



**Management's Discussion and Analysis of Financial  
Condition and Results of Operations  
For the three months ended March 31, 2016**  
(Expressed in Canadian Dollars, except where indicated)

## TABLE OF CONTENTS

1. INTRODUCTION .....	3
2. CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS.....	4
3. FIRST QUARTER HIGHLIGHTS AND SIGNIFICANT EVENTS.....	5
4. PROPERTY SUMMARY.....	6
5. SUMMARY OF QUARTERLY RESULTS .....	9
6. DISCUSSION OF OPERATIONS .....	9
7. LIQUIDITY AND CAPITAL RESOURCES .....	10
8. CONTINGENCIES .....	12
9. RELATED PARTY DISCLOSURES .....	12
10. CRITICAL ACCOUNTING POLICIES AND ESTIMATES .....	14
11. ACCOUNTING CHANGES AND RECENT ACCOUNTING PRONOUNCEMENTS.....	14
12. FINANCIAL INSTRUMENTS AND RELATED RISKS .....	14
13. RISKS AND UNCERTAINTIES .....	16
14. DISCLOSURE CONTROLS AND PROCEDURES .....	16
15. DISCLOSURE OF OUTSTANDING SHARE DATA.....	17
16. OFF-BALANCE SHEET ARRANGEMENTS .....	17

## PROPHECY DEVELOPMENT CORP.

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

For the three months ended March 31, 2016

(Expressed in Canadian Dollars, except where indicated)

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## 1. INTRODUCTION

This Management's Discussion and Analysis ("MD&A") of Prophecy Development Corp. and its subsidiaries ("Prophecy", or the "Company") was prepared by management as at May 12, 2016 and was reviewed, approved, and authorized for issue by the Company's Audit Committee. The following discussion of performance, financial condition and future prospects should be read in conjunction with the unaudited condensed interim consolidated financial statements of the Company and notes thereto for the three months ended March 31, 2016 prepared in accordance with International Financial Reporting Standards ("IFRS"), applicable to the preparation of interim financial statements, including International Accounting Standard ("IAS") 34 Interim Financial Reporting, as issued by the International Accounting Standards Board. This MD&A should be read also in conjunction with both the audited annual consolidated financial statements for the year ended December 31, 2015 (prepared in accordance with IFRS) ("Annual Financial Statements") and the related annual MD&A ("Annual MD&A") dated March 29, 2016, and the 2015 Annual Information Form ("AIF"), all of which are available under the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com).

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

### Description of Business

Prophecy is a company amalgamated under the laws of the Province of British Columbia, Canada. The Company's Common shares (the "Shares") are listed for trading on the Toronto Stock Exchange (the "TSX") under the symbol "PCY" and the Frankfurt Stock Exchange under the symbol "1P2".

The principal business of the Company is the acquisition, exploration and development of mineral, mining and energy projects in Mongolia, Bolivia and Canada. The Company owns a 100% interest in the following significant coal projects in Mongolia: the Ulaan Ovoo coal property, the Khavtgai Uul and Chandgana Tal coal deposits collectively known as the "Chandgana Coal Properties" and the Pulacayo Paca silver-lead-zinc property (the "Pulacayo Project") in Bolivia. The Company is focusing on building a successful and profitable intermediate development company. The Company's strategy is to actively pursue growth opportunities by securing financing, further improving operational efficiencies and reducing costs, delivering value through marketing and coal and mineral 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.

### General Corporate Information:

At March 31, 2016 and May 12, 2016, Prophecy had: (i) 365,570,454 and 368,521,550 Shares issued and outstanding, respectively; (ii) 30,284,167 and 30,081,417 stock options for Shares outstanding, respectively; and (iii) 52,210,384 warrants for Shares outstanding.

### Investor and Contact Information

All financial reports, news releases and corporate information can be accessed on our web site at [www.prophecydev.com](http://www.prophecydev.com)  
Investor & Media requests and queries: Bekzod Kasimov  
Tel: +1-604-563-0699 Email: [ir@prophecydev.com](mailto:ir@prophecydev.com)

### Transfer Agents and Registrars

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## PROPHECY DEVELOPMENT CORP.

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

For the three months ended March 31, 2016

(Expressed in Canadian Dollars, except where indicated)

---

#### Directors and Officers

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

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

#### Qualified Persons

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

## 2. CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

*This document contains forward-looking statements within the meaning of applicable Canadian securities legislation concerning anticipated developments in the Company's continuing and future operations in Mongolia and Bolivia, the adequacy of the Company's financial resources and financial projections. Such forward-looking statements include but are not limited to statements regarding the permitting, feasibility, plans for development and production of Prophecy's Chandgana power plant, including finalizing of any power purchase agreement; the likelihood of securing project financing; estimated future coal production at the Ulaan Ovoo coal property and the Chandgana Coal Properties; development of the Pulacayo Project and other information concerning possible or assumed future results of operations of Prophecy. See in particular, the sections Select Financial and Operational Data and 2016 Outlook descriptions under Part 4 – Property Summary.*

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

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

## PROPHECY DEVELOPMENT CORP.

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

For the three months ended March 31, 2016

(Expressed in Canadian Dollars, except where indicated)

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

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

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

### 3. FIRST QUARTER HIGHLIGHTS AND SIGNIFICANT EVENTS

For further information please view the Company's 2016 news releases under the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com).

- On January 25, 2016, the Company closed a non-brokered private placement involving the issuance of 8,000,000 units at a price of \$0.025 per unit. Each unit consists of one Share in the capital of the Company and one Share purchase warrant. Each warrant entitles the holder to acquire an additional Share at a price of \$0.04 per Share for a period of five years from the date of issuance.
- The Company entered into settlement and release agreements with certain of its officers, employees and consultants to settle various debts owing to them. Pursuant to the terms of those settlement and release agreements, the Company issued 1,320,643 Shares at a value of \$0.025 per Share, 6,138,499 Shares at a value of \$0.03 per Share and 7,364,528 Shares at a value of \$0.02 per Share to those officers, employees and consultants through its Share-Based Compensation Plan.
- On January 29, 2016, the Company announced that after a detailed review of the trading volume, costs and administrative requirements related to maintaining the Company's listing on the OTCQX International, it has voluntarily delisted its Shares from the OTCQX International effective January 29, 2016.
- On February 24, 2016, the Company entered into an agreement (the "**Second Amendment**") to increase and amend the revolving credit facility agreement dated March 12, 2015, as amended (the "**Credit Facility**"), with Linx Partners Ltd. ("**Linx**") a company controlled by Mr. John Lee, Executive Chairman of Prophecy. The previous maximum principal amount of \$1.5 million available to the Company under the Credit Facility will be increased with the Second Amendment to \$2.5 million. The Credit Facility, will fund

## PROPHECY DEVELOPMENT CORP.

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

For the three months ended March 31, 2016

(Expressed in Canadian Dollars, except where indicated)

---

Prophecy's ongoing business operations, bears an interest rate of 1.5% per month and is secured by promissory notes and a general security agreement.

A 5% "drawdown" fee will be applicable to amounts advanced over and above the original and outstanding \$1.5 million advanced under the Credit Facility, at the time of advance. In consideration of a bonus of 20% of the total amounts advanced under the Credit Facility, as of November 30, 2015 (the "**Bonus**"), Linx has agreed to postpone any repayments due under the Credit Facility, until the earlier of October 1, 2016, or such time as the Company is in a reasonable financial position to repay all or a portion of the amounts owing, and remove the requirement for the Company to pay any 20% penalties as a result of any future failure to repay any amounts when due under the terms of the Credit Facility. Including the Bonus and "drawdown" fee, the Credit Facility, carries an effective annual interest rate of 34.5%. The "drawdown" fee, Bonus and all interest payable will be accrued and added to the maximum principal amount as they are incurred.

- On March 30, 2016, the Company entered into a Debt Settlement Agreement with Linx and Mr. Lee pursuant to which, the Company agreed, subject to the approval of shareholders at the Company's upcoming 2016 Annual General Meeting to be held at 9:00 a.m. (PST) on June 2, 2016 (the "**2016 AGM**") and acceptance by the TSX, to issue 75,000,000 units (the "**Units**") to Mr. Lee, in satisfaction of \$1,500,000 of indebtedness currently owed by the Company to Linx under the Credit Facility. Each Unit consists of one Share and one Share purchase warrant (a "**Linx Warrant**"). Each Linx Warrant entitles the holder to acquire an additional Share at a price of \$0.04 per Share for a period of five years from the date of issuance.
- On March 30, 2016, the Company announced that it proposes to consolidate its issued and outstanding Shares on the basis of one (1) new Share for every one hundred (100) old Shares outstanding (the "**Consolidation**") subject to the approval of shareholders at the 2016 AGM and acceptance by the TSX. The effective date of the Consolidation, if approved, will occur immediately after TSX approval.

#### *Subsequent to period end*

- The Company issued 300,000 and 2,651,096 Shares through the Company's Share-Based Compensation Plan to Cor Capital Inc., who provides certain investor relations and shareholder communication services to the Company and to Nargil Molor, an insider of the company, to settle all outstanding debts owed to her, respectively.
- The Company paid off and closed out the US\$1.5 million line of credit facility with the Trade and Development Bank of Mongolia ("**LOC**").

For further information please view the Company's 2016 news releases under the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com).

## 4. PROPERTY SUMMARY

### Highlights on Pulacayo Project

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

#### **Select Financial and Operational Data**

Q1 2016

On January 2, 2015, pursuant to the terms of the acquisition agreement entered into between the Company and Apogee Silver Ltd. ("**Apogee**"), Prophecy acquired the Pulacayo Project in Bolivia through the acquisition of the issued and outstanding shares of ASC Holdings Limited and ASC Bolivia LDC, which together, hold the issued and outstanding shares of ASC Bolivia LDC Sucursal Bolivia. ASC Bolivia LDC Sucursal Bolivia controls the mining rights to the concessions through a separate joint venture agreement with the Pulacayo Ltda. Mining Cooperative who hold the mining rights through a lease agreement with state owned Mining Corporation of

## **PROPHECY DEVELOPMENT CORP.**

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

**For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

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Bolivia, COMIBOL.

The Pulacayo Project comprises 7 concessions covering an area of approximately 3,550 hectares of contiguous mining concessions centered on the historical Pulacayo mine and town site. The Environmental Impact Assessment for the Pulacayo Project was approved by the Ministry of Environment and Water of Bolivia in October 2013. The approval of the Environmental Impact Assessment allows for mine and concentrator construction with a targeted production rate of up to 560tpd at the Pulacayo Project.

On acquisition of the project, the Company implemented its fast-track development schedule of the project. During 2015 through Q1 2016, activities by the Company on the Pulacayo Project included exploration, completion of resource estimates, progress to resolve legacy financial obligations, hiring key personnel, and relinquishment of concessions

An exploration permit application was submitted during early 2015, but as of the date of this MD&A, the application was still under review. The exploration permit would allow geophysical work to complete Phase 1 then after review of the Phase 1 information and previous exploration information and planning, completion of Phase 2.

During the quarter ending March 31 2016, the Company incurred total costs of \$174,395 (same period 2015 – \$398,591) for the Pulacayo project including \$Nil (same period 2015 – \$192,988) for licenses, \$71,233 (same period 2015 – \$79,150) for geological and engineering consulting, and \$103,162 (same period 2015 – \$126,453) for personnel and general expenses.

#### **2016 Outlook**

The Company intends to develop the Pulacayo Project which includes assessing the mineral resource potential, mine re-opening and possible construction of a processing facility on site. Exploration will continue including the exploration to prove the planned stopes, completing the exploration plan to assess the mineral resource potential and tailings, continue with securing approval of the exploration permit, and the required exploration to maintain the concessions. The work toward mine re-opening and construction of a processing facility will continue including assessing financing options.

#### **Highlights on Ulaan Ovoo Coal Property**

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

#### **Select Financial and Operational Data**

Q1 2016

During the first quarter of 2016, the Company continued to keep the Ulaan Ovoo operations on standby. Modest sales from existing coal stockpiles continued. During the quarter, the mine shipped approximately 760 tonnes (same period 2015 – 26,400 tonnes) of coal to local customers from existing stockpiles. Total coal sales revenue of \$24,090 (same period 2015 – \$0.6 million) was realized during this period. The coal stockpile balance was approximately 80,800 tonnes. During the first quarter of 2016, the Company incurred operating costs of approximately \$93,000 (same period 2015 – \$1.3 million).

Revenue generating, cost reduction and debt reduction efforts continued. The Company has significantly reduced its general and administrative expenses, staff levels and associated expenses.

The required exploration for the Khujirt license was completed during January 2016. The Company decided to consider sale of the license and approached parties that may be interested but a sale was not completed.

#### **2016 Outlook**

Prophecy will continue to maintain Ulaan Ovoo on standby and reassess its production decision again in the summer of 2016. The Company will continue with the sale and loading of stockpiled coal with the goal of completing the sale of all remaining coal by summer 2016.

## **PROPHECY DEVELOPMENT CORP.**

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

**For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

---

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

Prophecy will continue to pursue government support to pave the 136km road between the Ulaan Ovoo mine and the Sukhbaatar railway station, as well as to build a 56km 35kv power line from nearby Tsagaannuur soum to bring power to Ulaan Ovoo. Both infrastructure initiatives, if implemented, will significantly reduce the operating cost of Prophecy's Ulaan Ovoo operation and increase the likelihood of sustainable mining operations at Ulaan Ovoo.

Drilling required as part of the annual license diligence is planned for the Khujirt license. The potential sale of the license will continue to be pursued.

At the current stage, the Company is unable to determine when improvement will materialize and if it does, be sustainable, when, if at all, greater access to Russian coal markets will be realized, the extent of project changes and operational modifications required and the time and degree they will improve profitability, and the full potential value of the coal resource will be realized.

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

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

#### ***Select Financial and Operational Data***

Q1 2016

During the first quarter of 2016, the Company incurred total costs of \$20,995 (same period 2015 – \$63,466) for the Chandgana Tal Property (including power plant consultants and land maintenance costs) and \$29,309 (same period 2015 – \$50,881) for the Khavtgai Uul Property. The Company worked with the Mineral Resources Authority of Mongolia to remove an environmentally sensitive portion of the Khavtgai Uul license which resulted in a reduction of the license maintenance cost.

#### ***2016 Outlook***

The Company plans to continue normal license maintenance work (payment of fees and environmental work) for Chandgana Tal. Work on the Khavtgai Uul license will include the required exploration report and other license maintenance work in order to retain exploration rights to the license.

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

There was no major activity during the quarter.

#### ***2016 Outlook***

The Company actively pursues the remaining agreements, approvals and permits required to proceed with the development of the Chandgana power plant project. The Company intends to conclude three major agreements with the government on the Chandgana power plant – the tariff agreement, power purchase agreement and concession agreement in 2016. Prophecy also continues to actively consider project financing options which include either debt, equity or a combination thereof in addition to joint ventures with international power project developers. Otherwise regular land use right maintenance work will continue.

**PROPHECY DEVELOPMENT CORP.**  
**Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**For the three months ended March 31, 2016**  
(Expressed in Canadian Dollars, except where indicated)

**5. SUMMARY OF QUARTERLY RESULTS**

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

	2016		2015	
	Q1	Q4	Q3	Q2
Operating expense	\$ (305,697)	\$ (540,153)	\$ (481,915)	\$ (805,826)
Net loss	(126,419)	(3,884,097)	(831,656)	(1,112,025)
Net loss per share, basic and diluted	\$ (0.00)	\$ (0.01)	\$ (0.00)	\$ (0.00)
Comprehensive loss	(126,419)	(3,884,097)	(831,656)	(1,112,025)
Comprehensive loss per share, basic and diluted	\$ (0.00)	\$ (0.01)	\$ (0.00)	\$ (0.00)

  

	2015		2014	
	Q1	Q4	Q3	Q2
Operating expense	\$ (565,716)	\$ (908,565)	\$ (381,890)	\$ (551,125)
Net loss	(1,994,753)	(12,624,317)	(997,563)	(874,952)
Net loss per share, basic and diluted	\$ (0.01)	\$ (0.05)	\$ (0.00)	\$ (0.00)
Comprehensive loss	(1,994,753)	(12,624,317)	(997,563)	(874,952)
Comprehensive loss per share, basic and diluted	\$ (0.01)	\$ (0.05)	\$ (0.00)	\$ (0.00)

**6. DISCUSSION OF OPERATIONS**

All of the information described below is accounted for in accordance with IFRS. The reader is encouraged to refer to Note 6 of the Company's Annual Financial Statements for the year ended December 31, 2015 for Prophecy's IFRS accounting policies. For discussion on each project, the reader is encouraged to refer to the "Business Overview" section of this MD&A.

For the three months ended March 31, 2016, Prophecy incurred operating expenses of \$305,697 compared to \$565,716 incurred for the same period in 2015.

Operating Expenses	Three months ended March 31,	
	2016	2015
Advertising and promotion	\$ 23,438	\$ 20,640
Consulting and management fees	49,132	108,499
General and administrative expenses	204,710	293,966
Professional fees	-	51,897
Share-based payments	20,898	46,004
Travel and accommodation	7,519	44,710
	\$ 305,697	\$ 565,716

The decrease by \$260,019 in operating expenses was a result of cost cutting initiatives across the Company. Of note are the following items:

- Consulting and management fees decreased by \$59,367 mainly due to a reduction of CEO's compensation.
- General and administrative expenses decreased by \$89,256. The decrease was due primarily to decreased director fees, salaries and office expenses.
- Professional fees decreased by \$51,897 due to no legal or accounting fees incurred in Q1 2016.
- Travel and accommodation expense decreased by \$37,191 due to reduced corporate travel costs.

For the three months ended March 31, 2016, the Company incurred other expenses classified as "Other Items" amounting to a gain of \$179,278 compared to a loss \$1,429,037 for the same period of 2015.

**PROPHECY DEVELOPMENT CORP.****Management's Discussion and Analysis of Financial Condition and Results of Operations****For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

Other Items	Three months ended March 31,	
	2016	2015
Costs in excess of recovered coal	31,437	1,318,174
Finance cost	307,353	-
Foreign exchange loss/(gain)	(538,125)	101,111
Gain on sale of available-for-sale investment	(59,698)	-
Interest expense	79,755	9,752
	\$ (179,278)	\$ 1,429,037

The decrease by \$1,608,315 is the net result of changes to a number of other items. Of note are the following items:

- Costs in excess of recovered coal were reduced by \$1,286,737 due to keeping operations at Ulaan Ovoo mine on standby;
- In Q1 2016, the Company incurred finance cost of \$307,353 associated with the Credit Facility;
- Foreign exchange gain of \$538,125 was due to fluctuations in the value of the Canadian dollar compared to the Mongolian tugrik, Bolivian boliviano, and the United States dollar;
- In Q1 2016, the Company recorded a gain on sale of a total of 335,266 of remaining Wellgreen Platinum shares released from trust of \$59,698 with no available-for-sale investments to be sold in Q1 2015;
- Increase in interest expense by \$ 70,003 was due to interest charges related to the Credit Facility.

**7. LIQUIDITY AND CAPITAL RESOURCES**

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

**Working Capital**

At March 31, 2016 Prophecy had cash of \$52,659, representing an increase of \$19,117 from the \$33,542 held at December 31, 2015. Working capital deficit amounted to \$4.0 million at March 31, 2016 compared to working capital deficit of \$3.89 million as at December 31, 2015.

During the three months ended March 31, 2016, the Company raised \$186,000 in equity financing and received \$94,198 from Guaranteed Investment Certificate redemption and sale of Wellgreen Platinum shares released from trust.

As at the date of this MD&A, the Company had a total outstanding balance of \$2.28 million under the Credit Facility. The Company has entered into a Debt Settlement Agreement with Linx and Mr. Lee pursuant to which, the Company has agreed, subject to the approval of shareholders at the Company's upcoming 2016 AGM and acceptance by the TSX, to issue 75,000,000 Units to Mr. Lee, in satisfaction of \$1.5 million of indebtedness owed by the Company to Linx under the Credit Facility.

As at the date of this MD&A, the Company fully repaid and closed out the LOC.

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

## PROPHECY DEVELOPMENT CORP.

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

For the three months ended March 31, 2016

(Expressed in Canadian Dollars, except where indicated)

Credit Facility, which may limit the Company's ability to access future funding. These factors, and others, are considered when shaping the Company's capital management strategy.

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

#### Cash Flow Highlights

	Three months ended March 31	
	2016	2015
Cash provided by operating activities	\$ 68,590	\$ 378,140
Cash provided by (used in) investing activities	(327,450)	(1,285,247)
Cash provided by financing activities	277,977	989,208
Increase (decrease) in cash for period	19,117	82,101
Cash balance, beginning of period	33,542	200,994
Cash balance, end of period	\$ 52,659	\$ 283,095

**Operating activities:** Cash provided by operating activities was \$68,590 during Q1 2016 compared to cash provided of \$378,140 during Q1 2015. The Company will require financing in the near term to fund operations.

**Investing activities:** Cash used by investing activities totalled \$327,450 in Q1 2016 compared to \$1,285,247 cash used in Q1 2015. The Company spent \$421,648 on capital additions and received \$94,198 from GIC redemption and sale of Wellgreen Platinum shares released from trust. In Q1 2015, the Company spent \$1,048,023 on capital additions and paid 237,224 to acquire the Apogee Subsidiaries.

**Financing activities:** A total of \$277,977 was provided by financing activities during Q1 2016 compared to \$989,208 cash provided in Q1 2015. In Q1 2016, The Company received \$147,068 from the Credit Facility, \$186,000 from issuing shares in a private placement, paid \$45,143 toward the LOC outstanding balance and related interest of \$9,948. In Q1 2015, the Company received \$1,064,280 from the Credit Facility and paid \$75,072 toward the LOC outstanding balance.

#### Contractual Commitments

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

#### Capital Risk Management

Prophecy considers its capital structure to consist of share capital, share options and warrants. The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the exploration and development of its projects and to pursue and support growth opportunities. The Board of Directors does not establish quantitative returns on capital criteria for management. The overall objectives for managing capital remained unchanged in 2016 from the prior comparative period.

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

## **PROPHECY DEVELOPMENT CORP.**

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

**For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

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## **8. CONTINGENCIES**

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

### **ASC Tax Claim**

Pursuant to the terms of the acquisition agreement, Prophecy agreed to assume all liabilities of the Apogee Subsidiaries, including legal and tax liabilities associated with the Pulacayo Project. During Apogee's financial year ended June 30, 2014, it received notice from the Servicio de Impuestos Nacionales, the national tax authority in Bolivia, alleging that ASC Bolivia LDC Sucursal Bolivia, the Company's wholly-owned subsidiary, owed approximately Bs42,000,000 (\$6,813,611) in taxes, interest and penalties relating to a historical tax liability in an amount originally assessed at approximately \$760,000 in 2004, prior to Apogee acquiring the subsidiary in 2011. Apogee disputed the assessment and disclosed to the Company that it believed the notice was improperly issued. The Company continued to dispute the assessment and hired local legal counsel to pursue an appeal of the tax authority's assessment on both substantive and procedural grounds.

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

### **Red Hill Tax Claim**

During the year ended December 31, 2014, Red Hill was issued a letter from the Sukhbaatar District Tax Division notifying it of the results of the Sukhbaatar District Tax Division's VAT inspection of Red Hill's 2009-2013 tax imposition and payments that resulted in validating VAT credit of only MNT235,718,533 from Red Hill's claimed VAT credit of MNT2,654,175,507. Red Hill disagreed with the Sukhbaatar District Tax Division's findings as the tax assessment appeared to the Company to be unfounded. The Company disputed the Sukhbaatar District Tax Division's assessment and submitted a complaint to the Capital City Tax Tribunal. On March 24, 2015, the Capital City Tax Tribunal resolved to refer the matter back to the Sukhbaatar District Tax Division for revision and separation of the action between confirmation of Red Hill's VAT credit, and the imposition of the penalty/deduction for the tax assessment. The Sukhbaatar District Tax Division appealed the Capital City Tax Tribunal's resolution to the General Tax Tribunal office, but was denied on June 4, 2015 on procedural grounds. As a result, the Sukhbaatar District Tax Division implemented the Capital City Tax Tribunal's resolution on June 25, 2015, finding: (1) with respect to confirmation of Red Hill's VAT credit, that after inspection the amount was to be MNT235,718,533; and (2) with respect to the imposition of the penalty/deduction for the tax assessment, that no penalty was to be issued but that Red Hill's loss to be depreciated and reported to be MNT1,396,668,549 in 2010 and MNT4,462,083,700 in 2011. The Company continues to dispute the Sukhbaatar District Tax Division's assessment and delivered a complaint to Capital City Tax Tribunal on July 24, 2015. Due to the uncertainty of realizing the VAT balance, the Company has recorded an impairment charge for the full VAT balance at December 31, 2015. As there were no changes from January 1 to March 31, 2016, the impaired value of \$Nil for VAT receivable remains unchanged.

## **9. RELATED PARTY DISCLOSURES**

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

- Linx Partners Ltd., a private company controlled by John Lee, Director, CEO and Executive Chairman of Prophecy, provides management and consulting services to the Company.
- MaKevCo Consulting Inc., a private company 50% owned by Greg Hall, Director of Prophecy, provides consulting services to the Company.
- Sophir Asia Ltd., a private company controlled by Masa Igata, Director of Prophecy, provides consulting services to the Company.

**PROPHECY DEVELOPMENT CORP.****Management's Discussion and Analysis of Financial Condition and Results of Operations****For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

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

<b>Related parties</b>	<b>Three months ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
Directors and officers	\$ 87,751	\$ 77,021
Linx Partners Ltd.	52,500	113,988
MaKevCo Consulting Inc.	3,800	11,519
Sophir Asia Ltd.	3,500	18,743
	\$ 147,550	\$ 221,271

The amounts due to related parties are non-interest bearing and are due upon demand.

See Note 10 to consolidated financial statements for information regarding the Company's Credit Facility with Linx.

As at the date of this MD&A, the Company had a total outstanding balance of \$2.28 million under the Credit Facility. The Company has entered into a Debt Settlement Agreement with Linx and Mr. Lee pursuant to which, the Company has agreed, subject to the approval of shareholders at the Company's upcoming 2016 AGM and acceptance by the TSX, to issue 75,000,000 Units to Mr. Lee, in satisfaction of \$1.5 million of indebtedness owed by the Company to Linx under the Credit Facility.

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

<b>Related parties</b>	<b>Three months ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
Consulting and management fees	\$ 28,500	\$ 91,190
Directors' fees	10,800	40,503
Mineral properties	39,000	22,797
Salaries and benefits	69,250	66,780
	\$ 147,550	\$ 221,271

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

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

As at March 31, 2016, deferred compensation totalled \$70,800 which was classified as current liabilities on the statement of financial position.

During the three months ended March 31, 2016, the Company's officers received their reduced salaries in the form of Shares to conserve cash resources (Note 11(b) to consolidated financial statements).

As at March 31, 2016, amounts due to related parties (excluding deferred compensation) totaled of \$90,620 (December 31, 2015 – \$129,891) and was comprised of \$57,250 (December 31, 2015 - \$54,060) for director fees, \$Nil (December 31, 2015 - \$2,400) for consulting fees, \$Nil (December 31, 2015 - \$9,600) for managing mineral properties, \$33,370 (December 31, 2015 - \$63,831) for salaries and reimbursable expenses.

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

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

**PROPHECY DEVELOPMENT CORP.****Management's Discussion and Analysis of Financial Condition and Results of Operations****For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

<b>Key Management Personnel</b>	<b>Three months ended March 31,</b>			
		<b>2016</b>		<b>2015</b>
Salaries and short term benefits	\$	69,250	\$	67,637
Share-based payments		29,181		36,182
	\$	98,430	\$	103,819

**10. CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The Company's consolidated financial statements are prepared in accordance with IFRS as issued by the IASB. The Company followed the same accounting policies and methods of computation in the Annual Financial Statements for the three months ended March 31, 2016. The significant accounting policies applied and recent accounting pronouncements are described in Notes 4 and 6 to the Annual Financial Statements.

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

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

**11. ACCOUNTING CHANGES AND RECENT ACCOUNTING PRONOUNCEMENTS**

There were no previously undisclosed significant accounting pronouncements issued during the period ended March 31, 2016.

**12. FINANCIAL INSTRUMENTS AND RELATED RISKS**

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

**Financial Instruments**

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

**Related Risks****(a) Liquidity risk**

Liquidity risk is the risk that an entity will be unable to meet its financial obligations as they fall due. The Company manages liquidity risk by preparing cash flow forecasts of upcoming cash requirements. As at March 31, 2016, the Company had a cash balance of \$52,659 (December 31, 2015 – \$33,542) in order to meet short-term business requirements.

## **PROPHECY DEVELOPMENT CORP.**

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

**For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

---

At March 31, 2016, the Company had accounts payable and accrued liabilities of \$2,105,243 (December 31, 2015 - \$2,637,557), which have contractual maturities of 90 days or less and lines of credit payments of \$2,378,495. The Company is seeking financing in order to be in a position to satisfy its current liabilities.

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

#### (b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risk primarily associated to cash and cash equivalents and receivables, net of allowances. The significant concentration of credit risk is situated in Mongolia. The carrying amount of assets included on the statements of financial position represents the maximum credit exposure.

#### (c) Market risk

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

##### (i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. As at March 31, 2016, the Company drew down \$2,224,851 on its Credit Facility, bearing an interest rate of 18% per annum and had an outstanding balance of \$153,644 of LOC facility bearing an annual coupon rate of 17.4% with monthly interest payments. Due to the short-term nature of these financial instruments, and that the Company's line of credit bears interest at fixed rate, fluctuations in market rates do not have a significant impact on the fair values or future cash flows of the financial instruments as of March 31, 2016. The Company manages interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity.

##### (ii) Foreign currency risk

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

Based on the above, net exposures as at March 31, 2016, with other variables unchanged, a 10% (December 31, 2015 – 10%) strengthening (weakening) of the Canadian dollar against the Mongolian tugrik would impact net loss with other variables unchanged by \$88,000. A 10% strengthening (weakening) of the Canadian dollar against the Bolivian boliviano would impact net loss with other variables unchanged by \$681,000. A 10% (December 31, 2015 – 10%) strengthening (weakening) of the US dollar against the Canadian dollar would impact net loss with other variables unchanged by \$63,000. The Company currently does not use any foreign exchange contracts to hedge this currency risk.

##### (iii) Commodity and equity price risk

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

## **PROPHECY DEVELOPMENT CORP.**

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

**For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

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taken by the Company. Fluctuations in value may be significant.

#### **13. RISKS AND UNCERTAINTIES**

Readers should carefully consider the risks and uncertainties described in the Company's most recently filed AIF "Risk Factors" page 77 which is available under the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com). Additional risks not currently known to the Company, or that the Company currently deems immaterial, may also impair the Company's operations. If any of the foregoing risks actually occur, the Company's business, financial condition and operating results could be adversely affected.

#### **14. DISCLOSURE CONTROLS AND PROCEDURES**

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

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

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

The Company's management, with the participation of the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting using the criteria set forth in the *Internal Control – Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of March 31, 2016.

##### **Changes in internal control over financial reporting**

There have been no changes in the Company's internal control over financial reporting during the three months ended March 31, 2016, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

##### **Limitations of controls and procedures**

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

## **PROPHECY DEVELOPMENT CORP.**

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

**For the three months ended March 31, 2016**

(Expressed in Canadian Dollars, except where indicated)

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achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

#### **15. DISCLOSURE OF OUTSTANDING SHARE DATA**

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

- 368,521,550 Common shares outstanding with recorded value of \$153,867,676;
- 30,081,417 stock options outstanding with a weighted average exercise price of \$0.09. Each option is exercisable to purchase one Common share of the Company at prices ranging from \$0.05 to \$0.28 and which expire between 2017 and 2020; and
- 52,210,384 share purchase warrants outstanding exercisable to purchase one Common share of the Company at any time at prices ranging from \$0.04 to \$0.10 and which expire between June 2016 and January 2021.

#### **16. OFF-BALANCE SHEET ARRANGEMENTS**

During the three months ended March 31, 2016, Prophecy was not a party to any off-balance-sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations, financial condition, revenues or expenses, liquidity, capital expenditures or capital resources of Prophecy.



**Condensed Interim Consolidated Financial Statements**  
**For the three months ended March 31, 2016 and 2015**  
(Expressed in Canadian Dollars)

**Unaudited – Prepared by Management**

## TABLE OF CONTENTS

Condensed Interim Consolidated Statements of Financial Position .....	4
Condensed Interim Consolidated Statements of Operations and Comprehensive Loss .....	5
Condensed Interim Consolidated Statements of Changes in Equity .....	6
Condensed Interim Consolidated Statements of Cash Flows .....	7
1. NATURE OF OPERATIONS AND GOING CONCERN .....	8
2. BASIS OF PRESENTATION .....	9
3. ACQUISITION .....	9
4. SEGMENTED INFORMATION .....	10
5. CASH AND RESTRICTED CASH EQUIVALENTS .....	11
6. AVAILABLE-FOR-SALE INVESTMENTS .....	11
7. PROPERTY AND EQUIPMENT .....	12
8. MINERAL PROPERTIES .....	14
9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES .....	14
10. CREDIT FACILITIES .....	14
11. SHARE CAPITAL .....	15
12. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS .....	18
13. FINANCIAL RISK MANAGEMENT DISCLOSURES .....	18
14. RELATED PARTY DISCLOSURES .....	20
15. KEY MANAGEMENT PERSONNEL COMPENSATION .....	22
16. SUPPLEMENTAL CASH FLOW INFORMATION .....	22
17. CONTINGENCIES .....	22
18. EVENTS AFTER THE REPORTING DATE .....	23

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

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

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

As at	Notes	March 31, 2016	December 31, 2015
<b>Assets</b>			
<b>Current assets</b>			
Cash	5	\$ 52,659	\$ 33,542
Receivables		298,700	400,289
Prepaid expenses		144,863	203,258
		496,222	637,089
<b>Non-current assets</b>			
Restricted cash equivalents		-	34,500
Reclamation deposits		27,554	27,554
Property and equipment	7	1,198,209	1,307,483
Mineral properties	8	25,520,908	25,296,210
		\$ 27,242,893	\$ 27,302,836
<b>Liabilities and Equity</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	9	\$ 2,105,243	\$ 2,637,557
Credit facilities	10	2,378,495	1,889,462
		4,483,738	4,527,019
<b>Non-current liabilities</b>			
Provision for closure and reclamation		208,993	208,993
Tax provision	17	6,813,611	7,287,855
		11,506,342	12,023,867
<b>Equity</b>			
Share capital	11	153,821,910	153,281,631
Reserves		21,249,420	21,205,698
Deficit		(159,334,779)	(159,208,360)
		15,736,551	15,278,969
		\$ 27,242,893	\$ 27,302,836

Approved on behalf of the Board:

**"John Lee"**  
John Lee, Director

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

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

**Contingencies** (Note 17)

**Events after the reporting date** (Note 18)

See accompanying notes to the consolidated financial statements.

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

		<b>Three Months Ended March 31,</b>	
	Notes	<b>2016</b>	<b>2015</b>
<b>General and Administrative Expenses</b>			
Advertising and promotion		\$ 23,438	\$ 20,640
Consulting and management fees		49,132	108,499
Depreciation and accretion		18,572	14,306
Director fees		10,800	30,002
Insurance		13,345	24,312
Office and administration		48,121	53,368
Professional fees		-	51,897
Salaries and benefits		77,000	122,864
Share-based payments	11	20,898	46,004
Stock exchange and shareholder services		36,872	49,114
Travel and accommodation		7,519	44,710
		<b>(305,697)</b>	<b>(565,716)</b>
<b>Other Items</b>			
Costs in excess of recovered coal		(31,437)	(1,318,174)
Finance cost	10	(307,353)	-
Foreign exchange (loss)/gain		538,125	(101,111)
Gain on sale of available-for-sale investment	6	59,698	-
Interest expense	10	(79,755)	(9,752)
		<b>179,278</b>	<b>(1,429,037)</b>
<b>Net Loss for Period</b>		<b>(126,419)</b>	<b>(1,994,753)</b>
<b>Comprehensive Loss for Period</b>		<b>\$ (126,419)</b>	<b>(1,994,753)</b>
<b>Loss Per Common Share, basic and diluted</b>		<b>\$ (0.00)</b>	<b>\$ (0.01)</b>
<b>Weighted Average Number of Common Shares Outstanding</b>		<b>352,701,256</b>	<b>311,204,477</b>

See accompanying notes to the consolidated financial statements.

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

	Numbers of shares	Share Capital	Reserves	Deficit	Total
<b>Balance, December 31, 2014</b>	251,878,634	\$ 147,947,292	\$ 20,502,885	\$ (151,385,829)	\$ 17,064,348
Shares issued for acquisition, net of share issue costs	60,000,000	3,900,000	-	-	3,900,000
Private placements, net of share issue costs	17,370,000	782,532	5,468	-	788,000
Debt Settlement	13,498,150	651,807	-	-	651,807
Share-based payments	-	-	697,345	-	697,345
Loss for the year	-	-	-	(7,822,531)	(7,822,531)
<b>Balance, December 31, 2015</b>	342,746,784	\$ 153,281,631	\$ 21,205,698	\$ (159,208,360)	\$ 15,278,969
Private placements, net of share issue costs	8,000,000	175,817	10,183	-	186,000
Debt Settlement	14,823,670	364,462	-	-	364,462
Share-based payments	-	-	33,539	-	33,539
Loss for the period	-	-	-	(126,419)	(126,419)
<b>Balance, March 31, 2016</b>	365,570,454	\$ 153,821,910	\$ 21,249,420	\$ (159,334,779)	\$ 15,736,551

See accompanying notes to the consolidated financial statements

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

	<b>Three Months Ended March 31,</b>	
	<b>2016</b>	<b>2015</b>
<b>Operating Activities</b>		
Net loss for period	\$ (126,419)	\$ (1,994,753)
Adjustments to reconcile net loss to net cash flows:		
Depreciation and accretion	109,274	14,306
Share-based payments	20,898	46,004
Costs in excess of recovered coal	31,437	1,318,174
Finance cost	307,353	-
Interest costs	79,755	-
Gain on sale of available-for-sale investment	(59,698)	-
	<b>362,600</b>	<b>(616,269)</b>
Working capital adjustments		
Receivables	101,589	(333,663)
Prepaid expenses	58,395	144,901
Inventory	-	430,515
Accounts payable and accrued liabilities	(453,994)	752,656
	<b>(294,010)</b>	<b>994,409</b>
<b>Cash Used in Operating Activities</b>	<b>68,590</b>	<b>378,140</b>
<b>Investing Activities</b>		
Acquisition of Apogee Subsidiaries, net of cash acquired (Note 3)	-	(237,224)
Cash received from GIC redemption	34,500	-
Property and equipment expenditures	(161,739)	(498,146)
Mineral property expenditures	(259,909)	(549,877)
Proceeds from sale of available-for-sale investment	59,698	-
<b>Cash Provided by Investing Activities</b>	<b>(327,450)</b>	<b>(1,285,247)</b>
<b>Financing Activities</b>		
Credit facility paid	(45,143)	(75,072)
Funds borrowed under credit facility	147,068	1,064,280
Interest paid	(9,948)	-
Proceeds from share issuance, net of share issue costs	186,000	-
<b>Cash Provided by (Used in) Financing Activities</b>	<b>277,977</b>	<b>989,208</b>
Net Decrease in cash	19,117	82,101
Cash - beginning of period	33,542	200,994
Cash - end of period	\$ 52,659	\$ 283,095

Supplemental cash flow information (Note 16)

See accompanying notes to the consolidated financial statements.

## **PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

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### **1. NATURE OF OPERATIONS AND GOING CONCERN**

Prophecy Development Corp. (“**Prophecy**” or the “**Company**”) is incorporated under the laws of the province of British Columbia, Canada and is engaged in exploring and developing mining properties and energy projects in 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. On January 2, 2015, the Company acquired an interest in the Pulacayo Project in Bolivia.

These unaudited condensed interim consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. The Company incurred a net loss of \$126,419 during the three months ended March 31, 2016 and as of that date the Company’s deficit was \$159.3 million.

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

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

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

## PROPHECY DEVELOPMENT CORP.

Notes to the Condensed Interim Consolidated Financial Statements  
For the three months ended March 31, 2016 and 2015  
(Expressed in Canadian Dollars) (Unaudited)

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### 2. BASIS OF PRESENTATION

#### (a) Statement of compliance

These unaudited condensed interim consolidated financial statements have been prepared in accordance with IAS 34, Interim Financial Reporting. They do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Company's annual financial statements as at and for the year ended December 31, 2015. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Company's financial position and performance since the last annual consolidated financial statements as at and for the year ended December 31, 2015 ("**Annual Financial Statements**").

These unaudited condensed interim consolidated financial statements were approved and authorized for issue by the Audit Committee on May 12, 2016.

#### (b) Significant accounting policies

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

#### (c) Use of judgments and estimates

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

#### (d) Changes in accounting standards

There were no previously undisclosed significant accounting pronouncements issued during the three months ended March 31, 2016.

### 3. ACQUISITION

On January 2, 2015, the Company completed the acquisition of 100% of Apogee Silver Ltd.'s ("**Apogee**") interest in ASC Holdings Limited and ASC Bolivia LDC (which together, hold ASC Bolivia LDC Sucursal Bolivia, which in turn, holds Apogee's joint venture interest in the Pulacayo Paca silver-lead-zinc mining project in Bolivia (the "**Pulacayo Project**")) and Apogee Minerals Bolivia S.A. (collectively, the "**Apogee Subsidiaries**") by paying to Apogee \$250,000 in cash and issuing to Apogee 60 million Prophecy Common shares (the "**Consideration Shares**"). The Company also agreed, pursuant to the terms of the share purchase agreement it entered into with Apogee on November 3, 2014, as amended (the "**Agreement**"), to assume all liabilities of the Apogee Subsidiaries. Apogee agreed to forgive, waive and discharge the intercompany debt owing by Apogee Minerals Bolivia S.A. to Apogee pursuant to the terms of the Agreement.

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

**3. ACQUISITION (cont'd...)**

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 Common shares trading on the Toronto Stock Exchange (the "TSX") reach certain price levels or in the face of certain major triggering events. 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.

The acquisition of the Apogee Subsidiaries has been accounted for as an asset acquisition as their activities at the time of the acquisition consisted of mineral properties under care and maintenance. The consideration was allocated based on the fair value of the assets acquired and liabilities assumed.

The purchase price of \$4,150,000 consisted of the following:

Cash consideration	\$	250,000
Fair value of Consideration Shares		3,900,000
<b>Purchase price</b>	<b>\$</b>	<b>4,150,000</b>

The purchase price allocation is as follows:

Cash and cash equivalents	\$	12,776
Property & equipment		862,900
Mineral properties		9,652,598
Accounts payable		(6,378,274)
<b>Net assets acquired</b>	<b>\$</b>	<b>4,150,000</b>

**4. SEGMENTED INFORMATION**

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

	March 31, 2016			
	Canada	Mongolia	Bolivia	Total
Reclamation deposits	\$ 6,500	\$ 21,054	\$ -	\$ 27,554
Property and equipment	68,054	454,489	675,666	1,198,209
Mineral properties	-	14,231,110	11,289,798	25,520,908
	<b>\$ 74,554</b>	<b>\$ 14,706,653</b>	<b>\$ 11,965,464</b>	<b>\$ 26,746,671</b>
	December 31, 2015			
	Canada	Mongolia	Bolivia	Total
Reclamation deposits	\$ 6,500	\$ 21,054	\$ -	\$ 27,554
Property and equipment	81,128	557,128	669,227	1,307,483
Mineral properties	-	14,180,807	11,115,403	25,296,210
	<b>\$ 87,628</b>	<b>\$ 14,758,989</b>	<b>\$ 11,784,630</b>	<b>\$ 26,631,247</b>

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

**5. CASH AND RESTRICTED CASH EQUIVALENTS**

Cash and restricted cash equivalents of Prophecy are comprised of bank balances and a guaranteed investment certificate which can be readily converted into cash without significant restrictions, changes in value or penalties. The carrying amounts of cash and cash equivalents approximate fair value. Prophecy's cash is denominated in the following currencies:

	March 31, 2016	December 31, 2015
Denominated in Canadian dollars	\$ 36,043	\$ 7,767
Denominated in US dollars	11,757	18,135
Denominated in Mongolian tugriks	2,068	4,850
Denominated in Bolivian boliviano	2,790	2,790
	\$ 52,659	\$ 33,542
Restricted Cash Equivalents in Canadian dollars	\$ -	\$ 34,500

**6. AVAILABLE-FOR-SALE INVESTMENTS**

As of March 31, 2016 and December 31, 2015 the Company does not hold available-for sale investments. Pursuant to the plan of arrangement and consolidation in share capital in the acquisition of Wellgreen Platinum Ltd. shares ("**Wellgreen Platinum**") in June 2011, the Company acquired 22,500,000 and reserved 4,417,643 Wellgreen Platinum's issued and outstanding common shares for distribution to option and warrant holders of the Company. Pursuant to the plan of arrangement each option and warrant holder of Prophecy Development as at June 9, 2011 will, upon the exercise of their Prophecy Development options and warrants, ("**June 9, 2011 Options and Warrants**") receive 0.094758 of a Wellgreen Platinum common share, in addition to one common share of the Company for each whole option or warrant of the Company held and exercised. Any Wellgreen Platinum shares held in-trust, but not delivered, due to the expiry of unexercised June 9, 2011 Options and Warrants, shall be returned to the Company. During the three months ended March 31, 2016, a total of 335,266 of remaining Wellgreen Platinum's reserved held in-trust common shares were returned back to the Company due to the expiry of applicable June 9, 2011 Options and Warrants. The Company sold these released Wellgreen Platinum's common shares for proceeds of \$59,698 which was reflected on the consolidated statement of operations and comprehensive loss. At March 31, 2016, there were Nil Wellgreen Platinum shares held in-trust.

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

**7. PROPERTY AND EQUIPMENT**

	Computer Equipment	Furniture & Equipment	Vehicles	Computer Software	Leasehold Improvements	Mining Equipment	Total
<b>Cost</b>							
Balance, December 31, 2014	\$ 155,837	\$ 373,217	\$ 787,308	\$ 197,813	\$ 172,818	\$ 6,248,390	\$ 7,935,383
Additions	7,716	40,386	33,858	-	-	814,798	896,758
Disposals	(1,594)	(24,670)	(361,937)	-	-	(5,489,090)	(5,877,291)
Balance, December 31, 2015	\$ 161,959	\$ 388,933	\$ 459,229	\$ 197,813	\$ 172,818	\$ 1,574,098	\$ 2,954,850
<b>Accumulated depreciation</b>							
Balance, December 31, 2014	\$ 115,210	\$ 207,303	\$ 478,015	\$ 135,684	\$ 125,653	\$ 2,511,536	\$ 3,573,401
Depreciation for year	21,641	40,723	89,028	62,129	9,433	703,823	926,777
Disposals	(939)	(17,159)	(236,698)	-	-	(2,598,015)	(2,852,811)
Balance, December 31, 2015	\$ 135,912	\$ 230,867	\$ 330,345	\$ 197,813	\$ 135,086	\$ 617,344	\$ 1,647,367
<b>Carrying amount</b>							
At December 31, 2014	\$ 40,627	\$ 165,914	\$ 309,293	\$ 62,129	\$ 47,165	\$ 3,736,854	\$ 4,361,982
At December 31, 2015	\$ 26,047	\$ 158,066	\$ 128,884	\$ -	\$ 37,732	\$ 956,754	\$ 1,307,483
<b>Cost</b>							
Balance, December 31, 2015	\$ 161,959	\$ 388,933	\$ 459,229	\$ 197,813	\$ 172,818	\$ 1,574,098	\$ 2,954,850
Additions/disposals	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Balance, March 31, 2016	\$ 161,959	\$ 388,933	\$ 459,229	\$ 197,813	\$ 172,818	\$ 1,574,098	\$ 2,954,850
<b>Accumulated depreciation</b>							
Balance, December 31, 2015	\$ 135,912	\$ 230,867	\$ 330,345	\$ 197,813	\$ 135,086	\$ 617,344	\$ 1,647,367
Depreciation for period	\$ 8,611	\$ 7,911	\$ 5,315	\$ -	\$ 8,732	\$ 78,705	\$ 109,274
Balance, March 31, 2016	\$ 144,523	\$ 238,778	\$ 335,660	\$ 197,813	\$ 143,818	\$ 696,049	\$ 1,756,641
<b>Carrying amount</b>							
At December 31, 2015	\$ 26,047	\$ 158,066	\$ 128,884	\$ -	\$ 37,732	\$ 956,754	\$ 1,307,483
At March 31, 2016	\$ 17,436	\$ 150,155	\$ 123,569	\$ -	\$ 29,000	\$ 878,049	\$ 1,198,209

## PROPHECY DEVELOPMENT CORP.

Notes to the Condensed Interim Consolidated Financial Statements  
For the three months ended March 31, 2016 and 2015  
(Expressed in Canadian Dollars) (Unaudited)

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

#### Ulaan Ovoo Property

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

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

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

Pre-commercial operations for the period from commencement in November 2010 until December 31, 2014, along with project exploration and development costs were capitalized to Ulaan Ovoo deferred exploration costs within property and equipment. Coal sales revenue and associated costs to deliver the coal have been recorded against deferred exploration, within property and equipment. At December 31, 2014, the Company assessed the recoverable amount of the Ulaan Ovoo property and concluded that the deferred exploration costs were impaired and wrote them off.

The Ulaan Ovoo property ceased pre-commercial operations in June 2015. Modest sales of coal from existing stockpiles have been recorded against costs incurred at the mine, classified as costs in excess of recovered coal on the consolidated statement of operations and comprehensive loss.

As there were no benchmark or market changes from January 1 to March 31, 2016, the impaired value of \$Nil for deferred development costs remains unchanged.

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

**8. MINERAL PROPERTIES**

	Chandgana Tal	Khavtgai Uul	Pulacayo	Total
<b>Balance, December 31, 2015</b>	\$11,040,916	\$3,139,891	\$11,115,403	\$25,296,210
<i>Additions:</i>				
Acquisition cost	\$ -	\$ -	\$ -	\$ -
Deferred exploration costs:				
Licenses, power plant application	15,994	27,429	-	43,423
Geological core and consulting	3,119	-	71,233	74,352
Personnel, camp and general	1,881	1,880	103,162	106,923
	20,995	29,309	174,395	224,698
<b>Balance, March 31, 2016</b>	\$11,061,910	\$3,169,200	\$11,289,798	\$25,520,908

**9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

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

	March 31, 2016	December 31, 2015
Current liabilities		
Trade accounts payable	\$ 1,988,427	\$ 2,533,557
Accrued liabilities	116,816	104,000
	\$ 2,105,243	\$ 2,637,557

**10. CREDIT FACILITIES**

In order to meet interim working capital requirements to fund the Company's business operations and financial commitments, the Company arranged a revolving credit facility with Linx Partners Ltd. ("**Linx**"), a private company wholly-owned and controlled by John Lee, Director, CEO and Executive Chairman of the Company by entering into an agreement dated March 12, 2015 (the "**Credit Facility**"). The Credit Facility had a maximum principal amount available for advance of \$1.5 million, a two year term (formerly one year, but amended on May 5, 2015 and approved by the TSX) with an option to extend it for any number of subsequent one-year terms subject to TSX approval, and bears a simple interest rate of 18% per annum.

On February 24, 2016, the Company entered into an agreement (the "**Second Amendment**") to increase and amend the Credit Facility. The previous maximum principal amount of \$1.5 million available to the Company under the Credit Facility will be increased with the Second Amendment to \$2.5 million. The Credit Facility, will fund Prophecy's ongoing business operations, bears an interest rate of 1.5% per month and is secured by promissory notes and a general security agreement.

## PROPHECY DEVELOPMENT CORP.

Notes to the Condensed Interim Consolidated Financial Statements  
For the three months ended March 31, 2016 and 2015  
(Expressed in Canadian Dollars) (Unaudited)

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### 10. CREDIT FACILITIES (cont'd...)

A 5% “drawdown” fee will be applicable to amounts advanced over and above the original and outstanding \$1.5 million advanced under the Credit Facility, at the time of advance. In consideration of a bonus of 20% of the total amounts advanced under the Credit Facility, as of November 30, 2015 (the “**Bonus**”), Linx has agreed to postpone any repayments due under the Credit Facility, until the earlier of October 1, 2016, or such time as the Company is in a reasonable financial position to repay all or a portion of the amounts owing, and remove the requirement for the Company to pay any 20% penalties as a result of any future failure to repay any amounts when due under the terms of the Credit Facility. Including the Bonus and “drawdown” fee, the Credit Facility, carries an effective annual interest rate of 34.5%. The “drawdown” fee, Bonus and all interest payable will be accrued and added to the maximum principal amount as they are incurred.

On March 30, 2016, the Company entered into a Debt Settlement Agreement with Linx and Mr. Lee pursuant to which, the Company agreed, subject to the approval of shareholders at the Company’s upcoming 2016 Annual General Meeting and acceptance by the TSX, to issue 75,000,000 units (the “**Units**”) to Mr. Lee, in satisfaction of \$1,500,000 of indebtedness currently owed by the Company to Linx under the Credit Facility. Each Unit consists of one Common share and one Share purchase warrant (a “**Linx Warrant**”). Each Linx Warrant entitles the holder to acquire an additional Share at a price of \$0.04 per Share for a period of five years from the date of issuance.

As at March 31, 2016, the outstanding balance of the Credit Facility was \$2,224,851 including interest payable of \$270,431. For the three months ended March 31, 2016, the Company recorded an interest expense of \$79,755 and finance cost of \$307,353 which included Bonus of \$300,000 and draw-down fees of \$7,353.

As at March 31, 2016, the outstanding balance of a line of credit with the Trade and Development Bank of Mongolia (“**LOC**”) was \$153,644 (December 31, 2015 - \$198,787). For the three months ended March 31, 2016, Red Hill recorded an interest expense and interest payable of \$8,829 (December 31, 2015 - \$130,492), and interest paid of \$9,948 (December 31, 2015 - \$140,629).

Subsequent to period end, the LOC has been fully repaid and closed out.

### 11. SHARE CAPITAL

#### (a) Authorized

The authorized share capital consists of an unlimited number of common shares without par value (the “**Shares**”). There are no authorized preferred shares. At March 31, 2016, the Company had 365,570,454 (December 31, 2015 – 342,746,784) common shares issued and outstanding.

#### (b) Equity issuances

During the three months ended March 31, 2016, Prophecy had the following common share capital transactions:

On January 25, 2016, the Company closed a non-brokered private placement (the “**Placement**”) involving the issuance of 8,000,000 units at a price of \$0.025 per unit. Each unit consists of one Share and one Share purchase warrant (a “**Warrant**”).

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

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

## (b) Equity issuances (cont'd...)

Each Warrant entitles the holder to acquire an additional Share at a price of \$0.04 per Share for a period of five years from the date of issuance.

The Company paid in cash, finder's fees totaling \$14,000 and issued 560,000 finder's Share purchase warrants which are exercisable at a price of \$0.04 for a period of two years from the closing of the Placement. Proceeds of the Placement are expected to be used to develop Prophecy's mineral projects and for general working capital purposes.

The Company entered into settlement and release agreements with certain of its officers, employees and consultants to settle various debts owing to them. Pursuant to the terms of those settlement and release agreements, the Company issued 1,320,643 Shares at a value of \$0.025 per Share, 6,138,499 Shares at a value of \$0.03 per Share and 7,364,528 Shares at a value of \$0.02 per Share to those officers, employees and consultants through its Share-Based Compensation Plan.

## (c) Equity-based compensation plans

The following is a summary of the changes in Prophecy's stock options from December 31, 2014 to March 31, 2016:

	Number of Options	Weighted Average Exercise Price
Outstanding, December 31, 2014	26,563,750	\$0.13
Granted	13,500,000	\$0.05
Expired	(3,139,583)	\$0.12
Cancelled	(2,550,000)	\$0.23
Outstanding, December 31, 2015	34,374,167	\$0.10
Granted	-	-
Expired	(100,000)	\$0.28
Forfeited	(3,590,000)	\$0.22
Cancelled	(400,000)	\$0.06
Outstanding, March 31, 2016	30,284,167	\$0.09

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

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

## (c) Equity-based compensation plans (cont'd...)

As of March 31, 2016, the following Prophecy Share purchase options were outstanding:

March 31, 2016		December 31, 2015		Expiry Date
Exercise Price	Options Outstanding	Exercise Price	Options Outstanding	
\$ 0.050	3,280,000	\$ -	3,350,000	June 22, 2020
\$ 0.050	9,050,000	\$ -	9,200,000	April 7, 2020
\$ 0.065	5,475,000	\$ 0.065	5,555,000	May 1, 2019
\$ 0.08	-	\$ 0.080	100,000	January 9, 2019
\$ 0.10	500,000	\$ 0.100	500,000	February 3, 2019
\$ 0.105	5,150,000	\$ 0.105	5,150,000	January 27, 2019
\$ 0.12	3,450,000	\$ 0.120	3,450,000	August 16, 2018
\$ 0.13	250,000	\$ 0.130	250,000	July 22, 2018
\$ 0.18	150,000	\$ 0.180	230,000	August 16, 2017
\$ 0.18	375,000	\$ 0.180	375,000	September 24, 2017
\$ 0.18	1,724,167	\$ 0.180	3,654,167	August 22, 2017
\$ 0.25	10,000	\$ 0.250	10,000	June 1, 2017
\$ 0.28	-	\$ 0.280	100,000	February 14, 2016
\$ 0.28	870,000	\$ 0.280	2,450,000	June 18, 2017
30,284,167		34,374,167		

At March 31, 2016, the Company had 21,893,542 exercisable share purchase options outstanding (December 31, 2015 - 22,904,167) with the weighted average price of \$0.10 (December 31, 2015 - \$0.13). The three months ended March 31, 2016, included \$20,898 (Q1 2015 - \$46,004) in share based payment costs related to stock options expensed as general and administrative expenses and \$12,641 (Q1 2015 - 7,526) capitalized to mineral properties.

## (d) Share purchase warrants

The following is a summary of the changes in Prophecy's share purchase warrants from December 31, 2015 to March 31, 2016 (see Note 11(b)):

	Number of Warrants	Weighted Average Exercise Price
Outstanding, December 31, 2015	43,650,384	\$0.06
Issued	8,560,000	\$0.04
Outstanding, March 31, 2016	52,210,384	\$0.06

The value of \$10,183 of 560,000 finder's warrants was included in share issue costs and determined using the Black-Scholes option pricing model using the following assumptions: a risk-free rate of 0.46%; warrant expected life of two years; expected volatility of 134%; and dividend yield of nil. No value was assigned to the warrants issued as part of the unit offering.

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

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

## (d) Share purchase warrants (cont'd...)

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

Exercise price	Number of Warrants		Expiry date
	At March 31, 2016	At December 31, 2015	
\$0.10	2,541,065	2,541,065	June 19, 2016
\$0.05	12,000,000	12,000,000	May 22, 2020
\$0.06	11,476,819	11,476,819	June 24, 2017
\$0.07	11,120,000	11,120,000	September 30, 2020
\$0.07	6,250,000	6,250,000	November 13, 2020
\$0.07	262,500	262,500	November 13, 2017
\$0.04	8,000,000	-	January 25, 2021
\$0.04	560,000	-	January 25, 2018
	52,210,384	43,650,384	

**12. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS**

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

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

	As at March 31, 2016	As at December 31, 2015
Fair value through profit or loss		
Cash	\$ 52,659	\$ 33,542
Restricted cash equivalents	-	34,500
Receivables	298,700	400,289
	\$ 351,359	\$ 468,331
Other financial liabilities		
Accounts payable and accrued liabilities	\$ 2,105,243	\$ 2,637,557
Credit facility	2,378,495	1,889,462
	\$ 4,483,738	\$ 4,527,019

**13. FINANCIAL RISK MANAGEMENT DISCLOSURES**

## (a) Liquidity risk

Liquidity risk is the risk that an entity will be unable to meet its financial obligations as they fall due. The Company manages liquidity risk by preparing cash flow forecasts of upcoming cash requirements. As at March 31, 2016, the Company had a cash balance of \$52,659 (December 31, 2015 – \$33,542) in order to meet short-term business requirements.

## **PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements  
For the three months ended March 31, 2016 and 2015  
(Expressed in Canadian Dollars) (Unaudited)

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### **13. FINANCIAL RISK MANAGEMENT DISCLOSURES (cont'd...)**

#### (a) Liquidity risk (cont'd...)

At March 31, 2016, the Company had accounts payable and accrued liabilities of \$2,105,243 (December 31, 2015 - \$2,637,557), which have contractual maturities of 90 days or less and lines of credit payments of \$2,378,495. The Company is seeking financing in order to be in a position to satisfy its current liabilities.

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

#### (b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risk primarily associated to cash and cash equivalents and receivables, net of allowances. The significant concentration of credit risk is situated in Mongolia. The carrying amount of assets included on the statements of financial position represents the maximum credit exposure.

#### (c) Market risk

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

##### (i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Company drew down \$2,224,851 on its Credit Facility, bearing an interest rate of 18% per annum and had an outstanding balance of \$153,644 of LOC facility bearing an annual coupon rate of 17.4% with monthly interest payments. Due to the short-term nature of these financial instruments, and that the Company's line of credit bears interest at fixed rate, fluctuations in market rates do not have a significant impact on the fair values or future cash flows of the financial instruments as of March 31, 2016. The Company manages interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity.

##### (ii) Foreign currency risk

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

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements  
For the three months ended March 31, 2016 and 2015  
(Expressed in Canadian Dollars) (Unaudited)

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**13. FINANCIAL RISK MANAGEMENT DISCLOSURES (cont'd...)**

## (a) Market risk (cont'd...)

## (ii) Foreign currency risk (cont'd...)

Based on the above, net exposures as at March 31, 2016, with other variables unchanged, a 10% (December 31, 2015 – 10%) strengthening (weakening) of the Canadian dollar against the Mongolian tugrik would impact net loss with other variables unchanged by \$88,000. A 10% strengthening (weakening) of the Canadian dollar against the Bolivian boliviano would impact net loss with other variables unchanged by \$681,000. A 10% (December 31, 2015 – 10%) strengthening (weakening) of the US dollar against the Canadian dollar would impact net loss with other variables unchanged by \$63,000. The Company currently does not use any foreign exchange contracts to hedge this currency risk.

## (iii) Commodity and equity price risk

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

**14. RELATED PARTY DISCLOSURES**

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

- Linx Partners Ltd., a private company controlled by John Lee, Director, CEO and Executive Chairman of Prophecy, provides management and consulting services to the Company.
- MaKevCo Consulting Inc., a private company 50% owned by Greg Hall, Director of Prophecy, provides consulting services to the Company.
- Sophir Asia Ltd., a private company controlled by Masa Igata, Director of Prophecy, provides consulting services to the Company

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

**14. RELATED PARTY DISCLOSURES (cont'd...)**

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

Related parties	Three months ended March 31,	
	2016	2015
Directors and officers	\$ 87,751	\$ 77,021
Linx Partners Ltd.	52,500	113,988
MaKevCo Consulting Inc.	3,800	11,519
Sophir Asia Ltd.	3,500	18,743
	\$ 147,550	\$ 221,271

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

Related parties	Three months ended March 31,	
	2016	2015
Consulting and management fees	\$ 28,500	\$ 91,190
Directors' fees	10,800	40,503
Mineral properties	39,000	22,797
Salaries and benefits	69,250	66,780
	\$ 147,550	\$ 221,271

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

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

As at March 31, 2016, deferred compensation totalled \$70,800 (December 31, 2015 - \$Nil) which was classified as current liabilities on the statement of financial position.

During the three months ended March 31, 2016, the Company's officers received their reduced salaries in the form of Shares to conserve cash resources (Note 11(b)).

As at March 31, 2016, amounts due to related parties (excluding deferred compensation) totaled of \$90,620 (December 31, 2015 – \$129,891) and was comprised of \$57,250 (December 31, 2015 - \$54,060) for director fees, \$Nil (December 31, 2015 - \$2,400) for consulting fees, \$Nil (December 31, 2015 - \$9,600) for managing mineral properties, \$33,370 (December 31, 2015 - \$63,831) for salaries and reimbursable expenses.

The amounts due to related parties are non-interest bearing and are due upon demand. See Note 10 for information regarding the Company's Credit Facility with Linx Partners Ltd.

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements

For the three months ended March 31, 2016 and 2015

(Expressed in Canadian Dollars) (Unaudited)

**15. KEY MANAGEMENT PERSONNEL COMPENSATION**

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

Key Management Personnel	Three months ended March 31,	
	2016	2015
Salaries and short term benefits	\$ 69,250	\$ 67,637
Share-based payments	29,181	36,182
	\$ 98,430	\$ 103,819

**16. SUPPLEMENTAL CASH FLOW INFORMATION**

Supplementary information	Three Months Ended March 31,	
	2016	2015
Non-Cash Financing and Investing Activities		
Shares issued for assets acquisition	\$ -	\$ 3,900,000
Shares issued to settle debt	\$ 364,462	\$ -
Capitalized depreciation	\$ -	\$ 428,525
Capitalized interest	\$ 9,948	\$ 37,154
Property & equipment expenditures included in accounts payable	\$ 1,620,573	\$ 1,961,779
Mineral property expenditures included in accounts payable	\$ 592,736	\$ 225,485
Share-based payments capitalized in mineral properties	\$ 12,641	\$ 7,526

**17. CONTINGENCIES**

## ASC tax claim

Pursuant to the terms of the Agreement, Prophecy agreed to assume all liabilities of the Apogee Subsidiaries, including legal and tax liabilities associated with the Pulacayo Project. During Apogee's financial year ended June 30, 2014, it received notice from the Servicio de Impuestos Nacionales, the national tax authority in Bolivia, that ASC Bolivia LDC Sucursal Bolivia, the Company's wholly-owned subsidiary, owed approximately Bs42,000,000 (\$6,813,611) in taxes, interest and penalties relating to a historical tax liability in an amount originally assessed at approximately \$760,000 in 2004, prior to Apogee acquiring the subsidiary in 2011. Apogee disputed the assessment and disclosed to the Company that it believed the notice was improperly issued. The Company continued to dispute the assessment and hired local legal counsel to pursue an appeal of the tax authority's assessment on both substantive and procedural grounds.

On May 26, 2015, the Company received a positive Resolution issued by the Bolivian Constitutional Court that among other things, declared null and void the previous Resolution of the Bolivian Supreme Court issued in 2011 (that imposed the tax liability on ASC Bolivia LDC Sucursal Bolivia) and sent the matter back to the Supreme Court to consider and issue a new Resolution. The Company plans to continue to vigorously defend its position and make submissions to the Supreme Court during the new hearing. Based on these developments, the tax claim amount of \$6,813,611 was classified as non-current liabilities.

**PROPHECY DEVELOPMENT CORP.**

Notes to the Condensed Interim Consolidated Financial Statements  
For the three months ended March 31, 2016 and 2015  
(Expressed in Canadian Dollars) (Unaudited)

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**17. CONTINGENCIES (cont'd...)**

## Red Hill tax claim

During the year ended December 31, 2014, Red Hill was issued a letter from the Sukhbaatar District Tax Division notifying it of the results of the Sukhbaatar District Tax Division's VAT inspection of Red Hill's 2009-2013 tax imposition and payments that resulted in validating VAT credits of only MNT235,718,533 from Red Hill's claimed VAT credit of MNT2,654,175,507. Red Hill disagreed with the Sukhbaatar District Tax Division's findings as the tax assessment appeared to the Company to be unfounded. The Company disputed the Sukhbaatar District Tax Division's assessment and submitted a complaint to the Capital City Tax Tribunal. On March 24, 2015, the Capital City Tax Tribunal resolved to refer the matter back to the Sukhbaatar District Tax Division for revision and separation of the action between confirmation of Red Hill's VAT credit, and the imposition of the penalty/deduction for the tax assessment. The Sukhbaatar District Tax Division appealed the Capital City Tax Tribunal's resolution to the General Tax Tribunal office, but was denied on June 4, 2015 on procedural grounds. As a result, the Sukhbaatar District Tax Division implemented the Capital City Tax Tribunal's resolution on June 25, 2015, finding: (1) with respect to confirmation of Red Hill's VAT credit, that after inspection the amount was to be MNT235,718,533; and (2) with respect to the imposition of the penalty/deduction for the tax assessment, that no penalty was to be issued but that Red Hill's loss to be depreciated and reported to be MNT1,396,668,549 in 2010 and MNT4,462,083,700 in 2011. The Company continues to dispute the Sukhbaatar District Tax Division's assessment and delivered a complaint to Capital City Tax Tribunal on July 24, 2015. Due to the uncertainty of realizing the VAT balance, the Company has recorded an impairment charge for the full VAT balance at December 31, 2015. As there were no changes from January 1 to March 31, 2016, the impaired value of \$Nil for VAT receivable remains unchanged.

**18. EVENTS AFTER THE REPORTING DATE**

The following events occurred subsequent to March 31, 2016:

- The Company paid off and closed out the US\$1.5 million line of credit facility with the Trade and Development Bank of Mongolia.
- The Company issued 2,951,096 Shares through the Company's Share-Based Compensation Plan to a consultant and an employee to settle all outstanding debts owed to them.