

PROPHECY DEFI INC.

(Formerly Bucephalus Capital Corp.)

Consolidated Financial Statements

For the Years Ended December 31, 2021 and 2020

(Expressed in Canadian dollars)

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of the Company have been prepared by management in accordance with International Financial Reporting Standards. These consolidated financial statements contain estimates based on management's judgment. Management maintains an appropriate system of internal controls to provide reasonable assurance that transactions are authorized, assets safeguarded, and proper records maintained.

The Audit Committee of the Board of Directors reviews the results of the annual audit and the consolidated financial statements prior to submitting the consolidated financial statements to the Board for approval.

The Company's auditors, Kingston Ross Pasnak LLP, are appointed by the shareholders to conduct an audit and their report follows.

Signed: "**John McMahon**"
Chief Executive Officer

Toronto, Ontario
May 2, 2022



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ROSS
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May 2, 2022
Edmonton, Alberta

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Prophecy DeFi Inc.

Opinion

We have audited the consolidated financial statements of Prophecy DeFi Inc. (the "Company"), which comprise the consolidated statement of financial position as at December 31, 2021, and the consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2021, and the consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Company in accordance with ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The consolidated financial statements for the year ended December 31, 2020 were audited by another auditor who expressed an unmodified opinion on those financial statements on April 28, 2021.

Other Information

Management is responsible for the other information. The other information comprises the information, other than the consolidated financial statements and our auditor's report thereon, which includes Management's Discussion and Analysis.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

(continues)

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Independent Auditor's Report to the Shareholders of Prophecy DeFi Inc. *(continued)*

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

The engagement partner on the audit resulting in this independent auditor's report is Jane Davidson, CPA, CA.

Kingston Ross Pasmak LLP
Kingston Ross Pasmak LLP
Chartered Professional Accountants

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Consolidated Statement of Financial Position

(In Canadian Dollars)

	December 31, 2021	December 31, 2020
Assets		
Current assets		
Cash	\$ 6,652,988	\$ 18,424
Digital currencies (note 6)	6,187,917	-
Accrued interest receivable (note 8)	7,539	24,811
Prepaid expenses and deposits (note 7)	71,990	750
Accounts receivable	-	17,653
Bridge loans, current portion (note 8)	10,000	36,020
Portfolio investments (note 9)	94,179	258,866
	<u>13,024,613</u>	<u>356,524</u>
Bridge loans (note 8)	89,520	-
Office premise and other (note 10)	998,471	-
Goodwill (note 11)	19,704,882	-
	<u>\$ 33,817,486</u>	<u>\$ 356,524</u>
Liabilities		
Accounts payable and accrued liabilities (note 18)	\$ 429,665	\$ 530,364
Lease liability, current portion (note 12)	103,718	-
	<u>533,383</u>	<u>530,364</u>
Lease liability (note 12)	513,735	-
Convertible debentures (note 13)	4,817,723	-
	<u>5,864,841</u>	<u>530,364</u>
Shareholders' Equity		
Share capital (note 14(b))	28,327,353	3,235,409
Contributed surplus (note 14(c))	7,377,693	35,343
Deficit	(9,405,670)	(3,444,592)
Accumulated other comprehensive loss	1,653,269	-
Total shareholders' equity	<u>27,952,645</u>	<u>(173,840)</u>
	<u>\$ 33,817,486</u>	<u>\$ 356,524</u>

On Behalf of the Board:

"John McMahon" _____ Director

"Stuart Hensman" _____ Director

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

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Consolidated Statement of Changes in Shareholders' Equity

For the Year Ended December 31, 2021

(In Canadian Dollars)

	Share Capital	Contributed Surplus	Deficit	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	\$	\$	\$	\$	\$
Balance, December 31, 2019	3,235,409	35,343	(3,069,259)	-	201,493
Net income (loss) for the year	-	-	(375,333)	-	(375,333)
Balance December 31, 2020	3,235,409	35,343	(3,444,592)	-	(173,840)
Issuance of shares, net of costs	23,380,243	3,663,206	-	-	27,043,449
Issuance of performance warrants (note 14(c)(iii))	-	1,731,500	-	-	1,731,500
Issuance of broker warrants (note 14(c)(iv))	-	160,650	-	-	160,650
Issuance of stock options (note 14(d))	-	2,299,725	-	-	2,299,725
Exercise of warrants (note 14(b))	1,257,884	(506,398)	-	-	751,486
Exercise of stock options (note 14(b))	293,193	(97,193)	-	-	196,000
Convertible debentures (note 13)	160,624	90,860	-	-	251,484
Net income (loss) for the year	-	-	(5,961,078)	-	(5,961,078)
Unrealized gain on digital currencies	-	-	-	1,653,269	1,653,269
Balance December 31, 2021	28,327,353	7,377,693	(9,405,670)	1,653,269	27,952,645

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

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)
Consolidated Statement of Operations and Comprehensive Loss
For the Year Ended December 31, 2021
(In Canadian Dollars)

	2021	2020
Revenue		
Realized gain on sale of portfolio investments (note 9)	\$ 693,508	\$ -
Fee income	653,949	-
Realized gain on digital currencies	208,722	-
Interest income	11,181	5,098
Foreign exchange gain	45	912
Discount on note (note 8(c))	(71,074)	-
Change in value of portfolio investments (note 9(b) and (c))	(154,934)	92
Dividend income	-	1,268
Credit losses	-	(60,836)
	<u>1,341,397</u>	<u>(53,466)</u>
Expenses		
Stock based compensation (note 14(d))	2,299,725	-
Service agreement (note 14(c)(iii))	1,731,500	-
Promotional	1,041,839	-
Consulting fees (note 18)	652,827	276,000
Salaries	484,648	-
Audit and legal fees	448,962	17,100
Office expenses	135,736	3,431
Director fees	124,223	-
Filing and listing fees	118,350	25,336
Amortization (note 10)	75,106	-
News releases and investor relations	64,043	-
Memberships	57,883	-
Insurance	38,880	-
Interest on lease liability (note 12)	15,757	-
Interest on convertible debentures (note 13)	12,996	-
	<u>7,302,475</u>	<u>321,867</u>
Net loss	(5,961,078)	(375,333)
Other comprehensive loss		
Unrealized gain on digital currencies	1,653,269	-
Comprehensive loss for the year	<u>\$ (4,307,809)</u>	<u>\$ (375,333)</u>
Net loss per share (note 15)		
Basic	\$ (0.06)	\$ (0.01)
Diluted	\$ (0.06)	\$ (0.01)
Weighted average number of shares outstanding		
Basic	84,289,264	29,514,241
Diluted	84,289,264	29,514,241

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

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Consolidated Statement of Cash Flows
For the Year Ended December 31, 2021
(In Canadian Dollars)

	2021	2020
Operating activities		
Net income (loss) for the year	\$ (5,961,078)	\$ (375,333)
Adjustments for non-cash items:		
Change in value of portfolio investments	154,934	(619)
Stock based compensation	2,299,725	-
Service agreement	1,731,500	-
Promotional	150,000	-
Amortization	75,106	-
Fee income	(653,949)	-
Realized gain on sale of portfolio investments	(693,508)	-
Realized gain on digital currencies	(208,722)	-
Discount on loan	71,074	-
Financing fees	6,584	-
Interest income	-	(4,739)
Credit losses	-	60,836
Net changes in non-cash working capital balances		
Accrued interest receivable	17,272	745
Prepaid expenses	(71,240)	(100)
Accounts receivable	17,653	3,318
Accounts payable	(156,300)	279,733
	<u>(3,220,949)</u>	<u>(36,159)</u>
Investing activities		
Advances of bridge loans	(157,068)	-
Cash acquired on business combination	199,216	-
Proceeds from sale of portfolio investments	745,971	-
Purchase of digital currencies	(1,850,100)	-
Purchase of furniture and office equipment	(412,918)	-
	<u>(1,474,899)</u>	<u>-</u>
Financing activities		
Proceeds from financing activities	10,441,890	-
Exercise of stock options	196,000	-
Exercise of warrants	751,486	-
Payments of lease obligation	(58,964)	-
	<u>11,330,412</u>	<u>-</u>
Increase (decrease) in cash	6,634,564	(36,159)
Cash, beginning of year	18,424	54,583
Cash, end of year	\$ 6,652,988	\$ 18,424
Interest paid	\$ 26,420	\$ -
Income taxes paid	\$ -	\$ -

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

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

1. Nature of Business

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.) ("PDFI" or the "Company") invests its funds for the purpose of generating returns from capital appreciation and income. It plans to accomplish these goals by bringing together technology start-ups in the Blockchain and Decentralized Finance sectors to fund innovation, elevate industry research, and create new business opportunities in a coherent ecosystem. The Company is a public company incorporated and domiciled in Ontario, Canada. The Company's registered office is located at 87 Scollard Street, Suite 100, Toronto, Ontario M5R 1G4. The Company's subordinate voting shares commenced trading on the Canadian Securities Exchange ("CSE") on March 14, 2016.

In early 2020, there was a global outbreak of COVID-19 (coronavirus), which had a significant impact on businesses through restrictions put in place by the Canadian federal, provincial, and municipal governments regarding travel, business operations, and isolations/quarantine orders. While the Company has not yet experienced any material impact on its ability to conduct operations, it is unknown the extent of the future impact the COVID-19 outbreak may have on the Company as this will depend on future developments that are highly uncertain and that cannot be predicted with confidence. These uncertainties arise from the inability to predict the ultimate geographic spread of the disease and the duration of the outbreak, including the duration of travel restrictions, business closures or disruptions and quarantine/isolation measures that are currently, or may be put, in place by Canada and other countries to fight the virus.

2. Basis of Presentation

Statement of Compliance

These consolidated financial statements, including comparative periods have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements include those of Prophecy Defi Inc. and its wholly owned subsidiaries, Bradstone Financial Corp. ("BFC") and Layer2 Blockchain Inc. ("Layer2"), from the date on which control is acquired by the Company. Consolidation ended on March 2, 2021 for BFC, the date the Company sold 100% of its shares. The financial statements for the consolidated entity are prepared for the same reporting period as the Company, using consistent accounting policies. All intercompany transactions and balances have been eliminated in the preparation of these consolidated financial statements.

The reporting currency used for the consolidated financial statements is Canadian dollars. The functional currency used by the Company and its subsidiary is Canadian dollars.

These consolidated financial statements were approved by the Company's Board of Directors on May 2, 2022.

These consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair value.

3. Summary of Significant Accounting Policies

These consolidated financial statements have been prepared by management in accordance with IFRS. Outlined below are those policies considered particularly significant for the Company.

A. Use of Estimates

The preparation of these consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of

contingent liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the year. Financial statement items subject to significant management judgment include:

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies - continued

A. Use of Estimates - continued

- Credit losses – Management exercises judgement to determine the expected credit losses on loans (note 3 (B)).
- Valuation of portfolio investments – Where investments are not traded in an active market, management exercises judgement to determine the fair value of these assets. These assumptions include observation of recent private sales on the underlying securities (if available).
- The Black-Scholes option pricing model is used to determine the fair value of the share-based payments and utilizes subjective assumptions such as expected price volatility and expected life of the option. Discrepancies in these input assumptions can significantly affect the fair value estimate (note 3 (I)).
- Business combinations – assumptions and estimates are made in determining the fair value of assets and liabilities, including the identification and valuation of separately identifiable intangible assets acquired as part of an acquisition and the allocation of the purchase price. These estimates may be further based on management's best assessment of the related inputs used in valuation models, such as future cash flows and cost of capital.
- Office premise and other – Management determines the carrying value of its office premise based on policies that incorporate assumptions, estimates and judgements relative to the useful lives and residual values of assets.
- Impairment of non-financial assets – Impairment exists where the carrying value of an asset, or CGU exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value. The fair value less costs of disposal calculated is based on available data from binding sales transactions in an arm's length transaction of similar assets or other observable market prices less incremental costs of disposal. The value in use calculation is based on discounted cash flow models. The estimated future cash flows are derived from management assumptions, estimates, budgets and past performance and do not include activities that the Company is not yet committed to or significant investments that will enhance the asset's performance of the CGU being tested. The recoverable amount is sensitive to the cost of capital used for the discounted cash flow model as well as the expected future cash flows.
- Revenue recognition – The Company recognizes revenue from the provision of liquidity. As consideration for these services, the Company receives digital currency. Management has exercised significant judgment in determining the completion stage for this revenue stream and examined various factors surrounding the substance of the Company's operations, and determined the stage of completion being the receipt of proceeds to the Company's control.
- Going concern – The Company regularly reviews and makes an assessment of its ability to continue as a going concern. This assessment relies on significant judgements and assumptions, taking into account all known future information.
- Digital currencies valuation – Digital currencies consist of cryptocurrency denominated assets and are included in current assets. The digital currency market is still a new market and is highly volatile, historical prices are not necessarily indicative of future value and a significant change in the market prices for digital currencies would have a significant impact on the Company's earnings and financial position.
- Income taxes – Income taxes are subject to measurement uncertainty due to possible changes in tax legislation or changes in the characterization of income sources. Further, estimating income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the ability to use the underlying future tax deductions against future taxable income. The Company's assessment to recognize a deferred tax asset is based upon estimating tax laws and estimates of future taxable income.

While management believes that the estimates and assumptions are reasonable, actual results may differ materially from those estimates.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies – continued**B. Financial instruments**

Financial assets and financial liabilities, including derivatives, are recognized on the statements of financial position when the Company becomes a party to the financial instrument or derivative contract.

Classification

The Company classifies its financial assets and financial liabilities in the following measurement categories:

- (1) those to be measured subsequently at fair value through profit or loss (“FVTPL”);
- (2) those to be measured subsequently at fair value through other comprehensive income (“FVTOCI”);
and
- (3) those to be measured subsequently at amortized cost.

The classification of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows. Financial liabilities are classified as those to be measured at amortized cost unless they are designated as those to be measured subsequently at FVTPL (irrevocable election at the time of recognition). For assets and liabilities measured at fair value, gains and losses are recorded in the statements of operations and comprehensive loss.

The Company reclassifies financial assets when and only when its business model for managing those assets changes. Financial liabilities are not reclassified.

The Company’s classification and measurements of financial assets and liabilities are summarized below:

	IFRS 9
	Classification
Cash	Amortized cost
Accrued interest receivable	Amortized cost
Accounts receivables	Amortized cost
Bridge loans	Amortized cost
Portfolio investments	FVTPL
Accounts payable and accrued liabilities	Amortized cost
Convertible debentures	Amortized cost

Financial assets at amortized cost

This category includes financial assets that are held within a business model with the objective to hold the financial assets in order to collect contractual cash flows that meet the solely payment of principal and interest (“SPPI”) criterion. Financial assets classified in this category are measured at amortized cost using the effective interest method.

Financial assets at fair value through profit or loss

This category includes derivative instruments as well as equity instruments which the Company has not irrevocably elected, at initial recognition or transition, to classify at FVTOCI. This category also includes debt instruments whose cash flow characteristics fail the SPPI criterion or are not held within a business model whose objective is either to collect contractual cash flows, or to both collect contractual cash flows and sell. Financial assets in this category are recorded at fair value with changes recognized in the statements of operations and comprehensive loss.

Measurement

All financial instruments are required to be measured at fair value on initial recognition, plus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are directly attributable to the acquisition or issuance of the financial asset or financial liability. Transaction costs of financial assets and financial liabilities carried at FVTPL are expensed in profit or loss. Financial assets and financial liabilities with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies – continued**B. Financial instruments - continued**

Financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of the subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods, with any changes taken through the statements of operations and comprehensive loss.

Fair value hierarchy

Financial assets measured at fair value or where their fair value is disclosed in the notes must be classified into one of the three hierarchy levels set forth below for disclosure purposes. Each level is based on the transparency of the inputs used to measure the fair value of assets and liabilities.

- Level 1: Inputs are unadjusted quoted prices of identical instruments in active markets;
- Level 2: Valuation models which utilize predominately observable market inputs; and
- Level 3: Valuation models which utilize predominately non-observable market inputs.

The classification of a financial asset in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value.

The Company's fair value financial instruments are classified as follows:

<i>Financial instrument</i>	<i>Classification</i>
Portfolio investments	Levels 1 and 3

At the end of each reporting period, management estimates the fair value of investments based on the criteria below and reflects such valuations in the restated financial statements.

- Securities including shares, options, and warrants which are traded in an active market, such as on a recognized securities exchange and for which no sales restrictions apply, are presented at fair value based on quoted closing trade prices at the end of the reporting period or the closing trade price on the last day the security traded if there were no trades at the end of the reporting period. These are included in Level 1 of the fair value hierarchy.
- For options, warrants, and conversion features which are not traded on a recognized securities exchange, no market value is readily available. When there are sufficient and reliable observable market inputs, a valuation technique is used. Valuation models such as the Black-Scholes valuation model ("Black-Scholes") are used when there are sufficient and reliable observable market inputs. These market inputs include risk-free interest rate, exercise price, market price at the date of valuation, expected dividend yield, expected life of the instrument and expected volatility of the underlying security based on historical volatility. These are included in Level 2 of the fair value hierarchy.
- Convertible debts and loans issued by investee companies are generally valued at the price in which the instrument was issued. The Company regularly considers whether any indications of deterioration in the value of the underlying business exist, which suggest that the debt instrument will not be fully recovered. The fair value of convertible debentures is measured using valuation techniques such as Black-Scholes model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment and assumptions provided by management is required in establishing fair values. Judgments include consideration of inputs such as credit risk, discount rates, volatility, probability of certain triggering events, and share price of private company borrowers. Changes in assumptions relating to these factors could affect the reported fair value of the financial instruments. These are included in Level 3 of the fair value hierarchy.
- Private company investments
All privately-held investments (including options, warrants, and conversion features) are initially recorded at the transaction price, being the fair value at the time of acquisition. At the end of each reporting period, the fair value of an investment may (depending upon the circumstances) be adjusted using one or more of the valuation indicators described below.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies - continued**B. Financial instruments - continued**

The determination of fair value of the Company's privately-held investments at other than initial cost, is subject to certain limitations. Financial information for private companies in which the Company has investments, may not be available and, even if available, that information may be limited and/or unreliable.

Use of the valuation approach described below may involve uncertainties and determinations based on management's judgment and any value estimated from these techniques may not be realized or realizable.

Company-specific information is considered when determining whether the fair value of a privately-held investment should be adjusted upward or downward at the end of each reporting period. In addition to company-specific information, the Company will also consider trends in general market conditions and the share performance of comparable publicly-traded companies when valuing privately-held investments.

The fair value of a privately-held investment may be adjusted if:

- i. There has been a significant subsequent equity financing provided by outside investors at a valuation different than the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place;
- ii. There have been significant corporate, political, or operating events affecting the investee company that, in management's opinion, have a material impact on the investee company's prospects and, therefore, its fair value. In these circumstances, the adjustment to the fair value of the investment will be based on management's judgment and any value estimated may not be realized or realizable;
- iii. The investee company is placed into receivership or bankruptcy;
- iv. Based on financial information received from the investee company, it is apparent to the Company that the investee company is unlikely to be able to continue as a going concern;
- v. Release by the investee company of positive/negative operational results; and
- vi. Important positive/negative management changes by the investee company that the Company's management believes will have a very positive/negative impact on the investee company's ability to achieve its objectives and build value for shareholders.

Adjustments to the fair value of a privately-held investment will be based upon management's judgment and any value estimated may not be realized or realizable. The resulting values for non-publicly traded investments may differ from values that would be realized if a ready market existed.

In addition, the amounts at which the Company's privately-held investments could be currently disposed of may differ from the carrying value assigned.

Convertible Debentures

Convertible debentures issued by the Company are comprised of convertible unsecured debentures that can be converted to common shares at the option of the holder. The host liability component of a compounded financial instrument is recognized initially at the fair market value of a similar liability that does not have an equity conversion option. Any directly attributable transaction costs are allocated entirely to the host liability component.

Expected credit losses on financial assets

Determining an allowance for expected credit losses ("ECLs") for all debt financial assets not held at fair value through profit or loss ("FVTPL") requires management to make assumptions about the historical patterns for the probability of default, the timing of collection, and the amount of incurred credit losses, which are adjusted based on management's judgment about whether economic conditions and credit terms are such that actual losses may be higher or lower than what the historical patterns suggest.

Upon disposal of an investment, previously recognized unrealized gains or losses are reversed to recognize the full realized gain or loss in the period of disposition.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies - continued

C. Provisions

The Company recognizes provisions when a legal or constructive obligation exists as a result of past events, when it is probable that there will be an outflow of economic benefits from the entity, and a reliable estimate of the amount of the obligation can be made. When a provision is expected to settle beyond the immediate term, the provision is measured at the present value of future cash flows, discounted at prevailing market interest rates. With the passage of time, additional expenses are recorded as the provision accretes.

D. Business Combinations

All business combinations are accounted for by applying the acquisition method. Upon acquisition the assets (including intangible assets), liabilities and contingent liabilities acquired are measured at their fair value. The Company recognizes identifiable intangible assets as part of business combinations at fair value at the date of acquisition. The determination of these fair values is based upon management's judgement and includes assumptions on the timing and amount of future incremental cash flows generated by the assets acquired and the selection of an appropriate cost of capital. Acquisition and integration costs are recognized in profit or loss as incurred.

Goodwill represents the excess of the identifiable cost of an acquisition over the fair value of the Company's share of the net assets acquired at the date of acquisition. If the identifiable cost of acquisition is less than the fair value of the Company's share of the net assets acquired (i.e. a discount on acquisition) the difference is credited to the statement of income (loss) and comprehensive statement of income (loss) in the period of acquisition. At the acquisition date, goodwill acquired is recognized as an asset and allocated to each cash generating unit ("CGU") expected to benefit from the business combination's synergies and to the lowest level at which management monitors goodwill.

E. Revenue Recognition

The Company derives its income from digital currency received for providing liquidity to decentralized cryptocurrency exchanges. Revenue is recognized by the Company when payment, in the form of digital currency, is received for liquidity services rendered. Revenue is measured based on the fair value of the coins received. The fair value is determined using the daily weighted close price for the digital currency from www.polygonscan.com, www.etherscan.io, www.bscscan.com, www.urorascan.dev and www.explorer.roninchain.co.

Realized gains (losses) on disposal of digital currencies are reflected in the statements of operations and comprehensive loss on the transaction date. The Company has the control of the crypto assets prior to the sale and records revenue at the point in time when the sale is confirmed on the respective blockchain.

Realized gains (losses) on disposals of investments and unrealized gains (losses) on securities classified as FVTPL are reflected in the statements of operations and comprehensive loss on the transaction date and are calculated on an average cost basis. For all financial instruments measured at amortized cost and interest-bearing financial assets, interest income or expenses are recorded using the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or a shorter period where appropriate, to the net carrying amount of the financial asset or financial liability.

F. Foreign Currency Translation

Monetary assets and liabilities denominated in currencies other than Canadian dollars are translated into Canadian dollars at the rate of exchange in effect at the end of the reporting period. Non-monetary assets and liabilities are translated at the historical rates. Revenues and expenses are translated at the transaction exchange rate. Foreign currency gains and losses resulting from translation are reflected in profit or loss.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies - continued**G. Income Taxes**

Income tax comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity or other comprehensive income, in which case the income is also recognized directly in equity or other comprehensive income.

Current income tax is the expected tax payable on the taxable income for the period, using tax rates enacted at the end of the reporting period, and any adjustments to tax payable in respect of previous years. Current tax assets and current tax liabilities are only offset if a legally enforceable right exists to offset the amounts and the Company intends to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Deferred income tax is recognized in respect of all qualifying temporary differences arising between the tax basis of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the end of the reporting period and are expensed to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered. Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset tax assets and liabilities and when the deferred tax balances relate to the same taxation authority.

Deferred tax assets are recognized to the extent future recovery is probable. At each reporting period end, deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

H. Cash

Cash consists of cash balances and highly liquid investments with original maturities of three months or less.

I. Digital currencies

Digital currencies meet the definition of intangible assets as they are identifiable non-monetary assets without physical substance. They are initially recorded at the fair value on the acquisition date and the revaluation method is used to measure the digital assets subsequently. Under the revaluation method, increases in fair value are recorded in other comprehensive income, while decreases are recorded in profit or loss.

The Company revalue its digital assets at the end of its reporting periods. There is no recycling of gains from other comprehensive income to profit or loss. However, to the extent that an increase in fair value reverses a previous decrease in fair value that has been recorded in profit or loss, that increase is recorded in profit or loss. Decreases in fair value that reverse gains previously recorded in other comprehensive income are recorded in other comprehensive income.

The Company holds a variety of digital currencies which are measured at fair value using the quoted prices from www.polygonscan.com, www.etherscan.io, www.bscscan.com, www.urorascan.dev and www.explorer.roninchain.co. The digital currencies are valued based on the daily weighted closing price obtained at the time the digital currencies are acquired and at each reporting date. Management considers the fair value to be a level two input under the fair value hierarchy as the prices from this source represents an average of quoted prices on multiple digital currency exchanges.

The Company's determination to classify its holdings as current assets is based on management's assessment that the digital currencies held can be considered to be a commodity that may be readily sold because liquid markets are available.

J. Office premise and other

Furniture, office equipment and leasehold improvements are stated at historical cost, less any accumulated amortization and accumulated impairment in value. Historical cost includes all costs directly attributable to the acquisition.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies – continued**J. Office premise and other - continued**

Amortization is recognized using the declining balance method at a rate of 20% to amortize the cost of furniture and office equipment to their residual values over their estimated useful lives in profit or loss.

Amortization methods, useful lives and residual values are reviewed at the reporting period date. Such a review takes into consideration the nature of the assets, their intended use and technological changes.

Gains or losses on the sale of furniture and office equipment are determined by comparing the proceeds with the carrying amount and are recognized in the profit or loss in the period of disposition.

Leasehold improvements and right-of-use assets are amortized on a straight-line basis over their lease term and are accounted for at cost less accumulated amortization and reviewed at each balance sheet date to determine whether there is an indication of impairment.

K. Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the identifiable assets and liabilities acquired determined at the date of acquisition. Goodwill is carried at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment annually by assessing the recoverable amount of each CGU to which it relates, where applicable. The recoverable amount is the higher of fair value less costs of disposal, and value in use. When the recoverable amount of the CGU is less than the carrying amount, an impairment loss is recognized. Any impairment is recognized immediately in profit or loss and comprehensive profit or loss.

L. Share-based payments

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which they are granted. In situations where equity instruments are issued to non-employees and some of all of the goods or services received by the entity as consideration cannot be specifically identified, they are measured at fair value of the share-based payment.

The costs of equity-settled transactions are recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (“the vesting date”). The cumulative expense recognized for equity-settled transaction at each reporting date until the vesting date reflects the Company’s best estimate of the number of equity instruments that will ultimately vest. The profit or loss charge or credit for period represents the movement in cumulative expense recognized as at the beginning and end of that period and the corresponding amount is represented in contributed surplus.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied provided that all other performance and/or service conditions are satisfied.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement or is otherwise beneficial to the employee as a measure at the date of modification.

The dilutive effect of outstanding options is reflected as additional dilution in the computation of earnings or loss per share.

M. Loss per share

Basic loss per share is calculated using the weighted average number of multiple, subordinate and common shares outstanding during the period.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

3. Summary of Significant Accounting Policies - continued**M. Loss per share - continued**

Diluted loss per share is calculated by dividing net loss available to shareholders for the period by the diluted weighted average number of multiple, subordinate and common shares outstanding during the period. The diluted weighted average number of shares includes the potential dilution from shares issuable through stock options, if dilutive. This assumes that the proceeds from any shares issued on the exercise of stock options are used by the Company to repurchase and cancel shares at the average market price of the Company's share price for the period. As such, where the strike price of stock options exceeds the average market price of the Company's shares for the reporting period, the inclusion of these shares under the treasury stock method would be anti-dilutive, so these shares are excluded from the calculation of the weighted average number of diluted shares outstanding.

4. Significant New Accounting Standards

The following new standards, amendments and interpretations have been issued but are not effective for the fiscal year ending December 31, 2021 and, accordingly, have not been applied in preparing these consolidated financial statements.

A. Improving Accounting Policy Disclosures and Clarifying Distinction between Accounting Policies and Accounting Estimates (Amendments to IAS 1 and IAS 8)

In February 2021, the IASB issued narrow-scope amendments to IAS 1 Presentation of Financial Statements, IFRS Practice Statement 2 Making Materiality Judgments and IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The amendments to IAS 1 require companies to disclose their material accounting policy information rather than their significant accounting policies. The amendments to IFRS Practice Statement 2 provide guidance on how to apply the concept of materiality to accounting policy disclosures.

The amendments to IAS 8 clarify how companies should distinguish changes in accounting policies from change in accounting estimates. That distinction is important because changes in accounting estimates are applied prospectively only to future transactions and other future events, but changes in accounting policies are generally also applied retrospectively to past transactions and other past events.

The amendments are effective for annual reporting periods beginning on or after January 1, 2023. Earlier application is permitted. The Company is assessing the potential impact of these amendments.

B. IAS 12: Amendment to IAS 12, Deferred Tax Related to Assets and Liabilities Arising from a Single Transaction

In May 2021, the IASB issued targeted amendments to IAS 12 – Income Taxes to specify how companies should account for deferred tax on transactions such as leases and decommissioning obligations. In specified circumstances, companies are exempt from recognizing deferred tax when they recognize assets or liabilities for the first time. Previously, there had been some uncertainty about whether the exemption applied to transactions such as leases and decommissioning obligations transactions for which companies recognize both an asset and a liability. The amendments clarify that the exemption does not apply and that companies are required to recognize deferred tax on such transactions. The aim of the amendments is to reduce diversity in the reporting of deferred tax on leases and decommissioning obligations. The amendments are effective for annual reporting periods beginning on or after January 1, 2023, with early application permitted. The Company is assessing the potential impact of the amendment. The Company applied for the first-time certain standards and amendments, which are effective for annual periods beginning on or after January 1, 2021. The Company has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

4. Significant New Accounting Standards - continued**C. Interest Rate Benchmark Reform – Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16)**

The amendments provide temporary reliefs which address the financial reporting effects when an interbank offered rate (IBOR) is replaced with an alternative nearly risk-free interest rate (RFR). The amendments include the following practical expedients:

A practical expedient to require contractual changes, or changes to cash flows that are directly required by the reform, to be treated as changes to a floating interest rate, equivalent to a movement in a market rate of interest

Permit changes required by IBOR reform to be made to hedge designations and hedge documentation without the hedging relationship being discontinued

Provide temporary relief to entities from having to meet the separately identifiable requirement when an RFR instrument is designated as a hedge of a risk component

These amendments had no impact on the consolidated financial statements of the Company. The Company intends to use the practical expedients in future periods if they become applicable.

D. Covid-19-Related Rent Concessions beyond June 30, 2021 Amendments to IFRS 16

On May 28, 2020, the IASB issued Covid-19-Related Rent Concessions - amendment to IFRS 16 Leases. The amendments provide relief to lessees from applying IFRS 16 guidance on lease modification accounting for rent concessions arising as a direct consequence of the Covid-19 pandemic. As a practical expedient, a lessee may elect not to assess whether a Covid-19 related rent concession from a lessor is a lease modification. A lessee that makes this election accounts for any change in lease payments resulting from the Covid-19 related rent concession the same way it would account for the change under IFRS 16, if the change were not a lease modification.

The amendment was intended to apply until June 30, 2021, but as the impact of the Covid-19 pandemic is continuing, on March 31, 2021, the IASB extended the period of application of the practical expedient to June 30, 2022. The amendment applies to annual reporting periods beginning on or after April 1, 2021.

However, the Company has not received Covid-19-related rent concessions but plans to apply the practical expedient if it becomes applicable within allowed period of application.

5. Business Combination

The Company acquired 60% of the shares of Layer2 Blockchain Inc. ("Layer2"), on July 8, 2021, as consideration the Company issued 25,000,000 common shares of the Company to the shareholders of Layer2. The Company subsequently acquired the remaining 40% of the shares of Layer2 on September 13, 2021, as consideration the Company issued a further 25,000,000 common shares of the Company to the shareholders of Layer2 for a total purchase price of \$21,670,375. Layer2 is a technology company focused on the rapidly emerging Ethereum Layer Two decentralized finance ecosystem. The Company incurred acquisition-related costs of \$43,149, representing legal and other fees, which were recognized through profit or loss in the period.

Goodwill calculated in this acquisition represents the expected synergies from combining the operations of Layer2 with the Company, revenue growth, future market development and expertise in the sector. These benefits are not recognized separately from goodwill as their fair value cannot be measured reliably individually. Goodwill from this acquisition is deductible for tax purposes, and was established as follows:

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

5. Business Combination - continued

Purchase price	\$	21,670,375
Cash		(199,216)
Digital currencies		(1,821,878)
Accounts payable		55,601

Goodwill	\$	19,704,882
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Selected information for the acquisition since the acquisition date:

Revenue	\$	862,671
Operating expenses		(808,193)
Net income		54,478
Unrealized gain on digital currencies		1,653,269

Comprehensive income	\$	1,707,747
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Selected information for the acquisition as if the acquisition had taken place at the beginning of the reporting period:

Revenue	\$	862,671
Operating expenses		(863,807)
Net loss		(1,136)
Unrealized gain on digital currencies		1,174,373

Comprehensive income	\$	1,173,237
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6. Digital Currencies

The continuity of digital currencies for the year ended December 31, 2021:

	December 31 2021	December 31 2020
Opening balance	\$ -	\$ -
Acquired on business combination	1,821,877	-
Purchased	1,850,100	-
Fee income earned	653,949	-
Realized gain on dispositions	208,722	-
Revaluation adjustment	1,653,269	-
Total	\$ 6,187,917	\$ -

7. Prepaid Expenses and Deposits

	December 31 2021	December 31 2020
Prepaid consulting contract	\$ 16,950	\$ -
Prepaid insurance	43,354	-
Lease security deposit	11,686	-
Other prepaid	-	750
Total	\$ 71,990	\$ 750

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

8. Bridge Loans

		Due Date	Stated Interest Rate		December 31 2021	December 31 2020
Individual Corporation	(a)	October 31, 2021	12%	\$	10,000	\$ 10,000
Corporation	(b)	June 30, 2020	12%		-	26,020
Corporation	(c)	March 2, 2026	12%		89,520	-
Total				\$	99,520	\$ 36,020

The fair values of the notes receivable are estimated to be approximately equivalent to their carrying values as the market rate of interest approximates the effective interest rate.

- As at December 31, 2021, \$7,539 (December 31, 2020 - \$5,931) in interest has been accrued. The loan is secured by a promissory note, a corporate guarantee, and equipment. A payment of \$6,000 was due in May 2021 with the remaining principal and interest due on October 31, 2021.
- The loan was based in US dollars and the principal amount of the loan was US\$129,029 or C\$164,396 (December 31, 2020 - C\$164,280). US\$105,000 or C\$133,780 (December 31, 2020 - C\$133,686) was syndicated to other lenders and therefore the net amount of the loan to the Company was US\$24,029 or C\$29,781 (December 31, 2020 - C\$30,594). During the reporting period this loan was settled with shares of Hank Payments Corp. (note 9(c)).
- The principal of the loan is \$148,765. As at December 31, 2021, \$Nil (December 31, 2020 - \$Nil) of interest has been accrued. The Company determined that the interest rate was preferential and has discounted the future cash flows at an effective rate of 12%, with a discount on note of \$ 71,074 recorded in the year.

9. Portfolio Investments

	December 31 2021	December 31 2020
Common shares in Marathon Mortgage Corp. (a)	\$ -	\$ -
Other marketable securities (b) (c)	94,179	258,866
Total	\$ 94,179	\$ 258,866

- As at December 31, 2021, the Company held nil (2020 – 3,358,636) common shares of Marathon Mortgage Corp. (“MMC”). On March 2, 2021, the Company sold its 3,358,636 common shares of MMC at a value of \$670,000.
- As at December 31, 2021, the Company held 1,391,085 –2020 - 437,500) common shares of Uptempo Inc. A fair value adjustment of \$152,076 was recorded in the year.
- As at December 31, 2021, the Company held 284,656, (2020 – nil) common shares of Hank Payments Corp. A fair value adjustment of \$39,852 was recorded in the year.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

10. Office Premise and Other

	Office Premise (Right-of-Use Asset)	Leasehold Improvements	Furniture & Office Equipment	Total
Cost				
Balance, January 1, 2021	\$ -	\$ -	\$ -	\$ -
Additions	660,660	306,875	106,042	1,073,577
Disposals	-	-	-	-
Balance, December 31, 2021	<u>\$ 660,660</u>	<u>\$ 306,875</u>	<u>\$ 106,042</u>	<u>\$1,073,577</u>
Accumulated Amortization				
Balance, January 1, 2021	\$ -	\$ -	\$ -	\$ -
Amortization	(44,044)	(20,458)	(10,604)	(75,106)
Balance, December 31, 2021	<u>\$ (44,044)</u>	<u>(20,458)</u>	<u>(10,604)</u>	<u>(75,106)</u>
Carrying Amount				
Balance, December 31, 2021	<u>\$ 616,616</u>	<u>\$ 286,417</u>	<u>\$ 95,438</u>	<u>\$ 998,471</u>

11. Goodwill

Cost	
Balance, January 1, 2021	\$ -
Business combination (note 5)	19,704,882
Balance, December 31, 2021	<u>\$ 19,704,882</u>
Carrying Amount	
Balance, December 31, 2021	<u>\$ 19,704,882</u>

12. Lease Liability

The Company leases an office premise at 87 Scollard Street, Suite 100, Toronto, Ontario M5R 1G4. The lease expires in 2026, with a five-year option to extend.

The lease liability is measured at the present value of the lease payments that are not paid at the balance sheet date. Lease payments are apportioned between interest expense and a reduction of the lease liability using the Company's incremental borrowing rate to achieve a constant rate of interest on the remaining balances of the liability.

The carrying value of the Company's lease liability is as follows:

Balance, January 1, 2021	\$ -
Addition of lease liability	636,753
Interest expense	15,757
Cash payments	(35,057)
Balance, December 31, 2021	<u>\$ 617,453</u>
Current portion of lease liability	<u>(103,718)</u>
Non-current portion of lease liability	<u>\$ 513,735</u>

As at December 31, 2021, the carrying rate of the Company's lease liability was \$617,453 (December 31, 2020 - \$Nil) and the carrying rate of the right-of-use asset was \$616,616 (December 31, 2020 - \$Nil). During the year ended December 31, 2021, the Company incurred amortization expense of \$44,044 (December 31, 2020 - \$Nil) on the right-of-use asset.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

13. Convertible Debentures

On December 23, 2021, the Company completed the offering of \$5,854,000 aggregate principal amount of 10% unsecured convertible debentures of the Company. Each convertible debenture matures 36 months following the closing of the offering and bears interest at a rate of 10% per annum, payable quarterly in cash. As at December 31, 2021, \$ 12,996 of interest has been paid.

The convertible debentures are convertible into common shares of the Company at the option of the holder at any time prior to the maturity date or on the business day immediately preceding a date fixed for redemption of the convertible debentures, at a conversion price equal to \$0.60 per common share. The Company has the right to force conversion of the convertible debentures at the conversion price if the daily volume weighted average trading price of the common shares on the Canadian Securities Exchange is greater than \$1.20 for 10 consecutive trading days.

Each convertible debenture includes 1,667 common share purchase warrants of the Company. Each warrant is exercisable into one common share at a price of \$0.90 per common share for a period of 36 months from the closing of the offering.

The host liability component of the convertible debentures recognized on the consolidated financial statements of financial position was calculated as follows:

Principal amount outstanding	\$	5,854,000
Less: Transaction costs (net of amortization)		(744,923)
Liability component on initial recognition		5,109,077
Debt discount (net of amortization)		(291,354)
	\$	<u>4,817,723</u>

14. Share Capital

a) Authorized:

Unlimited common shares ("CS")

b) Shares issued and outstanding:

For the year ended December 31	SVS		MVS		CS	
	Number of Shares	Amount	Number of Shares	Amount	Number of Shares	Amount
Balance December 31, 2019	23,752,062	2,559,257	5,762,179	676,152	-	-
Converted from MVS to SVS	57,333	7,783	(57,333)	(7,783)	-	-
Balance December 31, 2020	23,809,395	2,567,040	5,704,846	668,369	-	-
Converted from MVS to SVS (i)	946,491	110,889	(946,491)	(110,889)	-	-
Converted from MVS/SVS to CS (ii)	(61,555,885)	(3,444,740)	(4,758,355)	(557,480)	66,314,240	4,002,220
Private placement, net of costs (iii)	25,000,000	199,795	-	-	-	-
Private placement, net of costs (iv)	9,999,999	405,983	-	-	-	-
Private placement, net of costs (v)	-	-	-	-	10,000,000	954,090
Issuance for business combination (vi)	-	-	-	-	51,000,000	21,670,375
Issuance for fee payable (vii)	-	-	-	-	250,000	150,000
Convertible debentures, net of costs	-	-	-	-	-	160,624
Warrant exercise	-	-	-	-	4,382,972	1,257,884
Stock option exercise	1,800,000	161,033	-	-	200,000	132,160
Balance December 31, 2021	-	-	-	-	132,147,212	28,327,353

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

For the Year Ended December 31, 2021

(In Canadian Dollars)

14. Share Capital - continued

- (i) During the three months ended March 31, 2021, 946,491 multiple voting shares ("MVS") were converted on a one for one basis to 946,491 subordinate voting shares ("SVS"). The rights of MVS and SVS are identical other than voting rights. MVS are entitled to four votes per share whereas SVS are entitled to one vote per share.
- (ii) During the three months ended June 30, 2021, all of the issued and outstanding SVS and MVS of the Company were automatically converted into common shares of the Company on the basis of one common share for each SVS and MVS outstanding.
- (iii) On March 19, 2021, the Company closed a non-brokered private placement issuing 25,000,000 units at a price of \$0.05 per Unit for gross proceeds of \$1,250,000. Each Unit consisted of one subordinated voting common share of the Company and one subordinate voting share purchase warrant. Each full warrant entitles the holder to acquire one additional subordinate voting share expiring on March 19, 2024 at an exercise price of \$0.25. The Company incurred issuance costs of \$422,450 including finder's fees/commissions of \$80,250, \$23,000 in legal fees and 1,750,000 finders warrants entitling certain eligible persons to acquire a Unit exercisable at a price of \$0.05 for a period of thirty-six months from closing, of these costs, \$101,992 has been recorded as share issuance costs.
- (iv) On April 23, 2021, the Company closed a non-brokered private placement issuing 9,999,999 units at a price of \$0.15 per Unit for gross proceeds of \$1,500,000. Each Unit consisted of one subordinated voting common share of the Company and one Common Share purchase warrant. Each full warrant entitles the holder to acquire one additional Common Share for a period of thirty-six months expiring on April 23, 2024 at an exercise price of \$0.25. However, should the closing price at which the Common Shares trade on the Canadian Securities Exchange (or any such other stock exchange in Canada as the Common Shares may trade at the applicable time) exceed \$0.75 for 10 consecutive trading days at any time following the date of issuance, the Company may accelerate the Warrant Term such that the Warrants shall expire on the date which is 30 business days following the date a press release is issued by the Company announcing the Reduced Warrant Term. The Company incurred issuance costs of \$299,915, including finder's fees/commissions of \$126,300, \$29,400 in legal fees and 491,466 finders warrants entitling certain eligible persons to acquire one common share exercisable at a price of \$0.25 for a period of thirty-six months from closing, of these costs, \$101,460 has been recorded as share issuance costs.
- (v) On June 1, 2021, the Company closed a non-brokered private placement issuing 10,000,000 units at a price of \$0.30 per Unit for gross proceeds of \$3,000,000. Each Unit consisted of one common share of the Company and one Common Share purchase warrant. Each full warrant entitles the holder to acquire one additional Common Share for a period of thirty-six months expiring on June 1, 2024 at an exercise price of \$0.50. However, should the closing price at which the Common Shares trade on the Canadian Securities Exchange (or any such other stock exchange in Canada as the Common Shares may trade at the applicable time) exceed \$1.00 for 10 consecutive trading days at any time following the date of issuance, the Company may accelerate the Warrant Term such that the Warrants shall expire on the date which is 30 business days following the date a press release is issued by the Company announcing the Reduced Warrant Term. The Company incurred issuance costs of \$588,697, including commission of \$210,000, \$56,850 in legal fees and 700,000 brokers warrants entitling certain eligible persons to acquire one common share exercisable at a price of \$0.50 for a period of thirty-six months from closing, of these costs, \$232,932 has been recorded as share issuance costs.
- (vi) On July 9, 2021, the Company issued an aggregate of 25,000,000 common shares as consideration for 60% of the issued and outstanding common shares of Layer2. On September 13, 2021, the Company issued an aggregate of 25,000,000 common shares as consideration for the remaining 40% of the issued and outstanding common shares of Layer2. All common shares issued are subject to a four-month and one day resale restriction and voluntary lock-ups of up to 21 months, subject to certain accelerated relates in the event the Company's common shares trade above certain prices. The Company issued 1,000,000 common shares to certain eligible finders. The shares issued to such finder are subject to a four-month and one date resale restriction and the same lock-ups as noted above.

Prophecy DeFi Inc. (formerly Bucephalus Capital Corp.)

Notes to the Consolidated Financial Statements

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(In Canadian Dollars)

14. Share Capital - continued

(vii) On September 13, 2021, the Company issued an aggregate of 250,000 common shares to North Equities Corp. as consideration for a fee payable of \$150,000 for a 6-month marketing and consulting contract. These shares will be subject to a statutory holding period expiring on the date that is four months and one day from the issuance date.

c) Warrants

(i) On March 19, 2021, the Company issued 25,000,000 warrants as part of the private placement financing described in note 8(b). Each warrant entitles the holder to acquire one additional subordinate voting share expiring on March 19, 2024 at an exercise price of \$0.25. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 0.53% discount rate, 0% expected dividend. The resulting value represented approximately 75.9% of the value of the Unit with the remaining 24.1% attributed to the value of the subordinate voting share within the Unit. The warrants were allocated \$948,213 of the net proceeds of the financing.

The Company issued 1,750,000 finders warrants as part of the private placement financing described in note 8(b). Each warrant entitles the holder to acquire one additional Unit expiring on March 19, 2024 at an exercise price of \$0.05. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 0.53% discount rate, 0% expected dividend. The warrants had a value of \$319,200.

(ii) On April 23, 2021, the Company issued 9,999,999 warrants as part of the private placement financing described in note 8(b). Each warrant entitles the holder to acquire one additional subordinate voting share expiring on April 23, 2024 at an exercise price of \$0.25. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 0.49% discount rate, 0% expected dividend. The resulting value represented approximately 66.2% of the value of the Unit with the remaining 33.8% attributed to the value of the subordinate voting share within the Unit. The warrants were allocated \$992,557 of the net proceeds of the financing.

The Company issued 491,466 finders warrants as part of the private placement financing described in note 8(b). Each warrant entitles the holder to acquire one common share expiring on April 23, 2024 at an exercise price of \$0.25. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 0.49% discount rate, 0% expected dividend. The warrants had a value of \$144,196.

(iii) On April 27, 2021, the Company entered into a service agreement with Ninepoint Partners GP Inc. who will receive a \$25,000 per month advisory fee and were issued 5,000,000 performance warrants exercisable at a price of \$0.35 to purchase common shares of the Company for a period expiring on the earlier of 3 years or a date that is 90 days after the advisory ceases to provide services to the Company. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 0.48% discount rate, 0% expected dividend. The warrants had a value of \$1,731,500 which were recorded as a service agreement expense.

(iv) On June 1, 2021, the Company issued 10,000,000 warrants as part of the private placement financing described in note 8(b). Each warrant entitles the holder to acquire one additional subordinate voting share expiring on June 1, 2024 at an exercise price of \$0.50. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 0.51% discount rate, 0% expected dividend. The resulting value represented approximately 60.4% of the value of the Unit with the remaining 39.6% attributed to the value of the subordinate voting share within the Unit. The warrants were allocated \$1,812,978 of the net proceeds of the financing.

The Company issued 700,000 brokers warrants as part of the private placement financing described in note 8(b). Each warrant entitles the holder to acquire one common share expiring on June 1, 2024 at an exercise price of \$0.50. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 0.51% discount rate, 0% expected dividend. The warrants had a value of \$320,740.

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14. Share Capital - continued

On December 23, 2021, the Company issued 473,333 warrants to the lead agent in connection with the issuance of convertible debentures. Each warrant entitles the holder to acquire one common share expiring on December 23, 2024 at an exercise price of \$0.90. The value of a warrant was determined using the Black-Scholes model, using 150% volatility, 3-year term, 1.04% discount rate, 0% expected dividend. The warrants had a value of \$160,650.

d) Stock Options

The Company has a stock option plan (the "Plan") under which the Company may grant options to directors, officers, employees and consultants. The maximum number of common shares reserve for issue under the plan at any point in time may not exceed 10% of the number of shares issued and outstanding. As at December 31, 2021, the Company had 5,489,721 (December 31, 2020 – 480,940) options available for issuance under the plan.

The continuity of outstanding stock options for the year ended December 31, 2021 is as follows:

	Number of stock options	Weighted average exercise price per share \$
Balance, December 31, 2019 and 2020	1,900,000	0.07
Exercised	(2,000,000)	0.07
Expired	(100,000)	0.07
Granted	7,925,000	0.43
Balance, December 31, 2021	7,725,000	0.43

The following table summarizes the assumptions used with the Black-Scholes valuation model for the determination of the share-based payments for the stock options issued during the year ended December 31, 2021:

Grant Date	March 19, 2021	April 28, 2021	June 23, 2021	July 22, 2021
Number of options	1,400,000	2,150,000	875,000	600,000
Exercise Price	\$0.22	\$0.42	\$0.60	\$0.35
Expected life in years	3	3	3	3
Volatility	150%	150%	150%	150%
Risk-free interest rate	0.46%	0.48%	0.61%	1.42%
Dividend yield	0.00%	0.00%	0.00%	0.00%
Vesting	Immediately	Immediately	Immediately	Immediately
Fair value of options granted	\$236,040	\$729,065	\$353,325	\$186,480
Grant Date	August 4, 2021	September 1, 2021	September 8, 2021	December 31, 2021
Number of options	500,000	500,000	500,000	1,400,000
Exercise Price	\$0.36	\$0.36	\$0.45	\$0.60
Expected life in years	3	3	3	3
Volatility	150%	150%	150%	150%
Risk-free interest rate	1.42%	1.28%	0.54%	1.02%
Dividend yield	0.00%	0.00%	0.00%	0.00%
Vesting	6 months	6 months	6 months	Immediately
Fair value of options granted	\$164,000	\$145,750	\$157,550	\$454,440

During the year ended December 31, 2021, the Company recognized \$2,299,725 of stock based compensation related to stock options granted (December 31, 2020 - \$Nil).

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15. Income (loss) per Share

Basic income (loss) per share has been calculated using the weighted average number of SVS, MVS and CS outstanding during the period. Diluted income (loss) per share has been calculated using the weighted average number of SVS, MVS and CS outstanding during the period as the effect of stock options and warrants issued and outstanding are considered antidilutive.

16. Income Taxes

The following table reconciles the expected income tax provision at the Canadian federal and provincial statutory rate of 26.5% (2020 – 26.5%) to the amounts recognized in the consolidated statement of operations and comprehensive loss:

	December 31, 2021	December 31, 2020
Loss before income taxes	\$ (4,307,809)	\$ (375,333)
Expected income tax recovery	(1,141,569)	(99,460)
Stock based compensation	609,427	-
Unrealized gain on digital currencies	(438,116)	-
Other adjustments	-	(340)
Change in tax benefits not recognized	970,258	99,800
Income tax	\$ -	\$ -

Deferred taxes are provided as a result of temporary differences that arise due to the difference between the income tax values and the carrying amount of assets and liabilities. Deferred tax assets have not been recognized in respect of the following deductible temporary differences.

	December 31, 2021	December 31, 2020
Non-capital losses	\$ 1,496,490	\$ 2,269,380
Leasehold improvements, furniture & office equipment	(24,596)	-
Office premise	222	-
Financing fees	(38,085)	-
Marketable securities	-	890,850
Bridge Loans	-	12,260
Share issuance costs	-	1,640
Tax asset not recognized	(1,434,031)	(3,174,130)

As at December 31, 2021, the Company has approximately \$5,647,132 of non-capital losses carry forward available to reduce taxable income for future years. These losses will expire in 2035 to 2041.

17. Fair Value and Financial Risk Management

Financial instruments recorded at fair value on the consolidated statement of financial position are classified using a fair value hierarchy that reflects the observability of significant inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 Valuation is based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 Valuation techniques are based on inputs other than quoted prices included in Level 1 that are observations for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 Valuation techniques include one or more significant inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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17. Fair Value and Financial Risk Management - continued

The fair value hierarchy required the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Investments consisted of the following at December 31, 2021 and 2020.

	Level 1 Quoted Market Price \$	Level 2 Observable Market Inputs \$	Level 3 Non- Observable Market Inputs \$	Total Fair Value \$
Investments				
As at December 31, 2021				
Equities	94,179	-	-	94,179
Total Investments	94,179	-	-	94,179
As at December 31, 2020				
Equities	21,663	-	231,603	258,866
Total Investments	21,663	-	231,603	258,866

There were no changes in the classification of financial instruments between levels 1, 2, and 3 during the years ended December 31, 2021 and 2020.

The primary goals of the Company's risk management programs are to ensure that the outcomes of activities involving elements of risk are consistent with the Company's objectives and risk tolerance, and to maintain an appropriate risk/reward balance while protecting the Company's financial operations from events that have the potential to materially impair its financial strength. Balancing risk and reward is achieved through aligning risk tolerance with the Company's business strategy, diversifying risk, pricing appropriately for risk, mitigating risk through preventative controls and transferring risk to third parties.

Capital Management

The Company considers the items included in shareholders' equity as capital. The Company's capital management objectives are to maintain a strong and efficient capital structure to provide liquidity to support continued asset growth. A strong capital position also provides flexibility in considering accretive growth opportunities. It is the intention of the Company in the long term to pay out a portion of its future annual earnings to shareholders in the form of dividends. There has been no change in the capital management approach from the prior period.

Risk Management

The success of the Company is dependent upon its ability to assess and manage all forms of risk that affect its operations. The Company is exposed to many factors that could adversely affect its business, financial conditions or operating results. Developing policies and procedures to identify risk and the implementation of appropriate risk management policies and procedures is the responsibility of senior management and the Board of Directors. The Board directly, or through its committees, reviews and approves these policies and procedures, and monitors their compliance with them through ongoing reporting requirements. A description of the Company's most prominent risks follows.

Credit Risk

Concentration of credit risk may arise from exposures to a single debtor or to a group of debtors having similar characteristics such that their ability to meet their current obligations is expected to be affected similarly by changes in economic or other conditions. The Company is exposed to credit risk on its cash, accrued interest receivable, and bridge loans. The Company's maximum exposure to credit risk is \$6,760,047 (December 31, 2020 - \$96,908).

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17. Fair Value and Financial Risk Management - continuedMarket Risk

The Company is exposed to certain market risk that the value of, or future cash flows from, the Company's financial assets will significantly fluctuate due to changes in market prices. The value of the financial assets can be affected by changes in interest rates, foreign exchange rates, and equity and commodity prices. The Company is required to mark to market its fair value through profit or loss investments at the end of each reporting period. This process could result in significant write-downs of the Company's portfolio investment over one or more reporting periods, particularly during periods of overall market instability, which would have a significant unfavorable effect on the Company's financial position.

Digital Currencies Risk

Digital currencies are measured using level two fair values, determined by taking the rates from www.polygonscan.com, www.etherscan.io, www.bscscan.com, www.urorascan.dev and www.explorer.roninchain.co.

Digital currency prices are affected by various forces including global supply and demand, interest rates, exchange rates, inflation or deflation and the global political and economic conditions. The profitability of the Company is directly related to the current and future market price of coins; in addition, the Company may not be able to liquidate its inventory of digital currency at its desired price if required. A decline in the market prices for coins could negatively impact the Company's future operations. The Company has not hedged the conversion of any of its coin sales.

Digital currencies have a limited history, and the fair value historically has been very volatile. Historical performances of digital currencies are not indicative of their future price performance.

Liquidity Risk

Liquidity risk is the risk that the Company will not have sufficient cash to meet its obligations as they become due. As at December 31, 2021, the Company has cash of \$6,652,988 (December 31, 2020 - \$18,424) to meet current financial liabilities of \$533,383 (December 31, 2020 - \$530,364).

Currency Risk

The Company is exposed to certain currency risks that the value of certain financial instruments will fluctuate due to changes in foreign exchange rates. At December 31, 2021, none (December 31, 2020 - one) of the Company's bridge loans receivable is denominated in US dollars. A 10% fluctuation in the US dollar foreign exchange closing rate would have resulted in a fluctuation of approximately \$nil (December 31, 2020 - \$1,300) in net loss. The Company does not hedge against this foreign currency risk.

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18. Transactions with Related Parties

- a) The bridge loan described in note 8(c) was made to a company that has a common director with the Company.
- b) Compensation of key management personnel

The remuneration expense of directors and other members of key management personnel during the year ended December 31, 2021 and 2020 as follows:

	<u>2021</u>		<u>2020</u>
Consulting fees and salaries	\$ 404,170	\$	112,000
Stock based compensation	1,153,835		-
	\$ 1,558,005	\$	112,000

- c) As at December 31, 2021, included in accounts payable is \$68,905 (December 31, 2020 - \$202,382) due to directors and officers of the Company.
- d) Equity transactions

A director and key management personnel were issued 3,100,000 shares of the Company with a value of \$59,436 during the year.

A director and key management personnel were issued 3,100,000 warrants of the Company with a value of \$147,562 during the year.

Current and former directors and officers of the Company exercised 1,700,000 stock options for total gross proceeds of \$175,000 during the year.

19. Commitments and ContingenciesManagement Contingency

The Company is party to certain management contracts. These contracts require that additional payments of up to approximately \$1,080,000 be made upon the occurrence of certain events such as a change of control or termination. As a triggering event has not taken place, the contingent payments have not been reflected in these consolidated financial statements.

Legal Contingency

The Company is, from time to time, involved in various claims and legal proceedings. The Company cannot reasonably predict the likelihood or outcome of these activities. The Company does not believe that adverse decisions in any pending or threatened proceedings related to any matter, or any amount which may be required to be paid by reasons thereof, will have a material effect on the financial condition or future results of operations.

20. Subsequent Events

On February 12, 2022, a claim was commenced against Layer2 Blockchain Inc. and several other defendants for equitable relief or, in the alternative, damages in an amount to be determined. The Company believes this action is without merit and it intends to defend the proceeding. At this stage, it is not possible to predict the outcome of the proceedings.

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20. Subsequent Events - continued

On April 6, 2022, the Company provided an update regarding the exposure it's wholly owned subsidiary, Layer2 Blockchain Inc. had to the Ronin Network and its recent security breach. Layer2 has been providing liquidity to the decentralized exchange (DEX), Katana, which runs on the Ronin blockchain. Layer2 had approximately \$1 million of tokens deployed into a liquidity pool on the Katana DEX prior to the security breach. Currently, Layer2 has access to the tokens it has deployed into a Katana liquidity pool. The Ronin Network bridge will open once it has undergone a security upgrade and several audits.

21. Comparatives

Certain comparative information has been rearranged wherever necessary for the purpose of comparison.