

PROPHECY RESOURCE CORP.

FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

AUDITORS' REPORT

To the Shareholders of Prophecy Resource Corp.,

We have audited the balance sheets of Prophecy Resource Corp. as at September 30, 2009 and 2008 and the statements of loss, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

“DMCL”

DALE MATHESON CARR-HILTON LABONTE LLP
Chartered Accountants

Vancouver, Canada
November 26, 2009

PROPHECY RESOURCE CORP.
BALANCE SHEETS
AS AT SEPTEMBER 30

	2009	2008
ASSETS		
Current		
Cash	\$ 8,776	\$ 17,787
Short-term investments (Note 3)	60,000	170,000
Receivables	447	2,844
Government grant receivable (Note 10)	-	45,965
Prepays	-	4,950
	<u>69,223</u>	<u>241,546</u>
Mineral property (Note 4)	150,750	89,000
Deferred exploration costs (Note 5)	1,019,869	1,018,587
Reclamation bond (Note 4)	<u>6,500</u>	<u>6,500</u>
	<u>\$ 1,246,342</u>	<u>\$ 1,355,633</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	\$ 13,219	\$ 13,996
Due to related parties (Note 6)	-	5,307
	<u>13,219</u>	<u>19,303</u>
Future income taxes (Note 10)	<u>46,329</u>	<u>85,750</u>
	<u>59,548</u>	<u>105,053</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 7)	1,388,802	1,388,802
Contributed surplus (Note 7)	201,531	198,905
Deficit	<u>(403,539)</u>	<u>(337,127)</u>
	<u>1,186,794</u>	<u>1,250,580</u>
	<u>\$ 1,246,342</u>	<u>\$ 1,355,633</u>

Nature and continuance of operations (Note 1)

Commitment (Note 4)

Subsequent events (Note 13)

Approved on behalf of the Board:

<u>"Stuart Rogers"</u>	Director	<u>"James Brown"</u>	Director
Stuart Rogers		James Brown	

The accompanying notes are an integral part of these financial statements.

PROPHECY RESOURCE CORP.
STATEMENTS OF LOSS, COMPREHENSIVE LOSS AND DEFICIT
FOR THE YEAR ENDED SEPTEMBER 30

	2009	2008
EXPENSES		
Investor relations – stock-based compensation (Note 8)	\$ 2,626	\$ 13,133
Office, rent and miscellaneous (Note 6)	23,592	20,990
Management fees (Note 6)	15,000	17,000
Professional fees	35,301	41,440
Shareholder communications	20,298	79,055
Transfer agent and filing fees	13,939	19,460
Travel	374	96
LOSS BEFORE OTHER ITEM	(111,130)	(191,174)
OTHER ITEM		
Interest income	5,297	11,148
LOSS BEFORE INCOME TAXES	(105,833)	(180,026)
Future income tax recovery (Notes 7 and 10)	39,421	104,700
NET LOSS AND COMPREHENSIVE LOSS	(66,412)	(75,326)
DEFICIT, BEGINNING	(337,127)	(261,801)
DEFICIT, ENDING	\$ (403,539)	\$ (337,127)
LOSS PER COMMON SHARE - BASIC AND DILUTED		
	\$ (0.01)	\$ (0.01)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES		
OUTSTANDING – BASIC AND DILUTED	11,100,000	10,677,036

The accompanying notes are an integral part of these financial statements.

PROPHECY RESOURCE CORP.
STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED SEPTEMBER 30

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (66,412)	\$ (75,326)
Items not involving cash:		
Future income tax recovery	(39,421)	(104,700)
Investor relations – stock-based compensation	2,626	13,133
Changes in non-cash working capital items:		
Decrease in receivables	2,397	21,802
Decrease in government grant receivable	45,965	-
Decrease in prepaids	4,950	40,000
Increase (decrease) in accounts payable and accrued liabilities	(777)	838
Decrease in due to related parties	(5,307)	(9,735)
Net cash used in operating activities	<u>(55,979)</u>	<u>(113,988)</u>
CASH FLOWS USED IN INVESTING ACTIVITIES		
Short-term investments redemptions	110,000	5,000
Acquisition of mineral property	(61,750)	(20,000)
Deferred exploration costs	(1,282)	(560,930)
Net cash provided by (used in) investing activities	<u>46,968</u>	<u>(575,930)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Shares issued, net of share issuance costs	-	679,700
Net cash provided by financing activities	<u>-</u>	<u>679,700</u>
Decrease in cash	(9,011)	(10,218)
Cash, beginning	<u>17,787</u>	<u>28,005</u>
Cash, ending	<u>\$ 8,776</u>	<u>\$ 17,787</u>

Supplemental disclosures with respect to cash flows (Note 9)

The accompanying notes are an integral part of these financial statements.

1. NATURE AND CONTINUANCE OF OPERATIONS

Prophecy Resource Corp. (the “Company”) was incorporated under the Business Corporations Act (British Columbia) on February 9, 2006 and trades publicly on the TSX Venture Exchange (“TSX-V”).

The Company is a mineral property exploration company and has not yet determined whether its mineral properties contain economically recoverable reserves. The recoverability of the amounts shown for mineral properties is dependent upon the confirmation of economically recoverable reserves, the ability of the Company to obtain necessary financing to successfully complete their development and upon future profitable production.

These 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 continuing operations of the Company are dependent upon its ability to raise adequate financing to develop its mineral properties, and to commence profitable operations in the future. To date the Company has not generated any significant revenues and is considered to be in the exploration stage.

Management is also aware that material uncertainties exist, related to current economic conditions, which could adversely affect the Company’s ability to continue to finance its activities. Management’s plan includes continuing to pursue additional sources of financing through equity offerings, seeking joint venture partners to fund exploration, monitoring exploration activity and reducing overhead costs. As a result of the implementation of this plan, management expects that the Company will have sufficient capital to fund operations and keep its mineral property in good standing for the upcoming fiscal year. Further discussion of liquidity risk has been disclosed in Notes 11 and 12.

These financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

	2009	2008
Deficit	\$ (403,539)	\$ (337,127)
Working capital	\$ 56,004	\$ 222,243

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and are presented in Canadian dollars.

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results could differ from these estimates. Significant areas requiring the use of management estimates relate to the determination of impairment of mineral property interests, expected tax rates for future income tax recoveries, the fair values of financial instruments, determining the fair value of stock-based payments and management’s assessment of going concern. Where estimates have been used financial results as determined by actual events could differ from those estimates.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Government grants

Government assistance is recorded as either a reduction of the cost of the applicable assets or credited in the statement of loss as determined by the terms and conditions of the agreement under which the assistance is provided to the Company. Claims for tax credits are accrued upon the Company attaining reasonable assurance of collection from the Canadian tax authorities.

Mineral properties

The Company records its interests in mineral properties and areas of geological interest at cost. All direct and indirect costs relating to the acquisition of these interests are capitalized on the basis of specific claim blocks or areas of geological interest until the properties to which they relate are placed into production, sold or management has determined there to be an impairment. These costs will be amortized on the basis of units produced in relation to the proven reserves available on the related property following commencement of production. Mineral properties which are sold before that property reaches the production stage will have all revenues from the sale of the property credited against the cost of the property. Properties which have reached the production stage will have a gain or loss calculated based on the portion of that property sold.

The recorded cost of mineral exploration interests is based on cash paid, the value of share considerations and exploration and development costs incurred. The recorded amount may not reflect recoverable value as this will be dependent on the development program, the nature of the mineral deposit, commodity prices, adequate funding and the ability of the Company to bring its projects into production.

Management evaluates the carrying value of each mineral interest on a reporting period basis or as changes in events and circumstances warrant, and makes a determination based on exploration activity and results, estimated future cash flows and availability of funding as to whether capitalized costs are impaired. Mineral property interests, where future cash flows are not reasonably determinable, are evaluated for impairment based on management's intentions and determination of the extent to which future exploration programs are warranted and likely to be funded.

Ownership in mineral interests involves certain inherent risks due to the difficulties of determining and obtaining clear title to the claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral interests.

Deferred exploration costs

The Company defers all exploration costs relating to mineral properties and areas of geological interest until the properties to which they relate are placed into production, sold, abandoned or management has determined there to be an impairment. These costs will be amortized on the basis of units produced in relation to the estimated reserves available on the related property following commencement of production or written-off to operations in the period related properties are abandoned.

Values

The amounts shown for mineral properties and deferred exploration costs represent costs incurred to date, net of impairments, and do not necessarily represent present or future values which are entirely dependent upon the economic recovery from production or from disposal.

Asset retirement obligations

The Company has adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook section 3110, "Asset retirement obligations". This standard focuses on the recognition and measurement of liabilities related to obligations associated with the retirement of property, plant and equipment. Under this standard, these obligations are initially measured at fair value and subsequently adjusted for any changes resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. The asset retirement cost is to be capitalized to the related asset and amortized into earnings over time.

Mineral property related retirement obligations are capitalized as part of deferred exploration and development costs and amortized over the estimated useful lives of the corresponding mineral property.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Asset retirement obligations (cont'd...)

At September 30, 2009 and 2008, management has determined that there are no material asset retirement obligations to the Company.

Impairment of long-lived assets

The Company follows the recommendations of the CICA Handbook section 3063, "Impairment of Long-Lived Assets". Section 3063 establishes standards for recognizing, measuring and disclosing impairment of long-lived assets held for use. The Company conducts its impairment test on long-lived assets when events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment is recognized when the carrying amount of an asset to be held and used exceeds the undiscounted future net cash flows expected from its use and disposal. If there is an impairment, the impairment amount is measured as the amount by which the carrying amount of the asset exceeds its fair value, calculated using discounted cash flows when quoted market prices are not available.

Financial instruments

The Company adopted the CICA Handbook Sections 3855, "Financial Instruments – Recognition and Measurement"; Section 3856, "Hedges"; Section 3862, "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments Presentation". Section 3855 prescribes when a financial instrument is to be recognized on the balance sheet and at what amount. Under Section 3855, financial instruments must be classified into one of five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets, or other financial liabilities. All financial instruments, including derivatives, are measured at the balance sheet date at fair value except for loans and receivables, held-to-maturity investments, and other financial liabilities which are measured at amortized cost. Section 3862 and Section 3863 replace Section 3861, "Disclosure and Presentation" and revise and enhance disclosure requirements while carrying forward presentation requirements.

The Company's financial instruments consist of cash, short-term investments, receivables, reclamation bond, accounts payable and due to related parties. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency, or credit risks arising from these financial instruments. The Company has made the following classifications for the financial instruments:

- (i) Cash and short-term investments – held-for-trading; measured at fair value;
- (ii) Receivables – loans and receivables; measured at amortized cost;
- (iii) Reclamation bond – held to materiality; measured at amortized costs; and
- (iv) Accounts payable and due to related parties – other financial liabilities; recorded at amortized cost.

Fair value estimates are made at the balance sheet date, based on relevant market information and other information about financial instruments, and approximate carrying values unless otherwise noted.

The Company has determined that it does not have derivatives or embedded derivatives.

The Company does not use any hedging instruments.

Future income taxes

Future income taxes are recorded using the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Stock-based compensation

The Company has adopted the accounting standards issued by the CICA Handbook Section 3870, "Stock-based compensation and other stock-based payments", which recommends the fair-value based method for measuring compensation costs. The Company determines the fair value of the stock-based compensation using the Black-Scholes option pricing model.

Comprehensive income

The Company adopted CICA Handbook Section 1530, "Comprehensive Income". Section 1530 establishes standards for the reporting and presenting of comprehensive income which is defined as the change in equity from transaction and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income (loss). At September 30, 2009 and 2008 the Company had no significant items that caused other comprehensive loss to be different than net loss.

Loss per share

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the period. Basic and diluted loss per common share are calculated using the weighted-average number of common shares outstanding during the period. For the periods presented, dilutive loss per share is equal to basic loss per share.

Flow-through shares

The Company provides certain share subscribers with a flow-through component for tax incentives available on qualifying Canadian exploration expenditures. The Company renounces the qualifying expenditures upon the issuance of the respective flow-through common shares and accordingly is not entitled to the related taxable income deductions from such expenditures.

The Company has adopted the recommendation by the Emerging Issues Committee ("EIC") of the CICA relating to the recording of flow-through shares. EIC 146 stipulates that future income tax liabilities resulting from the renunciation of qualified resource expenditures by the Company from the issuance of flow-through shares are recorded as a reduction of share capital. Any corresponding realization of future income tax benefits resulting in the utilization of prior year losses available to the Company not previously recorded, whereby the Company did not previously meet the criteria for recognition, are reflected as part of the Company's operating results in the period the Company files the appropriate tax documents with the Canadian tax authorities.

Accounting changes

CICA Handbook Section 1506, "Accounting Changes," establishes criteria for changes in accounting policies, accounting treatment and disclosure regarding changes in accounting policies, estimates and corrections of errors. In particular, this section allows for voluntary changes in accounting policies only when they result in the financial statements providing reliable and more relevant information. This section requires changes in accounting policies to be applied retrospectively unless doing so is impracticable.

Capital disclosure

CICA Handbook Section 1535 "Capital Disclosure", specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as a capital; (iii) whether the entity has not complied with any capital requirements; and (iv) if it has not complied, the consequences of such noncompliance. The Company has included disclosures recommended by this new section in Note 11 to these financial statements.

General standards for financial statement presentation

In June 2007, the CICA modified section 1400 "General Standards of Financial Statement Presentation" in order to require that management make an assessment of the Company's ability to continue as going concern over a period which is at least, but not limited to, twelve months from the balance sheet date. The Company has included this required disclosure in Note 1 to these financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Credit risk and the fair value of financial assets and financial liabilities

In January 2009, the CICA approved EIC 173, "Credit Risk and the Fair Value of Financial Assets and Liabilities". This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. The implementation of the recommendations of this new section has not had a material impact on the Company's financial statements.

Mining exploration costs

In March 2009 the CICA approved EIC 174, "Mining Exploration Costs". The guidance clarified that an enterprise that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The implementation of the recommendations of this new section has not had a material impact on the Company's financial statements.

Recent accounting pronouncements

In 2006, the Canadian Accounting Standards Board ("AcSB") published a strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with International Financial Reporting Standards ("IFRS") over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own generally accepted accounting principles. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended September 30, 2010. The Company continues to monitor and assess the impact of Canadian GAAP and IFRS.

Other accounting pronouncements issued by the CICA with future effective dates are either not applicable or are not expected to be significant to the financial statements of the Company.

3. SHORT-TERM INVESTMENTS

Short-term investments consists of highly liquid Canadian dollar denominated guaranteed investment certificates with term to maturity of greater than ninety days but not more than one year. The counter-parties are financial institutions. At September 30, 2009, the instruments were yielding an annual interest rate of 1.70 % (2008 – 2.80%). The fair market value of the Company's short-term investment approximates its carrying value at the balance sheet dates.

4. MINERAL PROPERTY

	September 30, 2009	September 30, 2008
Okeover Property, British Columbia, Canada	\$ 150,750	\$ 89,000

Title to mining properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mining properties. The Company has investigated title to its mineral property and to the best of its knowledge, title to its property is in good standing.

On March 8, 2006 the Company acquired Goldrush Resources Ltd.'s ("Goldrush") option with Eastfield Resources Ltd. ("Eastfield") whereby Goldrush had the right to earn an interest in mineral exploration claims located north of Powell River in British Columbia (the "Okeover Property") from Eastfield.

PROPHECY RESOURCE CORP.
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2009

4. MINERAL PROPERTY (cont'd...)

Subject to an underlying agreement, the Company paid \$5,000 and issued 100,000 shares with a fair value of \$12,000 to Goldrush to acquire the option during the year ended September 30, 2006. Pursuant to the underlying agreement, the Company paid the final \$10,000 due to Goldrush during the year ended September 30, 2007. The Company also paid \$27,000 to Eastfield for property payments. During the year ended September 30, 2009, the Company paid an additional \$36,750 to Eastfield for property payments.

The Company can earn a 60% interest, subject to a 2.5% net smelter royalty, in the Okeover Property from Eastfield in exchange for cash and common shares as follows:

- \$5,000 cash to be paid upon the acquisition of the option (paid); and
- \$100,000 in exploration expenditures by September 30, 2006 (completed).

The Company also has the following optional commitments:

- \$10,000 in cash or issuance of common shares by March 8, 2007 (issued common shares),
- \$20,000 in cash or issuance of common shares by March 8, 2008 (paid),
- \$25,000 in cash or issuance of common shares by March 8, 2009, (paid)
- \$50,000 in cash or issuance of common shares by March 8, 2010; and
- Have completed \$1,000,000 in cumulative exploration expenditures by March 8, 2010 (completed).

At September 30, 2009, the Ministry of Energy, Mines and Petroleum Resources of British Columbia holds a \$6,500 (2008 - \$6,500) reclamation bond from the Company to guarantee reclamation of the environment on the Okeover Property.

5. DEFERRED EXPLORATION COSTS

The following exploration costs were incurred on the Okeover Property to September 30, 2009:

Balance as at September 30, 2007	\$ 498,315
Assay and drilling	323,793
Consulting	95,577
Field expenses	131,697
Road building	12,213
Property maintenance	2,957
	<u>566,237</u>
Government grant	<u>(45,965)</u>
	<u>520,272</u>
Balance as at September 30, 2008	1,018,587
Field expenses	<u>1,282</u>
Balance as at September 30, 2009	<u>\$ 1,019,869</u>

6. RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with related parties:

- a) Paid office rent of \$18,000 (2008 - \$19,000) to a company controlled by a director and officer of the Company;
- b) Paid management fees of \$15,000 (2008 - \$17,000) to a director and officer of the Company; and

PROPHECY RESOURCE CORP.
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2009

6. RELATED PARTY TRANSACTIONS (cont'd...)

- c) Paid \$Nil (2008 - \$226,660) to a private company in which a director is a 50% partner for exploration work incurred on the Company's property.

These transactions were in the normal course of operations and were measured at the exchange amount, which was the amount of consideration established and agreed to by the related parties.

At September 30, 2009 \$Nil (2008 - \$5,307) was owing to related parties. Amounts due to related parties are non-interest bearing, unsecured and have no fixed terms of repayment. The fair value of amounts due to related parties is not determinable as they have no specified repayment terms.

7. SHARE CAPITAL

	Number of Shares	Amount	Contributed Surplus	Total
Authorized				
Unlimited common shares without par value				
Issued				
Balance as at September 30, 2007	8,250,000	\$ 906,557	\$ 178,767	\$ 1,085,324
Private placement	1,450,000	507,500	-	507,500
Finder's warrants	-	(7,005)	7,005	-
Share issuance costs	-	(37,800)	-	(37,800)
Exercise of warrants	1,400,000	210,000	-	210,000
Stock-based compensation	-	-	13,133	13,133
Renounced flow-through shares	-	(190,450)	-	(190,450)
Balance as at September 30, 2008	11,100,000	1,388,802	198,905	1,587,707
Stock-based compensation	-	-	2,626	2,626
Balance as at September 30, 2009	11,100,000	\$ 1,388,802	\$ 201,531	\$ 1,590,333

As at September 30, 2009, there are 457,500 (2008 - 1,372,500) common shares included in share capital being held in escrow subject to a three year escrow agreement pursuant to TSX-V policies.

2009

There were no share capital transactions during the year ended September 30, 2009.

2008

On November 2, 2007 the Company completed a non-brokered private placement of 1,450,000 flow-through units at a price of \$0.35 per unit for gross proceeds of \$507,500. Each unit consisted of one common share of the Company and one half share purchase warrant, with each full warrant exercisable into one additional common share of the Company for a period of eighteen months from closing at an exercise price of \$0.45 per share. Finder's fees of \$37,800 were paid on a portion of this placement along with the issuance of 108,000 finder's warrants, exercisable at \$0.35 per share until April 30, 2009. The granting of these 108,000 finder's warrants resulted in stock-based compensation expense, calculated using the Black-Scholes option pricing model, of \$7,005 which has been charged to share issuance costs. The Company has included the fair value of the warrants in share capital.

During the year ended September 30, 2008 a total of 1,400,000 warrants were exercised for proceeds of \$210,000.

7. SHARE CAPITAL (cont'd...)

Flow-through shares

In accordance with accounting recommendations relating to the issuance of flow-through shares (Note 2), the Company reduced from flow-through share proceeds assigned to share capital and recognized as a future tax liability, the estimated tax effect of the timing difference resulting from renouncing exploration expenditures using currently enacted tax rates and laws.

Concurrently the Company recognized a future income tax recovery from the utilization of available tax losses of prior periods to offset the future tax liability recognized. The Company has not previously recognized tax benefits relating to losses of prior periods as the criteria for recognition had not been met.

8. STOCK OPTIONS AND WARRANTS

Stock options

The Company follows the policies of the TSX-V under which it would be authorized to grant options to executive officers and directors, employees and consultants enabling them to acquire up to 10% of the issued and outstanding common stock of the Company. Under the policies, the exercise price of each option equals the market price or a discounted price of the Company's stock as calculated on the date of grant. The options can be granted for a maximum term of five years.

The Company expenses the fair value of all stock-based compensation awards as determined using the Black-Scholes option pricing model. There were no stock options granted during the year ended September 30, 2009. During the year ended September 30, 2008, the Company granted 200,000 incentive stock options, exercisable at \$0.25 per share for a two year period, to investor relations consultants. These options were cancelled during fiscal 2009. The fair value of the 200,000 stock options granted was estimated at \$15,759 and had a vesting provision which allocated the amount of compensation to be recorded over a twelve month service period. During the year ended September 30, 2009, the Company recognized \$2,626 (2008 - \$13,133) in compensation expense related to the options granted. The weighted average fair value of the stock options granted in 2009 was \$Nil (2008 - \$0.08).

The following assumptions were used for the Black-Scholes valuation of stock options granted during the year:

	2009	2008
Risk-free interest rate	-	3.55%
Expected life	-	2 years
Annualized volatility	-	53%
Dividend yield	-	0%

The following options were outstanding at September 30, 2009:

Number of Shares	Exercise Price	Expiry Date
450,000	\$0.25	February 14, 2012

Stock option transactions are summarized as follows:

	Number of Options Outstanding	Number of Options Exercisable	Weighted Average Exercise Price
Balance, September 30, 2007	450,000	450,000	\$ 0.25
Options granted	200,000	166,667	0.25
Balance, September 30, 2008	650,000	616,667	0.25
Options expired/cancelled	(200,000)	(166,667)	0.25
Balance, September 30, 2009	450,000	450,000	0.25

PROPHECY RESOURCE CORP.
NOTES TO THE FINANCIAL STATEMENTS
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8. STOCK OPTIONS AND WARRANTS (cont'd...)

Stock options (cont'd...)

The weighted average life remaining of the stock options outstanding and exercisable at September 30, 2009 is 2.37 years.

Warrants

There were no warrants outstanding at September 30, 2009.

The following assumptions were used for the Black-Scholes valuation of agent's warrants granted during the year ended September 30, 2008 (Note 7):

	2009	2008
Risk-free interest rate	-	3.98%
Expected life	-	1.5 years
Annualized volatility	-	52%
Dividend yield	-	0%

Warrant transactions and the number of warrants are summarized as follows:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Life Remaining (in years)
Balance, September 30, 2007	2,570,000	\$ 0.23	0.65
Issued	833,000	0.44	-
Exercised	(1,400,000)	0.15	-
Expired	(420,000)	0.20	-
Balance, September 30, 2008	1,583,000	0.42	0.59
Expired	(1,583,000)	0.42	-
Balance, September 30, 2009	-	\$ -	-

9. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

	2009	2008
Cash paid during the year for interest	\$ -	\$ -
Cash paid during the year for income taxes	\$ -	\$ -

There were no significant non-cash transactions during the year ended September 30, 2009.

The significant non-cash transactions during the year ended September 30, 2008 included:

- a) Recording finder's warrants as share issuance costs at a fair value of \$7,005 (Note 7).
- b) Recording in due to related parties \$5,307 for deferred exploration expenditures.
- c) Recording a government grant of \$45,965.

PROPHECY RESOURCE CORP.
NOTES TO THE FINANCIAL STATEMENTS
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10. INCOME TAXES

	2009	2008
Net loss before income taxes	\$ (105,833)	\$ (180,026)
Expected income tax recovery at 31% (2008 – 31.80%)	\$ (32,808)	\$ (57,248)
Non-deductible items	814	(7,829)
Share issuance costs	(11,702)	36,525
Tax credits earned	-	(34,933)
Tax rate change	4,275	19,672
Change in valuation allowance	-	(60,887)
Future income tax	\$ (39,421)	\$ (104,700)

The significant components of the Company's future income tax assets and liabilities are as follows:

	2009	2008
Canadian exploration expenses	\$ (197,134)	\$ (205,000)
Investment tax credits	22,982	23,000
Non-capital losses	127,823	96,250
Net future tax liability	\$ (46,329)	\$ (85,750)

The Company has non-capital losses of approximately \$511,000 which may be available to offset future income for income tax purposes which commence expiring in 2026. Due to the uncertainty of realization of these loss carry-forwards, the benefit is not reflected in the financial statements as the Company has provided a full valuation allowance for the potential future tax assets resulting from these loss carry-forwards.

During the year ended September 30, 2008, the Company issued 1,450,000 flow-through units at a price of \$0.35 per share for proceeds of \$507,500 pursuant to a private placement (Note 9). The flow-through subscription agreements required the Company to renounce certain tax deductions for Canadian exploration expenditures incurred on the Company's mineral property to the flow-through participants. The Company filed the renunciation documentation for \$507,500 of expenditures to the subscribers during 2008 which was effective December 31, 2007. Accordingly, \$190,450, being the taxable benefit renounced, has been charged as a reduction to share capital (Note 9). Concurrent with the renunciation, the Company realized a future tax benefit. The realized tax benefit was recorded as a future income tax recovery during the year ended September 30, 2008, in accordance with CICA EIC-146.

As at September 30, 2008, the Company has satisfied its flow-through commitments and has fulfilled its commitment to expend the funds on qualifying exploration in accordance with the provisions of the Canadian Income Tax Act.

During the year ended September 30, 2008, the Company applied for a mining tax refund from the Government of British Columbia of \$45,965 for exploration work incurred on the Okeover property. This refund was received by the Company during the year ended September 30, 2009.

11. CAPITAL MANAGEMENT

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The property in which the Company currently has an interest is in the exploration stage, as such the Company is dependent on external financing to fund its activities. In order to carry out the planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

The Company is not subject to internally imposed capital requirements and there has been no change to the Company's approach to managing capital.

12. FINANCIAL INSTRUMENTS

The Company is exposed in varying degrees to a variety of financial instrument related risks.

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's primary exposure to credit risk is on its bank accounts and short-term investments, whose balance at September 30, 2009 were \$8,776 and \$60,000 respectively. Bank accounts are held with a major bank in Canada. As all of the Company's cash is held by a Canadian bank and all the short-term investments are also held by the same Canadian bank, there is a concentration of credit risk with one bank in Canada. This risk is managed by using a major bank that is a high credit quality financial institution as determined by rating agencies. The Company's secondary exposure to credit risk is on its receivables and reclamation bond. This risk is minimal as receivables consist primarily of refundable government sales taxes and the reclamation bond is held with government authorities.

Currency Risk

The Company operates in Canada and is therefore not exposed to foreign exchange risk arising from transactions denominated in a foreign currency.

Interest Rate Risk

Interest rate risk is the risk that an investment's value will change due to a change in the level of interest rates. The Company's exposure to interest rate risk relates to its ability to maintain the current rate of interest on its short-term investment.

Liquidity and Funding Risks

Liquidity risk arises through the excess of financial obligations over available financial assets due at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time. Funding risk is the risk that market conditions will impact the Company's ability to raise capital through equity markets under acceptable terms and conditions. Under current market conditions, both liquidity and funding risks are assessed as high.

Industry Risk

The Company is engaged primarily in the mineral exploration field and manages related industry risk issues directly. The Company is potentially at risk for environmental reclamation and fluctuations in commodity based market prices associated with resource property interests. Management is of the opinion that the Company addresses environmental risk and compliance in accordance with industry standards and specific project environmental requirements.

13. SUBSEQUENT EVENTS

Subsequent to September 30, 2009, the Company entered into the following transactions:

- a) The Company entered into an option agreement with Victory Nickel Inc. (“Victory”) to acquire a 100% interest in the Lynn Lake Nickel-Copper Property (the “Lynn Lake Project”) located in Manitoba, Canada. The Company has the right to acquire a 100% interest in the Lynn Lake Project by paying Victory \$4,000,000 over a four year period and incurring \$3,000,000 in exploration expenditures over a three year period. The Company will also issue to Victory 10% of the Company’s outstanding shares, post-financing, and grant Victory the right to participate in future equity financings on a pro-rata basis so that Victory may maintain its 10% interest in the Company. In order to fund the initial property payment to Victory, the Company has agreed to enter into a non-brokered private placement of 7,000,000 units at a price of \$0.05 per unit for gross proceeds of \$350,000, which has been received in full by the Company. Each unit will be comprised of one common share and one-half of one share purchase warrant, with each warrant entitling the holder to purchase an additional share at an exercise price of \$0.10 per share for a period of two years from the date of issuance. The option agreement and private placement are subject to acceptance for filing by the TSX-V.
- b) The Company agreed to grant 1,500,000 stock options to directors and consultants at an exercise price of \$0.25 for a period of 5 years.

PROPHECY RESOURCE CORP.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS For the Year ended September 30, 2009

The following discussion and analysis should be read in conjunction with the annual Financial Statements for Prophecy Resource Corp (the "Company") and related notes for the year ended September 30, 2009. All dollar amounts included therein and in the following management discussion and analysis ("MDA") are stated in Canadian funds. This discussion is based on information available as at December 11, 2009.

This discussion contains forward-looking statements that involve risks and uncertainties. Such information, although considered reasonable by the Company's management at the time of preparation, may prove to be inaccurate and actual results may differ materially from those anticipated in the statements made.

The Company was incorporated under the *Business Corporations Act* (British Columbia) on February 9, 2006 under the name "Prophecy Resource Corp." Prophecy is focused on the acquisition of base and precious metal exploration properties primarily in Canada. The Company has no subsidiaries.

Overview

On March 8, 2006 the Company acquired Goldrush Resources Ltd.'s option with Eastfield Resources Ltd. whereby Goldrush had the right to earn an interest in mineral exploration claims located north of Powell River in British Columbia (the "Okeover Property") from Eastfield. James (Bill) Morton, a director of the Company, is the president and chief executive officer of Eastfield. The Company can earn a 60% interest in the Okeover Property from Eastfield by spending up to \$1,000,000 in exploration on the Okeover Property within four years of the date of the agreement (completed) and by making cash payments totalling \$110,000, of which \$60,000 has been paid. To acquire the option from Goldrush, the Company issued 100,000 shares to Goldrush and made cash payments totalling \$15,000. Upon the Company earning its 60% interest in the Okeover property, the Company and Eastfield intend to form a joint venture for the further exploration and development of the Okeover property, with Prophecy becoming the operator. Notwithstanding the final option payment of \$50,000 due in March 2010, the companies have agreed, by nature of the \$1,000,000 exploration commitment having been completed, to begin sharing ongoing exploration costs at Okeover on a pro rata basis.

In October, 2009 the Company entered into an Option Agreement with Victory Nickel Inc. (TSX:T: NI) whereby Prophecy has the right to acquire a 100% interest in the Lynn Lake Nickel-Copper Project located in Manitoba, Canada, subject to acceptance for filing by the TSX Venture Exchange.

The Okeover Copper-Molybdenum Property

The following represents information summarized from a technical report (the "Okeover Property Report") dated October 5, 2006 entitled "Technical Report on the OK Copper Property", prepared by N.C. Carter, Ph.D. P. Eng. pursuant to the provisions of National Instrument 43-101 ("NI 43-101").

N.C. Carter is a "qualified person" within the meaning of NI 43-101. N.C. Carter is independent of the Company applying all of the tests in section 1.5 of NI 43-101 and has not had prior involvement with the Okeover Property that is the subject of the Okeover Property Report.

The Okeover Property (copper-molybdenum) consists of eleven contiguous legacy and cell mineral claims located in the Vancouver Mining Division of south western British Columbia, 25 kilometres north of Powell River and 145 kilometres northwest of Vancouver. Collectively, the claims cover an area of approximately 5,882 hectares between latitudes 49°59.5' and 50°04.6' North and longitudes 124°37.0' and 124°41.2'

All claims are registered in the name of Eastfield and are subject to a March 4, 2003 option agreement with Robert Edward Mickle of Likely, B.C. whereby Eastfield has the right to earn a 100% interest in the property subject to a 2.5% net smelter royalty interest which may be purchased from the vendor for \$2 million on commencement of commercial production. Cash payments to the vendor totalling \$88,000 have now been completed in addition to the issuance of Eastfield securities amounting to 125,000 shares over the term of the agreement.

Copper and molybdenum mineralization was discovered in creek bottoms in the central part of the Okeover Property in 1965. Between 1966 and 1977, seven companies carried out a number of geological, geochemical and geophysical surveys, mechanical trenching and more than 14,000 metres of drilling. Companies working on the property included Noranda Exploration Company Ltd., Asarco Exploration Company of Canada Limited, Falconbridge Nickel Mines Ltd., Duval International Corporation, Granite Mountain Mines Ltd., Sierra Empire and Western Mines Ltd.

Drilling completed between 1966 and 1977 consisted of 13,831.5 metres of diamond drilling in 82 holes and 12 vertical percussion holes totalling 732 metres. Average diamond drill hole length was 169 metres and the deepest hole drilled was 363 metres in length. Vertical percussion holes were drilled to 61 metres depths.

2008 Exploration Program

On May 22, 2008 Prophecy initiated a six hole (1,449 metre) diamond drilling program at Okeover. The predominant thrust of this program was to significantly expand the known mineral resource at the North Lake Zone, which is one of eight known areas of significant copper-molybdenum mineralization on the Okeover project. Five of the six holes were completed as step outs to the south and west sides of the existing resource area at North Lake, with drill results being announced July 28, 2008.

Highlights of the 2008 drill program include Hole OK-08-03, which intersected 45.5 metres grading 0.33% copper and 0.003% molybdenum, including 12 metres grading 0.41% copper and 0.001% molybdenum. Hole OK-08-03 was drilled 90 metres to the south of the nearest hole in the current North Lake resource area and creates an open southern edge for future expansion of the resource area in this direction.

At Okeover, the objectives of the recent program were achieved and expanded the mineralized area of the North Lake Zone (calculated in 2006 by N.C. Carter, Ph.D., P. Eng to contain 86.8 million tonnes grading 0.31% copper and 0.014% MoS₂) a substantial distance to the south. Prophecy plans to incorporate the drill results from this current program and last year's drilling into an updated North Lake resource estimate to be completed in 2009.

A summary of the drill results from the 2008 exploration programs is as follows:

Hole	Intercept (m)	From (m)	To (m)	Cu %	Mo %
Ok-08-01	57.0	113.0	170.0	0.30	0.003
Including	42.0	122.0	164.0	0.33	0.003
Ok-08-02	26.3	72.5	98.8	0.26	0.002
And	16.5	107.3	123.8	0.33	0.003
Ok-08-03	198.5	39.5	238.0	0.16	0.001
Including	45.5	39.5	85.0	0.33	0.003
Including	12.0	73.0	85.0	0.41	0.001
Ok-08-04	2.2	98.2	98.0	0.21	0.004
Ok-08-05	46.4	2.1	48.5	0.10	0.001

Hole OK-08-06, drilled three kilometres further to the south, returned only anomalous values, with individual three metres sample intervals returning values to 0.28% Cu and 0.029% Mo.

With this drill program now complete, Prophecy has spent over \$1,000,000 in exploration at Okeover and satisfied its work commitment to earn a 60% interest from Eastfield Resources Ltd. (TSX.V: ETF).

Prophecy believes that well situated copper porphyry projects with access to the Asian Rim will continue to be valuable and can be expected to be in higher demand once the current western world recession abates.

The Company spent \$1,282 for field expenses on the Okeover property during the year ended September 30, 2009. As of September 30, 2009 the Company has spent a total of \$1,065,834 on exploration of the Okeover property. During the year ended September 30 2008, the Company applied for a mining tax refund from the Government of British Columbia of \$45,965 for exploration work incurred on the Okeover property. This refund was received during the current fiscal year.

Agreement to acquire Lynn Lake Nickel project in Manitoba

On October 21, 2009 the Company entered into an Option Agreement with Victory Nickel Inc. (TSX:T: NI) whereby Prophecy has the right to acquire a 100% interest in the Lynn Lake Nickel-Copper Project located in Manitoba, Canada, subject to acceptance for filing by the TSX Venture Exchange.

The Lynn Lake Project is located in the historic mining town of Lynn Lake in northern Manitoba, about 320 kilometres by road access northwest of the Thompson mining camp. The property is the former Sherritt Gordon Mines Limited mine site known as the Lynn Lake A mine and Farley mine, comprised of 30 mineral leases covering an area of 590 hectares. The property was operated by Sherritt Gordon from 1953 to 1976 for a total of 24 years, with reported production of 22.2 million tons at an average grade of 1.023% nickel and 0.535% copper. The Lynn Lake project contains a National Instrument 43-101 compliant Measured and Indicated resource of 17 million tonnes with an average grade of 0.62% Nickel and 0.31% Copper at a 0.4% nickel cut-off grade. The Lynn Lake Technical Report, dated December 5, 2007, was prepared by Wardrop Engineering Inc. for Independent Nickel Inc. and is available under Independent Nickel's filings at www.sedar.com.

Under the agreement, Prophecy shall have the right to acquire a 100% interest in the Lynn Lake project by paying Victory an aggregate of \$4,000,000 over a four year period and incurring an aggregate of \$3,000,000 in Exploration Expenditures over a three year period.

As part of the agreement, Prophecy will also issue to Victory 10% of Prophecy's outstanding shares, post financing, and grant Victory the right to participate in future equity financings on a pro rata basis so that Victory may maintain its 10% interest in Prophecy.

In order to fund the initial property payment to Victory, Prophecy has agreed to a non-brokered private placement of 7,000,000 units at a price of \$0.05 per unit for gross proceeds of \$350,000. Each unit will be comprised of one common share and one-half of one share purchase warrant, with each warrant entitling the holder to purchase an additional share at an exercise price of \$0.10 per share for a period of two years from the date of issue.

In addition, Mr. John Lee, CFA, was appointed as a Director of the Company, effective immediately.

On November 30th, 2009 Prophecy announced the appointment of Mr. Greg Hall and Dr. George Gale as Special Advisors of the company.

Mr. Greg Hall is a financial market professional with over 25 years of experience. Currently a director of Silvercorp Metals Inc (NYSE: SVM, TSX: SVM), he was part of the team that helped build Silvercorp into China's largest primary silver producer and the lowest cost silver producer among its industry peers.

Mr. Hall has previously held senior positions at Haywood Securities Inc., Canaccord Capital Corporation, and Leede Financial Markets and will be guiding Prophecy's corporate strategy and financing activities.

Dr. George Gale has been a mineral deposit geologist for more than 40 years. Currently VP Exploration and a director of VMS Ventures Inc. (TSX-V: VMS), he led the exploration activities that resulted in their discovery of the high-grade Manitoba Reed Lake VMS deposit in 2007.

Dr. Gale was the head of the Mineral Deposits Section of the Manitoba Geological Survey from 1977 to 1999. He will advise Prophecy's exploration activities based on his extensive geological expertise in Manitoba.

In conjunction with the foregoing appointments, John Lee, was appointed Chairman and CEO of the Company, with James Brown, the former President, continuing to serve as a Director. In addition, the Company agreed to grant options to consultants on 200,000 shares at an exercise price of \$0.38 per share for a period of five years.

John Lee states "Mr. Hall and Dr. Gale will have an immediate impact in shaping the future of Prophecy. The recent \$192 million acquisition of Canadian Royalties Inc. by China's Jilin Jien Nickel Industry Co. Ltd has set a positive tone for Prophecy, which is in the process of acquiring the former Lynn Lake nickel mine in Manitoba, one of the significant undeveloped NI 43-101 compliant nickel resources in Canada. We are thrilled with the addition of those two veterans to our team and we will work tirelessly to duplicate their previous success within Prophecy."

Options Granted

On October 29, 2009 the Company agreed to grant incentive stock options to directors and consultants on 1,500,000 common shares at an exercise price of \$0.25 per share for a period of five years.

Private Placement for \$1,800,000

On December 9, 2009 Prophecy announced that it had agreed to a non-brokered private placement of 6,000,000 units at a price of \$0.30 per unit for gross proceeds of \$1,800,000. Each unit will be comprised of one common share and one half of one share purchase warrant, with each warrant entitling the holder to purchase an additional share at an exercise price of \$0.40 per share for a period of two years from the date of issue.

In the event that the closing price of Prophecy's common shares on the TSX Venture Exchange is at least \$0.60 for twenty consecutive trading days at any time following four months from the date of closing, the Company may reduce the remaining exercise period of the Warrants to not less than 30 days from the date of providing notice of such reduced exercise period.

A finders fee will be payable on a portion of this placement, which is subject to acceptance for filing by the TSX Venture Exchange.

Going concern issue

The Company is in the exploration stage and has no revenue or income from operations. The Company has limited capital resources and has to rely upon the sale of equity and/or debt securities for cash required for exploration and development purposes, for acquisitions and to fund the administration of the Company. Since the Company does not expect to generate any revenues from operations in the near future, it must continue to rely upon the sales of its equity or debt securities or joint venture agreements to raise capital. It follows that there can be no assurance that financing, whether debt or equity, will be available to the Company in the amount required by the Company at any particular time or for any period and that such financing can be obtained on terms satisfactory to the Company.

The Company's 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 continuing operations of the Company are dependent upon its ability to obtain the necessary financing to meet its ongoing commitments and further its mineral exploration programs.

The Company may encounter difficulty sourcing future financing in light of the recent economic downturn. The current financial equity market conditions and the inhospitable funding environment make it difficult to raise capital through the private placements of shares. The junior resource industry has been severely affected by the world economic situation as it is considered speculative and high-risk in nature, making it even more difficult to fund. While the Company is using its best efforts to achieve its business plans by examining various financing alternatives, there is no assurance that the Company will be successful with any financing ventures.

Management's Discussion and Analysis

The following discussion and analysis is based on the Company's results of operations and financial position and should be read in conjunction with the interim financial statements for the year ended September 30, 2009.

The Company holds an option to earn a 60% interest in eleven contiguous mineral claims in British Columbia totaling approximately 3,950 hectares called the Okeover Property. Subsequent to the period under review, the Company entered into an agreement to acquire a 100% interest in the Lynn Lake Nickel-Copper Project in Manitoba, subject to acceptance for filing by the TSX Venture Exchange. The Company is a resource development company focused on the acquisition and exploration of mineral properties and therefore has no regular cash flow from operations. The level of operations has been determined by the availability of capital resources. To date, private placements have provided the main source of funding.

Results of Operations

Operating expenses for the year ended September 30, 2009 totaled \$111,130 as compared to \$191,174 during the same period a year prior. The significant expenditures were as follows:

During the year ended September 30, 2009 the Company incurred \$23,592 for office, rent and expenses, which was increased from the \$20,990 incurred during the same period a year prior.

During the year ended September 30, 2009 the Company incurred stock-based compensation expense, a non-cash expense, of \$2,626 for options granted to investor relations consultants in 2007 that vested during the period. This compares to stock-based compensation expense of \$13,133 incurred during the same period a year prior when these same options were vested over a longer period.

The Company spent \$13,939 for transfer agent and filing fees during the year ended September 30, 2009. This was reduced from the \$19,460 incurred for transfer agent and filing fees during the same period a year prior when the Company was more actively promoting its shares and raising money through private placements.

During the year ended September 30, 2009 the Company incurred only \$20,298 for shareholder communications expenses, which included web site maintenance, consulting, news release dissemination and advertising. This compares to \$79,055 incurred during the same period a year prior. This reduction was due to Company efforts to conserve cash during the difficult market conditions prevalent during the 2009 fiscal year.

Management fees of \$15,000 incurred during the year ended September 30, 2009 were reduced from the \$17,000 paid during the comparable period a year prior as part of the Company's cost cutting efforts.

During the year ended September 30, 2009 professional fees were reduced to \$35,301 from the \$41,440 incurred during the same period a year prior due to a reduction in legal fees.

During the year ended September 30, 2009 the Company earned interest income of \$5,297 on short-term investments and cash on hand. This is reduced from the \$11,148 earned during the same period a year prior primarily due to a reduction in the Company's cash balance.

During the year ended September 30, 2008, the Company recognized a future income tax recovery of \$104,700 on the renunciation of flow-through shares as a result of the issuance of 2,200,000 flow-through shares during calendar 2007. There were no flow-through shares issued during the year ended September 30, 2009, however the Company recognized a \$39,421 future income tax recovery related to the renunciation of flow-through shares issued in fiscal 2008.

As a result of the foregoing, the Company incurred a net loss after income taxes for the year ended September 30, 2009 of \$66,412 as compared to a loss of \$75,326 for the comparable period a year prior.

Selected Annual Information

	Year ended September 30, 2009	Year ended September 30, 2008	Year ended September 30, 2007
Revenue	Nil	Nil	Nil
Income (Loss) before Other Items	(105,833)	(180,026)	(209,274)
Per Share	(0.01)	(0.02)	(0.03)
Net Income or (Loss)	(66,412)	(75,326)	(163,115)
Per Share	(0.01)	(0.01)	(0.02)
Total assets	\$1,246,342	\$1,355,633	\$846,416
Long-Term Liabilities	Nil	Nil	Nil

The net loss for the fiscal year ended September 30, 2007 of \$163,115 represented an increase from the net loss incurred during fiscal 2006 of \$98,686 (\$131,580 on an annualized basis) due to increased levels of expenditure during the current period in all categories related to the Company becoming publicly traded during the current fiscal period. Expenditures were incurred during fiscal 2007 for shareholder communications, management fees, and transfer agent and filing fees totalling \$77,915 that were not incurred during the prior fiscal period, when the Company was privately held.

The net loss for the fiscal year ended September 30, 2008 was reduced to of \$75,326 primarily due to a future income tax recovery of \$104,700 on the renunciation of flow-through shares during the period as a result of the issuance of 2,200,000 flow-through shares during calendar 2007. This was offset by increased expenditures during the current period for shareholder communications and professional fees.

The net loss for the year ended September 30, 2009 was reduced to \$66,412, primarily due to a future income tax recovery of \$39,421. Additionally, significant expense reductions were achieved in shareholder communications expense, stock-based compensation (a non-cash item), professional fees and transfer agent and filing fees.

Summary of Quarterly Results

	<u>Q4-09</u>	<u>Q3-09</u>	<u>Q2-09</u>	<u>Q1-09</u>	<u>Q4-08</u>	<u>Q3-08</u>	<u>Q2-08</u>	<u>Q1-08</u>
Revenue	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Net Income (Loss) (\$)	18,993	(11,701)	(48,791)	(24,913)	(33,717)	(31,219)	34,391	(44,781)
Per Share (Loss) (\$)	(0.00)	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	0.01	(0.01)

The loss for the first quarter of fiscal 2008 increased to \$44,781 primarily due to the elimination of an allowance for future income tax recovery of \$34,680 incurred during the fourth quarter of fiscal 2007 as a result of the issuance of 850,000 flow-shares during fiscal 2006 and renounced during fiscal 2007. This served to reduce the loss for the fourth quarter period to \$16,878 from the \$51,558 that would have been recorded otherwise, with the decrease in net loss to \$44,781 for the first quarter of 2008 due primarily to a reduction in charges for stock based compensation to \$1,313 from the \$26,392 incurred during the fourth quarter, offset by an additional charge of \$8,000 for investor relations consulting incurred during the first quarter of fiscal 2008.

The Company recorded income for the second quarter of fiscal 2008 of \$34,391 primarily due to recording a future income tax recovery of \$92,380 during the period as a result of the issuance of 2,200,000 flow-through shares during the prior calendar year. This served to offset the loss for the period of \$57,989 that would have been recorded otherwise, with the increase from the \$44,781 incurred during the first quarter of 2008 the result of additional professional fees incurred during the second quarter for preparation of the Company's audited financial statements for the prior fiscal year.

As there was no future income tax recovery in the third quarter of fiscal 2008, the Company incurred a loss of \$31,219 for the period. When compared to prior fiscal periods, this reduced loss was primarily as a result of reductions in expenditures for professional fees and transfer agent and filing fees, offset by additional expenditures for consultants providing shareholder communications services. The loss for the fourth quarter of fiscal 2008 was relatively unchanged at \$33,717.

The loss during the first quarter of fiscal 2009 was reduced to \$24,913 from the \$33,717 incurred during the fourth quarter of fiscal 2008 primarily due to a reduction in professional fees and expenditures on shareholder relations during the current period.

During the second quarter of fiscal 2009 the loss increased to \$48,791 as a result of additional professional fees and Part XII.6 tax paid to the Government of Canada during the period on funds raised by the Company through flow-through share offerings during prior years.

The loss for the third quarter of fiscal 2009 was reduced to \$11,701 due to the elimination of expenditures on professional fees and Part XII.6 during the quarter.

The Company recorded income for the fourth quarter of fiscal 2009 of \$18,993 primarily due to recording a future income tax recovery of \$39,421 during the period, which offset the loss of \$20,428 that would have been recorded otherwise, an increase over the third quarter of fiscal 2009 as a result of accounting fees accrued during the period for the completion of the year end audited financial statements for fiscal 2009.

Liquidity and Capital Resources

Prophecy is in the development stage and therefore has no regular cash flow. As at September 30, 2009, the Company had working capital of \$56,004, inclusive of cash and short-term investments on hand of \$69,223. This compares to working capital of \$222,243 at September 30, 2008, inclusive of cash on hand and short term investments of \$187,787.

At September 30, 2009 the Company had current assets of \$69,223, total assets of \$1,246,342 and total liabilities of \$13,219. The Company has no long-term debt other than a liability for future income taxes of \$46,329. There are no known trends in the Company's liquidity or capital resources.

The principal assets of the Company are its mineral exploration properties, amounting to \$1,170,619 as at September 30, 2009.

The decrease in cash during the year ended September 30, 2009 of \$9,011 was primarily due to cash used in operating activities of \$55,979 and cash invested in mineral properties of \$63,032, offset by cash received from the redemption of short-term investments of \$110,000.

The decrease in cash during the year ended September 30, 2008 of \$10,218 was primarily due to cash used by operations of \$113,988 and cash used for property exploration and acquisition expenditures of \$580,930, offset by cash received from share issuances of \$679,700.

The Company had sufficient funds on hand at September 30, 2009 to fund its operating expenses for the coming fiscal year but will not have sufficient funds to conduct additional exploration at its Okeover property. In November, 2007 the Company completed a private placement of flow-through securities for gross proceeds of \$507,500 to fund phase II exploration work on its Okeover property during fiscal 2008. This enabled Prophecy to earn its 60% interest in the Okeover property, with Eastfield and the Company intending to form a joint venture to fund further exploration on the Okeover project in proportion to their respective interests. At that time, the Company may have to obtain other financing or raise additional funds in order to continue to fund its share of Okeover exploration expenses.

In December 2009 the Company agreed to a non-brokered private placement of 6,000,000 units at a price of \$0.30 per unit for gross proceeds of \$1,800,000. This will provide the Company with sufficient funding to satisfy its obligations on the Lynn Lake Nickel project and working capital for at least the next six months, at which time the Company will be required to raise additional capital. Although the company has been successful in the past in obtaining financing through the sale of equity securities, there can be no assurance that the Company will be able to obtain adequate financing in the future or that the terms of such financing will be favorable. Failure to obtain such additional financing could result in the delay or indefinite postponement of further exploration and development of the Okeover property.

Cash flow to date has not satisfied the Company's operational requirements. The development of the Company may in the future depend on the Company's ability to obtain additional financings. In the past, the Company has relied on the sale of equity securities to meet its cash requirements. Future developments, in excess of funds on hand, will depend on the Company's ability to obtain financing through joint venturing of projects, debt financing, equity financing or other means. There can be no assurances that the Company will be successful in obtaining any such financing or in joint venturing its property.

Off Balance Sheet Arrangements

The Company has no off Balance Sheet arrangements.

Changes in Accounting Policies

Adoption of New Accounting Standards and Accounting Pronouncements

Effective January 1, 2008, the Company adopted the following new accounting standards that were issued by the Canadian Institute of Chartered Accountants. These accounting policy changes were adopted on a prospective basis with no restatement of prior period financial statements:

(i) *Financial Instrument Disclosures and Presentation*

CICA Handbook Sections 3862 "*Financial Instruments – Disclosures*" and Section 3863 "*Financial Instruments – Presentation*" replace Section 3861 "*Financial Instruments – Disclosure and Presentation*". The new standards carry forward the presentation requirements for financial instruments and enhance the disclosure requirements by placing increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

(ii) *Capital Disclosures*

CICA Handbook Section 1535 requires the company to disclose (a) its objectives, policies and processes for managing capital; (b) quantitative data about what the entity regards as capital; (c) whether the entity has complied with any capital requirements; and (d) if it has not complied, the consequences of such noncompliance.

(iv) *Going Concern*

CICA Handbook Section 1400 - General Standards of Financial Statements. The new standard requires management to make an

assessment of the Company's ability to continue as a going concern, and to disclose any material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

New Accounting Pronouncements Effective in Future Periods

CICA Handbook Section 3064 - Goodwill and other intangibles assets. This new section replaces Section 3062, Goodwill and other intangible assets and Section 3450, Research and development costs. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Management does not expect the adoption of this new standard to have a material impact on the financial statements of the Company or its business. The Company will adopt the new standards for its fiscal year beginning October 1, 2009.

International Financial Reporting Standards (IFRS)

In 2006, the Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transitional date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended September 30, 2010.

Management plans for conversion include internal training, external consulting on complex issues and Board and Audit Committee oversight. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS. Management has attended briefing seminars on the transition to IFRS, and we are awaiting the release of various exposure drafts and reports which will more clearly define the accounting standards for the mining exploration industry.

Risk, Uncertainties and Outlook

The business of mineral deposit exploration and extraction involves a high degree of risk. Few properties that are explored ultimately become producing mines. At present, none of the Company's properties has a known commercial ore deposit. Operations, the status of mineral property rights and the recoverability of amounts shown for mineral properties can be affected by changing economic, regulatory and political situations. Other risks facing the Company include competition for mineral properties, environmental and insurance risks, fluctuations in metal prices, fluctuations in exchange rates, share price volatility and uncertainty of additional financing.

Related Party Transactions

During the year ended September 30, 2009, \$18,000 was paid to a private company wholly-owned by Stuart Rogers, a director and Chief Financial Officer of the Company, for office rent and administration services provided to the Company.

During this same period, \$15,000 was paid to James Brown, the President and a director of the Company, for management services provided.

These amounts were incurred in the ordinary course of business.

Contingencies

The Company is aware of no contingencies or pending legal proceedings as of December 11, 2009.

Equity Securities Issued and Outstanding

The Company had 11,100,000 common shares issued and outstanding as of December 11, 2009. In addition, there were 2,150,000 incentive stock options outstanding as of December 11, 2009.

Disclaimer

The information provided in this document is not intended to be a comprehensive review of all matters concerning the Company.

It should be read in conjunction with all other disclosure documents provided by the Company, which can be accessed at www.sedar.com. No securities commission or regulatory authority has reviewed the accuracy or adequacy of the information presented herein.

Certain statements contained in this document constitute “forward-looking statements”. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressly stated or implied by such forward-looking statements. Such factors include, among others, the following: mineral exploration and development costs and results, fluctuation in the prices of commodities for which the Company is exploring, competition, uninsured risks, recoverability of resources discovered, capitalization requirements, commercial viability, environmental risks and obligations, and the requirement for obtaining permits and licenses for the Company’s operations in the jurisdictions in which it operates.