan developed. But the mining method is likely to be conventional drill and blast with shovels for removal and dump trucks for haulage. A conceptual mine plan was developed by applying net smelter return cut-off values to the block model then applying a Whittle pit optimization to ensure a reasonable strip ratio and assumption of economic extraction in order to model mineral resources and grade. The average pit slope used was 42° but other mining parameters are not known. This mine plan produces 13.6 million tons of ore by removing 71.7 million tons of overburden making a waste:ore ratio of 5.3 ton:1 ton.

The underground mining method will likely include shrinkage stoping above the San Leon Tunnel (Level 0) and long hole stoping below Level 0. Mining will be undertaken using a top down approach (i.e. access and infrastructure will be developed to the ore body as required). The shrinkage stopes will have a designed stoping height of 30 m and a stope length of 30 m. The stope width will depend on the thickness of the payable vein, which varies between 0.8 m and 2 m. Ore will be mined in horizontal slices from the bottom to the top of a stoping block. Mining will involve drilling, blasting, and removal of the swell leaving most of the loosened ore in the stope. This will leave enough headroom for drilling and the start of the next slice of ore. The remaining broken ore will be stored in the stope to support the sidewalls and to serve as a working platform. Once the entire stoping block has been mined out, the remaining ore will be drawn out via boxholes located along the ore drive at the base of the stope. The ore will be loaded into hopper cars and trammed out of the mine and tipped at the ore stockpile at the process plant. The mine will use one 4 tonne locomotive pulling five 3 tonne hopper cars to accomplish this. At the end of a stope's life, it will be sealed off accordingly. No backfill will be placed in the stopes.

The long hole stopes will have an average length of 10 m, a stope width that varies between 3 m and 6 m depending on the payable vein thickness and an average stoping height of 23.4 m. The level spacing of the old mine will be maintained, and as a result, the spacing varies from 21.5 m to 32.5 m. The bottom access will be used as a drilling and mucking level. Stopping will be done on retreat by drilling, blasting, and removal of ore by remote-controlled load-haul-dumps (LHDs). The LHDs will also be used to load rock at the mucking bays into trucks. The trucks will haul the ore out of the mine via the decline ramp system and tip at the stockpile at the process plant. Once all the broken ore has been removed from the stope, it will be filled with cemented backfill. The shrinkage stopes will be accessed via the *San Leon* tunnel and the long hole stopes will be accessed via a decline ramp system that will be developed from surface to allow rock to be trucked out of the mine. A second outlet from the mine located in the vent raise adjacent to the west ramp has been included in the design and will be available for people in case of emergencies.

The mine has been designed for an ore production of 1,000 tons (t) per day. The mine plan indicates a total of 3,557 million tons of ore and 0.839 million tons of waste. These will be extracted over a planned 12.5 Life of Mine (LOM). The average grades over the LOM are 239 g/t for silver, 1.09% for lead and 1.91% for zinc.

Though no detailed hydrogeological studies have taken place at the modern Pulacayo mine, water is not expected to be a problem on the first seven levels of the mine (Level Zero to Level 147). This conclusion is based on the information obtained from the existing workings at the mine. A geotechnical investigation of the rock mass using two rating systems found the rock mass to have a fair to poor rating. Stopes with dimensions of maximum 30 m (height) by maximum 10 m (length) and maximum 6 m (width) will be stable and are expected to remain free standing for a reasonable time. Cemented backfill placed after the broken ore has been drawn out will provide permanent support to the stope back. A 15 m wide sill pillar will be required below zero level to protect the San Leon tunnel from the proposed underground workings and a 15 m wide crown pillar will be required to protect the underground workings from the

planned future open pit mine. Crosscut protection pillars will also be required to support crosscuts during mining. Once all the stopes being serviced by the crosscut have been mined out, the crosscut pillar will be recovered on retreat. A 15 m wide crosscut protection pillar is deemed sufficient. Support tendons will be 20 mm diameter rock bolts with the lengths and spacings depend on ground conditions. Weld mesh, chain link wire mesh or shotcrete should be used for support in poor ground conditions and timber sets used in exceptionally poor ground conditions.

Development includes the decline ramp, ore and waste drives, and haulage tunnels. The decline ramp system will be developed from surface at an inclination of 8 degrees from the horizontal using conventional drill and blast techniques. Conventional drill and blast techniques will also be used to advance existing ore and waste drives, and to develop new shrinkage stopes. Utilities including compressed air and water pipelines, ventilation ducts and power cables will be installed as the ramp system advances. Cemented backfilling of mined out long hole stopes is planned to facilitate safe mining by providing permanent support to the stope excavation, particularly when mining adjacent areas.

The planned ventilation system, though complicated by a number of unknowns with respect to the existing workings is intended to ultimately establish through-ventilation on the main haulages of all levels, from which fans and ducts can draw air for stopes and ore access development. There will not be any 'main fan' installations on surface; instead, a number of relatively small (30 m³/s) 'booster' fans will be installed underground at positions leading to surface connections. The intent is to ensure that a positive flow of air will report underground to the fan inlets. Ventilation controls will be used to ensure that the air circulates through the production haulages on its way to the booster fans. The ventilation design is to route intake air to the center of the mine and to the various levels via the production ramp and central shaft then towards the extremities of each level.

The production elements of the Pulacayo mine will operate on a 24/7 basis using two 10 hour shifts per day over a period of 345 days per annum. Shift utilization was estimated to be 82.5% and mechanical availability 87.6%. The manpower requirements will vary from 79 to 179 workers and they will operate on an 8 days on - 4 days off roster with alternation between morning and night shifts. All the other departments (engineering, technical services and stores) will be operating during the day shift only.

The fleet of equipment required to meet the mine's production targets includes the equipment that the mine already owns and new equipment. This equipment includes: 4 locomotives, 4 flat cars, 10 x 1 tonne Granby cars, 5 x 4 tonne hoppers, 2 air loaders (each with a 0.5 tonne bucket), 12 stopers, 12 jackleg hand-drills, one LHD (load-haul-dump), one 20 t truck, one production drill rig, one roof bolter, one shotcreter, and various other equipment.

The underground infrastructure and mine services required to support the extraction of the ore body at Pulacayo include two vertical shafts, a fresh water line to transport water from the Yanapollera Dam, and a fresh water reservoir where water is stored at the San Leon tunnel entrance. The proposed mine services will include a compressed air supply, a water supply and distribution system, an electrical distribution system, an underground workshop, and a waste water collection/cleaning/removal system.

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

Mineral Resources and Reserves

Mineral resources were estimated for open pit and underground mineralized material. Only indicated and inferred resources were estimated because there are no resource blocks having the certainty of definition required for measured resources. Mineral resources were estimated by modeling the grade of each metal and the ore specific gravity considering the orientation and geometry of the TVS. For the open pit

material the oxide and sulfide ore was separately estimated because the recoverable metals differ. The net smelter return (NSR) was then calculated from the block grades and a cut-off applied to determine the potentially economic portions of the mineralization in order to estimate resources. The estimated Pulacayo mineral resources are given in Table 3. Mineral resources that are not mineral reserves do not have demonstrated economic viability. The estimate of mineral resources may be materially affected by environmental, permitting, legal, title, taxation, sociopolitical, marketing, or other relevant issues.

Table 3

MINERAL RESOURCES								
Resource Class	Type of Resource	Resource (mln tons)	Grade ³			Metal Content		
			Ag (g/ton)	Pb (%)	Zn (%)	Ag (mln oz)	Pb (tons)	Zn (tons)
Open Pit Resources¹ (base case, above 4,159 m ASL)								
Indicated	Oxide	1.500	95.9	0.96	0.13	4.626	NA	NA
Inferred	Oxide	0.248	71.2	0.55	0.31	0.569	NA	NA
Indicated	Sulphide	9.283	44.1	0.66	1.32	13.168	67,950	134,770
Inferred	Sulphide	2.572	33.4	0.92	1.36	2.765	25,995	38,440
	Waste Rock (mln tons)		71.679			Waste:Ore Ratio (t:t)	5.3:1	
Underground Resources² (below 4,159 m ASL)								
Indicated	Sulphide	6.197	213.6	0.86	1.74	42.547	58,750	118,860
Inferred	Sulphide	0.943	193.1	0.43	1.61	5.853	4,470	21,735
Totals and Weighted Averages								
Indicated	Ox+Sulph	16.980	110.5	0.74	1.49	60.341	126,700	253,630
Inferred	Ox+Sulph	3.763	75.9	0.79	1.43	9.187	30,465	60,175

Notes:

- (1) Average pit wall angle 42°, USD 13.20 NSR cut-off for sulphide resources and USD 23.20 for oxide resources.
- (2) USD 58.00 NSR cut-off. Metal prices used were USD 25.00/oz of silver, USD 0.89 for lead, and USD 1.00 for zinc.
- (3) Contributing 1 m assay composites capped at 1,500 g/t Ag, 15% Pb, and 15% Zn.

Mineral reserves were only estimated for the indicated underground minable resources. This was done by designing minable stopes within the mineralized zone and applying mining recovery and dilution factors. Only indicated mineral resource material has been converted to reserves because there is no measured mineral resource material. Any inferred material within the designed stopes is treated as waste and allocated a mineralization grade of zero. Two underground mining methods will be utilized at Pulacayo, shrinkage stoping and longhole open stoping. During mining it is estimated that 8% of the ore body will be lost, including to the existing mine workings and mining dilution will be 8%. Potentially economic portions of the mineralization were founded on operating costs provided by Apogee. The factors used to determine if a stope was viable and economic to mine included- (a) a minimum silver grade of 150 g/t silver, (b) a minimum NSR of USD 70/t, (c) shrinkage stope widths are between 0.8m and 1.5m and long-hole open stopes are between 3.0 and 6.0 meters wide, and (d) that the ore within the stopes on each level must pay for the development to reach and exploit that level. The estimated Pulacayo mineral reserves and related parameters are given in Table 4 below.

Table 4

MINERAL RESERVES AND RELATED PARAMETERS							
Resource Class	Reserve (mln tons)	Grade			Metal Content		
		Ag (g/ton)	Pb (%)	Zn (%)	Ag (mln oz)	Pb (tons)	Zn (tons)
Probable	3,558	239.4	1.09	1.91	27,385	38,927	67,705
	Mining Rate	1,000 ton per day		Mine Life	12.5 years		

Metal price changes or significant changes in costs or recoveries could materially change the estimated mineral reserves in either a positive or negative way. At the time of report preparation, there were no unique situations relative to environmental or socio-economic conditions that would put the Pulacayo mineral reserves at a higher level of risk than any other developing resource in Bolivia.

Recovery Methods

A mineral processing plant design was prepared to concentrate metal from the ore based on results of metallurgical test results performed on behalf of Apogee. The plant circuits will include conventional crushing, screening, clays washing and screening, grinding m(milling), lead flotation, zinc flotation, and concentrate filtration and storage and a reagents storage and handling facility, a tailings storage and disposal facility, a backfill handling and pumping facility, auxiliary services, and a process water treatment facility. The plant was designed to produce lead and zinc concentrates with silver reporting predominantly to the lead concentrate. There are redundant milling, flotation, and concentration circuits to ensure availability. The processing plant is a conventional design and comprises equipment of the type and size that has been proven in the plants processing similar mineral ores in the industry. The basic process flow is to crush the ore, screen and wash the crushed ore, mill the crushed ore, float the milled ore to remove the waste producing a concentrate, and dewater the concentrate. The waste (tailings) from flotation will be sluiced to the tailings storage area or the backfill plant to make paste backfill material to place in the mine. Process water is cleaned of solids and chemicals and reused. Auxiliary services and facilities will be provided to support the processing plant. The plant is designed to process 1,000 tons per day using three 8 hour shifts with an overall availability of 86.2%. The plant will be located one kilometer east of the San Leon tunnel portal and Pulacayo town to minimize haulage distance yet provide sufficient room for all functions and expansion if needed.

Environmental

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

Cost Estimates

The capital costs include initial and sustaining costs. For the mine these include mine development, equipment, services, and the backfill system and for the processing plant (concentrator) these include equipment for the plant and the tailings facility, and common costs including site development, infrastructure, EPCM, freight/taxes/insurance, inventory/commissioning, and owners costs. A contingency based on the initial capital costs is included. The capital costs are presented in Table 5.

Table 5

SUMMARY OF INITIAL AND SUSTAINING CAPITAL COSTS				
(mIn USD)				
Category	Item	Initial Cost	Sustaining Cost	Life of Mine (Total Cost)
Mine	Development	5.64	16.60	22.24
	Equipment	3.63	8.45	12.08
	Services	2.83	2.68	5.52
	Backfill System	2.11	1.32	3.43
Process Plant	Plant	12.79	1.48	14.27
	Tailings Storage	0.92	5.25	6.17
Common	Site Development	2.21	0.01	2.22
	Infrastructure	4.23	0	4.23
	EPCM	2.75	0.26	3.01
	Freight/Taxes/Insurance	0.74	0.67	1.41
	Inventory/Commissioning	1.35	0.16	1.51
	Owners Costs	3.02	3.33	6.35
Contingency		3.72	0.93	4.65
Total		45.95	41.14	87.09

The operating costs include those for mining, processing, and general and administrative. Mining costs include development, production, technical services, backfill system, and mine administration. The operating costs for processing include operating supplies, maintenance supplies, manpower, and general and administration. General and administrative includes labor, power, third party services, operational, accommodations, office, and other. The life-of-mine operating costs are given in Table 6.

Table 6

SUMMARY OF OPERATING COSTS		
(mIn USD)		
Category	Item	Cost
Mining	Development	15.78
	Production	48.81
	Technical Services	17.55
	Backfill System	22.62
	Mine Administration	3.01
Processing	Operating Supplies	36.33
	Maintenance Supplies	0.15
	Manpower	7.20
	General and Administrative	9.79
General and Administrative	Labor	6.68
	Third Party Services	2.83
	Operational	5.12
	Accommodation	5.33
	Office	8.81
	Other	2.96
Total		192.96
Operating Cost/ton Ore Processed (USD)		54.90

Financial Analysis

A technical-financial model (TFM) has been developed to evaluate the economic viability of Pulacayo mine. The following assumptions were made:

- All the costs are expressed in Q4 2012 US dollars (USD) and there is no escalation or inflation.
- Revenue is recognized as the concentrate is produced and sold with no allowance for time delays between shipment and payment for the concentrate.
- Ocean freight, concentrate containerization and terminal costs have not been accounted for.
- The initial capital expenditure will be financed by equity and revenue.
- Operating cash flows will be used to finance sustaining and working capital once the mine has reached full production.
- The estimated metal prices used in the model are: USD 0.86/lb lead, USD 1.00/lb zinc, and USD 28.00/oz silver.

The methodology of modeling was to start with the Free-on-Board (FoB) price and deduct the off-mine cost and the concentrate transportation cost to arrive at a Free-on-Truck (FoT) mine gate price. The steady state operating cost varies between about \$35 and \$53 per tonne of the mill feed over the mine life. The difference between the FoT price and the operating cost is the operating margin (before royalties). The operating margin was used to calculate the earnings before interest, tax and dividends (EBITD). Royalties were calculated for each concentrate based on contract rates, the metal contained in the concentrate, and the Net Smelter Revenue (NSR) as may be applicable.

The EBITD (after royalties) was calculated. The capital expenditure was then deducted to yield a cash flow before tax. The taxable amount was calculated taking depreciation into account. Two taxation rates were applied in the TFM - a corporate tax of 25% which is payable once both corporate tax and the cumulative corporate tax become positive and a mining tax rate of 12.5% which becomes payable when the local income turns positive. The cash flow after tax was then calculated. The final result of the TFM are the net present value (NPV) and internal rate of return (IRR) calculations of the operating margin and cash flows before and after taxes.

The TFM is based on the mine using conventional mining on Level Zero and trackless mining on the other levels. The capital cost associated with ore reserve development has been taken into account in the TFM. Ore reserve development is a sustaining capital investment that is made to accommodate future low commodity prices permitting ongoing development to be temporarily halted without loss of production and so enables the mine to maintain a positive cash flow when commodity prices are low. A summary of the results obtained from the model is given in Table 7. Other than the metal price, the project does not seem to be sensitive to any specific parameter.

Table 7

RESULTS OF TECHNICAL FINANCIAL MODEL FOR THE LIFE OF MINE		
Parameter	Constant Discount Rate	8%
	NPV (mil USD)	IRR (% per year)
Operating Margin	194	No IRR
Cash Before Tax	126	47
Cash After Tax	72.5	32.1
Maximum Months for NPV and IRR	174	174
Net Smelter Return/ton RoM (milled) (USD/t)		171.1
Cash Cost/oz Silver ¹ (USD/oz)		11.20
Cash Cost/oz Equivalent Silver ^{1,2} (USD/oz _{AgEq})		8.44
Payback Period ³ (months)		20

Notes:

(1) (Operating costs plus [selling] shipping costs) / silver in concentrate produced, excluding royalties.

- (2) *(Operating costs plus [selling] shipping costs) / (silver in concentrate produced + silver base metal credits). The application of "silver equivalent ounces", (OZ_{AgEq}) means the US dollar value of lead & zinc metals divided by the price of silver and added to the pure silver ounces in any applicable category. Economic calculations used the following factors: lead equivalent ounces is $Lead\ AgEq. = (Lead\ Tonnes \times 2204\ lbs/t \times \$0.86/lb) / \$28/oz$ and for zinc equivalent ounces is $Zinc\ AgEq. = (Zinc\ Tonnes \times 2204\ lbs/t \times \$1.00/lb) / \$28/oz$.*
- (3) *Does not consider loan interest.*

Project Risks and Mitigation

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

Recent Activities

Prophecy is currently assessing the historical tailings piles on the property, preparing for further exploration, and preparing for mine re-start. There are approximately 12 tailings piles on the property. These have been sampled and assayed and returned grades of up to 3.8% Pb, 3.42% Zn, 1200 g/t Ag, 5.8 g/t Au, and 155 g/t In. Further evaluation of the tailings piles is planned. Some of the known mineralized areas have not been fully explored, there are indications of other mineralized areas, and there are indications of other valuable metals. Prophecy is preparing for further exploration including geological mapping, geophysical surveys, and drilling of these areas. Preparations for re-start of the mine are in progress include budgeting, hiring, and mine planning.

Impairment Analysis

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

6. RISK FACTORS

The Company is in the business of acquiring, exploring and developing mineral properties, and is exposed to a number of risks and uncertainties that are common to other junior mineral exploration and development companies in the same business. The mining industry is capital intensive at all stages and is subjected to variations in commodity prices, market sentiment, exchange rates for currency, inflation and other risks. The Company currently has modest coal sales as a source of revenue in addition to interest on cash balances. The Company will rely mainly on coal sales, operating lines of credit and equity financing to fund its exploration and development activities.

History of Net Losses; No Foreseeable Positive Cash Flow

The Company has not received any material revenue or net profit to date from the exploitation activities on its Ulaan Ovoo Property. Exploration and development of mineral properties requires large amounts of capital and usually results in accounting losses for many years before profitability is achieved, if ever. The Company has incurred losses and negative operating cash flow during its most recently completed financial year and for the current financial year to date. The Company believes that commercial mining activity is warranted on its Ulaan Ovoo Property but has not made this determination for any of its other properties. Even if the Company undertakes further development activity on its Ulaan Ovoo Property or any of its other properties, there is no certainty that the Company will produce revenue, operate profitably or provide a return on investment in the future.

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

Exploration, Development and Production Risks

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

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

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

The long-term commercial success of Prophecy depends on its ability to find, acquire, develop and commercially produce coal and silver. No assurance can be given that Prophecy will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Prophecy may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

No History of Profitable Mineral Production

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

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

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

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

Commencing Mine Development Activities without a Feasibility Study

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

Mineral Resources and Reserves

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

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

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

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

mineralization. Any material reductions in estimates of mineralization, or of Prophecy's ability to extract this mineralization, could have a material adverse effect on Prophecy's results of operations or financial condition.

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

Capital Costs, Operating Costs, Production and Economic Returns

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

None of the Company's mineral properties, including the Ulaan Ovoo Property, have sufficient operating history upon which the Company can base estimates of future operating costs. Decisions about the development of these and other mineral properties will ultimately be based upon feasibility studies. Feasibility studies derive estimates of cash operating costs based upon, among other things:

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

Cash operating costs, production and economic returns, and other estimates contained in studies or estimates prepared by or for the Company, including the Ulaan Ovoo PFS, Pulacayo FS or other feasibility studies, if prepared, may differ significantly from those anticipated by the Company's current studies and estimates, and there can be no assurance that Prophecy's actual operating costs will not be higher than currently anticipated.

Foreign Operations and Political Conditions

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

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

Legal and Political Risk

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

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

In addition, while legislation has been enacted to protect private property against expropriation and nationalisation, due to the lack of experience in enforcing these provisions and political factors, these protections may not be enforced in the event of an attempted expropriation or nationalisation. Whether legitimate or not, expropriation or nationalisation of any of Prophecy's assets, or portions thereof, potentially without adequate or any compensation, could materially and adversely affect its business and results of operations. In addition, there can be no assurance that neighbouring countries' political and economic policies in relation to Mongolia will not have adverse economic effects on Prophecy's business, including its ability to transport and sell its product and access construction labour, supplies and materials.

The Bolivian government adopted a new constitution (the "NCPE") in early 2009 which increased state control over key economic sectors, including mining. The NCPE provides that all minerals, among all natural resources, belong to the Bolivian people who are represented by the Government. Such entity is the only one capable of managing all minerals throughout the production chain. Consequently, only the Bolivian Central Government possesses the authority to grant mining rights. Bolivian President Evo Morales signed a new law increasing the state's expropriation powers over the mining sector: the Law of Mining Rights. It was specifically drafted to target mines deemed by the state as unproductive, inactive or idle. The Government has assigned responsibility for determining whether a concession is idle to the Vice Ministry of Regulation, Auditing and Mining Policy. Mining areas occupied by cooperatives or local groups will not be regarded as idle. However, the Company cannot provide any assurance that its operations at the Pulacayo Project will not be affected by the current political environment in Bolivia.

Local Laws

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

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

In 2006, the Mongolian Government enacted a new minerals law. The 2006 Minerals Law, which preserves, to a limited extent, some of the substance of the former minerals legislation of 1997 minerals legislation, was drafted with the assistance of legal experts in the area of mining legislation and was widely regarded as progressive, internally consistent and effective legislation. However, the 2006 Minerals Law contains new provisions that have increased the potential for political interference and weakened the rights and security of title holders of mineral tenures in Mongolia. Certain provisions of the 2006 Minerals Law are ambiguous and it is unclear how they will be interpreted and applied in practice. Examples of such provisions include those relating to the designation of a mineral deposit as a Mineral Deposit of Strategic Importance. The Mongolian Government could determine that any one or more of the Company's projects in Mongolia is a Mineral Deposit of Strategic Importance.

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

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

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

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

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

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

Bolivia's "Law of Mother Earth"

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

Permits and Licenses

The Company's activities are subject to government approvals, various laws governing prospecting, development, land resumptions, production taxes, labour standards and occupational health, mine safety, toxic substances and other matters, including issues affecting local native populations. Although the Company believes that its activities are currently carried out in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail production or development. Amendments to current laws and regulations governing operations and activities of exploration and mining, or more stringent implementation thereof, could have a material adverse impact on the business, operations and financial performance of the Company. Further, the mining licenses and permits issued in respect of its projects may be subject to conditions which, if not satisfied, may lead to the revocation of such licenses. In the event of revocation, the value of the Company's investments in such projects may decline.

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

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

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

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

These recent and anticipated changes to mining laws and policies may adversely affect the Company.

Chandgana Power Plant Project Challenges

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

In addition to entering into a PAA and obtaining all required licences and permits for the construction and operation of the Chandgana Power Plant, any power plant development would be subject to large financing requirements (in the magnitude of an estimated \$800 million) as well as technical studies to confirm the technical and economic feasibility of a power plant supplied by Chandgana Tal coal to produce the power and secure a long-term power purchase contract for the proposed plant's electrical power output. There can be no assurance that such financing can be obtained on favourable terms or at all, or that such technical studies will yield positive results. Prophecy also does not have experience constructing or operating coal fired power plants or qualified personnel to do so, and will have to rely on contractors or potential partners to supply such expertise.

Title to Mineral Properties

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

Environmental Risks

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

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

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

Competition

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

Lack of Infrastructure

The Company has projects located in remote areas which currently lack or do not have sufficient basic infrastructure, including sources of electric power, water, housing, food and transport necessary to develop and operate a major mining project. While the Company has established limited infrastructure necessary to conduct its exploration and development activities at the Ulaan Ovoo Mine, infrastructure is not fully established. Most infrastructure must be developed for the Chandgana Properties in Mongolia. For the Pulacayo Project most infrastructure is in place. Lack of availability of the means and inputs necessary to establish such infrastructure may adversely affect mining feasibility. Establishing such infrastructure will, in any event, require significant financing, identification of adequate sources of raw materials and supplies and necessary approvals from national and regional governments.

Key Personnel

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

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

Uninsured Risks

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

Although the Company maintains insurance to protect against certain risks in amounts that it considers reasonable, its insurance will not cover all the potential risks associated with its operations. The Company may also be unable to maintain insurance to cover these risks at economically feasible premiums. Insurance coverage may not continue to be available or may not be adequate to cover any resulting liability. Moreover, insurance against risks such as environmental pollution or other hazards as a result of exploration and production is not generally available to the Company or to other companies in

the mining industry on acceptable terms. The Company may also become subject to liability for pollution or other hazards which may not be insured against or which the Company may elect not to insure against because of premium costs or other reasons. Losses from these events may cause the Company to incur significant costs that could have a material adverse effect upon its financial performance, results of operations and business outlook.

Fluctuating Market Prices

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

The price of coal and silver may have a significant influence on the market price of Prophecy's Shares and the value of Prophecy's mineral properties. Mineral prices fluctuate widely and are affected by numerous factors beyond the control of the Company. The level of interest rates, the rate of inflation, the world supply of mineral commodities and the stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns, monetary systems and political developments. The price of mineral commodities has fluctuated widely in recent years, and future price declines could cause commercial production to be impracticable, thereby having a material adverse effect on the Company's business, financial condition and result of operations.

Reliance on Contractors

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

Additional Financing

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

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

Foreign Exchange

In the past, Prophecy has raised its equity and maintained its accounts in Canadian dollars. Foreign operations carried out in U.S. or local Mongolian or Bolivian currency could subject Prophecy to foreign currency fluctuations that may materially and adversely affect Prophecy's financial position.

Anti-Corruption Legislation

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

Recent Global Financial Conditions

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

Dividends

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

Insurance Against All Risks

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

Conflicts of Interest

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

7. DIVIDENDS

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

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

8. DESCRIPTION OF CAPITAL STRUCTURE

8.1 General Description of Capital Structure

The authorized capital of Prophecy consists of an unlimited number of Shares without par value. As of the date of this AIF, there are 311,878,634 Prophecy Shares issued and outstanding. The holders of Prophecy Shares are entitled to vote at all meetings of shareholders of Prophecy to receive dividends if, as and when declared by the Board and to participate rateably in any distribution of property or assets upon the liquidation, winding-up or other dissolution of Prophecy. The Shares carry no pre-emptive rights, conversion or exchange rights, redemption, retraction, repurchase, sinking fund or purchase fund provisions. There are no provisions requiring the holders of the Shares to contribute additional capital and there are no restrictions on the issuance of additional securities by Prophecy. There are no restrictions on the repurchase or redemption of the Shares by the Company except to the extent that any such repurchase or redemption would render Prophecy insolvent pursuant to the BCBCA.

As of the date hereof, the Company also has stock options ("**Options**") outstanding to purchase up to 26,563,750 Shares with each Option exercisable to purchase one Prophecy Share at exercise prices ranging from \$0.055 to \$0.67 and having expiry dates ranging from 2015 to 2019.

As of the date hereof, the Company has Warrants outstanding to purchase up to 15,786,648 Shares with each Warrant exercisable to purchase one Prophecy Share at exercise prices ranging from \$0.055 to \$0.18 and having expiry dates ranging from April to October 2015.

Share-Based Compensation Plan

The Company has adopted a 20% fixed share-based compensation plan (the "**Share-Based Compensation Plan**"). The purpose of the Share-Based Compensation Plan is to allow the Company to grant Options, Bonus Shares and Stock Appreciation Rights (collectively, the "**Awards**") to directors, officers, employees and consultants, as additional compensation, and as an opportunity to participate in the success of Prophecy. The granting of Awards is intended to align the interests of such persons with that of the Company's Shareholders.

Options are exercisable for up to 10 years or as determined by the CGCC and are required to have exercise prices equal to or greater than the Market Price (as defined by the stock exchange on which the Shares are principally listed for trading and based on the volume weighted average trading price of the Shares as reported on such exchange for the five trading days immediately preceding the day that

Options are granted). Any Options granted under the Share-Based Compensation Plan vest at 12.5% per quarter over a two year period unless determined otherwise by the CGCC. In addition, the CGCC may accelerate the vesting date, permit the conditional exercise of Options, amend or modify the terms of the Options, or terminate Options.

Pursuant to the Share-Based Compensation Plan, the CGCC may from time to time authorize the issuance of Awards to directors, officers, employees and consultants of Prophecy or employees of companies providing management or consulting services to Prophecy. The maximum number of Shares which may be reserved for issuance under the Share-Based Compensation Plan is 50,080,263.

9. MARKET FOR SECURITIES

9.1 Trading Price and Volume

The Company's Shares trade on the TSX under the symbol "PCY". Prior to October 19, 2011, the Company's common shares traded on the TSX Venture Exchange. The following table shows the high and low trading prices and average daily trading volume of the Shares of the Company on the TSX and TSX Venture Exchange, as applicable, for the periods listed.

MONTH	HIGH (\$)	LOW (\$)	VOLUME
March 2015 ⁽¹⁾	0.07	0.05	120,476
February 2015	0.08	0.06	150,908
January 2015	0.07	0.05	117,043
December 2014	0.07	0.05	249,691
November 2014	0.08	0.06	138,705
October 2014	0.08	0.05	152,232
September 2014	0.09	0.06	131,891
August 2014	0.09	0.05	191,100
July 2014	0.07	0.05	75,923
June 2014	0.06	0.04	110,781
May 2014	0.07	0.05	105,386
April 2014	0.08	0.06	100,919
March 2014	0.09	0.06	218,405
February 2014	0.095	0.08	67,493
January 2014	0.11	0.075	161,587

Note:

(1) Up to and including March 31, 2015 being the date of the AIF.

9.2 Prior Sales of Unlisted Securities

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

9.3 Escrowed Securities

As of the date of this AIF, 60,000,000 Shares of the Company are being held in escrow pursuant to an Escrow Agreement dated January 2, 2015 between the Company, Apogee and Computershare Trust Company of Canada.

10. DIRECTORS AND OFFICERS

10.1 Name, Occupation and Security Holding

The following table sets forth the names and residencies of all directors and executive officers of the Company, the positions and offices with the Company held by such persons and their principal occupations. As of the date of this AIF, the directors and executive officers of the Company, as a group, beneficially own, or control or direct, directly or indirectly approximately 6.2% of the Company's Shares.

Name, Jurisdiction of Residence, Offices	Principal Occupation During Last Five Years⁽³⁾	Director/Officer Since	Number of Common Shares Beneficially Owned, Controlled or Directed, Directly or Indirectly⁽⁵⁾
John Lee Taipei, Taiwan, Interim CEO, Executive Chairman and Director	President of Mau Capital Management LLC (private investor relations firm) from July, 2004 to present; CEO of Prophecy Development Corp. from October, 2009 to November, 2012; Interim CEO of Prophecy Development Corp. from November, 2012 to present; Chairman of Prophecy Development Corp. from June, 2011 to January, 2013; Executive Chairman of Prophecy Development Corp. from January, 2013 to present	June 13, 2011 (Director of Pre-amalgamated company ⁽⁴⁾ since October 21, 2009)	15,240,590 ⁽⁶⁾
D. Greg Hall Vancouver, BC, Director ⁽¹⁾⁽²⁾	Self-employed businessman; Director of Silvercorp Metals Inc. from March, 2005 to September, 2010; Chairman and Director of Ivory Energy Inc., (junior oil and gas issuer listed on the TSX-V Exchange) from June, 2006 to March, 2009; Executive Vice-President, of Leede Financial Markets Inc. (investment brokerage house), from February, 2004 to February, 2005; Secretary and Director, of Makevco Consulting Inc. (private consulting company), from March, 2000 to present	June 13, 2011 (Director of Pre-amalgamated company ⁽⁴⁾ since October 21, 2009)	2,262,000 ⁽⁷⁾
Harald Batista Los Altos Hills, California, Director ⁽¹⁾⁽²⁾	Co-Founder, and consultant at Bayesco from August, 2012 to present; Power Messaging Coach at Corporate Visions Inc. from July, 2008 to present	July 27, 2012 (Special Advisor to Pre-amalgamated company ⁽⁴⁾ since January 5, 2010)	525,273
Masa Igata New Territories, Hong Kong, Director ⁽¹⁾⁽²⁾	Founder and CEO of Frontier Securities, (foreign investment bank in Mongolia) from March, 2007 to present	April 23, 2014	1,248,217 ⁽⁸⁾

Name, Jurisdiction of Residence, Offices	Principal Occupation During Last Five Years ⁽³⁾	Director/Officer Since	Number of Common Shares Beneficially Owned, Controlled or Directed, Directly or Indirectly ⁽⁵⁾
Irina Plavutska Port Coquitlam, BC, Chief Financial Officer	Controller, at C. Dikeakos Architects Inc. from August, 2006 to August, 2010; Controller, at Prophecy Development Corp. from August, 2010 to August, 2011; Interim CFO of Prophecy Development Corp. from August, 2011 to November, 2012; Controller at Prophecy Development Corp. from November, 2012 to September 9, 2013; CFO of Prophecy Development Corp. from September, 2013 to present	September 11, 2013	42,500
Tony Wong Vancouver, BC, Corporate Secretary	Senior Legal Counsel, at BC Securities Commission from November, 2005 to November, 2010; Senior Corporate Counsel at Global Relay Communications Inc. from December, 2010 to May, 2011; Lawyer (sole practitioner) from June, 2011 to January, 2014; General Counsel & Corporate Secretary of Prophecy Development Corp. from February, 2014 to present	February 3, 2014	28,000

Notes:

- (1) Member of the Audit Committee.
- (2) Member of the Corporate Governance and Compensation Committee.
- (3) The information as to principal occupation, business or employment and Shares beneficially owned or controlled is not within the knowledge of the management of Prophecy and has been furnished by the respective individuals. Each director or officer has held the same or similar principal occupation with the organization indicated or a predecessor thereof for the last five years.
- (4) Northern Platinum Ltd., Prophecy Holdings Inc. and Prophecy Resource Corp. were amalgamated on June 13, 2011 as one company under the name "Prophecy Resource Corp." Prophecy Resource Corp. changed its name to "Prophecy Coal Corp." on June 14, 2011. Prophecy Coal Corp. changed its name to "Prophecy Development Corp." on January 5, 2015.
- (5) The approximate number of Shares in all circumstances beneficially owned directly or indirectly, or over which control or direction is exercised by each director or officer as at the date hereof is based on information furnished by the named persons.
- (6) 10,593,170 of these Shares are held by Merit Holdings Ltd., a private company wholly owned and controlled by Mr. Lee.
- (7) 400,000 of these Shares are held by Makevco Consulting Inc., a private company owned by Mr. Hall and his spouse.
- (8) These Shares are held by Sophir Asia Limited, a private company wholly owned and controlled by Mr. Igata.

11. PROMOTERS

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

12. LEGAL PROCEEDINGS

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

Red Hill Mongolia Tax Claim

In Q4, 2014, Red Hill was issued a letter from the Sukhbaatar District Tax Division with the results of their VAT inspection of the 2009 -2013 tax imposition and payments, which resulted in an imposed VAT payable of MNT 2,654,175,507. Red Hill disagreed with the findings as the tax assessment appeared to be unfounded. The Company has been advised by its legal counsel that it is only possible, but not probable, that the action will succeed. The Company disputes the assessment and submitted a complaint to the Capital City Tax Tribunal. The Tribunal's decision is pending.

In the opinion of Prophecy, at December 31, 2014, a provision for this matter is not required.

ASC Bolivia Tax Claim

In connection with the transaction with Apogee, Prophecy has agreed to assume within certain limitations all liabilities, including legal and tax liabilities associated with the Apogee Subsidiaries and the Pulacayo Project. During Apogee's financial year ended June 30, 2014, it received notice from the Servicio de Impuestos Nacionales, the national tax authority in Bolivia that the Company's wholly owned subsidiary ASC Bolivia LDC Sucursal Bolivia owes approximately Bs42,000,000 (\$6,536,326) of taxes, interest and penalties relating to a historical tax liability which occurred in 2004, prior to Apogee acquiring the subsidiary in 2011. Apogee disclosed that it was not aware of this historical liability, originally assessed by the tax authority at an amount equivalent to approximately \$760,000 in 2004, and believes this notice was improperly provided. The Company disputes the assessment and is currently investigating the merits and legitimacy of same and has hired local counsel to investigate the matter further.

13. INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

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

14. REGISTRAR AND TRANSFER AGENT

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

15. MATERIAL CONTRACTS

Except for contracts entered into in the ordinary course of business, the only contracts entered into by the Company within the financial year ended December 31, 2014 and immediately prior to the date of this AIF that can reasonably be regarded as presently material to the Company are:

- (a) the Tariff Agreement dated May 14, 2013 between Prophecy Power and the Chandgana project working group designated by the Mongolian Ministry of Energy concerning tariff terms for 25 years for the coal mine mouth power plant project;
- (b) the CSA dated June 5, 2013 between Chandgana Coal LLC and Prophecy Power concerning the supply of 3.6 million tonnes of coal per year for 25 years;

- (c) the Consolidation Agreement dated August 15, 2014 between Chandgana Coal and Tugalgatai concerning the consolidation of the two entities into a newly-formed Mongolian company;
- (d) the Stock Purchase Agreement dated August 2014 between Prophecy and Cosmo concerning the purchase by Cosmo of 34% of the issued and outstanding common shares of Prophecy Power;
- (e) the Share Purchase Agreement dated November 3, 2014 between Prophecy and Apogee concerning the purchase by Prophecy of the Apogee Subsidiaries from Apogee;
- (f) the Amendment to Share Purchase Agreement dated December 3, 2014 between Prophecy and Apogee concerning the purchase by Prophecy of the Apogee Subsidiaries from Apogee;
- (g) the Escrow Agreement dated January 2, 2015 among Prophecy, Apogee and Computershare Trust Company of Canada concerning the escrow of 60,000,000 Shares paid to Apogee by Prophecy for the Apogee Subsidiaries; and
- (h) the credit facility agreement dated March 12, 2015 between Prophecy and Linx Partners Ltd. concerning the revolving credit facility of up to \$1.5 million at 18% annual interest available to Prophecy.

The material contracts specified above, which are required to be filed, are available under the Company's SEDAR profile at www.SEDAR.com.

16. INTERESTS OF EXPERTS

Prophecy retained Wardrop to prepare an independent NI 43-101 pre-feasibility report on the Ulaan Ovoo Property located in Mongolia. The Ulaan Ovoo Technical Report is referenced in Section 1.4 of this AIF - *Documents Incorporated by Reference*.

Prophecy retained Kravits Geological Services, LLC to prepare an independent NI 43-101 report on the Khavtgai Uul Property located in Mongolia. The Chandgana Technical Report is referenced in Section 1.4 of this AIF - *Documents Incorporated by Reference*.

Prophecy retained Boyd to prepare an independent NI 43-101 report on the coal resources and preliminary economic assessment on the Chandgana Tal Coal Project. The PEA is referenced in Section 1.4 of this AIF.

Davidson & Company LLP, Chartered Accountants prepared the auditor's report for the audited annual financial statements of Prophecy for the year ended December 31, 2014. Davidson & Company LLP is an independent auditor in accordance with the Rules of Professional Conduct of the Institute of Chartered Accountants of British Columbia.

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

17. ADDITIONAL INFORMATION

Additional information relating to the Company:

- (a) may be found under the Company's SEDAR profile at www.SEDAR.com;
- (b) including directors and officers remuneration and indebtedness, principal holders of the Company's securities and securities authorized for issuance under equity compensation plans is

contained in the Information Circular for the Company's most recent annual meeting of shareholders; and

- (c) is provided in the Company's financial statements and management discussion and analysis for its most recently completed financial year.

18. CORPORATE GOVERNANCE

18.01 Audit Committee

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

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

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

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

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

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

Pre-Approval Policies and Procedures

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

External Auditor Service Fees (By Category)

The aggregate fees billed by the Company's external auditors in each of the last two fiscal years for audit fees are as follows:

Financial Year Ending	Audit Fees ⁽¹⁾	Audit Related Fees ⁽²⁾	Tax Fees ⁽³⁾	All Other Fees ⁽⁴⁾
December 31, 2014	\$160,000	\$0	\$15,000	\$0
December 31, 2013	\$180,000	\$0	\$15,000	\$0

Notes:

- (1) "Audit Fees" include fees necessary to perform the annual audit and quarterly reviews of the Company's financial statements and includes the fees of the Company's auditor, Davidson & Company LLP for 2014 and 2013. Audit fees also include fees for review of tax provisions and for accounting consultations on matters reflected in the financial statements. Audit Fees also include audit or other attest services required

by legislation or regulation, such as comfort letters, consents, reviews of securities filings and statutory audits.

- (2) **"Audit-Related Fees"** include services that are traditionally performed by the auditor. These audit-related services include employee benefit audits, due diligence assistance, accounting consultations on proposed transactions, internal control reviews and audit or attest services not required by legislation or regulation.
- (3) **"Tax Fees"** include fees for all tax services other than those included in **"Audit Fees"** and **"Audit-Related Fees"**. This category includes fees for tax compliance, tax planning and tax advice. Tax planning and tax advice includes assistance with tax audits and appeals, tax advice related to mergers and acquisitions, and requests for rulings or technical advice from tax authorities.
- (4) **"All Other Fees"** include all other non-audit service.

18.02 Corporate Governance and Compensation Committee

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

APPENDIX "A"

AUDIT COMMITTEE CHARTER

1. Purpose: Responsibilities and Authority

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

(a) Relationship with Independent Auditor.

(i) Subject to the laws of British Columbia as to the role of the Shareholders in the appointment of independent auditors, the Committee shall have the sole authority to appoint or replace the independent auditor.

(ii) The Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work.

(iii) The independent auditor shall report directly to the Committee.

(iv) The Committee shall approve in advance all audit and permitted non-audit services of the independent auditor, including the terms of the engagements and the fees payable; provided that the Committee Chair may approve services to be performed by the independent auditors and the fee therefore between Committee meetings if the amount of the fee does not exceed \$20,000, provided that any such approval shall be reported to the Committee at the next meeting thereof. The Committee may delegate to the Chief Financial Officer ("**CFO**") or a subcommittee the authority to grant pre-approvals of audit and permitted non-audit services, provided that the decision of the CFO or any such subcommittee shall be presented to the full Committee at its next scheduled meeting.

(v) At least annually, the Committee shall review and evaluate the experience and qualifications of the lead partner and senior members of the independent auditor team.

(vi) At least annually, the Committee shall obtain and review a report from the independent auditor regarding:

(A) the independent auditor's internal quality-control procedures;

(B) any material issues raised by the most recent internal quality-control review, or peer review, of the auditor, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the firm;

(C) any steps taken to deal with any such issues; and

(D) all relationships between the independent auditor and the Company.

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

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

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

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

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

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

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

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

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

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

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

(C) other material written communications between the independent auditor and management since the prior report, such as any management letter or schedule of unadjusted differences, the development, selection and disclosure of critical accounting estimates, and analyses of the effect of alternative

assumptions, estimates or IFRS methods on the Company's financial statements.

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

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

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

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

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

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

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

(d) **Compliance and Oversight.**

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

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

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

(iv) At least annually and prior to the filing of the Annual Information Form ("**AIF**"), the Committee shall review with management and the independent auditor the disclosure controls and procedures and confirm that the Company (with CEO and CFO participation) has evaluated the effectiveness of the design and operation of the controls within 90 days prior to the date of filing of the AIF. The Committee also shall review with management

and the independent auditor any deficiencies in the design and operation of internal controls and significant deficiencies or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.

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

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

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

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

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

(e) **Related Party Transactions.**

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

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

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

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

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

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

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

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

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

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

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

2. **Structure and Membership**

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

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

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

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

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

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

3. **Procedures and Administration**

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

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

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

Executive Chairman.

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

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

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

4. Additional Powers

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

5. Limitation of Committee's Role

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

6. Committee Member Independence and Financial Literacy Requirements

A. Independence

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

B. Financial Literacy Requirements

NI 52-110

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

Section 1.6 defines the meaning of financial literacy as follows:

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