



1986 ANNUAL REPORT



PEGASUS GOLD INC.

A COMPANY
IN TRANSITION



Contents

Table Of Highlights . . .	Inside Front Cover
Corporate Profile	1
Letter From the President	2
Report on Operations	5
Exploration	10
Ore Reserves and	
Gold Equivalent Production	12
Consolidated Highlights	13
Mineral Inventory	13
Management's Discussion and Analysis of	
Financial Condition and	
Results of Operations	14
Financial Statements	16
Notes to Financial Statements	21
Auditors' Report	39
Corporate Information	40
	Inside Back Cover

TABLE OF HIGHLIGHTS

January	- Completed acquisition of Centennial Minerals, operator of the Montana Tunnels mine. - Replaced agreement on the development of the Montana Tunnels mine with USMX giving Pegasus a 100 percent working interest.
February	- Acquired 20 percent interest in USMX to bring total ownership to 29.4 percent
March	- Ground breaking at Montana Tunnels mine
April	- Ground breaking at Florida Canyon
May	- Completed \$25 million gold bond issuance in Europe
June	- Began construction of facilities at Montana Tunnels Began construction of facilities at Florida Canyon
July	- Acquired Relief Canyon mine from Lacana Mining, Inc.
August	- Completed \$15 million (43,000 ounces) gold loan with Citibank
September	- Commenced mining at Florida Canyon - Commenced preproduction mining at Montana Tunnels
October	- Completed 60,000,000 Swiss franc stock convertible debenture issuance in Switzerland - Commenced mining at Relief Canyon
November	- First gold pour at Florida Canyon - First gold pour at Relief Canyon
December	- Reached record production of 92,000 ounces of gold

Pegasus Gold Inc. is a British Columbia corporation which was created from the amalgamation in 1984 of Pegasus Gold Ltd. and Montoro Gold Inc. Pegasus is primarily engaged in the mining of gold and silver minerals and actively pursues the exploration and development of precious metal properties, principally in the western United States. All of Pegasus' mining operations are carried out in the United States through the Company's wholly owned U.S. subsidiary, Pegasus Gold Corporation.

Pegasus Gold Corporation operates the Zortman/Landusky mine in north central Montana, one of the largest heap leaching operations in the world. Since the inception of mining in 1979, the mine has produced 437,000 ounces of gold and 1,012,000 ounces of silver from 29,000,000 tons of ore. The Company also operates the Florida Canyon and Relief Canyon mines in northwestern Nevada. In addition, the Company recently placed into production the Montana Tunnels mine near Helena, Montana.

Morrison-Knudsen Engineers completed a feasibility study on the Florida Canyon project in November 1985. The preliminary design and engineering was based on a heap leaching operation processing 2,000,000 tons of ore per year for nine years. The current plans call for mining total ore reserves of 24,000,000 tons at a grade averaging 0.024 ounces of gold per ton over the six-year life of the mine at the rate of 4,000,000 tons per year. Total capital costs to bring the project on line were \$18 million, including initial working capital of \$1.3 million. Construction at the site began in April, 1986, mining commenced in September, and in November the first gold was poured. At full

production, the Florida Canyon mine will produce an estimated 65,000 ounces of gold annually.

In March 1986, Pegasus announced it had acquired a three-month option to purchase Relief Canyon, a heap leach mine, from Lacana Gold Inc. In July, 1986 Pegasus exercised the option to purchase the Relief Canyon mine from Lacana for 325,000 common shares of the Company and a \$200,000 cash payment. Pegasus commenced mining operations at Relief Canyon in October, and in November the first gold was poured. Current plans are to heap leach at a rate of 2,000,000 tons of ore per year. Relief Canyon is expected to produce 40,000 ounces of gold on an annual basis.

In February 1986, Pegasus acquired a 100 percent working interest in the Montana Tunnels property from USMX by agreeing to provide all of the project financing. The interest is subject to a minimum 5 percent net profits royalty interest during payback of capital and financing costs, and a 50 percent net profits royalty interest thereafter. A feasibility study completed by Wright Engineers Limited of Vancouver, British Columbia, dated October 1985, indicated that the Montana Tunnels Project had mineable proven and probable ore reserves of approximately 41,000,000 tons with a gold equivalent grade of 0.043 ounces per ton. The capital cost of the Project was estimated to be \$57.5 million, including working capital of \$4.5 million. Initial site preparation and road construction began in early March 1986. Financing arrangements were completed in October, and milling of ore commenced in late March 1987. The actual capital cost of the project totalled only \$51.5 million. Based on the projections contained in the feasibility study, Montana

Tunnels will produce an average of 106,000 ounces of gold, 1,700,000 ounces of silver, 26,000 tons of zinc and 6,000 tons of lead per year.

In February 1986, Pegasus acquired an additional 20 percent ownership interest in U.S. Minerals Exploration Company (USMX), the original owner of the Montana Tunnels property. The Company now owns 29 percent of the outstanding common stock of USMX. Pegasus has designated two members of the USMX Board of Directors, commensurate with its ownership position.

In August 1986, Pegasus acquired a 1.5 percent ownership interest in an Australian company, Pan Australian Mining Ltd. Early in 1987, an additional 1.5 percent was purchased, and more recently another 7 percent was purchased to bring our total equity interest to 10 percent. In addition, a 50/50 joint venture has been entered into with Pan Australian to explore 580 square miles of land in Queensland, Australia. Pan Australian has one producing property, the Mount Leyshon Mine, which currently is producing 65,000 ounces of gold per year.

Today, Pegasus is a dynamic and aggressive mining company with a proven track record in new mining technology and bright prospects for the future. The Company's common shares and warrants are listed on the Toronto Stock Exchange (TSE-PGU), quoted on the National Association of Securities Dealers Automated Quotation System (NASDAQ-PGULF), and registered with the Securities and Exchange Commission (SEC). During 1986, Pegasus raised approximately \$77 million of capital through issuing bonds convertible into gold, arranging a gold loan, and issuing bonds denominated in Swiss Francs and convertible into common stock.

LETTER TO THE SHAREHOLDERS

In 1986, Pegasus' growth-through-acquisition policy became a reality, with the Company rapidly becoming one of the major gold producers of North America. The Zortman/Landusky Mine reported record production of 86,400 ounces of gold and 214,000 ounces of silver. The Company commenced operation of two new mines, Florida Canyon and Relief Canyon, in November, and made substantial progress on the construction of the Montana Tunnels Mine, which commenced operations on March 25, 1987, three months ahead of schedule and \$6 million under budget. This has been an extraordinary period of accomplishment for the Company, with three new mines being placed into production during a 15-month span. 1987 is expected to be a year of transition as the Company becomes firmly established as a multi-mine corporation, with annual production expected to eventually exceed 280,000 ounces of gold and 1,900,000 ounces of silver when full capacity is reached at the new mines.

The Company also recorded the second highest level of earnings in its history with 1986 net earnings of \$4,653,565 (\$0.35 per share), on sales of \$35,054,395. This compares to a net loss in 1985 of \$1,167,325 (\$0.11 per share) on sales of \$18,014,588. Sales of gold during 1986 totalled 92,000 ounces at an average price of \$381 per ounce, compared to 57,700 ounces at an average price of \$312 during 1985. Pegasus' stock price performance exceeded that of most other North American gold producers in 1986 and early 1987. During the past 12 months, the share price has increased more than 300 percent.

Financial Condition

In 1986, we continued to enhance our position in the international financial community with the placement of a \$25-million gold-convertible bond issue in May, and a 60-million Swiss franc convertible debenture offering in October. Both of these issues were managed by Bank Gutzwiller, Kurz, Bungener, of Geneva, which in the past 18 months has raised \$85 million for our expansion programs. The contribution by Bank Gutzwiller to our growth cannot be understated. Without their assistance in developing and marketing such innovative financing techniques, we could not have accomplished so much in such a short period of time. In addition, Pegasus completed a 43,000-ounce gold loan valued at \$15 million with Citibank of New York. Recently, the Company also completed a \$30-million gold loan standby line of credit facility with a consortium of banks led by Citibank. Our relationships with the financial community have become an essential ingredient to the Company's continuing growth program. We look forward to further strengthening these relationships in the future.

The Company ended the year with \$38 million in working capital and total debt (including the gold loan) of \$101 million. While total debt has substantially increased over 1985, it is important to note that substantially all of our debt is either convertible into common stock or gold, and carries low fixed interest rates. In addition, many of our bondholders have already elected to voluntarily convert their debt into common stock. As such, long-term debt is now less than \$60

million. Put in this context, the debt level of our Company is very manageable. Shareholders' equity increased 44 percent from \$50.3 million at December 31, 1985, to \$72.7 million at December 31, 1986. Total assets once again more than doubled, going from \$80 million at the end of 1985 to \$191 million at year-end 1986. From a financial point of view, the Company is in the strongest position in its history.

Management

The aggressive growth experienced by Pegasus in 1986 and early 1987 has been achieved through a program of selective management and personnel additions at the mine locations. Although it was possible to accomplish growth in 1986 with no increase in corporate office personnel, several management changes were made early in 1987 to ensure that Pegasus is ready for the next phase of its growth. Our primary objective remains to ensure cost-effective operations and experience continued aggressive growth with a streamlined management organization that is dedicated to performance excellence.

James H. Foreman, President, has assumed the additional duties of Chief Executive Officer, as a result of the retirement of Hobart Teneff after 12 years with the Company. As Chief Executive Officer of the Company, Mr. Teneff made significant contributions to the growth of Pegasus. We wish him well in his retirement.

Michael L. Clark joined the Company as Vice-President, Operations. Mr. Clark joins Pegasus with over 20 years of mining operations experience, and

is responsible for all operations and new mine projects. Stanton B. Bennett has been appointed Director and Chief Legal Counsel of the Company to replace Milton H. Zink, who resigned. Mr. Bennett comes to Pegasus with over 30 years of experience in the legal affairs of major mining companies and is a welcome addition to the senior management team. Lyle F. Beaudoin has joined the Company as Vice-President, Business Development. Mr. Beaudoin has many years experience as an attorney in the mining industry, as well as considerable experience in acquisitions, and we welcome him to the Company. His appointment underscores our continued commitment to grow through acquisition.

We have also established an executive committee which will direct ongoing activities of the Company. The members of this committee are James Foreman, President; Rockne Timm, Chief Financial Officer; Stanton Bennett, Chief Legal Counsel; Michael Clark, Vice-President, Operations; Lyle Beaudoin, Vice-President, Business Development; and Douglas Belanger, Vice-President, Corporate Affairs.

Growth

The continued growth of the Company depends on our ability as a precious metals producer to identify new properties and companies that can be acquired on a cost-effective basis. In the past, we have been able to acquire and bring our mines into production at a cost of less than \$20 for each ounce of gold reserves in the ground. This has been achieved by evaluating projects with the objective of realizing a good return on our investment through optimization of acquisition, capital,

and operating costs. We do not limit our targets to the large, high grade mines that every company wants, but also include mines that may be small or lower grade, yet still yield a high return on our investment. Growth is an important facet of the Company's plan, and not simply for growth's sake, but for good return on investment. This is an important part of our acquisition policy. The acquisition costs of our mine properties is one of the lowest in the industry. Although we may have a slightly higher cash operating cost per ounce, our low capital recovery costs, resulting from our ability to acquire and build mines in a very cost-effective way, yields a total cost basis that compares very favorably with our competitors. Pegasus maintains an exploration program that has been very successful in increasing reserves at our existing mines, which is the lifeblood of any mining company. While Pegasus maintains contact with junior mining companies, prospectors, and others that are so often the discoverers of ore bodies, our exploration unit also carries out its own inexpensive, direct exploration program. We do not, as a matter of policy, hold a large number of properties, but choose instead to make rapid evaluations of deposits that have potential and drop those that do not meet our investment criteria. As a result, Pegasus has been able to expand reserves and acquire new mine properties while maintaining relatively low exploration costs.

Outlook

The future is very bright for Pegasus. We have just come through the first phase of growth and are now planning for the next phase. Placing three mines successfully into production in a

15-month period is a rare accomplishment for any mining company. It has been an extraordinary feat to grow from a one-mine, \$40-million company only two years ago, to a four-mine, \$200 million company today. On behalf of the Board of Directors, we would like to thank our employees, our primary mining contractor, N.A. Degerstrom, our suppliers, and our new project contractors for their dedication and commitment to excellence. Pegasus has earned a reputation as a good mine operator with strong financial management. We intend to build on this in the coming years and continue the Company's growth. The contribution by our shareholders and the financial community has also been an important one, and with your continued support we look to the future with excitement. The past years have been ones of consolidation and the establishment of policies which will ensure our continued growth. 1987 will be the year that all of this dedicated effort becomes apparent, and we hope to continue sharing this success with our shareholders in a tangible way. 1988 will be the first year in which all four mines will be operating at full capacity, and further growth in production from record levels anticipated in 1987 is expected. With all of this, we expect that there will be continued success in the marketplace for our shareholders. With a continuation of reasonable gold prices, further gains in the market valuation of the Company are anticipated.

On Behalf of the Board,



James H. Foreman, President

June 1, 1987



OPERATIONS Zortman/Landusky

Most of the production in 1986 came from the Zortman/Landusky mine. The Zortman/Landusky mine has been the mainstay of the Company for the last eight years, and in 1986 produced a record 86,400 ounces of gold and 214,000 ounces of silver. A total of 6,519,000 tons of ore were loaded on the pads in 1986, which now

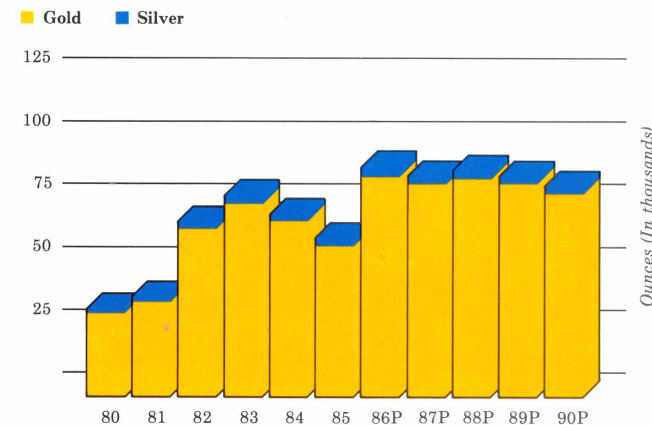
brings the total tons available for leaching to 29,513,000. Steve Banning was appointed General Manager of the Mine. Mr. Banning joined Pegasus as process manager at the Zortman/Landusky mine, and we welcome him to his new challenge. He is supported by an excellent team of experienced employees that have proven

performance records.

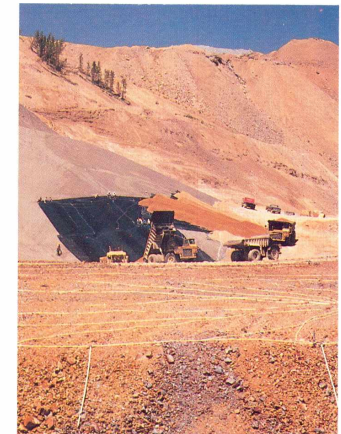
The mine had one of its longest operating seasons since production began in 1979, and 1987 is already one month ahead of our usual startup time. For 1987, 6,500,000 tons of ore and 3,500,000 tons of waste are planned for mining, and projected production is 80,000 ounces of gold and 225,000 ounces of silver.

Left: Drilling blast holes and hauling ore at Zortman/Landusky.

Zortman/Landusky Mine
Gold Equivalent Production



Actual and projected production at Zortman/Landusky Mine.



Leach pad under construction at Zortman/Landusky.



Ponds and plant facilities at Zortman/Landusky.



Florida Canyon/Relief Canyon Mine

Both mines were placed into production in the fourth quarter of 1986. Relief Canyon came up to and exceeded design levels very quickly and produced 1,800 ounces of gold in 1986. We had originally projected production of 30,000 ounces of gold from this mine in 1987, but it now appears that 40,000 ounces of gold will be recovered. Startup of the Relief Canyon mine, which was acquired from Lacana Mining, Inc. in July 1986, was very smooth due to the fact that the plant had already

been commissioned. The processing cycle was modified to include a crushing and agglomerating circuit, which corrected certain recovery problems encountered by Lacana.

The Florida Canyon mine was originally designed to operate at a rate of 2,000,000 tons of ore per year, and incorporates a unique ore stacking conveying system that reduces operating costs. The operations schedule and other areas were changed to provide for production at a rate of 4,000,000 tons of ore per year, following a

phased-in startup program.

Operations are currently at a rate of 3,000,000 tons per year, with the full production rate expected to be reached in the second quarter.

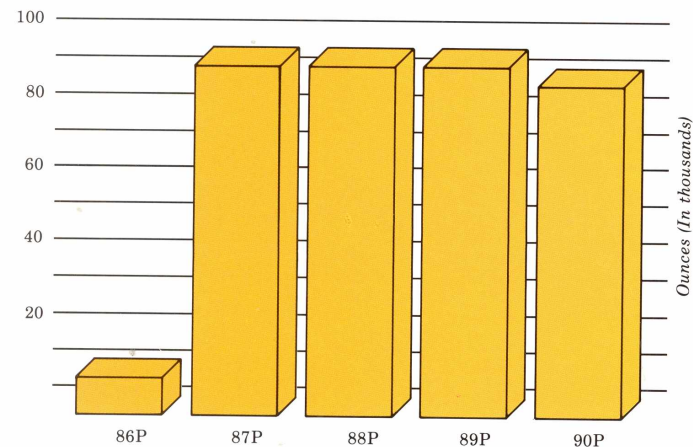
Production in 1987 is expected to be 65,000 ounces of gold.

Early in 1987, John Rice joined the Company as General Manager of the Florida/Relief Canyon mines, and Jim Geyer joined shortly after as onsite manager for the Relief Canyon unit. Both join the Company with extensive experience in the mining industry.

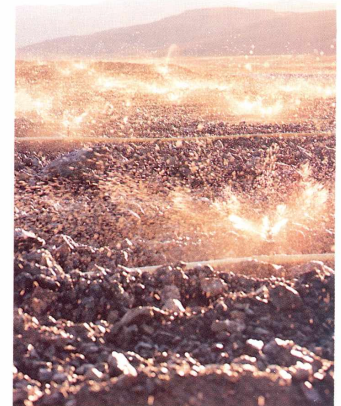
Left: Crushing and agglomerating area at Florida Canyon.

Florida Canyon/Relief Canyon Mine

Projected Gold Production



Projected production of gold from Florida/Relief Canyon. Both mines started production in late 1986.



Sprinklers on leach pad at Relief Canyon.



Crushing and agglomerating at Relief Canyon.



Montana Tunnels

The Montana Tunnels mine commenced production on March 25, 1987, and the first gold pour was on April 16, 1987. From ground breaking on March 3, 1986 to completion of construction, the time frame was just over one year, which is three months ahead of schedule. The final capital cost of \$51.5 million, including working capital, was \$6 million under budget. This is a tremendous

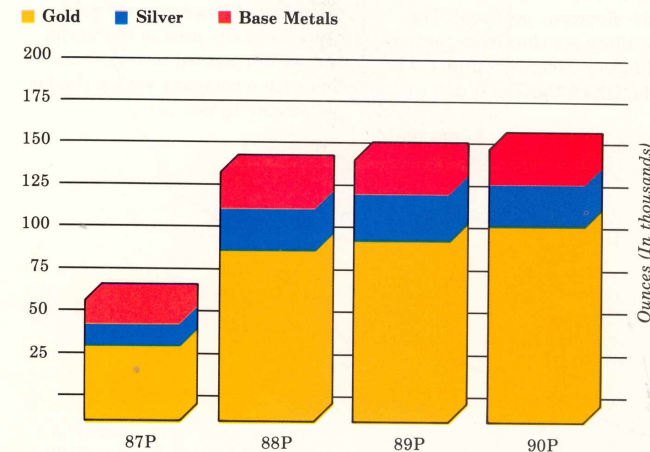
accomplishment, and we wish to acknowledge the contribution of Alan Richardson, General Manager, and his management team. We also wish to thank the contractors and suppliers, especially Wright Engineers and Commonwealth Pacific Construction, for their contribution to the mine development.

1987 production is estimated to be 50,000 ounces of gold, 700,000

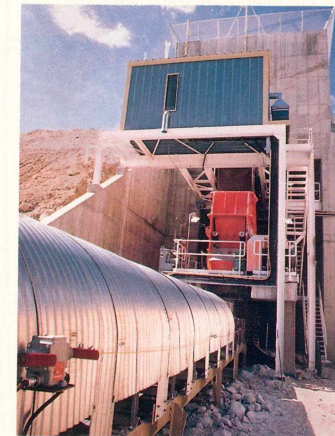
ounces of silver, 13,000 tons of zinc, and 3,000 tons of lead. This production estimate assumes that full production capacity is achieved by July 1, 1987. At full production capacity, the mine is projected to produce an average of 106,000 ounces of gold, 1,700,000 ounces of silver, 26,000 tons of zinc, and 5,700 tons of lead per year. The mine startup is progressing smoothly and no major problems are anticipated.

Left: Concentrator facilities at Montana Tunnels.

Montana Tunnels Mine Gold Equivalent Production



Montana Tunnels is projected to be in full production by mid-year 1987. This chart converts the silver and base metals into an equivalent value for gold in ounces.



Ore crushing at Montana Tunnels.



Flotation area of concentrator building at Montana Tunnels.

EXPLORATION AND DEVELOPMENT

Pegasus' acquisition and exploration activities are under the direction of Lyle Beaudoin and James Hastings. The exploration and development program is critical to the Company's growth objectives. In the past, exploration activities have centered on two primary areas. The first is maintenance of our existing reserve base at operating mines. This will continue to be a major focus of the exploration department. Second, the department plays a critical role in the evaluation of potential acquisition targets. In addition, the exploration department participates in limited general exploration on our own properties or through joint ventures with other companies or individuals.

Pegasus has been able to increase its reserves substantially in the last few years by acquisition and development. In 1987, with the success of the exploration department in identifying a larger reserve base, the Company is now able to reorder its priorities. With the policy of eliminating low priority projects and consolidating exploration and development activities, we will be able to maintain a high-quality program that will ensure the Company's continued growth.

Investment in USMX

In early 1986, two of the principal shareholders of U.S. Minerals Exploration Company (USMX) of Denver sold Pegasus a 20 percent interest in that company. USMX discovered the Montana Tunnels mine. This purchase, when combined with the interest that one of our subsidiaries already owned, increased our ownership in USMX to 29.4 percent. This purchase also made Pegasus the largest shareholder of USMX. Commensurate with this ownership interest, Pegasus also received two seats on the Board of Directors of USMX. As a result of this purchase, Pegasus accounts for its investment in USMX on an equity basis and records a pro-rata share of earnings.

In 1986, Pegasus also acquired a 100 percent working interest in the Montana Tunnels property from USMX, subject to a 5 percent net profits royalty interest during payback of capital costs, and a 50 percent royalty interest thereafter. Aside from its royalty interest in Montana Tunnels, USMX also has several interesting exploration properties, including a few that have development potential. The best of these are the Green Springs and Kingsley Mountain projects in Nevada. Green Springs is 100

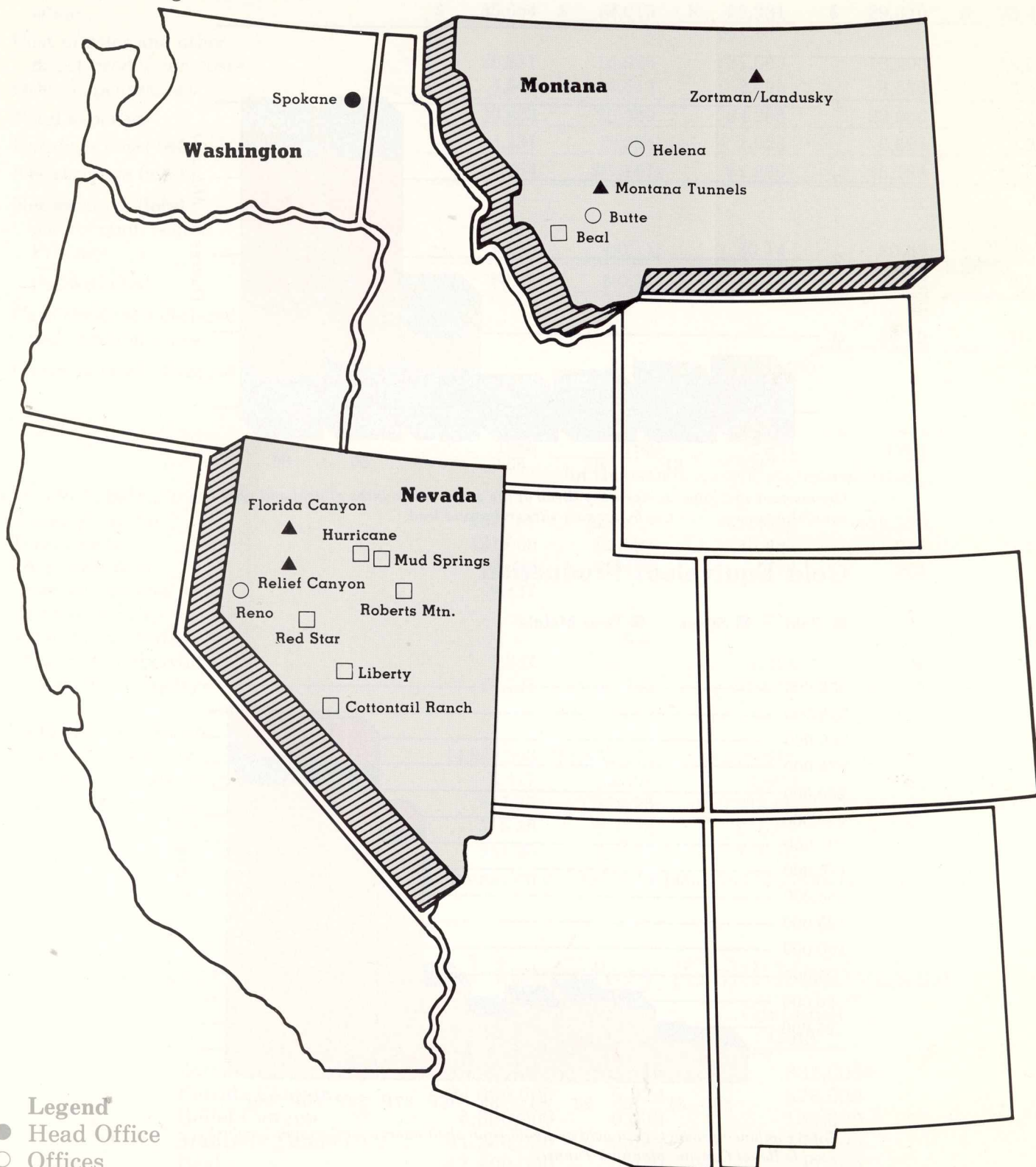
percent owned by USMX, and the Kingsley Mountain Project is operated by Cominco American Incorporated with USMX retaining a 40 percent working interest. A list of USMX properties and a location map is included herein. This has been a very successful investment for Pegasus, and we see a bright future for USMX becoming a gold producer.

Investment in Pan Australian Mining

In August 1986, Pegasus made a small equity investment in a new company in Australia, Pan Australian Mining Ltd. Pan Australian has just placed its first property, the Mount Leyshon Mine, into production at an annual rate of 46,000 ounces of gold per year. Pan Australian has many other properties, and we have agreed to share technical information and work together in the future on a joint venture basis. This link with Pan Australian will give Pegasus access to the South Pacific region without the tremendous expense of setting up our own infrastructure in the region. The South Pacific has one of the highest potentials for the discovery of large tonnage gold deposits of any area in the world, and we are pleased to make this link with a company with a similar philosophy to our own.

PEGASUS GOLD INC. PROPERTY & OFFICE LOCATIONS

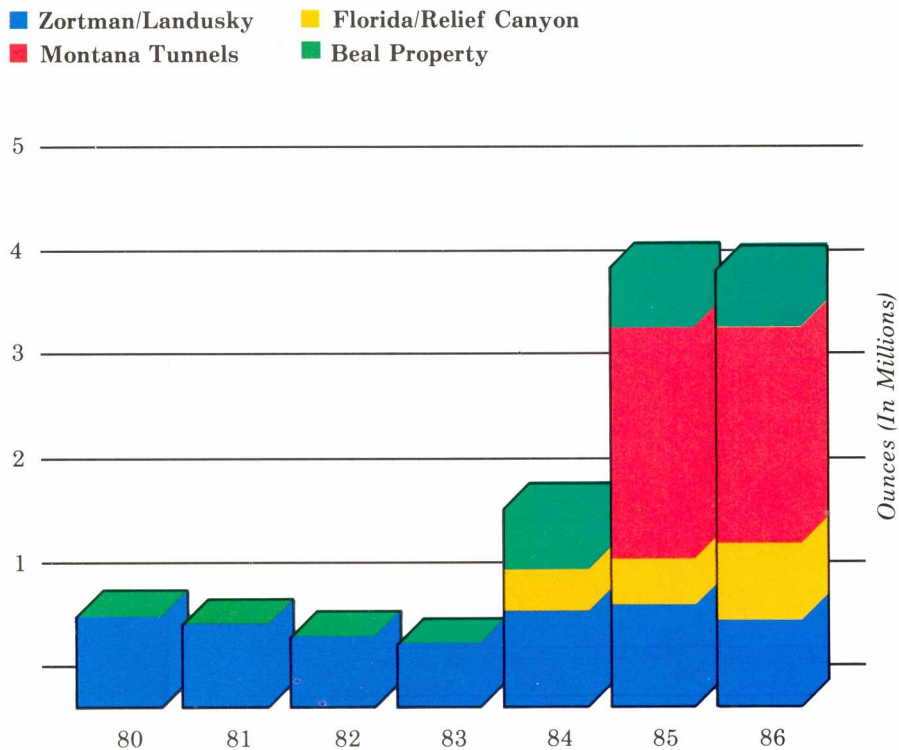
○ Vancouver, B.C.



- Legend***
- Head Office
 - Offices
 - ▲ Mine
 - Projects Under Construction
 - Exploration Properties

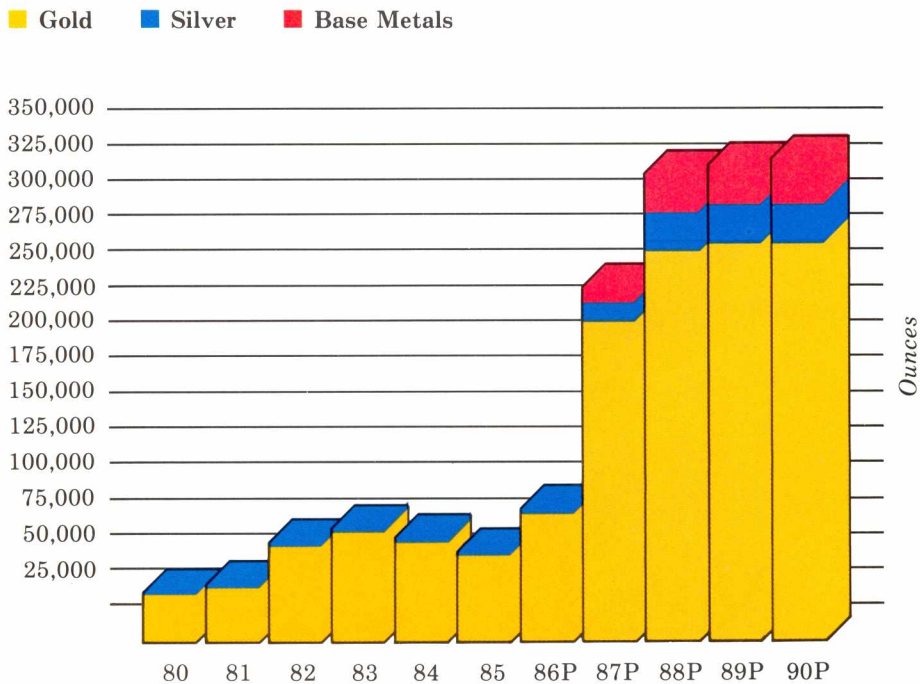
Ore Reserves

(Gold Equivalent)



Ore reserves and mineral inventory (Beal) of the projects in ounces of gold and gold equivalent giving credit to by-product silver, zinc and lead.

Gold Equivalent Production



Total combined production in gold and gold equivalent ounces for Zortman Landusky, Florida/Relief Canyon, Montana Tunnels.

Consolidated Highlights

For the years ended December 31,

STATEMENT OF OPERATIONS

DATA:

(In thousands, except per share amounts)

	1986	1985	1984	1983	1982
Sales of gold and silver	\$ 35,054	\$ 18,015	\$ 25,231	\$ 29,640	\$ 23,426
Cost of sales and other direct production costs	26,281	16,025	21,003	18,400	16,072
Other expenses, net	4,542	4,314	3,205	4,556	3,091
Total expenses	30,823	20,339	24,208	22,956	19,163
Earnings (loss) before income taxes	4,231	(2,324)	1,023	6,684	4,263
Net earnings (loss)	\$4,654	\$(1,167)	\$1,299	\$5,188	\$3,586
Net earnings (loss) per common share:					
Primary	\$0.35	\$(0.11)	\$0.14	\$0.63	\$0.49
Fully diluted	\$0.32	\$(0.11)	\$0.14	\$0.60	\$0.45
Cash dividends declared per common share				\$0.19	\$0.11
Common stock dividend			2%		

December 31,

BALANCE SHEET DATA:

	1986	1985	1984	1983	1982
Working capital	\$37,787	\$29,869	\$13,896	\$16,533	\$10,765
Total assets	191,059	80,184	40,287	41,041	27,547
Long-term debt	79,040	23,450	176	204	155
Deferred revenue	9,437	—	—	—	—
Deferred royalty	—	—	685	911	700
Minority interests	—	594	—	—	—
Other deferred credits	1,882	1,190	1,324	688	766
Shareholders' equity	72,743	50,322	35,017	32,976	21,159

STATISTICAL DATA:

Shares Outstanding at Year End	14,948,593	11,802,472	8,925,612	8,588,181	7,600,593
Number of Shareholders	5,417	5,500	4,400	3,800	3,400
Market Price — High	\$11.25	\$10.25	\$14.00	\$14.25	\$12.50
Low	\$ 5.38	\$ 6.13	\$ 5.88	\$ 8.88	\$ 3.00
December 31	\$11.25	\$ 6.75	\$ 6.75	\$13.13	\$12.50

All amounts have been restated to reflect the amalgamation in 1984 of Pegasus and Montoro on a pooling of interests basis.

Ore Reserves & Mineral Inventory (Gold Equivalent)

	Tons	Grade	Contained Gold
Zortman/Landusky . . .	36,000,000	0.019	832,000*
Florida Canyon	24,000,000	0.024	576,000
Relief Canyon	5,000,000	0.030	159,000
Montana Tunnels	41,200,000	0.043	2,184,000
Beal	11,800,000	0.049	590,000
Total	118,000,000		4,341,000

*Adjusted for gold remaining on the pads & silver

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

Operations at the Zortman/Landusky Mine are seasonal in nature. As the heap leaching process cannot be conducted when the air temperature is below freezing, precious metal recovery operations are discontinued for three to four months during the winter, usually from the end of November to March, but engineering, planning and other non-recovery functions continue. Mining operations usually cease from October through January.

As a result of the seasonality of its operations, the Company has generally had no sales during the first quarter, and its largest sales historically have occurred during the third quarter. Consequently, interim results, especially those of the first two quarters, have not been indicative of results for the full year. The Company expects that the seasonal fluctuations in its financial results will be substantially less pronounced in the future because the mines at Montana Tunnels, Florida Canyon and Relief Canyon are expected to operate year-round.

The Company's revenues, profitability and cash flow are strongly influenced by the price of gold and by the relationship of gold prices to production costs. The price of gold is determined by world and national markets and cannot be expected to match the trend of production costs. In addition, the price of gold has on occasion been subject to very rapid short-term changes because of speculative activities in the commodities futures market. Similar considerations affect the price of silver. The costs of production, on the other hand, are relatively fixed in the short term, although they are subject to the same inflationary pressures experienced by the economy generally.

1986 Compared to 1985

Net income for 1986 was \$4,653,565, compared to the net loss of \$1,167,325 for 1985. The following table highlights specific financial items:

	1986	1985	% Increase
Sales of gold	\$35,054,395	\$18,014,588	95
Average gold price realized per ounce	\$381	\$312	22
Gold ounces sold	92,000	57,700	59
Cost of sales and other direct production costs, including depreciation and amortization:			
Total	\$26,281,221	\$16,024,574	64
Per ounce	\$285	\$278	3

During 1986, the price of gold improved significantly over the depressed levels posted in 1985. This improvement in the gold price, together with increased production, has resulted in a significant increase in revenues during 1986, compared to 1985. The increase in gold production is principally attributable to the fact that 1985 production was adversely affected by the six-week cessation of leaching operations in mid-1985 caused by the shifting of 3,000,000 tons of ore on one of

the nine leach pads at the Zortman/Landusky Mine.

Production costs and other direct costs of sales per ounce increased slightly in 1986 compared to 1985, due to increased operating costs principally at the Landusky property. Consequently, cost of sales in 1986 when compared to 1985 increased 5% more than the percentage increase in ounces of gold sold when compared to 1985.

General and administrative expenses increased approximately \$1,012,000, which is principally attributable to increased management and labor expenses, expenses incurred in connection with arranging financing for the Montana Tunnels and Florida Canyon/Relief Canyon Mines, and other corporate activities. Royalty expense declined approximately \$538,000 between 1985 and 1986 as a result of the acquisition of the owner of the Zortman Property in June 1986. See "Properties -Zortman/Landusky Mine -Property Ownership Arrangements". Exploration expense increased approximately \$379,000 over 1985 due primarily to increased general exploration activities.

Interest and other income increased by approximately \$946,000 due principally to the increased cash available for short term investment. However, interest expense (net of amounts capitalized) increased significantly from \$1,356,400 in 1985 to approximately \$1,880,300 in 1986. The increase results principally from a full year's interest accrued on the bonds issued in August 1985, and additional interest on the bonds issued in May and October 1986. Additionally, in 1986 the Company recorded a gain on the sale of an investment in the amount of approximately \$624,000, which was largely offset by the loss on the translation of the 5¾% SFr. convertible bond obligation into U.S. dollars in the amount of approximately \$424,000 and the Company's proportionate share in the net loss recorded by USMX.

Income tax benefit declined between the periods, from \$1,156,486 in 1985 to \$422,226 in 1986, principally as a result of the change in earnings (loss) before income taxes. The tax benefit in 1986 was not proportional to the earnings before income taxes, principally due to the percentage depletion deduction. At December 31, 1986, the Company had net operating loss carryforwards for tax purposes of Cdn. \$2,435,000 and the Company's United States subsidiaries had net operating loss and investment tax credit carryforwards of \$25,680,000 and \$977,000, respectively.

1985 Compared to 1984

Net loss for the year ended December 31, 1985 was \$1,167,325, compared to net income of \$1,298,600 for 1984. The following table highlights specific financial items:

	1985	1984	% Decrease
Sales of gold	\$18,014,588	\$25,231,410	(29)
Average gold price realized per ounce	\$312	\$364	(14)
Gold ounces sold	57,700	69,417	(17)
Cost of sales and other direct production costs, which includes depre- ciation and amortiza- tion:			
Total	\$16,024,574	\$21,002,790	(24)
Per ounce	\$278	\$302	(8)

During 1985, gold prices continued to remain below 1984 levels and were as low as \$282 per ounce during the first quarter of 1985. This deterioration in the gold price, together with a decline in production, resulted in decreased revenues during 1985. The decline in gold production during 1985 is principally attributable to the temporary suspension of precious metals recovery operations described below, commencing mining operations later than usual due to colder spring weather, and to the longer period required for the construction and loading of the larger capacity leach pad on the Zortman property.

On July 23, 1985, approximately 3,000,000 tons of ore shifted on one of the nine leach pads at the Zortman/Landusky Mine, requiring a suspension of operations on that pad. Precious metal recovery operations were resumed on August 20, 1985 at approximately 40% of capacity and at 100% capacity by September 27, 1985. The costs incurred to rehabilitate the pad of approximately \$542,000 have been recorded as deferred mining costs and amortized accordingly. In addition, management estimates that the suspension of operations has resulted in an estimated deferral of production to 1986 and later years of approximately 21,000 ounces of gold and 42,000 ounces of silver. On November 13, 1985, the Company submitted a claim to its insurance carrier claiming a casualty loss of \$542,000 and a business interruption loss of approximately \$2,600,000. The insurance carrier has assigned an adjusting firm, engineers and auditors to review the data supporting the Company's claim. There is no assurance that insurance proceeds will be realized by the Company. The insurance policy does not insure against losses due to design or construction flaws, and the Company is holding discussions with the insurance carrier as to whether the ore shift was caused by such a flaw, in which case the carrier has indicated that it will disclaim coverage. Insurance proceeds will be recorded in the financial statements when received.

Interest and other income increased approximately \$206,000 in 1985 over 1984, as a result of the investment of the proceeds to the Company from the issuance of convertible bonds and the Peggold Bonds (see Note 9 to the Consolidated Financial Statements).

Production costs and other direct costs of sales per ounce of gold declined to \$278 in 1985 from \$302 in 1984 due to a reduction

in mining costs. Consequently, cost of sales and other direct production costs for 1985 declined seven percent more than the decline in sales of ounces of gold. Royalty expenses increased from approximately \$523,000 during 1984 to approximately \$675,000 during 1985 as a result of increased production on the Zortman property.

Interest expense (net of amounts capitalized) increased significantly from \$227,239 in 1984 to \$1,356,406 in 1985. The increase resulted principally from interest on the convertible bonds and the Peggold Bonds, interest accrued related to the outstanding royalty payable to Gold Reserve and interest expense attributable to the acquisition of the minority interest in the Landusky property previously owned by Wharf Resources Ltd. (see Note 9 to the Consolidated Financial Statements).

General and administrative expenses increased approximately \$401,000 during 1985 compared to 1984. The increase is due primarily to expenses associated with acquisition activities, the issuance of the convertible bonds and the Peggold Bonds and increased costs of complying with the reporting requirements of the Securities and Exchange Commission.

Net exploration expense declined approximately \$424,000 during 1985 as compared to 1984 due to the Company's focus on the Montana Tunnels Mine and the Florida Canyon/Relief Canyon Mines and the participation of other mining companies, under joint venture arrangements, in the Company's general exploration program.

Income tax benefit changed between the periods principally as a result of the change in earnings (loss) before income taxes. At December 31, 1985, the Company had net operating loss carryforwards for tax purposes of Cdn. \$2,697,000 and the Company's United States subsidiaries had net operating loss and investment tax credit carryforwards of \$13,501,000 and \$669,000, respectively.

The net loss for 1985 included \$663,724 in royalty expenses and \$394,982 in interest expense payable to Gold Reserve Montana under the lease of the Zortman Property. During the second quarter of 1986 the Company acquired Gold Reserve Montana, as a result of which a total of \$1,843,060 in accrued royalties and \$394,982 in accrued interest will not be paid to Gold Reserve (see Note 3 (a) to the Consolidated Financial Statements).

Liquidity and Capital Resources

Working Capital Requirements. In the past, the seasonality of the Company's business has required that significant working capital be available to sustain operations during the winter when the Company had only insignificant revenues but engineering, mine planning and other non-recovery functions take place. However, the Company expects that the seasonal fluctuations of its working capital requirements will diminish because its Montana Tunnels, Florida Canyon and Relief Canyon mines are expected to operate year-round. The Company's liquidity could, under certain circumstances, be adversely affected by its gold delivery commitments.

At December 31, 1986, the market price of gold exceeded the conversion prices

inherent in both the 5 percent and 7½ percent gold-convertible bonds. On March 24, 1987, the Company entered into an agreement with Citibank, N.A., Bank of New York, and Bank of Nova Scotia ("Banks") whereby the Banks jointly committed to lend the Company up to 67,000 ounces of gold, if necessary, for the sole purpose of satisfying requests for conversion of the 7½ percent gold-convertible bonds. Under terms of the agreement, any gold borrowed would be repayable in installments from January 2, 1988 to December 31, 1989, and bear interest at an annual rate of 2 percent of the average market value of the ounces of gold outstanding. Any gold borrowed under the agreement would be collateralized by a first mortgage on the Florida Canyon and Relief Canyon mines. Because of the availability of this financing facility, the 7½ percent gold-convertible bonds have been classified as a non-current liability. The 5 percent gold-convertible bonds have been classified as a current liability, offset in part by the \$3,528,090 balance of the zero coupon notes pledged as collateral for these bonds. See "Narrative Description of Business - Long-Term Gold Delivery Commitments."

At December 31, 1986, the market price of gold exceeded the conversion prices inherent in both the 5 percent and 7½ percent gold-convertible bonds. On March 24, 1987, the Company entered into an agreement with Citibank, N.A., Bank of New York, and Bank of Nova Scotia ("Banks") whereby the Banks jointly committed to lend the Company up to 67,000 ounces of gold, if necessary, for the sole purpose of satisfying requests for conversion of the 7½ percent gold-convertible bonds. Under terms of the agreement, any gold borrowed would be repayable in installments from January 2, 1988 to December 31, 1989, and bear interest at an annual rate of 2 percent of the average market value of the ounces of gold outstanding. Any gold borrowed under the agreement would be collateralized by a first mortgage on the Florida Canyon and Relief Canyon mines. Because of the availability of this financing facility, the 7½ percent gold-convertible bonds have been classified as a non-current liability. The 5 percent gold-convertible bonds have been classified as a current liability, offset in part by the \$3,528,090 balance of the zero coupon notes pledged as collateral for these bonds. See "Narrative Description of Business - Long-Term Gold Delivery Commitments."

At December 31, 1986, working capital amounted to \$37,787,102, representing an increase of approximately \$7,900,000, as compared to working capital at December 31, 1985. Sources of working capital include operating income (net of depreciation, amortization and other) of approximately \$9,512,000, the proceeds (net of offering expenses) from the issuance of long-term debt of approximately \$61,944,000, revenue deferred pursuant to a gold loan in the amount of \$15,028,500 and the issuance of common stock in the amount of approximately \$17,400,000. Development costs associated with the Montana Tunnels and Florida Canyon Mines, the acquisition of two subsidiaries from Gold Reserve Corporation, the purchase of 2,400,000

common shares (after a five for one reverse stock split) of U.S. Minerals Exploration Company and the application of funds to long-term debt and deferred revenue currently maturing represented the principal uses of working capital.

Included in working capital at December 31, 1986 are inventoriable deferred costs associated with ore under leach of \$23,455,052, which represent mining costs incurred that will be charged to cost of sales upon the recovery and sale of the remaining recoverable gold over the five year leach cycle. The Company estimates that approximately 39% of the recoverable gold remaining in the heap will be recovered during 1987.

As of March 26, 1987, approximately 29,735,000 SFr. of the 60,000,000 SFr. 5¼ percent convertible bonds have been converted into 1,867,358 common shares of the Company. Based upon the current Swiss franc exchange rate, the Company has incurred an unrealized foreign currency transaction loss of approximately \$1,028,000 on the 5¼ percent convertible bonds that remain outstanding and has an unrealized transaction gain of approximately \$529,000 on the bonds converted.

Capital Project Requirements. The Company has an ongoing capital expenditure program in connection with the expansion of leach pad capacity and other capital expenditures at the Zortman/Landusky Mine. The budget for this program is approximately \$3,100,000 for 1987, and is expected to be funded out of cash flow from operations.

The development costs of the Montana Tunnels Mine and related expenses are expected to aggregate approximately \$46,500,000. Of such amount, approximately \$38,000,000 had been spent as of December 31, 1986. The development costs of the Montana Tunnels Mine, together with initial working capital requirements of approximately \$5,000,000, are being financed from internally generated funds, a bond offering completed in May 1986, the proceeds of the gold loan and a bond offering completed in October 1986 (see Notes 9 and 10 to the Consolidated Financial Statements).

Impact of Tax Reform Act of 1986

On October 22, 1986, the Tax Reform Act of 1986 ("TRA") was enacted. Its provisions include, among other things, a reduction in corporate income tax rates (lowering the maximum rate from 46% of taxable income in 1986 to 40% in 1987 and to 34% in 1988 and thereafter); the elimination of the investment tax credit (ITC) generally effective January 1, 1986; a reduction in the amount of ITC allowable for carryovers in and after 1987; the institution of a new corporate alternative minimum tax in 1987; and other changes which will affect the timing and amount of taxes payable upon the reversal of deferred tax amounts.

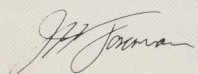
The effect of TRA on the effective tax rate for 1986 was not material. For 1987 and future years, the impact of the TRA upon the results of the Company's operations, which cannot now be predicted. Thus, the effects of TRA upon the Company's future financial statements cannot now be quantified.

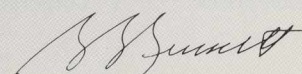
Consolidated Balance Sheets at December 31, 1986 and 1985

(In U.S. Dollars)

	1986	1985
ASSETS		
Current assets:		
Cash and cash equivalents (note 15(g))	\$ 28,629,402	\$ 11,842,659
Due from sales of product	3,188,218	2,186,408
Other receivables (notes 11 and 13)	1,738,908	641,039
Inventories (note 4)	27,561,187	19,391,299
Income taxes refundable (note 12)		88,804
Other current assets (notes 8 and 9)	4,627,141	346,522
Total current assets	65,744,856	34,496,731
Investments (note 7)	16,530,907	3,455,625
Property, plant and equipment, net (notes 6 and 10)	103,532,894	37,879,847
Deferred charges and other assets, net (note 8)	5,250,345	4,351,658
Total assets	\$191,059,002	\$ 80,183,861
LIABILITIES		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 11,923,097	\$ 1,183,402
Mining taxes payable	857,663	569,034
Royalties payable (note 13)	105,719	1,864,348
Accrued interest (note 13)	2,458,656	975,581
Income taxes currently payable (note 12)	206,336	—
Current portion of long-term debt (note 9)	6,814,283	35,498
Current portion of deferred revenue (note 10)	5,592,000	—
Total current liabilities	27,957,754	4,627,863
Long-term debt (notes 9 and 15(g))	79,039,936	23,450,466
Deferred revenue (note 10)	9,436,500	—
Deferred reclamation costs	1,064,920	928,150
Deferred income taxes (notes 3(a) and 12)	816,878	261,470
Minority interest in consolidated subsidiary (note 3(c))	—	594,070
Total liabilities	118,315,988	29,862,019
Commitments and contingencies (note 15)		
SHAREHOLDERS' EQUITY		
Class A preferred shares, \$10 par value:		
Authorized - 20,000,000 shares; none issued		
Common stock, no par value:		
Authorized - 30,000,000 shares; Issued and outstanding - 1986 - 14,948,593 shares, 1985 - 11,802,472 shares (notes 9, 11 and 15(c))	61,536,854	44,141,894
Retained earnings	14,456,815	9,803,250
Less:		
Net unrealized loss on investments (note 7)	—	(293,782)
Foreign currency translation adjustment (note 2(g))	(542,094)	(660,956)
Notes receivable on sale of common stock (note 11)	(2,708,561)	(2,668,564)
Total shareholders' equity	72,743,014	50,321,842
Total liabilities and shareholders' equity	\$191,059,002	\$ 80,183,861

The accompanying notes are an integral part of the consolidated financial statements.

 Director

 Director

Consolidated Statements of Changes in Shareholders' Equity

For the Years Ended December 31, 1986, 1985 and 1984

(In U.S. Dollars)

	Common Stock		Retained	Net	Foreign	Notes
	Number of	Amount	Earnings	Unrealized	Currency	Receivable on
	Shares			Loss on	Translation	Sale of
				Investments	Adjustment	Common Stock
Balance, December 31, 1983	8,558,181	\$22,305,664	\$11,050,666		\$(380,529)	
Net earnings			1,298,600			
2% stock dividend	143,566	1,376,802	(1,376,802)			
Cash dividend for fractional shares of stock dividend			(1,889)			
Common stock issued for the acquisition of subsidiary (note 3(e))	50,000	505,811				
Common stock issued under stock option plan (note 11)	139,865	424,327				
Common stock issued for property	34,000	298,670				
Net change in foreign currency translation adjustment					(240,028)	
Net change in notes receivable on sale of common stock (note 11)						\$(244,224)
Balance, December 31, 1984	8,925,612	24,911,274	10,970,575		(620,557)	(244,224)
Net loss			(1,167,325)			
Common stock issued for cash	675,000	4,982,802				
Common stock issued for property	4,000	33,569				
Common stock issued for the acquisition of subsidiary (note 3(c))	1,656,374	11,632,435				
Common stock issued under stock option plan (note 11)	535,460	2,540,257				
Common stock issued under employee savings plan (note 14)	6,026	41,557				
Net change in foreign currency translation adjustment					(40,399)	
Net change in unrealized loss on investments (note 7)				\$ (293,782)		
Net change in notes receivable on sale of common stock (note 11)						(2,424,340)
Balance, December 31, 1985	11,802,472	44,141,894	9,803,250	(293,782)	(660,956)	(2,668,564)
Net earnings			4,653,565			
Common stock issued for property (note 3(b))	439,000	3,235,312				
Common stock issued for the acquisition of subsidiaries (notes 3(a), (c), and (e))	1,655,000	6,144,925				
Common stock issued for the acquisition of investment (note 7)	760,000	5,937,500				
Common stock issued upon the exercise of warrants (note 3(d))	250,000	1,797,277				
Common stock issued under stock option plan (note 11)	30,260	195,709				
Common stock issued under employee savings plan (note 14)	11,861	84,237				
Net change in foreign currency translation adjustment					118,862	
Net change in unrealized loss on investments (note 7)				293,782		
Net change in notes receivable on sale of common stock (note 11)						(39,997)
Balance, December 31, 1986	<u>14,948,593</u>	<u>\$61,536,854</u>	<u>\$14,456,815</u>	<u>—</u>	<u>\$(542,094)</u>	<u>\$(2,708,561)</u>

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Operations

For the Years Ended December 31, 1986, 1985 and 1984

(In U.S. Dollars)

	1986	1985	1984
Sales of gold and silver	\$ 35,054,395	\$18,014,588	\$25,231,410
Cost of sales and other direct production costs (note 5)	21,378,985	13,320,517	18,305,534
Depreciation, depletion and amortization	4,902,236	2,704,057	2,697,256
	26,281,221	16,024,574	21,002,790
Gross profit	8,773,174	1,990,014	4,228,620
Operating expenses:			
General and administrative (note 13)	3,466,808	2,454,773	2,053,703
Royalty (note 13)	136,908	675,157	523,345
Depreciation and amortization	213,709	283,729	285,295
Exploration	790,527	411,382	835,427
	4,607,952	3,825,041	3,697,770
Earnings (loss) from operations	4,165,222	(1,835,027)	530,850
Other income (expense):			
Interest and other income (note 11)	1,812,574	866,505	660,092
Interest expense:			
Total interest cost	(3,890,930)	(1,460,923)	(227,239)
Less amount capitalized (note 6)	2,010,604	104,517	—
	(1,880,326)	(1,356,406)	(227,239)
Minority interest in net loss of consolidated subsidiary (note 3(c))	—	26,959	—
Gain on sale of investment (note 7)	624,163	—	—
Gain (loss) on foreign currency transactions (note 15(g))	(423,894)	(25,842)	60,162
Equity in net loss of affiliate (note 7)	(66,400)	—	—
	66,117	(488,784)	493,015
Earnings (loss) before income taxes	4,231,339	(2,323,811)	1,023,865
Income tax provision (benefit) (note 12):			
Current	215,123	(752,056)	(794,056)
Deferred	(637,349)	(404,430)	519,321
	(422,226)	(1,156,486)	(274,735)
Net earnings (loss)	\$ 4,653,565	\$ (1,167,325)	\$ 1,298,600
Earnings (loss) per share:			
Primary	\$0.35	\$(0.11)	\$0.14
Fully diluted	\$0.32	\$(0.11)	\$0.14
Weighted average common shares outstanding	13,273,063	10,155,047	8,961,235
Common stock dividend			2%

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Changes in Financial Position

For the Years Ended December 31, 1986, 1985 and 1984

(In U.S. Dollars)

	1986	1985	1984
Sources of working capital:			
Net earnings (loss) for the year	\$ 4,653,565	\$(1,167,325)	\$ 1,298,600
Add (deduct) items not affecting working capital:			
Depreciation, depletion and amortization	5,492,964	3,050,096	2,982,551
Deferred reclamation costs	136,770	269,706	117,269
Deferred income taxes	(637,349)	(404,430)	519,321
Gain on sale of investment	(624,163)	—	—
Other	490,294	(134,341)	204,236
Total from operations	9,512,081	1,613,706	5,121,977
Issuance of common stock	17,394,960	19,230,620	2,605,610
Proceeds from sale of investment	1,025,543	—	—
Proceeds from issuance of long-term debt	61,944,361	21,656,250	7,593
Revenue deferred pursuant to gold loan (note 10)	15,028,500	—	—
Minority interest in consolidated subsidiary (note 3(c))	—	621,029	—
Net change in foreign currency translation adjustment	118,862	—	—
Reclassify zero coupon notes to current assets (note 9)	3,182,916	—	—
	<u>108,207,223</u>	<u>43,121,605</u>	<u>7,735,180</u>
Uses of working capital:			
Net additions to property, plant and equipment	66,306,580	5,968,641	7,534,377
Non-current net assets of acquired minority interest (notes 3(c) and (d))	594,070	735,673	—
Non-current net assets of acquired companies (notes 3(a) and (c))	600,644	4,968,594	—
Purchase price attributed to property and mineral rights (notes 3(c) and (d))	2,669,011	6,672,092	509,405
Purchase price attributed to investments (note 3(c))	—	597,121	—
Purchase of investments	13,249,280	3,761,816	—
Dividends	—	—	1,378,691
Net additions to deferred charges and other assets (note 8)	4,458,622	1,231,052	—
Net increase in notes receivable on sale of common stock (note 11)	39,997	2,424,340	244,224
Deferred royalty paid or currently maturing	—	685,319	430,046
Long-term debt paid or currently maturing	6,778,785	64,030	35,411
Deferred revenue earned or currently maturing (note 10)	5,592,000	—	—
Net change in foreign currency translation adjustment	—	40,399	240,028
	<u>100,288,989</u>	<u>27,149,077</u>	<u>10,372,182</u>
Increase (decrease) in working capital	7,918,234	15,972,528	(2,637,002)
Working capital — beginning of year	29,868,868	13,896,340	16,533,342
Working capital — end of year	\$ 37,787,102	\$29,868,868	\$13,896,340

continued

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Changes in Financial Position (continued)

For the Years Ended December 31, 1986, 1985 and 1984

(In U.S. dollars)

	<u>1986</u>	<u>1985</u>	<u>• 1984</u>
Changes in components of working capital:			
Increase (decrease) in current assets:			
Cash and cash equivalents	\$16,786,743	\$10,913,898	\$(6,895,098)
Due from sales of product and other receivables	2,099,679	2,489,333	(2,850,190)
Inventories	8,169,888	3,934,521	3,754,100
Income taxes refundable	(88,804)	(148,429)	237,233
Other current assets	4,280,619	326,980	(61,606)
	<u>31,248,125</u>	<u>17,516,303</u>	<u>(5,815,561)</u>
Increase (decrease) in current liabilities:			
Accounts payable and accrued liabilities	10,739,695	359,604	(117,299)
Income taxes currently payable	206,336	—	(1,792,108)
Mining taxes payable	288,629	(60,679)	(50,357)
Dividends payable	—	—	(424,793)
Royalties payable	(1,758,629)	320,700	(745,530)
Accrued interest	1,483,075	975,581	—
Current portion of long-term debt	6,778,785	(51,431)	(48,472)
Current portion of deferred revenue	5,592,000	—	—
	<u>23,329,891</u>	<u>1,543,775</u>	<u>(3,178,559)</u>
Increase (decrease) in working capital	<u><u>\$7,918,234</u></u>	<u><u>\$15,972,528</u></u>	<u><u>\$(2,637,002)</u></u>

The accompanying notes are an integral part of the consolidated financial statements.

Notes to Consolidated Financial Statements

1. The Company and Basis of Presentation of Financial Statements

- (a) The Company, through its wholly-owned subsidiaries, operates the Zortman and Landusky gold and silver mines in Montana, U.S.A. and the Florida Canyon and Relief Canyon gold mines in Nevada, U.S.A. The Company is currently developing the Montana Tunnels mine in Montana, U.S.A. for commercial production, and is actively engaged in the exploration of other precious mineral properties in the western United States. The Company was formed August 20, 1984 pursuant to an amalgamation agreement between Pegasus Gold Ltd. (Pegasus) and Montoro Gold Inc. (Montoro). Under the terms of the agreement, each shareholder of Pegasus received one common share of the Company for each share of Pegasus, and each shareholder of Montoro received one common share of the Company for each 2-2/3 common shares of Montoro.

The net assets of the combining companies immediately prior to the amalgamation, net of intercompany transactions, were approximately as follows:

	Total Assets	Total Liabilities	Net Assets
Pegasus Gold Ltd.	\$36,263,000	\$10,417,000	\$25,846,000
Montoro Gold Inc.	\$ 5,150,000	\$ 222,000	\$ 4,928,000

The issued share capital of the Company immediately subsequent to the amalgamation was as follows:

	Number	%
Shares issued to Pegasus shareholders	7,394,761	83
Shares issued to Montoro shareholders	1,498,045	17
	<u>8,892,806</u>	<u>100</u>

The amalgamation was accounted for as a pooling-of-interests and, accordingly, the financial statements presented herein reflect the combined financial position and results of operations of the two predecessor companies. The revenues and net earnings of Montoro for 1984 are immaterial. All cash and common stock dividends presented herein were declared by Pegasus.

- (b) Sales to significant customers as a percentage of total sales were as follows:

	1986	1985	1984
Customer A	100.0%	99.7%	99.5%
Other	0.0%	0.3%	0.5%
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

- (c) The Company, a British Columbia corporation, presents all financial statements in United States dollars and under generally accepted accounting principles as practiced in the United States.

2. Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of the Company, its proportionate share of the accounts of unincorporated joint ventures in which it participates, and the following subsidiaries:

Pegasus Gold Corporation
Zortman Mining, Inc.
Florida Canyon Mining, Inc.
Centennial Minerals Ltd.
Montana Tunnels Mining, Inc.
Gold Reserve Montana, Inc.
Nevada Reserve Corp.
Westminster Investment, Inc.
Peggold Overseas Limited

During 1986, the Landusky Mining, Inc. and L.R.M. Holdings, Inc. subsidiaries were legally dissolved and merged into Zortman Mining, Inc. Also during 1986, the names of the Majestic Mining Company and Centennial Minerals, Inc. subsidiaries were changed to Florida Canyon Mining, Inc. and Montana Tunnels Mining, Inc., respectively.

Results of operations of purchased subsidiaries (see note 3) are included in the consolidated statements of operations from the date of acquisition. All subsidiaries except Peggold Overseas Limited are wholly-owned (see note 9). All significant intercompany transactions and accounts are eliminated in consolidation.

(b) Development and Exploration Costs

Development costs at operating mines and properties not yet producing are capitalized. Exploration costs incurred in finding specific areas of potential mineralization are expensed. Exploration costs with respect to operating mines and exploration properties with specific areas of potential mineralization are capitalized pending the determination of the project's economic viability. Upon commencing production, capitalized development and exploration costs are amortized over the estimated ore reserves benefitted. Deferred exploration costs of unsuccessful projects are expensed.

(c) Property, Plant and Equipment

Property, plant and equipment is recorded at cost. Replacements and major improvements related to properties in production are capitalized, as are interest costs related to properties in the development stage. Maintenance and repairs are charged to expense as incurred. The cost and related accumulated depreciation of assets sold or otherwise disposed of are removed from the accounts and any resulting gain or loss is charged to operations. Depreciation is provided using the straight-line and accelerated methods over the lesser of estimated useful lives of the related assets, or the mine life. Leach pads, property and mineral rights and development costs are amortized using the units-of-production method over the estimated ore reserves benefitted.

(d) Deferred Reclamation Costs

Deferred reclamation costs relating to mining properties are accrued on the units-of-production method.

(e) Revenue Recognition

Sales of metals are recorded at contractual amounts upon the availability of metals to be delivered under contracts for delayed delivery with custom metal traders, or upon actual delivery to custom metal traders where such contracts do not exist. The Company does not recognize gains or losses from changes in the market value of its delayed delivery contracts until the product is delivered.

(f) Income Taxes

Deferred income taxes arise principally from depreciation and mine development expenses which are deferred and amortized for financial statement purposes and deducted currently for income tax purposes. Investment and research and development tax credits are accounted for using the flow-through method.

(g) Foreign Currencies

Foreign currency translation adjustments, resulting from translation of the Company's Canadian operations from Canadian dollars to U.S. dollars, are accumulated as a separate component of shareholders' equity. All balance sheet accounts of the Canadian operations, other than common stock and retained earnings, are translated using the current exchange rate at the balance sheet date. Income and expenses of the Canadian operations are translated using the exchange rates at the dates on which each transaction was completed. Gains and losses realized from foreign currency transactions, which primarily result from the Company's issuance of the 5-3/4 percent convertible bonds denominated in Swiss francs, are included in results of operations.

(h) Earnings (Loss) Per Share

Earnings (loss) per share is calculated based upon the weighted average number of shares outstanding during each period (as restated for the amalgamation of Pegasus and Montoro) plus common stock equivalents, such as common stock options and warrants and convertible bonds, unless they are anti-dilutive. Primary earnings per share is computed as if common stock options and warrants were exercised at the beginning of the period (or at the time of issuance, if later), and as if the funds obtained thereby were used to purchase common stock of the Company at the average market price during the period. Fully diluted earnings per share is calculated as if the proceeds from the exercise of common stock options and warrants were used to purchase the Company's common stock at its average market price during the period or its market value at the end of the period, whichever is higher. Fully diluted earnings per share also assumes that all bonds convertible into the Company's common stock were converted at the beginning of each period (or date of issuance, if later), with earnings being increased for interest expense, net of taxes, that would not have been incurred had conversion taken place.

(i) Investments

Investments in marketable equity securities representing an ownership interest of less than 20 percent are recorded at the lower of cost or market value. The cost of marketable equity securities sold is determined based upon specific identification. Realized gains and losses on investments and unrealized losses on current marketable equity securities are included in net earnings of the period in which they occur. Unrealized losses on noncurrent marketable equity securities are accumulated as a separate component of shareholders' equity.

(j) Options

Premiums received by the Company for writing call options on its gold production are deferred until such time as the option is exercised or expires. The carrying value of the premiums deferred is adjusted to the market value of the written options at each reporting date, and the resulting gain or loss is included in operations. Included in sales of gold and silver for the year ended December 31, 1986 is \$511,295 of premium income recognized from writing call options (of which \$178,310 resulted from adjusting deferred premiums on open options to their market value at December 31, 1986). Included in accounts payable and accrued liabilities at December 31, 1986 is \$100,690 of deferred premiums on open call option positions.

(k) Reclassifications

Certain prior year balances have been reclassified to conform with the current year presentation.

3. Acquisitions

- (a) On March 19, 1985, the Company entered into an agreement to acquire two wholly-owned subsidiaries of Gold Reserve Corporation in exchange for 1,240,000 shares of the Company's common stock. The agreement was approved by the shareholders of Gold Reserve Corporation on April 10, 1986, and the Company subsequently acquired all of the outstanding shares of Gold Reserve Montana, Inc. (GRM), which owns a 30 percent net profits royalty interest in the Zortman property, and Nevada Reserve Corporation (NRC), which owns a 15 percent working interest in the Florida Canyon property.

The acquisition of GRM and NRC have been accounted for using the purchase method. Accordingly, the operations of GRM and NRC subsequent to April 10, 1986 are included in the consolidated statements of operations. Due to the affiliated nature of Gold Reserve Corporation (see note 13), the net assets acquired have been recorded (and the common shares issued have been valued) at the historical cost, net book value of GRM and NRC on April 10, 1986. The 1,240,000 common shares had a market value of \$7,440,000 on the date issued. The net assets acquired are summarized as follows:

Current assets	<u>\$2,281,200</u>
Non-current assets	1,793,401
Non-current liabilities (deferred income taxes)	<u>1,192,757</u>
Net non-current assets acquired	<u>600,644</u>
Net book value of GRM and NRC at April 10, 1986	<u><u>\$2,881,844</u></u>

Current assets acquired are comprised solely of royalty and interest receivable by GRM from the Company relative to the Zortman property. As a result of the acquisition, the Company will not be required to pay the \$2,281,200, and accordingly, has offset the current payable it previously recorded against the acquired receivable.

The unaudited consolidated results of operations on a proforma basis as though GRM and NRC had been acquired on January 1, 1985 are as follows:

	<u>Years ended December 31,</u>	
	<u>1986</u>	<u>1985</u>
Sales of gold and silver	<u>\$ 35,054,395</u>	<u>\$ 18,014,588</u>
Net earnings (loss)	<u>\$ 4,701,092</u>	<u>\$ (456,242)</u>
Primary earnings (loss) per share	<u>\$ 0.34</u>	<u>\$ (0.04)</u>

- (b) On September 29, 1986, the Company purchased the mineral rights and property, plant and equipment of the Relief Canyon mine from Lacana Mining, Inc. by issuing 325,000 shares of its common stock with a market value of \$2,539,062 and making a cash payment of \$200,000.
- (c) On September 4, 1985, the Company offered to acquire all common shares of Centennial Minerals Limited (Centennial) in exchange for 1,906,374 common shares of Pegasus and sufficient warrants for the purchase of an additional 1,271,666 Pegasus common shares at \$14.57 Cdn. exercisable on or before October 3, 1988. Under the terms of the offer, the holders of Centennial common shares receive 30 common shares of Pegasus and 100 common share purchase warrants of Pegasus for each 100 Centennial shares held. Five common share purchase warrants entitle the holder to purchase one common share of Pegasus. Centennial is also engaged in the exploration and development of mineral properties.

On October 27, 1985, the Centennial common shares acquired by the Company exceeded 50 percent of the total common shares outstanding, and the accounts of Centennial were consolidated with those of the Company. At December 31, 1985, the Company owned a total of 5,333,664, or 87 percent, of Centennial's total common shares outstanding. The market value of the 1,656,374 Pegasus shares issued for the purchase of Centennial shares through December 31, 1985 was \$11,632,435. At December 31, 1985, warrants for the purchase of 1,099,456 Pegasus common shares had been issued to Centennial shareholders. During 1986, the remaining Centennial common shares outstanding were acquired by issuing an additional 250,000 Pegasus shares with a market value of \$1,767,769 and warrants for the purchase of an additional 172,210 Pegasus common shares.

The acquisition of Centennial has been accounted for using the purchase method. Accordingly, the Company's proportional share of the operations of Centennial subsequent to October 27, 1985 are included in the consolidated statements of operations. The allocation of the purchase price and the net assets acquired are summarized as follows:

Current assets	\$ 520,864
Current liabilities	<u>505,207</u>
Working capital	15,657
Noncurrent assets	6,650,655
Noncurrent liabilities	<u>1,682,061</u>
Net noncurrent assets acquired	<u>4,968,594</u>
Net book value of Centennial at October 27, 1985	4,984,251
Minority interest	(621,029)
Net book value of Centennial acquired as of December 31, 1985	4,363,222
Excess of purchase price over net book value acquired during 1985 allocated to:	
Investment in marketable equity securities	597,121
Property and mineral rights	<u>6,672,092</u>
Market value of shares issued through December 31, 1985	11,632,435
Excess of purchase price over net book value acquired during 1986 allocated to:	
Acquisition of minority interest	594,070
Property and mineral rights	<u>1,173,699</u>
Market value of total shares issued	<u>\$13,400,204</u>

- (d) From January 24, 1985, through December 17, 1985, the Company executed a series of agreements with Wharf Resources, Ltd. (Wharf) whereby a 1978 joint venture and mining lease agreement between the companies was cancelled and all interests in the Landusky mining property were acquired by the Company. The Company was released from any remaining obligations under the 1978 mining lease agreement, including payment of the deferred royalty payable at December 31, 1984 of \$650,443. In addition, Wharf agreed to dismiss a writ of summons filed against the Company in 1984. As consideration for the benefits received under this agreement, the Company made cash payments and delivered gold bullion to Wharf with a total value of \$3,890,781. The Company also issued to Wharf warrants to purchase 250,000 shares of Pegasus common stock at \$10.00 Cdn., all of which were exercised during the year ended December 31, 1986.
- (e) On March 5, 1984, the Company acquired all of the outstanding common shares of Majestic Mining Company (Majestic) in consideration for issuing 215,000 common shares as provided for in an agreement dated December 2, 1983. Majestic owned a 22.6 percent interest in the Florida Canyon mine located in Nevada, U.S.A. At the time of the acquisition, a former vice-president of the Company was an officer, director and the owner of 44.3 percent of the common shares of Majestic.

During 1984, 50,000 common shares of the Company with a market value of \$505,811 were issued to the shareholders of Majestic. The acquisition has been accounted for using the purchase method. The 1984 operations of Majestic are immaterial. The net assets acquired, consisting primarily of property and mineral rights, approximated the market value of the 50,000 shares initially issued. During 1986, coincident with the commencement of commercial production at the Florida Canyon mine, an additional 165,000 common shares of the Company with a market value of \$1,495,312 were issued to the former shareholders of Majestic under terms of the December 2, 1983 agreement. The excess of purchase price over net book value acquired that resulted from issuing these additional 165,000 shares has been allocated to property and mineral rights of the Florida Canyon mine.

4. Inventories

Inventories at December 31, 1986 and 1985 consist of the following:

	<u>1986</u>	<u>1985</u>
Refined gold and silver	\$ 4,106,135	\$ 3,308,706
Deferred costs associated with ore under leach	<u>23,455,052</u>	<u>16,082,593</u>
	<u>\$27,561,187</u>	<u>\$19,391,299</u>

Inventories of refined gold and silver are valued at the lower of average production cost or net realizable value. At December 31, 1986, the Company had 70 ounces of refined gold and 798,500 ounces of refined silver in inventory, with a combined market value of approximately \$4,316,000.

Costs associated with ore being leached are deferred and amortized based on the estimated gold and silver to be recovered. Gold and silver are recovered over a five-year period at the Zortman and Landusky mines, a six-month period at the Florida Canyon mine, and a three-month period at the Relief Canyon mine. Approximately 67 percent of the total expected recovery at the Zortman and Landusky mines occurs during the first year ore is added to the leach pads. At December 31, 1986, approximately 39 percent of the remaining gold to be recovered from the ore already in place on the leach pads at the Zortman, Landusky, Florida Canyon and Relief Canyon mines is expected to be recovered in the next 12 months.

The activity in deferred costs associated with ore under leach for the years ended December 31, 1986, 1985 and 1984 is as follows (see note 15(d)):

	<u>1986</u>	<u>1985</u>	<u>1984</u>
Balance, beginning of period	\$16,082,593	\$12,297,970	\$ 9,732,778
Additional costs deferred	27,292,296	16,081,803	18,177,880
Amount charged to cost of sales	<u>(19,919,837)</u>	<u>(12,297,180)</u>	<u>(15,612,688)</u>
Balance, end of period	<u>\$23,455,052</u>	<u>\$16,082,593</u>	<u>\$12,297,970</u>

5. Changes in Estimates

During 1986, 1985 and 1984, the Company changed certain estimates based on changes in production results and mining plans. In 1986, the Company decreased its estimate of the amount of gold to be recovered at the Zortman mine and further refined the estimate of costs to complete the leaching cycle. In 1985, the Company reevaluated the units-of-production used to calculate the depletion of certain acquired interests in the property and mineral rights associated with the Zortman and Landusky mines. In 1984, the Company increased its estimate of the leach pads utilized and modified the method of calculating leach pad amortization. The effect of the change in 1986 was to increase earnings before income taxes by approximately \$828,000. The effect of the change in 1985 was to increase the loss before income taxes by approximately \$245,000. The effect of the change in 1984 was to increase earnings before income taxes by \$514,000.

6. Property, Plant and Equipment

Property, plant and equipment at December 31, 1986 and 1985 consists of the following:

	1986	1985
Property and mineral rights	\$ 20,057,336	\$ 13,474,479
Development costs	29,928,269	14,918,386
Buildings	3,251,716	1,505,113
Machinery and equipment	15,056,261	4,043,180
Leach ponds	2,578,825	1,556,327
Leach pads	19,980,812	13,238,764
Roads	1,446,117	1,259,257
Power line costs	1,006,743	306,399
Furniture and fixtures	439,721	665,403
	<u>93,745,800</u>	<u>50,967,308</u>
Less accumulated depreciation, depletion and amortization	<u>21,390,586</u>	<u>15,809,684</u>
	72,355,214	35,157,624
Construction in progress	29,996,711	2,632,721
Land	1,180,969	89,502
	<u>\$103,532,894</u>	<u>\$ 37,879,847</u>

The location of the Company's property, plant and equipment is summarized as follows:

	1986	1985
Operating properties:		
Zortman and Landusky mines	\$ 15,877,050	\$ 17,210,261
Florida Canyon and Relief Canyon mines . . .	<u>27,742,122</u>	<u>2,857,373</u>
	<u>43,619,172</u>	<u>20,067,634</u>
Development properties:		
Montana Tunnels mine	53,517,121	11,720,534
Beal mining property	<u>5,997,240</u>	<u>5,624,181</u>
	<u>59,514,361</u>	<u>17,344,715</u>
General corporate	<u>399,361</u>	<u>467,498</u>
	<u>\$103,532,894</u>	<u>\$ 37,879,847</u>

During the years ended December 31, 1986 and 1985, interest costs of \$2,010,604 and \$104,517, respectively, were capitalized and included in development costs. No interest costs were capitalized in 1984.

The Company continues to maintain its Beal property on a standby basis, pending further stabilization of gold prices.

7. Investments

Investments consist of the following:

	1986	1985
3,564,000 (1985 - 1,164,000) common shares of U.S. Minerals Exploration Company (USMX), at cost (1986 fair market value - \$13,810,500)	\$ 15,683,107	\$ 3,749,407
Less valuation allowance included in shareholders' equity		(293,782)
Less equity in net losses of USMX	(66,400)	
Investment in USMX at carrying value	15,616,707	3,455,625
1,000,000 common shares of Pan Australian Mining Ltd., at cost (fair market value - \$1,006,580)	914,200	
	<u>\$ 16,530,907</u>	<u>\$ 3,455,625</u>

The USMX common shares owned at December 31, 1985 and the Pan Australian Mining Ltd. common shares are investments in marketable equity securities representing an ownership interest of less than 20 percent, and, accordingly, are recorded at the lower of cost or market value.

During 1986, the Company purchased and later sold 1,000,000 common shares of Pan Australian Mining Ltd. and realized a gain of \$624,163.

On February 13, 1986, the Company agreed to purchase an additional 2,400,000, or 19.8 percent, of the outstanding common shares of USMX from two individuals and a company controlled by one of the individuals. As consideration for the purchase, the Company made two \$3,000,000 cash payments and issued 760,000 shares of its common stock, with a market value of \$5,937,500. The additional shares acquired increased the Company's ownership interest in USMX from 9.6 percent at December 31, 1985 to 29.4 percent. The Company began accounting for its investment in USMX using the equity method on February 13, 1986.

USMX is also engaged in the exploration and development of mineral properties. Its most significant property interest, the Montana Tunnels property, is currently being developed for commercial production and operation by the Company under an agreement with USMX. Under the agreement, the Company may acquire a 100 percent working interest in the Montana Tunnels property by providing all of the financing required to place the property into production, subject to a minimum 5 percent net profits royalty interest in favor of USMX during payback of certain development and financing costs and a 50 percent net profits royalty interest thereafter. The excess of the carrying value of the Company's investment over its proportionate share of the book value of the underlying net assets of USMX is approximately \$13,821,000. This amount, which is included as part of the investment, has been attributed to the property and mineral rights of the Montana Tunnels property, and will be amortized over the estimated ore reserves benefitted when commercial production commences at the mine.

8. Deferred Charges and Other Assets

Deferred charges and other assets consist of the following:

	1986	1985
Deferred debt issuance costs	\$ 4,704,673	\$ 1,420,445
Less accumulated amortization	(439,329)	(62,310)
Less current portion (included in other current assets)	(641,803)	(189,393)
	<u>3,623,541</u>	<u>1,168,742</u>
General Electric Credit International N.V. zero coupon guaranteed notes due 1993, at cost plus accreted discount (which approximates market)		3,182,916
5.75 percent certificate of deposit, at cost (which approximates market)	1,512,400	
Other assets	<u>114,404</u>	
	<u>\$ 5,250,345</u>	<u>\$ 4,351,658</u>

In connection with offering its convertible bonds and securing its gold loan financing, the Company has incurred external legal, accounting, underwriting and printing costs aggregating \$4,704,673. These costs have been deferred and are being amortized into expense using the straight-line method over the expected terms of each bond or financing arrangement.

At December 31, 1986, the zero coupon guaranteed notes have been reclassified as a current asset and are included in other current assets (see note 9(g)). These zero coupon guaranteed notes are pledged as collateral for the outstanding principal repayments of the Company's 5 percent gold-convertible bonds due in 1993 (see note 9(c)). The 5.75 percent certificate of deposit has been pledged in lieu of a bond with the Montana Department of State Lands to cover the total estimated costs of reclamation of the Montana Tunnels mining property.

9. Long-term Debt

(a) Long-term debt consists of the following:

	1986	1985
8½ percent convertible bonds due 1992	\$ 15,000,000	\$ 15,000,000
5 percent secured gold-convertible bonds due 1993	6,656,250	6,656,250
10 percent convertible debentures due 1989	1,449,275	1,518,603
7½ percent gold-convertible bonds due 1993	25,047,000	
5¾ percent convertible bonds, 60,000,000 Swiss francs, due 1996	37,267,082	
Other borrowings with various interest rates and maturities	<u>434,612</u>	<u>311,111</u>
	85,854,219	23,485,964
Less current portion	<u>6,814,283</u>	<u>35,498</u>
	<u>\$ 79,039,936</u>	<u>\$ 23,450,466</u>

- (b) The 8½ percent bonds due in 1992 are negotiable bearer bonds which are immediately convertible into common shares of the Company at a conversion price of \$10.7527 per share. These bonds are listed on the Luxembourg Stock Exchange. The bonds may be called for redemption by the Company in whole or in part at 109 plus accrued interest, decreasing at a rate of 1½ percent per year to par plus accrued interest on August 23, 1992. Any redemption prior to August 23, 1989 is allowed only if the market price of the Company's common stock is at least \$13.98 for each of 30 consecutive trading days. Interest is payable annually in arrears on the anniversary date of the bonds.
- (c) The 5 percent secured gold-convertible bonds ("Peggold bonds") due in 1993 are negotiable bearer bonds which were issued by Peggold Overseas Limited, an unaffiliated Cayman Islands company, whose accounts have been consolidated with those of the Company as if it were a wholly-owned subsidiary at the request of the Securities and Exchange Commission. These bonds are listed on the Luxembourg Stock Exchange. The Peggold bonds may be exchanged for gold bullion (or the cash equivalent thereof) at a fixed price of \$331.25 per ounce. The Company could be obliged to deliver up to the equivalent of approximately 20,000 ounces of gold pursuant to the issuance of the Peggold bonds. If the price of gold reaches \$600 per troy ounce, the Company may request bondholders to exchange their bonds for payment in gold at that time. The principal repayment of the Peggold bonds is collateralized by a senior security interest in an investment in zero coupon notes, whose face value at maturity will equal the principal amount of the Peggold bonds (see note 8). Interest is payable annually in arrears on the anniversary date of the bonds.
- (d) The 10 percent convertible subordinated debentures due in 1989 were originally issued by Centennial Minerals Ltd. and were convertible into Centennial common shares. Pursuant to the acquisition of Centennial by the Company (see note 3(c)) and a resulting resolution by debenture holders, these 10 percent debentures became convertible into Pegasus common shares at a conversion price of \$17.00 Cdn. per share. Interest is payable semi-annually in May and November.
- (e) The 7½ percent gold-convertible bonds due in 1993 are negotiable bearer bonds which may be exchanged for gold bullion (or the cash equivalent thereof) beginning May 20, 1987 at a fixed price of \$376.36 per ounce. The Company could be obliged to deliver up to the equivalent of approximately 66,500 ounces of gold pursuant to the issuance of these bonds. These 7½ percent bonds are listed on the Luxembourg Stock Exchange. Interest is payable annually in arrears on the anniversary date of the bonds.
- (f) On October 10, 1986, the Company issued Swiss francs (SFr.) 60,000,000 of 5¾ percent negotiable bearer bonds due in 1996. Beginning January 10, 1987, these SFr. bonds are convertible into common shares of the Company at a conversion price of \$9.607 per share (or 314 common shares for each SFr. 5,000 bond) (see note 15(g)). Beginning October 10, 1993, each SFr. 5,000 bond may be exchanged for a cash payment equal to the then current market value of 4.887 ounces of gold (an exchange price of \$617.25 per ounce). These bonds are listed on the Zurich, Basel and Geneva Stock Exchanges in Switzerland. The SFr. bonds may be called for redemption by the Company beginning January 10, 1987 at par plus accrued interest if the average market price of the Company's common stock for 30 consecutive trading days is at least \$12.49. Interest is payable in Swiss francs annually in arrears on the anniversary date of the bonds.

(g) The 5 percent and 7½ percent gold-convertible bonds can be converted into gold or the cash equivalent thereof at the holder's option at anytime after August 19, 1986 and May 20, 1987, respectively. At December 31, 1986, the market price of gold exceeded the conversion prices inherent in both the 5 percent and 7½ percent gold-convertible bonds. Since conversion would require the use of a current asset, the liability represented by these bonds is considered to be due currently. On March 24, 1987, the Company entered into an agreement with Citibank, N.A., Bank of New York, and Bank of Nova Scotia ("Banks") whereby the Banks jointly committed to lend the Company up to 67,000 ounces of gold, if necessary, for the sole purpose of satisfying requests for conversion of the 7½ percent gold-convertible bonds. Under terms of the agreement, any gold borrowed would be repayable in installments beginning January 2, 1988 and bear interest at an annual rate of 2 percent of the average market value of the ounces of gold outstanding. Any gold borrowed under the agreement would be collateralized by a first mortgage on the Florida Canyon and Relief Canyon mines. Because of the availability of this financing facility, the 7½ percent gold-convertible bonds have been classified as a non-current liability. Since the ounces committed by the Banks are not adequate to cover requests for conversion of the 5 percent gold-convertible bonds, they have been classified as a current liability. In connection therewith, the \$3,528,090 balance of the General Electric Credit International N.V. zero coupon notes due 1993 that are pledged as collateral for these 5 percent gold-convertible bonds has been reclassified as a current asset and is included in other current assets.

(h) At December 31, 1986, long-term debt matures as follows:

Year ending December 31,

1987	\$ 6,814,283
1988	59,228
1989	1,507,175
1990	9,215
1991	10,097
Thereafter	<u>77,454,221</u>
	<u>\$85,854,219</u>

10. Deferred Revenue

On August 11, 1986, the Company borrowed 43,000 ounces of gold bullion under a revolving loan agreement with Citibank, N.A. The gold borrowed was immediately delivered against previously contracted forward sales commitments, and the Company realized aggregate proceeds of \$15,028,500. The 43,000 ounces will be repaid from the Company's future gold production and, accordingly, the proceeds received have been recorded as deferred revenue. Interest on the loan is payable monthly at an annual rate of 2½ percent of the average market value of the ounces of gold outstanding during the preceding month. The ounces borrowed are scheduled for repayment as follows:

<u>Year ending December 31,</u>	<u>Ounces of Gold to be Repaid</u>	<u>Deferred Revenue to be Recognized</u>
1987	16,000	\$ 5,592,000
1988	16,000	5,592,000
1989	11,000	3,844,500
	<u>43,000</u>	<u>\$15,028,500</u>

Prepayment of a portion of the loan would be required to the extent that the market price of gold exceeds \$620 an ounce. The loan is collateralized by a first mortgage on the Zortman and Landusky mines, and the Company has agreed not to grant any security interests in the Florida Canyon mine without the prior consent of Citibank, N.A. The loan agreement contains several restrictive covenants which relate primarily to the maintenance of certain working capital and net worth levels.

11. Incentive Stock Option Agreements

In May 1985, the Company adopted the 1985 Incentive Stock Option Plan providing for the granting of options to purchase up to 900,000 shares of the Company's common stock. Simultaneously, the Company cancelled options for 232,410 shares that were outstanding under prior option plans, and granted options for 457,500 shares at the market price on the date of issue of \$8.13 Cdn. per share with the majority being exercisable immediately, and the balance exercisable over the three year period following the date of grant. All options granted are subject to adjustment by the Company's Compensation Committee.

During the years ended December 31, 1986, 1985 and 1984, a total of 705,585 shares of the Company's common stock was issued pursuant to stock option agreements as follows:

	Number of Shares	Option Price Per Share Cdn.	Expiration Date
Balance, December 31, 1983	614,735	\$3.10 - \$13.00	
Cancelled	(50,000)	11.70 - 13.00	
Granted	15,000	11.33	January 12, 1989
Granted	101,000	11.37 - 12.63	May 16, 1994
Exercised	(139,865)	3.10 - 5.33	
Balance, December 31, 1984	540,870	3.10 - 13.00	
Cancelled	(232,410)	11.37 - 13.00	
Granted	457,500	8.13	February 12, 1995
Granted	11,000	11.63	September 10, 1995
Granted	20,000	8.63	November 7, 1988
Exercised	(535,460)	3.10 - 12.63	
Expired	(55,000)	8.13	
Balance, December 31, 1985	206,500	8.13 - 12.63	
Cancelled	(35,000)	8.13 - 9.00	
Granted	60,000	9.38	January 6, 1996
Granted	66,000	9.00	March 12, 1996
Granted	285,000	8.00	June 6, 1996
Granted	37,500	11.00	August 8, 1996
Exercised	(30,260)	8.00 - 11.63	
Expired	(20,000)	9.00	
Balance, December 31, 1986	<u>569,740</u>	8.00 - 12.63	

During 1984, the Company adopted a financial assistance plan to enable key employees to purchase common stock of the Company. Any loans made pursuant to this plan are repayable in ten equal payments on January 15 of each year. The promissory notes, which bear interest at the prime rate of specified Canadian and U.S. banks, are collateralized by common stock of the Company valued at quoted market prices equal to 120 percent of the loan balance. Accrued interest is payable on December 15 of each year. Principal and interest payable under the notes may be offset by way of a bonus from time to time. The amounts receivable under the plan from key employees at December 31, 1986 and 1985, of \$2,708,561 and \$2,668,564, respectively, have been shown as a reduction of shareholders' equity. Included in interest and other income for the years ended December 31, 1986 and 1985 is \$243,210 and \$123,127, respectively, representing interest charged on these loans. Included in other receivables at December 31, 1986 and 1985 is accrued interest receivable of \$241,413 and \$118,905, respectively, relating to these loans. The interest accrued at December 31, 1986 was paid in January 1987.

The activity in notes receivable on the sale of common stock for the years ended December 31, 1986, 1985 and 1984 is as follows:

	1986	1985	1984
Balance, beginning of year	\$ 2,668,564	\$ 244,224	
Additions	235,520	2,449,312	\$ 244,224
Payments	(12,464)		
Loans offset by bonuses	(183,059)	(24,972)	
Balance, end of year	<u>\$ 2,708,561</u>	<u>\$ 2,668,564</u>	<u>\$ 244,224</u>

A special committee appointed by the Company's Board of Directors determined that the financial assistance plan had not been administered in accordance with its terms in that, among other things, certain loans made under the assistance plan had not been documented by the delivery of promissory notes, and had not been adequately collateralized by the common stock purchased. The Company is in the process of remedying these deficiencies by, in the case of continuing employees, obtaining the requisite promissory notes and collateral and, in other cases, has entered into a settlement agreement with certain former officers and a Company consultant (see note 13). Under terms of this agreement, a former officer and a Company consultant agreed to repay loans totalling \$1,970,935 (Cdn) by May 11, 1987, and guaranteed the repayment of a third former officer's loan of \$690,781.

12. Income Taxes

The components of the income tax provision (benefit) are:

	1986	1985	1984
Currently payable (refundable)			
Federal	\$ 279,887	\$ (666,937)	\$ (690,011)
State	(64,764)	(85,119)	(104,045)
	<u>215,123</u>	<u>(752,056)</u>	<u>(794,056)</u>
Deferred provision (benefit)			
Federal	(603,754)	(324,210)	460,412
State	(33,595)	(80,220)	58,909
	<u>(637,349)</u>	<u>(404,430)</u>	<u>519,321</u>
	<u>\$ (422,226)</u>	<u>\$(1,156,486)</u>	<u>\$ (274,735)</u>

The effective rate of income tax provision (benefit) on earnings (loss) before income taxes varies from the statutory federal income tax rate in the United States as follows:

	1986		1985		1984	
	Amount	%	Amount	%	Amount	%
Income tax expense (benefit)						
computed at statutory rate	\$ 1,946,416	46	\$(1,068,953)	(46)	\$ 470,978	46
State income taxes, net of						
federal benefit	(53,114)	(1)	(89,283)	(4)	(17,817)	(2)
Investment tax credits	(12,500)		(298,246)	(13)	(232,585)	(23)
Percentage depletion net of						
preference tax, including						
adjustments thereto	(2,440,841)	(58)	125,431	5	(457,378)	(45)
Original issue discount on						
convertible bonds	(328,021)	(8)				
Effect of a subsidiary's loss						
producing no current benefit			114,177	5		
Adjustment of prior years' tax						
estimate and other	465,834	11	60,388	3	(37,933)	(3)
Income tax benefit	<u>\$ (422,226)</u>	<u>(10)</u>	<u>\$ (1,156,486)</u>	<u>(50)</u>	<u>\$ (274,735)</u>	<u>(27)</u>

The deferred income tax provision (benefit) results from timing differences in the recognition of expenses for tax and financial statement reporting purposes. The sources of these differences and the tax effect of each are as follows:

	1986	1985	1984
Development and exploration costs	\$ 5,724,225	\$ 1,009,974	\$ 383,221
Tax depreciation over (under)			
book depreciation	175,500	493,321	(107,274)
Deferred royalty expense		33,706	170,014
Reversal of deferred taxes through			
application of net operating losses	(6,484,604)	(1,860,468)	
Other	(52,470)	(80,963)	73,360
Deferred tax provision (benefit)	<u>\$ (637,349)</u>	<u>\$ (404,430)</u>	<u>\$ 519,321</u>

Most of the Company's U.S. subsidiaries file a consolidated income tax return. Additionally, most of the subsidiaries previously used a June 30 year-end for income tax purposes, which resulted in the necessity of estimating percentage depletion deductions and the related preference tax. Effective December 31, 1986, all U.S. subsidiaries changed their year-end for income tax purposes to December 31.

As of December 31, 1986, the Company and certain U.S. subsidiaries have accumulated net operating loss carryforwards for Canadian and U.S. income tax purposes of approximately \$2,435,000 (Canadian dollars) and \$25,680,000, respectively, and the U.S. subsidiaries have accumulated investment tax credit carryforwards for tax purposes of approximately \$977,000. Certain of these carryforwards can only be used to offset the taxable income and income taxes payable of the subsidiary which generated the carryforwards. These carryforwards are available to reduce future taxable income and income taxes payable, and expire as follows:

	Canada	United States	
	Non-Capital Losses	Net Operating Losses	Investment Tax Credits
	(In Canadian \$)		
1987	\$ 115,000	—	—
1990	948,000	—	—
1991	802,000	—	—
1992	559,000	—	—
1993	11,000	—	—
1995	—	\$ 16,000	—
1996	—	1,215,000	\$ 20,000
1997	—	467,000	1,000
1998	—	1,672,000	10,000
1999	—	5,337,000	56,000
2000	—	2,785,000	507,000
2001	—	14,188,000	383,000
	<u>\$ 2,435,000</u>	<u>\$25,680,000</u>	<u>\$ 977,000</u>

For financial statement purposes, the Company and certain U.S. subsidiaries have approximately \$1,904,000 (Canadian dollars) and \$3,653,000 of Canadian and U.S. net operating loss carryforwards, respectively, which were all acquired in connection with the Centennial purchase. The benefit of these net operating losses, when and if utilized, would reduce property and mineral rights (see note 3(c)).

On October 22, 1986, the existing U.S. federal income tax law was substantially revised by the passage of the Tax Reform Act of 1986. Some of the changes included in this new tax legislation that may significantly impact the Company are:

- reduction of the maximum corporate tax rate from 46 percent to 34 percent effective July 1, 1987;
- repeal of the investment tax credit retroactive to January 1, 1986;
- reduction of investment tax credit carryforwards by 17½ percent if utilized in 1987 and 35 percent if utilized thereafter;
- creation of a new corporate alternative minimum tax based on taxable income increased by defined preference items, including percentage depletion and exploration and developments costs expensed for tax purposes, and certain other adjustments.

The Company has considered the applicable retroactive provisions of the Tax Reform Act of 1986 (primarily the repeal of the investment tax credit retroactive to January 1, 1986) in determining its income tax benefit for the year ended December 31, 1986.

13. Related Party Transactions

Fees for rent and legal, engineering and consulting services totalling \$226,253 for the year ended December 31, 1986 (1985-\$491,228, 1984-\$552,394) have been paid to firms in which certain officers, directors and employees of the Company are partners or owners. Royalties payable and accrued interest at December 31, 1985 include \$1,843,060 and \$394,982, respectively, due to Gold Reserve Corporation (see note 3(a)). During the year ended December 31, 1985, the Company incurred royalty and interest expense of \$663,724 (1984-\$354,851) and \$394,982, respectively, associated with the Gold Reserve Corporation mineral lease. The former president and the current chief financial officer of the Company are also the President and Treasurer, respectively, of Gold Reserve Corporation.

Included in other receivables at December 31, 1986 are an account receivable of \$22,138 (1985-\$131,242) from Gold Reserve Corporation, and advances to officers for relocation and certain other expenses of \$115,639 (1985-\$66,121).

On December 17, 1986, the Company's Board of Directors appointed a special committee ("Committee") to investigate and make recommendations to the Board concerning, among other things, potential undisclosed conflicts of interest in connection with transactions between the Company and American Trading and Investments, Ltd. ("ATI"). Under agreements entered into in 1981 and 1983, Montoro Gold Inc., a predecessor of the Company (see note 1 (a)), obtained from ATI the right to acquire a 62 percent interest in the principal portion of the Florida Canyon property, together with certain other interests therein. Pursuant to such agreements, the Company delivered 30,000 shares of its common stock (with a market value at the time of approximately \$268,000) to ATI in 1984. In addition, the Company was obligated to deliver an additional 435,625 shares of common stock to ATI when commercial production at the Florida Canyon property commenced in December 1986.

As a result of the Committee's investigation, the Company believes that two former officers and a Company consultant had substantial beneficial ownership interests in ATI which had not been disclosed to the Board of Directors of the Company. On February 10, 1987, the Company, with the approval of the Committee, entered into a settlement agreement with ATI and these former officers and Company consultant. Pursuant to this agreement, ATI has conveyed its interest in the Florida Canyon property to the Company in exchange for a cash payment by the Company of \$386,650 in lieu of the 435,625 shares of common stock (with a market value of approximately \$5,800,000 on February 10, 1987) that would have been required to be delivered under the terms of the Company's previous agreements with ATI. The cash payment represents an approximation of the investment made in ATI by the two former officers and a Company consultant, after adjustment for certain transactions and the time value of money. Pursuant to this agreement, ATI has transferred to the Company as part of the settlement 540,000 shares (representing approximately 11 percent of the total outstanding) of Gold Reserve Corporation, with a market value of approximately \$1,475,000 on February 10, 1987. As a result of this settlement, the Company's depletable cost basis relating to the Florida Canyon property will be substantially less than it would have been under the original ATI agreement.

Other related party transactions are disclosed in notes 3(a), 3(e), 11 and 15(b) to the consolidated financial statements.

14. Employee Savings Plan

During 1984, the Company adopted an employee savings plan under section 401(k) of the U.S. Internal Revenue Code. Substantially all of the U.S. employees are eligible to participate in the plan. Under the plan, employees may elect to contribute up to 6 percent of their base salary and the Company will make a matching contribution equal to 50 percent of the employee's contribution up to a maximum of \$100 a month. During 1985, the Company amended the plan to allow employees the option of applying amounts contributed towards the purchase of shares of the Company's common stock. The Company may, at its discretion, make additional contributions to the plan. During the years ended December 31, 1986, 1985 and 1984, the Company contributed \$96,576, \$116,682 and \$42,142, respectively, to the plan. Included in the 1986 contribution are 11,861 shares of the Company's common stock with a value of \$84,237 (1985-6,026 shares with a value of \$41,557).

15. Commitments and Contingencies

- (a) The Internal Revenue Service is presently examining the U.S. federal income tax returns of Zortman Mining, Inc. and Landusky Mining, Inc. for the tax periods ended December 31, 1981 and 1982 and June 30, 1983. The Company believes it has an adequate provision for any additional income taxes and interest that may become payable at the time of any settlement with the Internal Revenue Service.
- (b) The Company leases office space under an operating lease. Total rent expense under this lease for the years ended December 31, 1986, 1985 and 1984 was \$119,157, \$112,908 and \$108,228, respectively. The remaining aggregate minimum lease payments are as follows:

1987	\$120,720
1988	120,720
1989	30,180
	<u>\$271,620</u>

The lessor is a partnership in which the former president and a former consultant of the Company each have a 50 percent interest.

- (c) At December 31, 1986, a total of 7,142,053 shares of authorized common stock are reserved for the following:

Incentive stock options (see note 11)	589,740
Warrants (see note 3(c))	1,271,666
Convertible bonds (see notes 9(b), (d) and (f)) . .	5,280,647
	<u>7,142,053</u>

- (d) On July 23, 1985, approximately three million tons of ore shifted on the 1985 Zortman leach pad. The retaining dike and the impermeable liner remained intact and no structural damage to the dike or loss of leaching solution was encountered. Recovery operations were suspended from July 23, 1985 through August 19, 1985 while the heap was being rehabilitated. On August 20, 1985, leaching operations were resumed at approximately 40 percent of design capacity and on September 27, 1985, 100 percent capacity was attained. The costs incurred to rehabilitate the pad of approximately \$542,000 were recorded as deferred mining costs and have been amortized accordingly. The Company has submitted claims to its insurance carrier claiming a casualty loss of approximately \$542,000 and a business interruption loss of approximately \$2,600,000. The Company's insurance does not cover losses due to construction or design faults, and it is possible that the insurance carrier may seek to disclaim coverage on the basis that the ore shift was caused by such faults.
- (e) At December 31, 1986, the Company has several outstanding gold forward sale contracts with metals dealers requiring delivery of 103,900 ounces of gold in 1987 and 33,000 ounces of gold in 1988. The Company will realize an average of \$385.71 per ounce or a total of approximately \$52,804,000 upon the delivery of the gold. Gold ounces are scheduled for delivery as follows:

	<u>Gold Ounces</u>	
	<u>1987</u>	<u>1988</u>
January	—	2,000
February	11,000	13,000
March	4,000	2,000
April	—	5,000
May	4,900	1,000
June	3,000	1,000
July	8,000	3,000
August	8,000	1,000
September . . .	16,000	1,000
October	14,000	1,000
November	18,000	1,000
December	17,000	2,000
	<u>103,900</u>	<u>33,000</u>

The Company has arrangements with four metals dealers that a margin call will not occur until the market exposure exceeds \$21,500,000 with these dealers. At that time, the Company will cover the excess amount of market exposure with silver or gold bullion carried in inventory or cash. At December 31, 1986, the Company did not have any market exposure in excess of the above described limits relating to these contracts.

- (f) During 1986, the Company began developing its Montana Tunnels mine for commercial production. The development is scheduled to be completed in the second quarter of 1987. At December 31, 1986, the cost to complete the project is estimated to be approximately \$14,932,000. Included in property, plant and equipment at December 31, 1986 is approximately \$53,517,000 of construction and other costs already incurred on this project. As of December 31, 1986, the Company had entered into various purchase or construction commitments for the Montana Tunnels mine development, portions of which were not completed at that date and not reflected in the financial statements. These commitments amounted to approximately \$535,000 at December 31, 1986.
- (g) Included in cash and cash equivalents at December 31, 1986 is approximately 37,800,000 SFr. with a value in U.S. dollars at that date of approximately \$23,475,000 (see note 9). On December 29, 1986, the Company sold Citibank, N.A. an option to purchase its 37,800,000 SFr. at an exchange rate of 1.6082, and concurrently purchased an option to sell Citibank, N.A. 25,000,000 of its SFr. at an exchange rate of 1.6305. No premiums were paid or received in connection with these offsetting transactions. On February 12, 1987, Citibank, N.A. exercised its option and purchased the 37,800,000 SFr. for \$23,504,539.
- From January 1, 1987 through March 24, 1987, approximately 28,475,000 SFr., or 47 percent, of the 60,000,000 SFr. 5¾ percent convertible bonds were converted to 1,788,230 shares of the Company's common stock. The Company has realized transaction gains totalling approximately \$507,000 on these conversions. Based upon the SFr. exchange rate at March 24, 1987, the Company has incurred an unrealized foreign currency transaction loss of approximately \$1,024,000 on the 5¾ percent convertible bonds that remain outstanding.

16. Differences Between United States and Canadian Generally Accepted Accounting Principles

Accounting under United States and Canadian generally accepted accounting principles is substantially the same, except for the following:

- (a) Foreign Currency Translation - Under United States generally accepted accounting principles (Statement of Financial Accounting Standards No. 52), foreign currency translation adjustments resulting from translating the Company's Canadian operations from Canadian dollars to U.S. dollars are not included in the determination of net earnings (loss), but are disclosed and accumulated as a separate component of shareholders' equity. Additionally, all balance sheet accounts, other than common stock and retained earnings, are translated using the exchange rate at the balance sheet date. For income and expense items, the exchange rates at the dates on which the transactions were completed are used. Gains and losses from foreign currency transactions are included in net earnings (loss).

Under generally accepted accounting principles in Canada, monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the balance sheet date, and non-monetary assets and liabilities are translated at the exchange rate in effect at the date of the transaction. Income and expenses are translated at the average exchange rate for the year. Exchange gains or losses are included in the determination of net earnings (loss) except for those relating to non-current monetary assets and liabilities, which are deferred and amortized over the remaining life of the asset or liability.

- (b) Computation of Earnings (Loss) per Share - Under United States generally accepted accounting principles (Accounting Principles Board Opinion No. 15), the computation of primary earnings (loss) per share considers the weighted average number of shares outstanding during the year plus common stock equivalents, such as common stock options. This method requires that primary earnings (loss) per share be computed as if stock options were exercised at the beginning of the year (or at the time of issuance, if later), and as if the funds obtained thereby were used to purchase common stock of the Company at its average market price during the year. Fully diluted earnings (loss) per share shows the effect on earnings (loss) per share which would result if the proceeds from the exercise of common stock options were used to purchase the Company's common stock at its market price at the end of the year.

Basic earnings (loss) per share under Canadian generally accepted accounting principles is calculated using the weighted average number of shares outstanding during the year. Fully diluted earnings (loss) per share shows the effect on earnings (loss) per share which would result if the options outstanding at the end of the year had been exercised at the beginning of the year, or on the date the options were granted, if later.

The effects of all the differences between United States and Canadian generally accepted accounting principles on shareholders' equity, net earnings (loss) and earnings (loss) per share are as follows:

	1986	1985	1984
United States Generally Accepted Accounting Principles			
Shareholders' equity			
Common stock	\$61,536,854	\$44,141,894	\$24,911,274
Retained earnings	14,456,815	9,803,250	10,970,575
Other equity accounts	(2,708,561)	(2,962,346)	(244,224)
Equity adjustment from foreign currency translation	(542,094)	(660,956)	(620,557)
	<u>\$72,743,014</u>	<u>\$50,321,842</u>	<u>\$35,017,068</u>
Net earnings (loss)	<u>\$ 4,653,565</u>	<u>\$(1,167,325)</u>	<u>\$ 1,298,600</u>
Primary earnings (loss) per share	<u>\$0.35</u>	<u>\$(0.11)</u>	<u>\$0.14</u>
Fully diluted earnings (loss) per share	<u>\$0.32</u>	<u>\$(0.11)</u>	<u>\$0.14</u>
Canadian Generally Accepted Accounting Principles			
Shareholders' equity			
Common stock	\$65,314,177	\$44,105,061	\$24,874,440
Retained earnings	14,587,377	9,655,276	10,559,425
Other equity accounts	(2,708,561)	(2,962,346)	(244,224)
	<u>\$77,192,993</u>	<u>\$50,797,991</u>	<u>\$35,189,641</u>
Net earnings (loss)	<u>\$ 4,932,101</u>	<u>\$ (904,189)</u>	<u>\$ 1,146,209</u>
Basic earnings (loss) per share	<u>\$0.37</u>	<u>\$(0.09)</u>	<u>\$0.13</u>
Fully diluted earnings (loss) per share	<u>\$0.37</u>	<u>\$(0.09)</u>	<u>\$0.13</u>

Auditors' Report to the Shareholders

We have examined the consolidated balance sheets of Pegasus Gold Inc. and subsidiaries as of December 31, 1986 and 1985 and the consolidated statements of operations, changes in shareholders' equity and changes in financial position for the years ended December 31, 1986, 1985 and 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Pegasus Gold Inc. and subsidiaries as of December 31, 1986 and 1985, and the consolidated results of their operations and the changes in their financial position for the years ended December 31, 1986, 1985 and 1984 in accordance with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Coopers & Lybrand

Vancouver, B.C., Canada
February 27, 1987,
except for notes 9(g) and 15(g),
as to which the date is
March 24, 1987

CORPORATE INFORMATION

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Spokane, Washington

John C. Crabb
Pender Harbour, B.C.

James H. Foreman
Spokane, Washington

Peter R. Kutney
Calgary, Alberta

Robert A. Watts
Vancouver, B.C.

Officers

James H. Foreman
*President &
Chief Executive Officer*

Rockne J. Timm
*Vice President, Finance &
Chief Financial Officer*

Michael L. Clark
Vice President, Operations

A. Douglas Belanger
Vice President, Corporate Affairs

James S. Hastings
Vice President, Exploration

Lyle F. Beaudoin
Vice President, Business Development

Stanton B. Bennett
*Chief Legal Counsel &
Secretary*

Patrick D. McChesney
Controller

Albert K.F. Wu
Assistant Secretary

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CORPORATE INFORMATION

Shares Listed

Common
Toronto Stock Exchange - PGU
NASDAQ - PGULF

Warrants
Toronto Stock Exchange - PGUWT
NASDAQ - PGUWF

Bonds
8½% Guaranteed Bonds
Due 1992
Luxembourg

7½% Guaranteed Bonds
Due 1993
Luxembourg

5% Secured Bonds due 1993
Luxembourg

5¾% Guaranteed Convertible Bonds
Due October 10, 1996
Zurich, Basle and Geneva

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The Canada Trust Company
Toronto, Ontario

Co-Transfer Agent

General Transfer Company
Spokane, Washington

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