

*"We are committed  
to improving shareholder value  
through quality growth."*

*J. H. Fermin*



# CORPORATE PROFILE & HIGHLIGHTS

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Pegasus Gold Inc. is a British Columbia, Canada, corporation. The Company produces gold, silver, lead and zinc using open-pit mining methods, heap leaching technology, and conventional milling practices. Precious metal ores are processed into gold and silver bullion and

precious metal-bearing lead and zinc concentrates. Pegasus Gold Inc., with executive offices in Spokane, Washington, is the parent company of Pegasus Gold Corporation, a wholly owned U. S. subsidiary. Pegasus Gold Inc. currently operates five precious metals mines in the western

United States. Pegasus Gold Inc. common shares are traded on The American Stock Exchange and The Toronto Stock Exchange under the symbol PGU. Options on the Company's common shares are traded on the Chicago Board Options Exchange and the Vancouver Stock Exchange.

## 1988 HIGHLIGHTS

(In Thousands of U.S. Dollars, Except Share and Per Share Amounts)

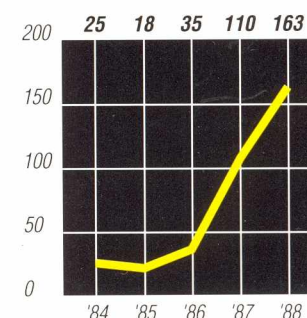
	Year Ended Dec. 31		
	1988	1987	% CHANGE
<b>FINANCIAL DATA:</b>			
Sales	\$162,757	\$110,435	+ 47.4
Net Income	\$ 17,779	\$ 14,492	+ 22.7
Cash Provided by Operations	\$ 43,073	\$ 6,654	+547.3
Total Assets	\$283,305	\$267,764	+ 5.8
Shareholders' Equity	\$221,890	\$203,562	+ 9.0
<b>OPERATING DATA:</b>			
Gold production (ounces)	283,800	228,100	+ 24.4
Silver Production (ounces)	1,360,700	778,300	+ 74.8
Zinc Production (lbs)	36,832,000	14,402,000	+155.7
Lead Production (lbs)	16,808,000	8,562,000	+ 96.3
Ore tons mined (000's)	22,101	17,640	+ 25.3
<b>COMMON SHARE DATA:</b>			
Earnings Per Share			
Primary/Fully Diluted	\$ 0.75	\$ 0.70	+ 7.1
<b>Common Shares Outstanding</b>			
At December 31,	23,886,274	23,508,773	+ 1.6
Weighted average	23,781,440	20,822,247	+ 14.2

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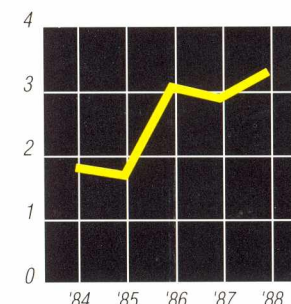
## Total Revenues

In Millions of U.S. Dollars



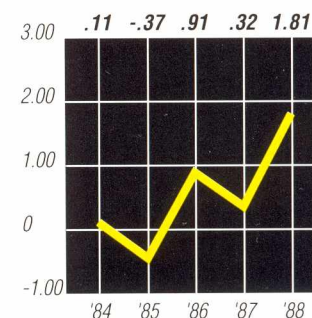
## Reserves - Contained Gold Ounces

In Millions of Ounces



## Cash Flow per Share

In U.S. Dollars





## CHAIRMAN'S LETTER TO SHAREHOLDERS

Dear Shareholder:

On behalf of the Board of Directors and all employees, I am pleased to report that during 1988, Pegasus emerged as a major North American gold producer. Gold production increased to 283,800 ounces, a 24 percent increase over the previous year, and cash production costs were reduced by 8.6 percent to \$234 per ounce of gold produced. Revenues were \$162.8 million, up 47 percent over 1987. Ore reserves were significantly increased at existing mines to total 3.2 million ounces of gold (5 million ounces of gold equivalents) at year-end. Operating cash flow increased to \$43.1 million, or \$1.81 per share, and earnings increased by 23 percent to \$17.8 million, or \$0.75 per share.

Our continued growth in 1988 was the result of a number of significant achievements. Problems were solved with the production process at Montana Tunnels that had plagued the project during its development in 1987. In May 1988, the complex polymetallic mine was brought up to its originally planned production level. Cash production costs of \$129 per ounce of gold, including by-product credit adjustments, were achieved at Montana Tunnels.

Development of a fifth mine, Beal Mountain, near Anaconda, Montana, commenced in February. All necessary permits were obtained, construction of the facilities was essentially completed, and all systems were tested. Leaching commenced in November, and a small quantity of gold was produced before year-end. In the process of developing Beal Mountain, Pegasus also received an award from the United States Forest Service for our efforts to minimize the impact of the project on the environment and local residents.

Significant results were achieved from increased emphasis on ore reserve expansion drilling during 1988. Additional reserves of 16 million tons of ore containing approximately 313,000 ounces of gold were developed at the Florida Canyon mine. We also added 27 million tons of reserves containing nearly 460,000 ounces of gold to reserves at the Zortman/Landusky mine. Exploration was significantly expanded in 1988 to locate new properties that will provide future growth.

Despite the improved performance in 1988, Pegasus did not escape the effects of the almost \$70-per-ounce reduction in gold prices during the last three quarters. Along with other North American gold companies, the market price of our common shares declined during the year. We recognize that this is a matter of concern for our shareholders and believe the decline is excessive given the underlying strength of your Company.

Pegasus' performance in 1988 compared favorably to other North American gold producers. On a per share basis, cash flow, earnings, production and reserves were excellent. We are convinced this position, coupled with our strong financial position and outstanding management team, has established Pegasus in an excellent position to improve shareholder value through quality growth.

Our primary goals continue to be the increase of ore reserves and the addition of low cost production through both development of properties and acquisitions. In 1988, Pegasus evaluated many possible acquisitions; however, very few offered the quality growth at reasonable cost we are seeking. Although we did not conclude a major acquisition during the year, a number of smaller investments were made which offer long-term growth

potential. We believe that continued pursuit of our primary goals and an aggressive program to keep the financial markets aware of our progress will ensure the value of our shareholders' investment is maximized.

In view of the unique position of Pegasus as a Canadian corporation with the majority of its shares held in the United States, the Board of Directors adopted a new type of Shareholder Rights Plan in December. The plan, which will be submitted to shareholders for ratification at the 1989 annual meeting, was designed to provide shareholders with protection against abusive takeover tactics using differences between U.S. and Canadian securities law. The unique "Permitted Bid" feature of our Plan ensures that all shareholders receive equal treatment, that any takeover bid is made fairly and with full disclosure, and that shareholders continue to have the right to decide the merits of Permitted Bids.

The Board of Directors underwent some changes in 1988. Robert A. Watts left the Board after many years of distinguished service as a Director and in other capacities. I would like to thank Bob for his many contributions to the success of Pegasus. The size of the Board was expanded in recognition of the need for additional expertise as the Company continues to grow. We were fortunate to be able to attract to the Board two individuals with extensive business experience. James C. O'Rourke, President of Cassiar Mining Corp. joined the Board in August, and L. Jack Smith, President and Chief Executive Officer of Westar Group Ltd., was elected to the Board in the first few days of 1989. Pegasus is fortunate to have the benefit of the wealth of experience these gentlemen bring to the Board.

During 1988, I informed the Board of Directors of my desire to become less involved in the operations of Pegasus. This led to an extensive search for my successor. In January 1989, John M. Willson was elected a Director, President and Chief Executive Officer, and I was elected Chairman. Mr. Willson was formerly President and Chief Executive Officer of Western Canada Steel and has extensive experience in mining and management. He is well qualified to lead the continued growth of the Company.

It has been my privilege to serve as your Chief Executive for the past few years and to have participated in the growth of Pegasus from a small, one-mine Company to a major presence in the North American precious metals industry. While I take pride in our accomplishments, I believe that we have only established a sound foundation upon which quality growth and a brighter future for Pegasus will be based.

The Board of Directors and I would like to express our thanks to the Company's employees for their key role in the success Pegasus has enjoyed. We also extend our appreciation to all shareholders for the confidence in the future of Pegasus Gold. We believe that confidence is justified and will be rewarded as your Company continues to grow and prosper.



James H. Foreman  
Chairman



## PRESIDENT'S LETTER TO SHAREHOLDERS



*Seated (L. to R.): Lindsay D. Norman, John M. Willson, James H. Foreman, Stanton B. Bennett, James C. O'Rourke. Standing (L. to R.): M. Norman Anderson, L. Jack Smith, John J. Crabb, Peter R. Kutney.*

Dear Shareholder:

I am extremely pleased to have the opportunity to serve as your President and Chief Executive Officer. Pegasus is a dynamic Company in an industry where the opportunities for growth and increased shareholder value are exceptional. Your Company is well-positioned to participate in these opportunities.

Since I have only been associated with Pegasus for a very short time as I write this message, I will not present you with the specifics of our corporate strategy. However, I do have some thoughts that I would like to share with you.

My initial objective is to ensure that transfer of the duties and responsibilities of Chief Executive Officer is accomplished in an orderly manner. Pegasus has achieved a great deal under the direction of Jim Foreman and it is my intent to see that the momentum developed during his tenure is maintained. You will not see any immediate changes in the direction of Pegasus. Management, myself and your Board of Directors will, however, conduct an in-depth review of our strategy. If that review indicates that changes are needed to provide additional opportunities for quality growth, we will not hesitate to make those changes.

I believe that Pegasus has a sound base upon which future growth can be built. We have five operating mines, a solid financial position, and an outstanding group of people with expertise and experience to manage our growth effectively.

We have a strong sense of direction. It appears, however, that we have at times not communicated that direction as well as we might. As a result there may have been a greater level of uncertainty about Pegasus than was necessary. I intend to make certain that all our constituencies clearly understand where we intend to take Pegasus and how we propose to get to our destination. This will better enable our employees to act as a team toward the achievement of our objectives. It will also ensure that the financial markets give us full credit for not only our past accomplishments but also our ability to accomplish more in the future.

I believe that acquisitions offer more opportunities for growth than ever before. We will continue to pursue growth through acquisitions and will increase this level of activity. However, we will resist the temptation to make acquisitions for their own sake. We will only take action when we believe that quality growth and increased shareholder value will result.

Our efforts to generate shareholder value will not be restricted to acquisitions. We are conducting an exploration program that first began in earnest in 1988. Those efforts will continue in 1989 and beyond. As a result, we are involved in a number of properties and will become involved with others as time progresses. Our continuing exploration program, and the subsequent development of properties that program identifies as minable, will be an important factor in the growth of Pegasus. We may explore new avenues of growth beyond the mining of precious metals, but we will not become involved in areas where we have insufficient expertise.

We have a team of people with the skills and experience necessary to generate the type of growth—quality growth—that will, over the long-term, result in the greatest possible increase in shareholder value. It is critical that the management structure of the Company assist employees in carrying out their responsibilities. Accordingly, some changes in the structure of management may be required as we grow.

The coming years will be exciting ones for Pegasus. I am pleased to have the opportunity to help continue the excellent record your Company has established.

John M. Willson  
President and Chief Executive Officer



From an operating standpoint, the year 1988 was a particularly good one for Pegasus Gold. **Gold production for the year was 283,800 ounces, up over 24 percent from the previous year.** Silver production increased almost 75 percent to 1.36 million ounces. Production of lead and zinc effectively doubled. The average cash cost per ounce of gold production, net of by-product credits, declined by \$22 to \$234 from its 1987 level of \$256. Production problems at the Montana Tunnels mine that had prevented the project from achieving its planned production levels were solved by mid-year. A fifth mine, the Beal Mountain Project, was taken from the

## THE ZORTMAN/LANDUSKY MINE Malta, Montana

In 1988, the tenth year of operation, the Zortman/Landusky project produced **111,700 ounces of gold.** This was more than in any previous year. In addition to the increased amount of ore mined in 1988, a major factor in the increased production was improvement of the system that circulates and delivers the leaching solution to the leach pads. Solution flows were increased and the buried drip system (which makes winter leaching possible) allowed leaching to continue for eleven months, considerably longer than was formerly possible during the severe winter weather typically experienced at Zortman/Landusky.

As part of Pegasus' continuing efforts to reduce and control its production costs, the Company began conversion of the Zortman section of the project to a system that uses lime instead of caustic soda to control the chemical characteristics of the leach solution. This was in response to rapid increases in the cost of caustic soda and increased uncertainty over the availability of supplies.

Because the Zortman/Landusky ore grade of 0.018 ounces of gold per ton may be the lowest of any operating mine in the world, even small improvements in operating costs are important. The constant efforts of employees at the mine to identify and take advantage of opportunities to improve

start of the permitting process, through construction and testing to the point where it was ready for startup of production before winter shutdown.

**The main focus of our operations for 1989 will be to continue to identify opportunities for increased efficiency.** Additionally, several possibilities for increasing production at existing mines will be investigated. These will include, the expansion of plant capacities in association with larger minesite ore reserves, and the development of bio-oxidation technology for the treatment of non-oxide reserves at the Zortman/Landusky mine.

the operation have enabled Pegasus to produce substantial amounts of gold profitably from ore that most mining organizations would consider waste. Cash operating costs were reduced to \$241 per ounce of gold in 1988 as a result of mining cost savings.

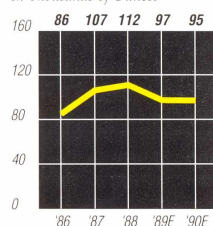
**Important additions to reserves at the Zortman/Landusky mine were made in 1988.** A total of 27 million tons of ore grading 0.017 ounces of gold per ton were added. At present mining rates, the new reserves provide approximately three additional years of life to the mine. With the new reserves, the total reserves at the project amount to 48.3 million tons having a grade of 0.018 ounces of gold per ton.

**A metallurgical study was completed in 1988 that indicated earlier gold recovery estimates made on the basis of higher grade ores were in some cases overstated.** The Zortman/Landusky uncrushed ores require an extended leach cycle of up to five years compared to less than six months for crushed ores at other mines. The study indicated that gold in some of the lower grade ores placed on pads in 1982 to 1985 could not be economically recovered through continued leaching, and the deferred in-process inventory costs were reduced by \$6,120,000.

In 1989, the Zortman/Landusky mine is expected to produce approximately 97,000 ounces of gold from approximately 9 million tons of ore.

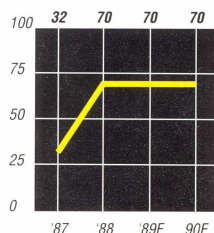
*Opposite page: Drill rigs (background) prepare holes for ore-waste separation blast at Zortman/Landusky.*

Gold Production  
Zortman/Landusky, MT  
In Thousands of Ounces





Gold Production  
Montana Tunnels, MT  
In Thousands of Ounces



## MONTANA TUNNELS

Jefferson County, Montana

The year 1988 was a landmark for the Montana Tunnels mine. **Planned production levels at this unique polymetallic project were finally achieved.** Production from Montana Tunnels included 70,400



Flotation deck at the Montana Tunnels mill.

ounces of gold, 1.05 million ounces of silver, 36.8 million pounds of zinc, and 16.8 million pounds of lead.

The major accomplishment at Montana Tunnels in 1988 was the successful completion of modifications to the process cycle. The original design involved a complex process intended to produce dore bullion. That process, however, was plagued by problems that prevented expected production levels from being achieved. Pegasus modified the process to one that produces gold and silver in zinc and lead concentrates. The modified process cycle will be in place for the full year in 1989.

The polymetallic nature of the Montana Tunnels mine allows the company to use the revenues realized from the sale of byproduct metals to be used as credits against the cost



Aerial view of Beal Mountain mine site.

of gold production. This results in an exceptionally low cash cost per ounce of gold production. **In 1988, the cash cost per ounce of gold produced was \$129.**

## BEAL MOUNTAIN

Anaconda, Montana

Development of the Beal Mountain mine, Pegasus Gold's newest, was essentially completed during 1988. Beal Mountain is particularly notable because of the speed with which it was brought on stream. Application for permits began in February. Permits were received and construction began by July. Loading of ore on the leach pad was able to start in early autumn and leaching began in November. By the time operations halted for the winter, the mine's systems had been tested and were ready for production.

Startup of operations at Beal began in early March 1989. **Planned production levels should be achieved by the end of May.**

**Cash production costs at Beal Mountain are projected to average approximately \$210 per ounce.** The Beal Mountain project is a reflection of Pegasus' goal of growth through the identification of opportunities to develop low-cost projects, and the profitable development of those projects, using the Company's accumulated technical operating expertise.

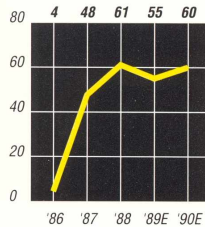
Beal Mountain will make a significant contribution to Pegasus in 1989 and beyond. Gold production in 1989 is projected to be 33,000 ounces. Reserves at Beal Mountain at the end of 1988 were 11.1 million tons of ore with a grade of 0.046 ounces of gold per ton. At anticipated mining rates, Beal Mountain currently has a mine life in excess of ten years.

Opposite page: Montana Tunnels site looking south. Mill and offices in foreground.

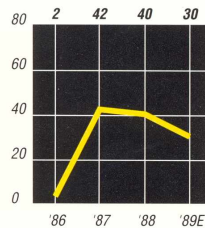




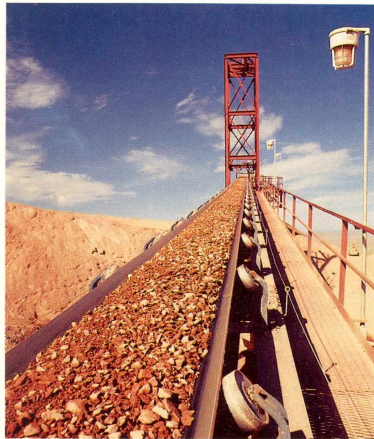
Gold Production  
Florida Canyon, NV  
In Thousands of Ounces



Gold Production  
Relief Canyon, NV  
In Thousands of Ounces



Conveyor transporting ore to  
leach pad at Florida Canyon.



#### FLORIDA CANYON Pershing County, Nevada

The Florida Canyon mine, which began operations in late 1986, operated at its full production level for the entire year in 1988. The combination of full-year production and a number of technical improvements, including a winter drip leaching system, resulted in increased production to 61,300 ounces of gold in 1988. Florida Canyon also produces a small amount of silver.

During 1988, the third quadrant of the unique circular leach pad used at Florida Canyon was completed. The circular configuration stems from the innovative stacker-conveyor system used to load ore on the pad. The additional capacity will accommodate ore to be mined during 1989.

Major additions to reserves were made in 1988. Sixteen million tons of ore containing a total of 313,000 ounces of gold were located and added to reserves. The addition brought total reserves at Florida Canyon to 34 million tons with a grade of 0.022 ounces of gold per ton as of the end of 1988, and increased the remaining life of the mine to more than eight years at present mining rates.

Also in 1988, preliminary testing began on low-grade ore to determine if it can be

leached without undergoing the crushing or agglomeration processes now being used at Florida Canyon. If the simpler process proves technically and economically feasible, the low-grade ore may be a source of additional gold production.

Production at Florida Canyon in 1989 is expected to be approximately 55,000 ounces of gold. The annual capacity can be increased somewhat in future years.

#### RELIEF CANYON Pershing County, Nevada

The Relief Canyon mine has been an exceptionally good investment for Pegasus since the project was acquired in 1986. The annual return on investment in the project has been in excess of 100 percent.

The investment in the Relief Canyon project was made with the knowledge that the mine would have a relatively short life. Mining operations will end during the second half of 1989 as ore reserves are exhausted. Exploration in the area surround-



Relief Canyon ore pit.

ing the mine site has not yielded evidence that any additional minable ore deposits exist.

Although mining operations will end in 1989, leaching operations will continue into 1990 and possibly beyond. Some gold will be produced after 1989 although the amounts are uncertain and have not been considered in future production estimates.

A reclamation plan for the Relief Canyon site will be developed in 1989. The reclamation plan will be implemented when leaching operations are complete toward the end of 1990.

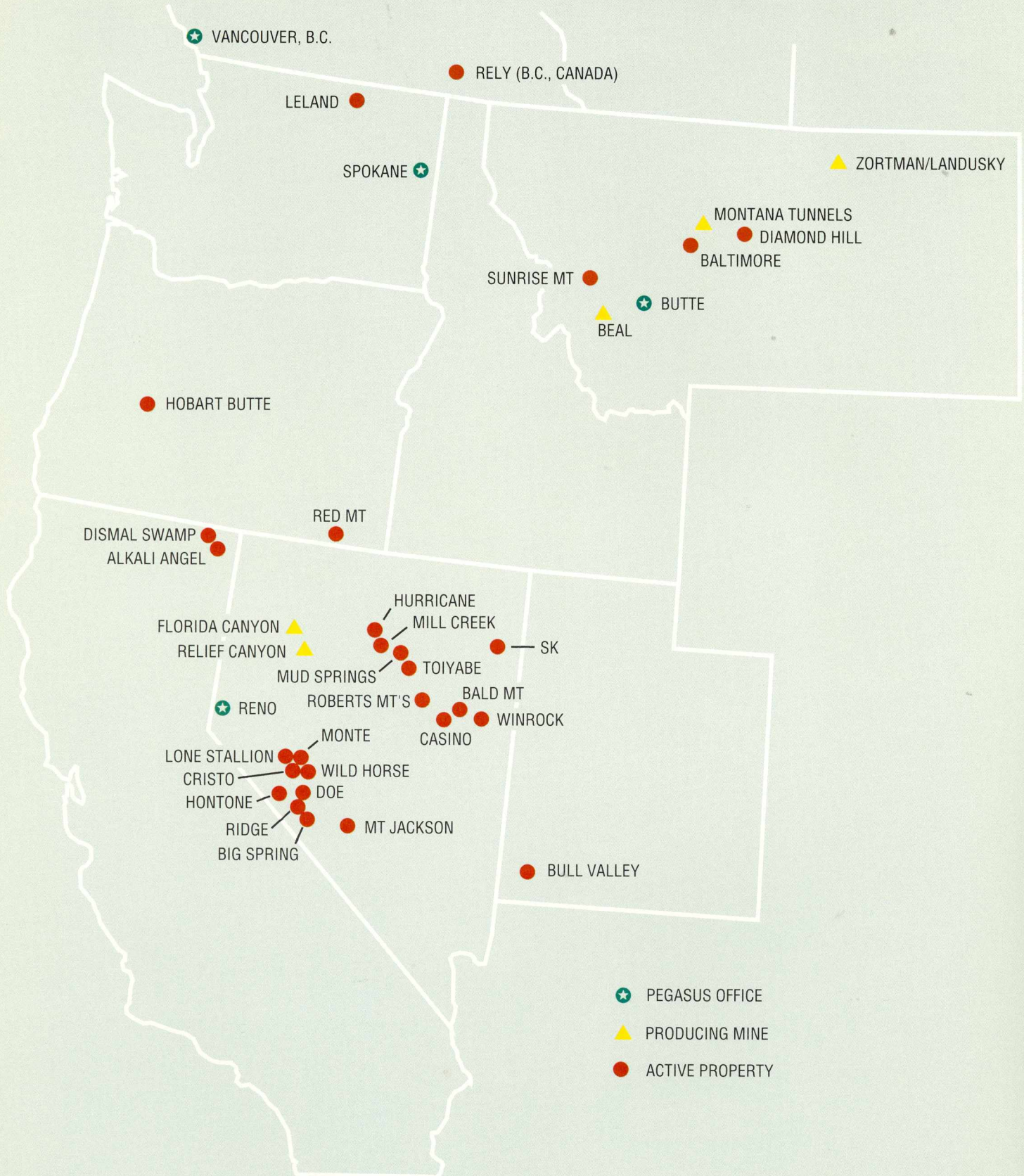
As operations at Relief Canyon wind down, some of the plant and equipment will become available for use in the development and operation of new projects. The availability of this equipment should result in capital savings in future years.

Opposite page: Overlooking leach pad toward ore body, Florida Canyon Mine.





# MINE, OFFICE AND EXPLORATION PROPERTY LOCATIONS



- ★ PEGASUS OFFICE
- ▲ PRODUCING MINE
- ACTIVE PROPERTY





Exploration drilling at Florida Canyon.

**The Company's exploration activities were greatly expanded in 1988.** Exploration expenses rose to \$7.2 million in 1988 compared to \$2.3 million in 1987. Although the Company has always recognized the need for ongoing exploration, its priorities prior to 1988 required that resources be diverted from exploration while new mines were brought into production.

Exploration efforts emphasize the search for high-tonnage, disseminated gold deposits that can be mined by open-pit methods. Additionally,

the Company conducts exploration efforts in the vicinity of its existing mines as a means of expanding the reserves at those mines and, hence, their operating life.

The increased emphasis on exploration was reflected in the number of new exploration properties added during 1988. **Pegasus was able to acquire 24 new properties and, as of year-end, had 30 properties in inventory.** This compares to 19 properties at the end of 1987. A total of 13 properties were abandoned during the year.

**Drilling activity increased by over 280 percent in 1988.** A total of 108,000 feet of drilling was done during the year on 23 different properties compared to 38,000 feet of drilling on eight properties in 1987. To assure that the necessary equipment would be available to conduct drilling activities on a timely basis, Pegasus entered into long term leases of two drilling rigs. The availability of this equipment was a major factor in the increased drill footage.

**Significant results were achieved by Pegasus' exploration activities in 1988.** Exploration at operating mines resulted in the addition of 27 million tons of ore to reserves at the Zortman/Landusky mine and 16 million tons of ore to reserves at the Florida Canyon mine. Pegasus has maintained a record of replacing the total reserves it mined each year. In 1988, however, the company was able to add more than twice the amount of reserves depleted through mining operations. Additionally, drilling on six new properties yielded encouraging results. Although the results on these new properties are preliminary, they indicate that further, more detailed analysis of these properties is warranted.

While exploration is a vital and integral part of the Company's strategy for growth, it is a long-term process. Pegasus has only been aggressively pursuing exploration objectives since mid-1987. The results of exploration may not be evident immediately.

**Exploration expenditures in 1989 are expected to be in the same range as 1988.** Efforts in 1989 will include further exploration in the immediate vicinity of the Company's operating mines, more extensive drilling on those properties that showed promise in 1988, and expansion of exploration activities into areas where Pegasus has not thus far been active.

The identification of minable gold ore bodies will continue to be the focus of Pegasus' exploration efforts in 1989. In particular, the Company will seek out situations amenable to mining by open-pit methods and the employment of the Company's acknowledged expertise in the heap leach process. Additionally, the Company intends to become more active in the evaluation of properties that would require underground mining methods.

**As a second priority, the Company plans to conduct a certain amount of exploration aimed at locating other precious metals, base metals and industrial minerals.** Economic conditions are such that other commodities could be a significant source of growth and diversification if suitable deposits can be located and developed economically.

Economic conditions in 1989 should also result in an increase in the number of exploration properties submitted by outside parties who lack sufficient resources to pursue evaluation or development of properties alone. Submittals of this type are an important source of new properties for evaluation. They provide opportunities that might not otherwise be available because of limitations on the Company's in-house resources. In 1988, Pegasus acquired 11 new properties through submittals from other companies and individuals.

Pegasus has thus far confined its exploration activities, with certain exceptions, to the western United States. **However, in 1989 and beyond, exploration activities will expand geographically.** This will be accomplished not only through Company exploration personnel but also through participation in additional joint ventures or funding of other parties' efforts. Pegasus has established an exploration office in Melbourne, Australia and is actively seeking opportunities for additional investment in Australian properties or projects. Additionally, the Company may participate in other projects worldwide on a case-by-case basis.



The business development activities of Pegasus Gold are directed toward identifying opportunities in which the Company can acquire or take a position in mineral properties that are more advanced toward development than exploration properties. Advanced properties generally offer the advantage of lower risk because the characteristics of the project are usually better defined and the economic benefits are more accurately quantifiable. Additionally, more advanced projects can be brought into production in a shorter time than exploration properties. However, advanced properties also are, as a general rule, more expensive to acquire than those acquired through exploration. Additionally, there is often a higher level of competition for advanced properties.

**During 1988, Pegasus accelerated its business development efforts.** The Company was able to do this because its operations had matured, making sufficient funds available to permit the serious pursuit of opportunities that offered the potential for substantial growth in the relatively near future.

**Acquisition and investment opportunities increased dramatically during 1988.** An unprecedented number of proposals were received from various sources. This was partially attributable to the increased difficulty junior companies encountered in raising capital. They looked to major companies like Pegasus as an alternate source of funds when capital from traditional sources became unavailable.

Most of the proposals evaluated during the year did not make economic sense for Pegasus. In others, the quality of the projects under consideration were not consistent with Pegasus' objective of quality growth. **In a few instances, however, opportunities of a suitable quality did present themselves** and the Company pursued them actively. These opportunities included possible mergers as well as equity positions and other forms of investment.

Pegasus has not insisted on acquiring outright control of other entities in the course of its business development efforts. **The Company has been willing to take minority positions** when significant potential exists and in which a

long-term relationship can be developed. In doing so, Pegasus can also offer its acknowledged operating expertise to further chances that a project's full potential will be realized.

In August, **Pegasus took a 20 percent equity position in Inland Gold and Silver Corporation** of Spokane, Washington. In making this investment, Pegasus gained participation in Inland's Toiyabe mine in Nevada's Cortez gold belt. **In October, an investment was made in Vancouver, British Columbia-based Pioneer Metals Corporation** in the form of a \$12 million (Canadian) debenture convertible into Pioneer common shares. Subsequently, that initial investment has been increased through the acquisition of Pioneer common shares and warrants. Excluding the convertible debenture and unexercised warrants, Pegasus currently holds approximately eight percent of the outstanding shares of Pioneer Metals. Over time it is expected that Pegasus and Pioneer will enter into joint ventures for the development of precious metals properties in both the United States and Canada.

Business development activities in 1988 were not restricted to acquisitions, however. An investment in Pan Australian Mining Ltd. was sold and a gain recorded on the transaction. Pegasus continuously reevaluates its positions with respect to all entities with which the Company has a relationship and modifies its position when and if changing conditions so dictate.

Business development activity for Pegasus in 1989 is expected to accelerate further. The economic conditions are expected to cause a further trend toward consolidation in the mining industry. Activities will focus primarily on North America but will also include a program to identify promising Australian situations. Additionally, consideration of specific situations in other locations may be considered on an individual basis. The company will seek opportunities for acquisitions, joint ventures, equity investments, and other situations that offer quality growth potential.



# SELECTED FINANCIAL DATA

	For the years ended December 31,				
	1988	1987	1986	1985	1984
Statement of Operations Data:					
Sales of gold and other metals	\$162,757	\$110,435	\$ 35,054	\$ 18,015	\$ 25,231
Cost of goods sold	131,686	84,085	26,281	16,025	21,003
Other expenses, net	9,162	8,932	4,541	4,314	3,204
Income (loss) before income taxes and extraordinary credit	\$ 21,909	\$ 17,418	\$ 4,232	\$ (2,324)	\$ 1,024
Net income (loss)	\$ 17,779	\$ 14,492	\$ 4,654	\$ (1,167)	\$ 1,299
Net income (loss) per common share:					
Primary	\$ 0.75	\$ 0.70	\$ 0.35	\$ (0.11)	\$ 0.14
Fully diluted	\$ 0.75	\$ 0.70	\$ 0.32	\$ (0.11)	\$ 0.14
Cash dividends per common share	\$ 0.10	\$ 0.10			

	December 31,				
	1988	1987	1986	1985	1984
Balance Sheet Data:					
Cash & cash equivalents	\$ 49,615	\$ 54,212	\$ 28,630	\$ 11,843	\$ 929
Total assets	283,305	267,764	191,059	80,184	40,531
Term debt	33,441	36,311	85,854	23,486	263
Deferred revenue	3,841	9,437	15,029	--	--
Shareholders' equity	221,890	203,562	72,743	50,322	35,017

	December 31,				
	1988	1987	1986	1985	1984
Statistical Data:					
Shares outstanding at year end	23,886,274	23,508,773	14,948,593	11,802,472	8,925,612
Number of shareholders	4,990	4,650	5,417	5,500	4,400
Market Price (\$ U.S.)					
High	\$17.25	\$26.37	\$11.25	\$10.25	\$14.00
Low	\$10.75	\$10.75	\$ 5.38	\$ 6.13	\$ 5.88
December 31	\$11.50	\$16.25	\$11.25	\$ 6.75	\$ 6.75



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

## INTRODUCTION

The Company's revenues, profitability and cash flow are strongly influenced by the price of gold. During 1988, silver, zinc and lead became more important to the Company's results of operations with the achievement of full production at the Montana Tunnels Mine. Sales of other metals accounted for 23 percent of all sales in 1988, compared to 13 percent in 1987. The Company anticipates that sales of other metals will continue to bear the same relationship to total sales in 1989 as they did in 1988.

Gold prices fluctuate widely and are affected by numerous factors beyond the Company's control, including expectations for inflation, the strength of the U.S. dollar, global and regional demand, and political and economic conditions. The aggregate effect of these factors is impossible to predict. If the market price of gold falls below the Company's production costs at a particular mine and remains at such level for any sustained period, the Company will experience losses. Under these circumstances, the Company may suspend operations at a particular mine (or mines) in order to minimize losses. See "Liquidity and Capital Resources-Impact of Changing Metals Prices".

The Company has experienced increased costs because of inflation, but the costs of production remain relatively unchanged over the short-run although they are generally subject to the same inflationary pressures experienced by the entire economy. In addition, inflation will affect the interest rates paid by the Company, the effect of which will vary with the amount of the Company's outstanding borrowings at any particular time. However, the fluctuation in market prices for products produced by the Company has a much greater impact than inflation on the Company's revenues and profitability.

## RESULTS OF OPERATIONS

### 1988 Compared to 1987

Net income for the year ended December 31, 1988 was \$17,779,000 (after the extraordinary credit relating to the utilization of Canadian income tax loss carryforwards), compared to \$14,492,000 for 1987. The following table highlights specific financial items:

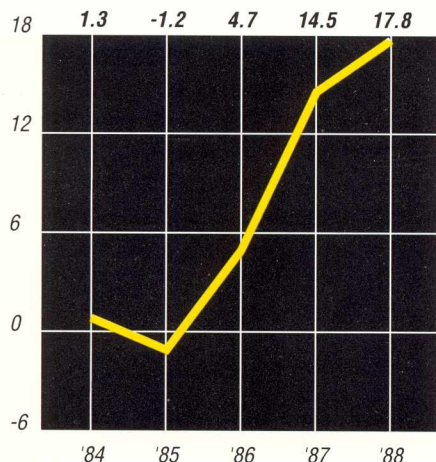
	1988	1987
Sales of gold	\$124,802,000	\$ 96,392,000
Sales of other metals	37,955,000	14,043,000
Total sales	\$162,757,000	\$110,435,000
Average gold price realized per ounce	\$436	\$429
Gold ounces sold	286,500	224,700
Gross profit	\$ 31,071,000	\$ 26,350,000
Gross margin	19.1%	23.9%

The increase in sales is principally the result of a 28 percent increase in the number of ounces of gold sold and a 170 percent increase in revenues from other metals. The increase in production and revenues is due primarily to the inclusion of a full year of operations at the Montana Tunnels Mine for 1988. The mine was not in production during the first half of 1987.

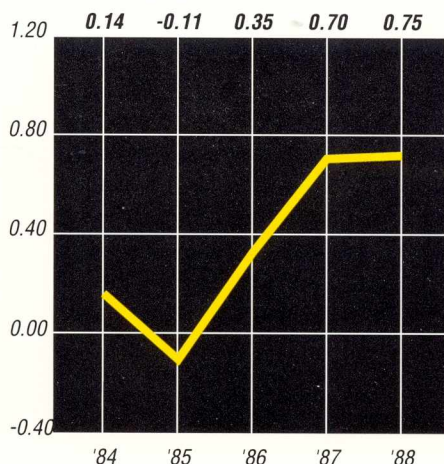
Gross margin declined, from 23.9 percent in 1987 to 19.1 percent in 1988, due to two main factors: (1) the writedown of deferred mining costs taken at the Zortman/Landusky Mine and (2) reduced recoveries and higher production costs at the Relief Canyon Mine.

The Company's policy is to defer costs associated with ore under leach and to amortize those costs as the ounces

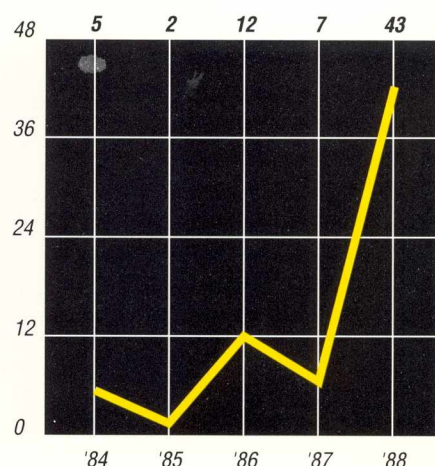
**Net Income**  
In Millions of U.S. Dollars



**Earnings per Share**  
In U.S. Dollars



**Operating Cash Flow**  
In Millions of U.S. Dollars





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

are recovered. In the fourth quarter of 1988 the Company reduced its estimates of the remaining ounces of gold recoverable at the Zortman/Landusky Mine. Consequently, deferred costs amounting to \$6,120,000 were charged to cost of sales during the quarter, reflecting the reduced number of ounces in inventory. These costs relate mainly to ounces that were originally estimated to be recoverable from ore placed on the pads during the years 1982 through 1985. This charge to cost of sales reduced gross margin for 1988 by 3.8 percent.

General and administrative expenses increased by \$79,000 in 1988 compared to 1987, due primarily to increased salaries and benefits, which were largely offset by decreased expenditures for outside services, legal fees and public relations. The increase in royalty expense of \$360,000 in 1988 compared to 1987 relates primarily to the increase in ore mined and an increase in the royalty rate from 2 percent to 2.5 percent in March of 1988 at the Landusky Property.

The significant increase in 1988 exploration expenditures, to \$7,182,000, compared to \$2,304,000 in 1987, is due primarily to increased emphasis on the Company's exploration and acquisition program. Included in the 1988 amount are \$1,700,000 of deferred costs associated with the abandoned Buffalo Hump exploration project in Idaho.

Interest and other income increased from \$2,512,000 in 1987 to \$6,174,000 in 1988, due principally to the increase in cash available for short-term investment for the entire year in 1988 and the receipt of cash dividends from Pan Australian Mining Ltd. in the amount of \$1,300,000.

Interest expense, net of amounts capitalized, declined slightly from \$2,788,000 in 1987 to \$2,680,000 in 1988. Gross interest costs declined principally as a result of the

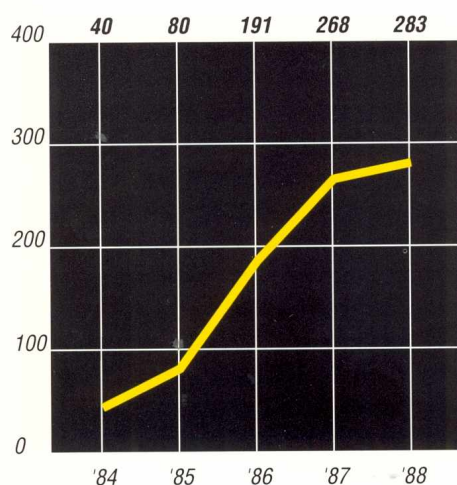
decrease in long-term debt outstanding, due to bond conversions which occurred throughout 1987. However, this decrease in costs was offset by the decline in interest capitalized in 1988. Capitalized interest relates to the construction of the Beal Mine in 1988 and the Montana Tunnels Mine in 1987.

In 1988, the Company sold its remaining 8 percent investment (6,520,400 shares) in Pan Australian Mining Ltd. (Pan Aust) and recorded a gain of \$4,963,000. In 1987, the Company sold 1,000,000 shares of Pan Aust and recorded a gain of \$2,254,000.

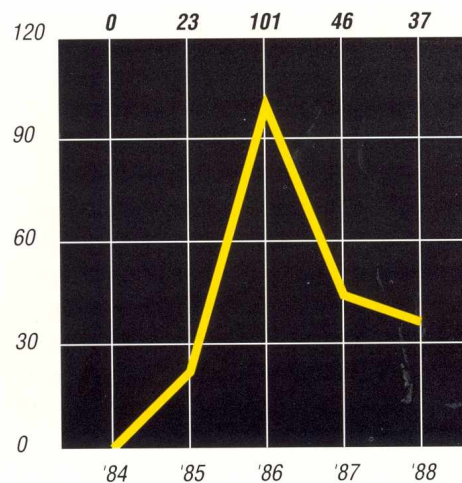
The income tax provision increased from 1987 to 1988 due to the increase in income before income taxes, and an increase in the effective tax rate for the year from 17 percent in 1987 to 29 percent in 1988. The increase in the effective tax rate is due to the application of the alternative minimum tax in the U.S., and the effect of the differential between the Canadian tax rate of 47 percent and the U.S. alternative minimum tax rate of 20 percent on approximately \$4,600,000 of Canadian taxable income. The increase in the effective tax rate is almost entirely offset by the recognition of an extraordinary credit from the utilization of Canadian tax loss carryforwards to completely offset Canadian taxable income, which reduces the net effective tax rate to 19 percent. There are virtually no remaining loss carryforwards to offset future income. The effective rate in 1989 is expected to be approximately 20 percent.

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96 - Accounting for Income Taxes (SFAS No. 96). This new standard requires that an asset and liability approach be used to account for and report income taxes for finan-

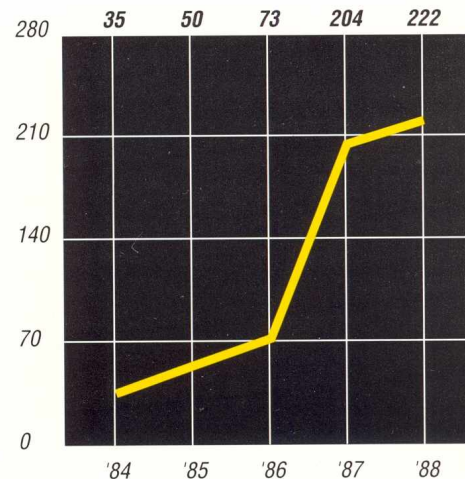
**Assets**  
In Millions of U.S. Dollars



**Debt**  
In Millions of U.S. Dollars



**Shareholders' Equity**  
In Millions of U.S. Dollars





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

cial statement purposes. SFAS No. 96 will require the Company to recognize a current or deferred tax liability for the tax consequences of all events recognized in the financial statements. The new standard represents a significant change in accounting for the effects of deferred taxes. Under SFAS No. 96, deferred taxes will be based on the difference between the tax bases of assets and liabilities and their amounts for financial statement purposes. The Company will be required to recompute its tax liabilities if the tax rates change, and to recognize the effect thereof in operations. The Company must adopt the requirements of SFAS No. 96 no later than January 1, 1990. The Company has not determined the effects of adopting this new standard.

## 1987 Compared to 1986

Net income for the year ended December 31, 1987 was \$14,492,000, compared to net income of \$4,654,000 for 1986. The following table highlights specific financial items:

	1987	1986
Sales of gold	\$ 96,392,000	\$35,054,000
Sales of other metals	14,043,000	-0-
Total sales	\$110,435,000	\$35,054,000
Average gold price realized		
per ounce	\$429	\$381
Gold ounces sold	224,700	92,000
Gross profit	\$ 26,350,000	\$ 8,773,000
Gross margin	23.9%	25.0%

The increase in sales of gold is the result of an increase of 144 percent in the number of ounces of gold sold and a 13 percent increase in the realized price per ounce of gold. Production for 1987 totalled 228,100 ounces of gold compared to 92,400 ounces in 1986. The increase in production is attributable to commencement of production at three new mines and record gold production at the Zortman/Landusky Mine.

Although gross profit increased 200 percent over 1986 as a result of higher production, gross margin declined slightly, from 25.0 percent in 1986 to 23.9 percent in 1987, due primarily to higher costs incurred at the Florida Canyon and Montana Tunnels Mines during start-up and process modifications.

General and administrative expenses in 1987 increased \$2,882,000 over the prior year, principally as a result of increased salary, public relations and travel expenses, and certain one-time costs incurred in connection with a special investigation by the Board of Directors. The increase in royalty expense incurred during 1987 relates primarily to the Florida Canyon and Relief Canyon Mines, which were not in full production during 1986. As a result

of increased emphasis on the Company's exploration program, exploration expense increased to \$2,304,000 in 1987, compared to \$790,000 in 1986.

Interest expense, net of amount capitalized, increased from \$1,880,000 in 1986 to \$2,788,000 in 1987. The increase in gross interest costs results principally from additional interest accrued on the bonds issued in May and October 1986. During 1987, the Company recorded a foreign currency transaction gain of \$1,182,000 related to the 5-3/4 percent Swiss franc convertible bonds. The Company recorded its proportionate share of the net loss recorded by USMX, Inc. (accounted for using the equity method), in the amount of \$285,000. In addition, the Company recorded losses on conversions of its gold bonds in the amount of \$349,000. In 1987, the Company sold 1,000,000 shares in Pan Aust and other securities and realized gains of \$2,452,000, compared to a gain of \$624,000 realized in 1986.

The income tax provision increased from 1986 to 1987 as a result of the increase in income before income taxes and the impact of the new alternative minimum tax, which increased the Company's overall tax provision by approximately \$1,035,000.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Flow

At December 31, 1988, the Company had cash and cash equivalents in the amount of \$49,615,000, representing a decrease of \$4,597,000 from December 31, 1987.

Cash provided by operating activities of \$43,073,000 and proceeds from the sale of the investment in Pan Aust of \$20,139,000 were the major sources of cash for the year ended December 31, 1988. Additions to property, plant and equipment in the amount of \$34,557,000 (which includes approximately \$20,000,000 expended on the development of the Beal Project), the investments in USMX, Inland Gold and Pioneer in the amount of \$25,550,000, and the net repayment of long-term debt and deferred revenue in the amount of \$6,966,000 represented the principal uses of cash.

### Impact of Changing Metals Prices

During 1988, the price of gold ranged from \$484 per ounce to \$396 per ounce. From January 1, 1989 to March 14, 1989, the price of gold ranged from \$412 per ounce to \$380 per ounce. In order to protect against adverse moves in the gold market the Company employs two basic hedging strategies: forward sales, and a combination of put and call options. A forward sale is a commitment by the Company to deliver gold at a future date at a set price. As of March 14, 1989, the Company has committed 50 percent of its projected 1989 production and 26 percent of its projected 1990 production for delivery under forward sales contracts at average prices of \$422 per ounce and



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

\$450 per ounce, respectively.

The combination of put and call options is a net-zero cost hedging transaction which establishes a floor price by buying puts (the right of the put holder to sell gold at a fixed strike price) which are paid for by selling calls (the right of the call holder to buy gold at a fixed strike price). This strategy is designed to establish a floor price for gold while maintaining the ability to sell gold into an escalating market up to the call price. The Company currently owns 45,000 ounces of puts at a strike price of \$410 and has sold 13,500 ounces of calls at a strike price of \$535, both of which expire in 1989.

The impact of the decline in the gold price in 1988 on the Company's revenue has been partially offset by the increase in the zinc price. During 1988, the price of zinc averaged 62 cents per pound.

Montana Tunnels Mining, Inc. has acquired title to the Montana Tunnels Mine Project, properties, mineral rights, water rights and other real property and personal property, subject to a 5 percent net profits royalty interest in favor of USMX until certain capital and financing costs, totalling approximately \$82,000,000, have been recovered by Montana Tunnels Mining, Inc. (payback). After payback, USMX will become entitled to a 50 percent net profits royalty. The precise date payback will occur can only be estimated because an assumption must be made as to a number of factors in the future, some of which are beyond the Company's control. In particular, payback is sensitive to the price of metals. Based on current mine plans, ore reserve estimates, mining and processing costs and metal prices of \$400 per ounce - gold, \$6.00 per ounce - silver, \$.40 per pound - lead and \$.75 per pound - zinc, payback will occur in late 1992. However, any cash distribution will not occur until late 1993 as a result of retiring certain gold debentures associated with the project.

If the assumed metal prices were reduced by 10 percent, payback would not occur until 1996, assuming all other factors remain constant. Conversely, a 10 percent increase in metal prices would accelerate the payback to first quarter 1992, subject to the reduced cash distribution in 1993 due to the retiring of gold debentures. However, there can be no assurance that mining plans and mining and processing costs, which are to some degree dependent upon metals prices, would not also change in the event of changing metals prices. Metal prices fluctuate widely and are affected by numerous factors beyond the Company's control, and no assurance can be given that such prices will be realized. Moreover, the Company makes no representation that it will not revise mining plans or make other changes that would affect the timing of such payback.

## *Capital Requirements*

The Company has an ongoing capital expenditure program in connection with the expansion of leach pad capacity, plant improvements, and other capital expenditures at its operating mines. The budget for these capital expenditures is \$13,500,000 for 1989. These expenditures are expected to be funded out of cash flow from operations. However, the discovery, development and acquisition of mineral properties are in many instances unpredictable events. Future metal prices, the success of exploration programs and other property transactions can have a significant impact on capital requirements.

## *Repayments of Long-term Debt*

The Company has entered into various long-term debt arrangements under which it may be required to deliver gold bullion or to make payments computed by reference to the price of gold. In connection with the 7-1/2 percent Guaranteed Bonds Due 1993, the Company may be obligated to deliver up to 60,600 ounces of gold (or cash equivalent), at a conversion price of \$376.36 per ounce of gold, at any time up to maturity. In connection with the 5 percent Secured Bonds Due 1993, the Company may be obligated to deliver up to 16,800 ounces of gold (or cash equivalent), at a conversion price of \$331.25 per ounce of gold, at any time up to maturity. Under the terms of a gold loan with Citibank, the Company's remaining obligation is to deliver 11,000 ounces of gold, which was delivered on March 13, 1989 (see Notes 7 and 8 to the Consolidated Financial Statements).

## *Line of Credit*

The Company has in place a revolving and term loan credit facility with a syndicate of major banks. Under the terms of the credit facility, the Company can borrow up to \$100,000,000 or, at the Company's option, the gold equivalent thereof, for general corporate purposes (including the satisfaction of obligations pursuant to any conversions of the gold-convertible bonds). Amounts may be borrowed on a revolving credit basis until December 16, 1990, and are repayable in ten quarterly installments beginning on March 16, 1991. Dollar borrowings will bear interest at a rate based on an adjusted London Interbank Offered Rate, an adjusted certificate of deposit rate, or a bank reference rate, at the Company's option. Gold borrowings will bear interest based on the bank's cost of borrowing gold applied to the average market value of the ounces of gold outstanding. As of December 31, 1988, there were no borrowings outstanding under this facility.

The Company believes that cash on hand, plus the line of credit facility, should provide it with the necessary cash to meet its short and intermediate-term cash needs.




# CONSOLIDATED BALANCE SHEETS

December 31, 1988 and 1987  
(In Thousands of U.S. Dollars)

	1988	1987
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 49,615	\$ 54,212
Due from sales of product	19,050	17,135
Other receivables	669	635
Inventories	28,265	34,401
Other current assets	2,603	1,959
Total current assets	100,202	108,342
Investments	39,862	31,332
Property, plant and equipment, net	136,341	121,461
Deferred charges and other assets, net	6,900	6,629
Total assets	<u>\$283,305</u>	<u>\$267,764</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 11,226	\$ 6,302
Mining taxes payable	4,168	2,703
Royalties payable	247	443
Accrued interest	1,459	1,511
Income taxes payable	678	1,351
Current portion of long-term debt	48	55
Current portion of deferred revenue	3,841	5,592
Dividends payable	2,389	2,351
Total current liabilities	24,056	20,308
Long-term debt	33,393	36,256
Deferred revenue		3,845
Deferred reclamation costs	2,244	1,522
Deferred income taxes	1,722	2,271
Total liabilities	<u>61,415</u>	<u>64,202</u>
Commitments and contingencies		
<b>SHAREHOLDERS' EQUITY</b>		
Class A preferred stock, Series 1, \$10 par value:		
Authorized-20,000,000 shares; none issued		
Common stock, no par value:		
Authorized-50,000,000 shares; Issued		
and outstanding-23,886,274 and 23,508,773 shares	181,385	177,792
Retained earnings	41,988	26,598
Less:		
Net unrealized loss on marketable equity securities	(1,016)	(371)
Foreign currency translation adjustment	(467)	(457)
Total shareholders' equity	<u>221,890</u>	<u>203,562</u>
Total liabilities and shareholders' equity	<u>\$283,305</u>	<u>\$267,764</u>

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, 1988, 1987 and 1986  
(In Thousands of U.S. Dollars)

	Common Stock		Retained Earnings	Net Unrealized Loss on Marketable Equity Securities	Foreign Currency Translation Adjustment	Notes Receivable from Sale of Common Stock
	Number of Shares	Amount				
Balance, December 31, 1985	11,802,472	\$ 44,142	\$ 9,803	\$ (294)	\$(661)	\$(2,668)
Net income			4,654			
Common stock issued for:						
Property	439,000	3,235				
Acquisition of subsidiaries	1,655,000	6,145				
Acquisition of investment	760,000	5,938				
Exercise of warrants	250,000	1,797				
Stock option plan	30,260	196				
Employee savings plan and other	11,861	84				
Other net changes				294	119	(41)
Balance, December 31, 1986	14,948,593	61,537	14,457	-0-	(542)	(2,709)
Net income			14,492			
Cash dividend (\$0.10 per share)			(2,351)			
Common stock issued for:						
Cash, net of offering expenses	3,450,000	67,609				
Conversion of bonds	4,688,958	45,484				
Stock option plan	416,200	3,091				
Employee savings plan and other	5,022	71				
Other net changes				(371)	85	2,709
Balance, December 31, 1987	23,508,773	177,792	26,598	(371)	(457)	-0-
Net income			17,779			
Cash dividend (\$0.10 per share)			(2,389)			
Common stock issued for:						
Conversion of bonds	139,500	1,439				
Stock option plan	152,373	1,094				
Exercise of warrants	71,307	848				
Employee savings plan and other	14,321	212				
Other net changes				(645)	(10)	
Balance, December 31, 1988	<u>23,886,274</u>	<u>\$181,385</u>	<u>\$41,988</u>	<u>\$(1,016)</u>	<u>\$(467)</u>	<u>-0-</u>

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



# CONSOLIDATED INCOME STATEMENTS

For the Years Ended December 31, 1988, 1987 and 1986  
(In Thousands of U.S. Dollars, Except Per Share Amounts)

	1988	1987	1986
Sales of gold and other metals	\$162,757	\$110,435	\$35,054
Cost of sales and other direct production costs	111,028	68,962	21,379
Depreciation, depletion and amortization	20,658	15,123	4,902
	<u>131,686</u>	<u>84,085</u>	<u>26,281</u>
Gross profit	<u>31,071</u>	<u>26,350</u>	<u>8,773</u>
Operating expenses:			
General and administrative	6,428	6,349	3,467
Royalties	3,167	2,807	137
Depreciation and amortization	258	196	214
Exploration	7,182	2,304	790
	<u>17,035</u>	<u>11,656</u>	<u>4,608</u>
Income from operations	<u>14,036</u>	<u>14,694</u>	<u>4,165</u>
Other income (expense):			
Interest and other income	6,174	2,512	1,813
Interest expense, net of amounts capitalized	(2,680)	(2,788)	(1,880)
Gain on sale of investments, including foreign exchange	4,963	2,452	624
Gain (loss) on foreign currency transactions	320	1,182	(424)
Equity in net losses of affiliates and other	(904)	(634)	(66)
	<u>7,873</u>	<u>2,724</u>	<u>67</u>
Income before income taxes and extraordinary credit	21,909	17,418	4,232
Income tax provision (benefit)	<u>6,303</u>	<u>2,926</u>	<u>(422)</u>
Income before extraordinary credit	15,606	14,492	4,654
Extraordinary credit from utilization of foreign tax loss carryforwards	<u>2,173</u>		
Net income	<u>\$ 17,779</u>	<u>\$ 14,492</u>	<u>\$ 4,654</u>
Income per share:			
Primary:			
Before extraordinary credit	\$ 0.66	\$ 0.70	\$ 0.35
Extraordinary credit	<u>0.09</u>		
	<u>\$ 0.75</u>	<u>\$ 0.70</u>	<u>\$ 0.35</u>
Fully diluted			
Before extraordinary credit	\$ 0.66	\$ 0.70	\$ 0.32
Extraordinary credit	<u>0.09</u>		
	<u>\$ 0.75</u>	<u>\$ 0.70</u>	<u>\$ 0.32</u>
Weighted average common shares outstanding	<u>23,781</u>	<u>20,822</u>	<u>13,273</u>

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



# CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 1988, 1987 and 1986  
(In Thousands of U.S. Dollars)

	1988	1987	1986
Operating activities:			
Net income	\$ 17,779	\$ 14,492	\$ 4,654
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	20,916	15,319	5,493
Deferred reclamation costs	722	457	137
Deferred income taxes	(549)	1,454	(636)
Interest on debt converted to equity		1,531	
Gain on sale of investments	(4,963)	(2,452)	(624)
(Gain) loss on foreign currency transactions	(320)	(1,160)	422
Equity in net losses of affiliates	607	285	66
Other	599	481	
	34,791	30,407	9,512
Change in receivables	(1,949)	(12,843)	(2,100)
Change in inventories	6,136	(6,840)	(8,170)
Change in accounts payable and accrued liabilities	5,468	(3,241)	13,238
Change in other current assets	(1,373)	(829)	(339)
Net cash provided by operating activities	43,073	6,654	12,141
Investing activities:			
Proceeds from sale of investments	20,139	4,939	1,026
Additions to property, plant and equipment	(34,557)	(34,152)	(63,449)
Purchase of investments	(25,550)	(17,039)	(7,311)
Other, net	(123)	(389)	(1,626)
Net cash applied to investing activities	(40,091)	(46,641)	(71,360)
Financing activities:			
Dividend paid	(2,351)		
Proceeds from issuance of long-term debt and deferred revenue		13,674	77,027
Payments of long-term debt and deferred revenue	(6,966)	(21,455)	
Proceeds from issuance of common stock	2,154	70,771	2,077
Repayments of loans to purchase stock		2,709	
Debt issuance costs	(416)	(130)	(3,098)
Net cash provided by (applied to) financing activities	(7,579)	65,569	76,006
Net increase (decrease) in cash and cash equivalents	(4,597)	25,582	16,787
Cash and cash equivalents, beginning of year	54,212	28,630	11,843
Cash and cash equivalents, end of year	\$ 49,615	\$ 54,212	\$ 28,630
Supplemental disclosures (see notes 3 and 7):			
Cash paid during the year for:			
Interest (net of amount capitalized)	\$ 1,811	\$ 1,452	\$ 398
Income taxes	3,151	36	5

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



# INDEPENDENT AUDITOR'S REPORT

## *Board of Directors and Shareholders Pegasus Gold Inc.*

We have examined the consolidated balance sheets of Pegasus Gold Inc. and subsidiaries as of December 31, 1988 and 1987 and the related consolidated income statements and statements of changes in shareholders' equity and cash flows for the years ended December 31, 1988, 1987 and 1986. 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, 1988 and 1987, and the consolidated results of their operations and their cash flows for the years ended December 31, 1988, 1987 and 1986 in accordance with generally accepted accounting principles in the United States applied on a consistent basis.

*Coopers & Lybrand*

Vancouver, B.C., Canada  
February 8, 1989

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(All Tabular Dollar Amounts In Thousands of U.S. Dollars)*

### **1. The Company and basis of presentation of financial statements**

(a) The Company, through its wholly-owned subsidiaries, operates precious metals mines in Montana, U.S.A. (Zortman, Landusky, Beal and Montana Tunnels) and Nevada, U.S.A. (Florida Canyon and Relief Canyon). The Company is also actively engaged in the exploration and development of other mining properties.

(b) The Company sells a majority of its production primarily to four metals brokers; however, due to the nature of precious metals, the Company is not dependent upon these significant customers to provide a market for its products.

(c) The Company, a British Columbia, Canada 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, all its subsidiaries, and its proportionate share of the accounts of unincorporated joint ventures in which it participates. Accounts of purchased subsidiaries are included in the consolidated financial statements from the date of acquisition. All subsidiaries except Peggold Overseas Limited are wholly-owned (see note 7(c)). All significant intercompany transactions and accounts are eliminated in consolidation.

#### **(b) Inventories**

Inventories are recorded at the lower of average cost or estimated net realizable value.

#### **(c) Development and exploration costs**

Development costs at operating mines and properties not yet producing are capitalized. Exploration costs incurred in finding 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 benefited. Deferred exploration costs of unsuccessful projects are expensed.

Interest costs are capitalized as part of the cost of developing operating mines. Interest costs of \$1,223,000, \$2,321,000 and \$2,011,000 were capitalized during 1988, 1987 and 1986, respectively.

#### **(d) Property, plant and equipment**

Property, plant and equipment is recorded at cost. Replacements and major improvements related to property, plant and equipment are capitalized. 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 reflected in income. Depreciation is provided using straight-line and accelerated methods over the lesser of the estimated useful lives of the related assets or the mine life. Property and mineral rights, development costs, leach pads and ponds, and certain machinery and equipment are amortized using units-of-production methods over the estimated related ore reserves.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## **(e) Revenue recognition**

Metal products sold directly to smelters are recorded as sales when they are received at the smelter, at estimated metal prices. Recorded values are adjusted periodically and upon final settlement. Metal in products tolled and metal products sold directly to refineries or metals brokers are generally sold under contracts for future delivery. Such sales are recorded at contractual amounts when products are available to be processed by the smelter or refinery, or upon actual delivery when no such contracts exist.

## **(f) Income taxes**

Deferred income taxes arise from differences in the timing of recognition of revenues and expenses for financial statement and income tax purposes, principally from depreciation, mine development and exploration expenses and investments accounted for using the equity method.

## **(g) Foreign currencies**

Foreign currency translation adjustments, resulting from translation of the Company's foreign operations to U.S. dollars, are accumulated as a separate component of shareholders' equity. All balance sheet accounts of foreign operations, other than common stock and retained earnings, are translated using the current exchange rate at the balance sheet date. Income and expenses of foreign operations are translated using average exchange rates during the year. Realized gains and losses from foreign currency transactions are reflected in income.

## **(h) Net income per share**

Net income per share is calculated based upon the weighted average number of shares outstanding during each period plus common stock equivalents, such as common stock options and warrants, unless they are anti-dilutive. Primary income per share is computed as if common stock options and warrants were exercised at the beginning of the period, 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 income 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 income per share also assumes that all bonds convertible into the Company's common stock were converted at the beginning of each period, with income being increased for interest expense, net of income taxes, that would not have been incurred had conversion taken place.

## **(i) Investments**

Investments in marketable equity securities representing an ownership interest of 20 percent or more are accounted for using the equity method. Investments in marketable equity securities representing an ownership interest of less than 20 percent are recorded at the lower of cost or market value. Investments in other securities are recorded at cost, which approximates market. The cost of investments sold is determined based upon specific identification. Realized gains and losses on investments are reflected in income in the period in which they occur. Net 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 reflected in income.

The Company also writes options with offsetting positions, which act to hedge gold production within certain price parameters. These offsetting options are generally written in tandem with no net premium. No gain or loss is recognized in connection with writing these options unless the options are exercised.

## **(k) Cash equivalents**

For purposes of the statements of cash flows, the Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

## **(l) Reclassifications**

Certain prior year balances have been reclassified to conform with the current year presentation. These reclassifications had no effect on net income or retained earnings as previously presented.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 3. Acquisition

During 1985 and 1986, the Company acquired all outstanding common shares of Centennial Minerals Limited (Centennial) in exchange for 1,906,374 of its common shares, with a value of \$13,400,000, and sufficient warrants for the purchase of an additional 1,271,666 of its common shares at Canadian \$14.57, which were exercisable on or before their expiration date of October 3, 1988. During 1988, warrants to purchase 71,307 common shares were exercised prior to their expiration.

The acquisition of Centennial was accounted for using the purchase method. The allocation of the purchase price and the net assets acquired are summarized as follows:

Current assets	\$ 520
Current liabilities	<u>505</u>
Net current assets acquired	<u>15</u>
Noncurrent assets	6,651
Noncurrent liabilities	<u>1,682</u>
Net noncurrent assets acquired	<u>4,969</u>
Net book value of Centennial acquired	4,984
Excess of purchase price over net book value acquired allocated to:	
Investment	597
Property and mineral rights	7,846
Minority interest	<u>(27)</u>
Market value of shares issued	<u><u>\$13,400</u></u>

## 4. Inventories

Inventories consist of the following:

	<u>1988</u>	<u>1987</u>
Stockpiled ore	\$ 1,548	\$ 520
Deferred costs associated with ore under leach	24,023	29,252
Concentrates and other metal products		1,391
Refined gold and silver	55	1,555
Materials and supplies	<u>2,639</u>	<u>1,683</u>
	<u>\$28,265</u>	<u>\$34,401</u>

Costs associated with ore under leach are deferred and amortized as the contained gold is actually recovered. Gold is recovered over approximately a five-year period at the Zortman and Landusky mines, and over six to nine-month periods at the Florida Canyon and Relief Canyon mines. Approximately 68 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, 1988, approximately 59 percent of the remaining recoverable gold already in place on the leach pads at all mines is expected to be recovered in the next year.

Based upon actual metal recoveries and operating plans, the Company continuously evaluates and refines estimates used in determining the amortization and carrying value of deferred costs associated with ore under leach. During 1988, the Company determined that its estimates of the remaining ounces of gold recoverable from ore on certain leach pads at the Zortman and Landusky mines were overstated. Accordingly, \$6,120,000 of deferred costs associated with these ounces were charged to cost of sales.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 4. Inventories (continued)

The activity in deferred costs associated with ore under leach is as follows:

	1988	1987	1986
Balance, beginning of year	\$29,252	\$23,455	\$16,083
Additional costs deferred	57,483	52,728	27,292
Amount charged to cost of sales, including \$6,120 in 1988 associated with revised estimates of recoverable gold	(62,712)	(46,931)	(19,920)
Balance, end of year	<u>\$24,023</u>	<u>\$29,252</u>	<u>\$23,455</u>

## 5. Property, plant and equipment

Property, plant and equipment consists of the following:

	1988	1987
Property and mineral rights	\$ 17,911	\$ 19,832
Development costs	70,018	59,759
Buildings	6,593	4,229
Machinery and equipment	54,480	41,545
Leach ponds	2,923	2,579
Leach pads	30,211	25,017
Roads	3,922	2,640
Power line costs	842	924
Furniture and fixtures	897	589
	<u>187,797</u>	<u>157,114</u>
Less accumulated depreciation, depletion and amortization	<u>56,042</u>	<u>37,207</u>
	131,755	119,907
Construction in progress	1,681	276
Land	<u>2,905</u>	<u>1,278</u>
	<u>\$136,341</u>	<u>\$121,461</u>



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 6. Investments

Investments consist of the following:

	<u>Carrying Value</u>	<u>Cost</u>	<u>Market Value</u>
December 31, 1988:			
Investments in affiliates:			
USMX, Inc. (35% owned)	\$19,046	\$21,775	\$15,685
Inland Gold and Silver Corp. (20% owned)	6,712	6,712	4,027
	25,758	28,487	19,712
Marketable equity securities	4,062	5,078	4,062
Other investments	10,042	10,042	10,042
Total	<u>\$39,862</u>	<u>\$43,607</u>	<u>\$33,816</u>
December 31, 1987:			
Investment in affiliate:			
USMX, Inc. (26% owned)	\$15,104	\$15,987	\$17,455
Marketable equity securities	16,228	16,599	16,228
Total	<u>\$31,332</u>	<u>\$32,586</u>	<u>\$33,683</u>

USMX, Inc. (USMX) is engaged in the exploration, development and operation of mining properties. One of its most significant interests, the Montana Tunnels property, is operated by the Company under an agreement with USMX. Under the agreement, the Company has a 100 percent working interest in the Montana Tunnels property, subject to a 5 percent net profits royalty interest in favor of USMX during recovery 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 \$15,119,000. 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 is being amortized using the units-of-production method over the estimated related ore reserves.

Inland Gold and Silver Corp. (Inland Gold) is also engaged in the exploration, development and operation of mining properties. 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 Inland Gold is approximately \$4,752,000. This amount, which is included as part of the investment, has been attributed to various properties and interests of Inland Gold. Amortization of the excess amount is and will be determined based upon the ore reserves identified at the various properties.

At December 31, 1988 and 1987, the marketable equity securities portfolios included gross unrealized gains of

\$16,000 and \$1,147,000, respectively, and gross unrealized losses of \$1,032,000 and \$1,518,000, respectively.

Other investments at December 31, 1988 include \$12,000,000 (Canadian) of 9% secured, convertible debenture bonds of Pioneer Metals Corp. (Pioneer) due in 1998. Beginning May 10, 1989, these bonds are convertible, at the option of the Company, into common shares of Pioneer at a fixed conversion price of \$4.00 (Canadian) per share. The bonds are collateralized by various guarantees, mortgages, assignments and security interests in the assets of Pioneer and its subsidiaries.

## 7. Long-term debt

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

	<u>1988</u>	<u>1987</u>
8-1/2 percent convertible bonds due 1992	\$ 4,862	\$ 6,362
5 percent secured gold-convertible bonds due 1993	5,580	5,899
7-1/2 percent gold-convertible bonds due 1993	22,796	23,798
Other borrowings with various interest rates and maturities	203	252
	33,441	36,311
Less current portion	48	55
	<u>\$33,393</u>	<u>\$36,256</u>



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 7. Long-term debt (continued)

(b) The 8-1/2 percent convertible bonds due in 1992 are negotiable bearer bonds which are 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 106 plus accrued interest, decreasing at a rate of 1-1/2 percent per year to par plus accrued interest on August 23, 1992. Interest is payable annually in arrears on the anniversary date of the bonds. During 1988 and 1987, \$1,500,000 and \$8,638,000, respectively, of these bonds were voluntarily converted by the bondholders into 139,500 and 803,311 common shares of the Company.

(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. At December 31, 1988, the Company could be obliged to deliver up to the equivalent of approximately 16,800 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 certain zero coupon notes, whose face value at maturity will equal the principal amount of the Peggold bonds. Interest is payable annually in arrears on the anniversary date of the bonds. During 1988 and 1987, \$319,000 and \$757,000, respectively, of these bonds were voluntarily converted by the bondholders into gold or cash equivalent payments in lieu of gold.

(d) The 7-1/2 percent gold-convertible bonds due in 1993 are negotiable bearer bonds which may be exchanged for gold bullion (or the cash equivalent thereof) at a fixed price of \$376.36 per ounce. At December 31, 1988, the Company could be obliged to deliver up to the equivalent of approximately 60,600 ounces of gold pursuant to the issuance of these bonds. These bonds are listed on the Luxembourg Stock Exchange. Interest is payable annually in arrears on the anniversary date of the bonds. During 1988 and 1987, \$1,002,000 and \$1,249,000, respectively, of these bonds were voluntarily converted by the bondholders into gold or cash equivalent payments in lieu of gold.

(e) The 5 percent and 7-1/2 percent gold-convertible bonds can be converted into gold or the cash equivalent thereof at the bondholder's option. At December 31, 1988, the market price of gold exceeded the conversion prices of

both the 5 percent and 7-1/2 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. However, because of the availability of the long-term credit facility described in the following paragraph, the gold-convertible bonds have been classified as noncurrent liabilities at December 31, 1988.

(f) The Company has a revolving and term loan credit facility with a syndicate of major banks. Under the terms of the facility, the Company can borrow up to \$100,000,000 or, at the Company's option, the gold equivalent thereof. Amounts may be borrowed on a revolving credit basis through December 16, 1990, and are repayable in ten equal quarterly installments beginning on March 16, 1991. Dollar borrowings will bear interest at a rate based on an adjusted London Interbank Offered Rate (LIBOR), an adjusted certificate of deposit rate, or a bank reference rate, at the Company's option. Gold borrowings will bear interest based on the banks' cost of borrowing gold applied to the average market value of the ounces of gold outstanding. A commitment fee is payable quarterly at the rate of 1/2 of 1% on the unused portion of the first \$50,000,000, and 1/8 of 1% on the unused portion of the remaining \$50,000,000 of revolving credit. At December 31, 1988, there were no borrowings outstanding under this facility.

(g) At December 31, 1988, long-term debt matures as follows:

1989	\$ 48
1992	4,862
Thereafter	<u>28,531</u>
	<u>\$33,441</u>

## 8. Deferred revenue

During 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 \$15,029,000. The gold borrowed is being repaid from the Company's gold production and, accordingly, the remaining proceeds are recorded as deferred revenue. Interest on the loan is payable monthly at an annual rate of 2-1/2 percent of the average market value of the ounces of gold outstanding during the preceding month. At December 31, 1988, the 11,000 remaining unpaid ounces of gold are scheduled for repayment in 1989, at which time all remaining deferred revenue will be recognized.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 8. Deferred revenue (continued)

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.

## 9. Stock options

Under the 1987 stock option plan adopted in May, 1987, both incentive and non-qualified options to purchase up to a total of 600,000 common shares can be granted to officers and key employees. At December 31, 1988, 69,167 common shares were available for grant under the 1987 stock option plan. The plan requires that

the exercise price of incentive stock options be equal to at least 100% of the quoted market value of the stock on the date of grant. The exercise price of non-qualified stock options must equal at least 90% of the quoted market value of the stock on the date of grant. Options granted become exercisable ratably over a two-year period beginning with the date of grant, and generally terminate ten years from the date of grant. The plan is administered by the Stock Option and Compensation Committee of the Board of Directors. The Company's 1985 stock option plan terminated during 1987, except with respect to options previously granted thereunder.

Stock option transactions are summarized as follows:

	Number of Shares	Option Price Per Share Canadian	Expiration Date
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	569,740	8.00 - 12.63	
Granted	70,000	20.25	March 23, 1997
Granted	17,500	30.25	August 10, 1997
Granted	312,500	19.00	October 21, 1997
Exercised	(416,200)	8.00 - 11.00	
Balance, December 31, 1987	553,540	8.00 - 30.25	
Granted	22,500	17.75	March 23, 1998
Granted	90,000	17.13	March 23, 1998
Granted	425,000	17.25	March 23, 1998
Exercised	(152,373)	8.00 - 17.25	
Cancelled	(400,000)	19.00 - 30.25	
Expired	(6,667)	17.25	
Balance, December 31, 1988	532,000	9.00 - 17.75	



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 10. Income taxes

The income tax provision (benefit) is based on the following amounts of income (loss) before income taxes:

	1988	1987	1986
United States	\$17,991	\$13,937	\$4,244
Foreign	3,918	3,481	(12)
	<u>\$21,909</u>	<u>\$17,418</u>	<u>\$4,232</u>

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

	1988	1987	1986
Currently payable (refundable)			
Federal	\$4,432	\$1,472	\$ 280
State	247		(65)
Foreign	2,173		
	<u>6,852</u>	<u>1,472</u>	<u>215</u>
Deferred provision (benefit)			
Federal	(610)	1,209	(603)
State	61	245	(34)
	<u>(549)</u>	<u>1,454</u>	<u>(637)</u>
	<u>\$6,303</u>	<u>\$2,926</u>	<u>\$(422)</u>

The effective tax rate on income before income taxes varies from the statutory federal income tax rate in the United States as follows:

	1988		1987		1986	
	Amount	%	Amount	%	Amount	%
Income tax provision						
computed at statutory rate	\$ 7,449	34	\$ 6,967	40	\$ 1,946	46
State income taxes	204	1	158	1	(53)	(1)
Percentage depletion	(5,506)	(25)	(3,768)	(22)	(2,441)	(58)
Effect of foreign income, primarily due to rate differential	841	4	(1,372)	(8)		
Additional tax resulting from alternative minimum tax	2,653	12	1,035	6		
Adjustment of prior years' tax estimate and other	662	3	(94)		126	3
Income tax provision (benefit)	<u>\$ 6,303</u>	<u>29</u>	<u>\$ 2,926</u>	<u>17</u>	<u>\$ (422)</u>	<u>(10)</u>



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 10. Income taxes (continued)

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

	<u>1988</u>	<u>1987</u>	<u>1986</u>
Development and exploration costs	\$(957)	\$ (332)	\$ 5,724
Tax depreciation over book depreciation	66	591	176
Reinstatement (reversal) of deferred taxes through utilization (application) of net operating losses and investment tax credits	314	1,003	(6,485)
Foreign currency transaction gain		473	
Investments accounted for using the equity method	28	(213)	
Other		(68)	(52)
	<u>          </u>	<u>          </u>	<u>          </u>
Deferred tax provision (benefit)	<u>\$ (549)</u>	<u>\$1,454</u>	<u>\$ (637)</u>

The Canadian parent company files a separate Canadian income tax return. All of the Company's U.S. subsidiaries are part of a consolidated group and file a single consolidated U.S. income tax return.

During 1988, the Canadian parent company utilized approximately \$4,600,000 of financial statement basis net operating loss carryforwards to offset the current foreign income tax provision, resulting in an extraordinary credit of \$2,173,000. Also during 1988, one of the Company's U.S. subsidiaries utilized approximately \$5,800,000 of tax basis net operating loss carryforwards acquired as part of the Centennial purchase (see note 3) to reduce federal and state income taxes currently payable. The tax benefit of approximately \$2,200,000 realized from utilizing these carryforwards has been offset against the cost of property and mineral rights of the Montana Tunnels mine.

As of December 31, 1988, the Company and its U.S. subsidiaries have tax basis net operating loss carryforwards for Canadian and U.S. income tax purposes of approximately \$178,000 (Canadian) and \$20,955,000, respectively, available to offset future regular taxable income. The Company's U.S. subsidiaries have tax basis investment tax credit carryforwards of approximately \$334,000 available to offset future regular income taxes payable only. Certain of these carryforwards can only be used to offset the taxable income and income taxes payable of the subsidiary which generated the carryforwards. There are no material remaining financial statement basis net operating loss or investment tax credit carryforwards available.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 10. Income taxes (continued)

The U.S. carryforwards expire as follows:

	Net Operating Losses	Investment Tax Credits
1996	\$ 576	
1997	467	
1998	306	
1999	2,890	
2000	792	\$ 31
2001	12,601	303
2002	1,212	
2003	2,111	
	<u>\$20,955</u>	<u>\$334</u>

Included in the net operating loss carryforward amounts above is \$18,855,000 attributable to preference related items and net operating losses already used to offset alternative minimum taxable income. This portion of the carryforward is not available to offset future alternative minimum taxable income, but is available to offset future regular taxable income. The Company has alternative minimum tax credit carryforwards of approximately \$1,465,000 available to offset future regular income taxes to the extent that they exceed the alternative minimum tax.

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96 - Accounting for Income Taxes (SFAS No. 96). This new standard requires that an asset and liability approach be used to account for and report income taxes for financial statement purposes. SFAS No. 96 will require the Company to recognize a current or deferred tax liability for the tax consequences of all events recognized in the financial statements. The new standard represents a significant change in accounting for the effects of deferred taxes. Under SFAS No. 96, deferred taxes will be based on the difference between the tax bases of assets and liabilities and their amounts for financial statement purposes. The Company will be required to recompute its tax liabilities if the tax rates change, and to recognize the effect thereof in operations. The Company must adopt the requirements of SFAS No. 96 no later than January 1, 1990. The Company has not determined the effects of adopting this new standard.

## 11. Related party transactions

Fees for rent and legal, engineering and consulting services totalling \$96,000 for the year ended December 31, 1988 (1987-\$254,000, 1986-\$226,000) have been paid to firms in which certain current and former officers, directors and employees of the Company are partners or owners.

## 12. Employee savings plan

The Company has an employee savings plan qualifying under section 401(k) of the U.S. Internal Revenue Code. Substantially all U.S. employees are eligible to participate in the plan. Under the plan, employees may elect to contribute up to ten percent of their cash compensation, up to a maximum of \$7,313 for 1988. The Company will make a matching contribution equal to 50 percent of the first six percent of the employee's contribution. Employees have the option of designating that all or a portion of the total amounts contributed be invested in 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, 1988, 1987 and 1986, the Company contributed \$266,000, \$197,000 and \$97,000, respectively, to the plan. During the years ended December 31, 1988, 1987 and 1986, the plan purchased 14,321, 3,382 and 11,861 shares, respectively, of the Company's common stock to satisfy employees' investment designations.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 13. 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 adequately provided for any additional income taxes and interest that may become payable at the time of any settlement with the Internal Revenue Service.

(b) At December 31, 1988, the Company has outstanding gold forward sale contracts with various metals brokers requiring delivery of 125,500 ounces of gold in 1989 and 63,500 ounces of gold in 1990. This includes 29,500 ounces of gold available for delivery on December 31, 1988 which were recorded as a 1988 sale. The Company will receive an average of \$439.34 per ounce upon the delivery of the gold.

The Company has arrangements with its metals brokers that a margin call will not occur until the market exposure exceeds \$38,000,000 with these brokers. At that time, the Company could cover the excess amount of market exposure with silver or gold bullion carried in inventory or cash. At December 31, 1988, the Company did not have any market exposure in excess of the above described limits relating to these contracts.

(c) At December 31, 1988, the Company has outstanding a number of gold option contracts with metals brokers to hedge its gold production within certain price parameters. Each individual option contract is comprised of offsetting put and call positions, and did not involve the payment or receipt of any net option premium. These offsetting positions, all of which expire in 1989, are comprised of put options on 45,000 ounces of gold (with an average exercise price of \$410.00 per ounce) and call options on 13,500 ounces of gold (with an average exercise price of \$535.00 per ounce).

(d) A total of 984,166 shares of authorized common stock are reserved for the following:

Stock options (see note 9)	532,000
Convertible bonds (see note 7(b))	<u>452,166</u>
	<u>984,166</u>

## 14. Shareholders' equity

On December 1, 1988, the Board of Directors adopted a Shareholder Protection Rights Plan which entitles each shareholder of the Company's common stock to one Right. The Rights were distributed to shareholders of record as of the close of trading on December 12, 1988, and will attach to any future issuance of shares. The Rights are exercisable on the eighth trading day following a person acquiring ten percent or more of the Company's common stock, or making an offer to acquire ten percent or more of the Company's common stock, other than pursuant to a "permitted bid" as defined in the Plan. Rights entitle the holder to purchase one one-hundredth of a Class A Preferred Share, Series 1 of the Company at an exercise price of \$55. Each whole preferred share has rights and attributes which render it the economic equivalent of 100 common shares of the Company. Upon the occurrence of certain defined events, each Right entitles the holder to purchase one one-hundredth of a preferred share of the Company which has a market value (determined on the basis that market value of a preferred share is equal to the market value of 100 common shares) equal to twice the exercise price. The Rights are subject to redemption by the Company's Board of Directors for \$.01 per Right at any time prior to the earlier of the expiration of the Rights in December 1998 or the time that any person has acquired, or makes an offer to acquire, beneficial ownership of at least 10 percent of the Company's common stock. The plan will be submitted to the shareholders for ratification.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 15. Quarterly data (unaudited)

Selected unaudited quarterly data for the years ended December 31, 1988 and 1987 is as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Year Ended December 31, 1988:					
Sales of gold and other metals	\$27,354	\$45,426	\$52,929	\$37,048	\$162,757
Income (loss) from operations	\$ 1,708	\$ 8,428	\$ 7,852	\$ (3,952)	\$ 14,036
Income before extraordinary credit	\$ 1,686	\$ 7,032	\$ 6,420	\$ 468	\$ 15,606
Net income	\$ 1,686	\$ 7,032	\$ 6,420	\$ 2,641	\$ 17,779
Income per share:					
Before extraordinary credit	\$ 0.07	\$ 0.30	\$ 0.27	\$ 0.02	\$ 0.66
Extraordinary credit				0.09	0.09
	\$ 0.07	\$ 0.30	\$ 0.27	\$ 0.11	\$ 0.75
Year Ended December 31, 1987:					
Sales of gold and other metals	\$ 6,263	\$28,927	\$34,176	\$41,069	\$110,435
Income (loss) from operations	\$ (943)	\$ 5,806	\$ 6,672	\$ 3,159	\$ 14,694
Net income (loss)	\$ (273)	\$ 4,304	\$ 7,029	\$ 3,432	\$ 14,492
Income (loss) per share	\$ (0.02)	\$ 0.22	\$ 0.30	\$ 0.14	\$ 0.70

During the fourth quarter of 1988, the Company determined that its estimates of the remaining ounces of gold recoverable at certain mines were overstated, and \$6,120,000 of deferred costs associated with these ounces were charged to cost of sales.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(All Tabular Dollar Amounts In Thousands of U.S. Dollars)*

## **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 income, but are accumulated and disclosed 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 income.

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 nonmonetary 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 during the year. Exchange gains or losses are included in the determination of net income, except for those relating to noncurrent monetary assets and liabilities, which are deferred and amortized over the remaining life of the asset or liability.

### **(b) Income per Share**

Under United States generally accepted accounting principles (Accounting Principles Board Opinion No. 15), the computation of primary income per share considers the weighted average number of shares outstanding during the year plus common stock equivalents, such as common stock options and warrants. This method requires that primary income per share be computed as if stock options and warrants 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 income per share shows the effect on income

per share which would result if the proceeds from the exercise of common stock options and warrants were used to purchase the Company's common stock at its market price at the end of the year.

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

### **(c) Investments**

Under United States generally accepted accounting principles (Statement of Financial Accounting Standards No. 12), investments in marketable equity securities representing an ownership interest of less than 20 percent are recorded at the lower of cost or market value. Unless they are judged to be other than temporary, unrealized losses on noncurrent marketable equity securities are not reflected in income, but are instead accumulated as a separate component of shareholders' equity. Unrealized losses that are judged to be other than temporary are reflected in income.

Under Canadian generally accepted accounting principles, noncurrent marketable equity securities are carried at cost unless a decline in market value below cost is judged to be other than temporary. If an unrealized loss is judged to be other than temporary, the security is written down to market value, and the writedown is reflected in income.

### **(d) Acquisitions**

Under United States Securities and Exchange Commission regulations, common shares issued to acquire certain affiliated companies are valued at the historical cost basis, net book value of the net assets acquired. Under Canadian generally accepted accounting principles, common shares issued to acquire all companies, including those with affiliations, are valued at the market value of the shares issued.



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All Tabular Dollar Amounts In Thousands of U.S. Dollars)

## 16. Differences between United States and Canadian generally accepted accounting principles *(continued)*

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

	1988	1987	1986
<b>United States generally accepted accounting principles</b>			
Shareholders' equity:			
Common stock	\$181,385	\$177,792	\$ 61,537
Retained earnings	41,988	26,598	14,457
Other equity accounts	(1,016)	(371)	(2,709)
Foreign currency translation adjustment	(467)	(457)	(542)
	<u>\$221,890</u>	<u>\$203,562</u>	<u>\$ 72,743</u>
Net income	<u>\$ 17,779</u>	<u>\$ 14,492</u>	<u>\$ 4,654</u>
Primary income per share	<u>\$ 0.75</u>	<u>\$ 0.70</u>	<u>\$ 0.35</u>
Fully diluted income per share	<u>\$ 0.75</u>	<u>\$ 0.70</u>	<u>\$ 0.32</u>
<b>Canadian generally accepted accounting principles</b>			
Shareholders' equity:			
Common stock	\$185,162	\$181,569	\$ 65,314
Retained earnings	40,914	26,354	14,588
Other equity accounts	-0-	(371)	(2,709)
	<u>\$226,076</u>	<u>\$207,552</u>	<u>\$ 77,193</u>
Net income	<u>\$ 16,948</u>	<u>\$ 14,118</u>	<u>\$ 4,932</u>
Basic income per share	<u>\$ 0.72</u>	<u>\$ 0.69</u>	<u>\$ 0.37</u>
Fully diluted income per share	<u>\$ 0.72</u>	<u>\$ 0.66</u>	<u>\$ 0.37</u>



## CORPORATE INFORMATION

### DIRECTORS

James H. Foreman, *Chairman*  
*Spokane, Washington*  
M. Norman Anderson  
*Vancouver, B.C.*  
Stanton B. Bennett  
*Spokane, Washington*  
John J. Crabb  
*Pender Harbour, B. C.*  
Peter R. Kutney  
*Calgary, Alberta*  
Dr. Lindsay D. Norman  
*Butte, Montana*  
James C. O'Rourke  
*Vancouver, B.C.*  
L. Jack Smith  
*Vancouver, B.C.*  
John M. Willson  
*Spokane, Washington*

### OFFICERS

John M. Willson  
*President & Chief  
Executive Officer*  
Lyle F. Beaudoin  
*Vice President,  
Business Development*  
Stanton B. Bennett  
*Vice President,  
Chief Legal Counsel &  
Secretary*  
Michael L. Clark  
*Vice President,  
Operations*  
C. J. Byrne McNamara  
*Vice President, Finance &  
Chief Financial Officer*  
James H. Moore  
*Controller*  
Eric E. Kinneberg  
*Treasurer*  
Albert K. F. Wu  
*Assistant Secretary -  
Treasurer*

### OFFICES

#### Executive Headquarters

Suite 400 - North 9 Post  
Spokane, WA 99201  
(509) 624-4653  
Tele-Copier (509) 838-8317

#### Canadian Office

305-1177 West Hasting St.  
Vancouver, B.C. V6E 3T2  
(604) 682-0911  
Tele-Copier (604) 682-0918

#### Registered Office

2800 Vancouver Center  
650 W. Georgia Street  
Vancouver, B.C. V6B 4R7

#### Australian Office

G.R. Appleyard,  
*Managing Director*  
Pegasus Gold Australia, Ltd  
10th Floor, 406 Collins St.  
Melbourne, Victoria 3000,  
Australia

#### Operations Offices

Steve Banning,  
*General Manager*  
Zortman/Landusky  
Mine  
P.O. Box 313  
Zortman, MT 59546  
Tom Weitz,  
*General Manager*  
Montana Tunnels Mine  
P.O. Box 176  
Jefferson City, MT 59638  
John Rice,  
*General Manager*  
Florida Canyon/Relief  
Canyon Mine  
Box 330  
Inlay, NV 89418  
Carson Rife,  
*General Manager*  
Beal Mountain Mine  
1600 Fairmont Road  
Anaconda, MT 59711

#### Exploration Offices

James B. Lincoln,  
*Manager, Exploration*  
Executive Headquarters  
Ron C. Long,  
*District Geologist*  
Suite 108  
W. 255 Moana Lane  
Reno, NV 89509  
Jerry Harrold,  
*District Geologist*  
P.O. Box 4048  
Butte, MT 59702

### SHARES LISTED

#### Common

Toronto Stock Exchange  
- PGU  
American Stock Exchange  
- PGU

#### Options

Chicago Board Options  
Exchange - PGU  
Vancouver Stock Exchange  
- PGU

#### Bonds

8-1/2% Guaranteed  
Convertible Bonds  
*Due 1992*  
Luxembourg  
7-1/2% Guaranteed Bonds  
*Due 1993*  
Luxembourg  
5% Secured Bonds  
*Due 1993*  
Luxembourg

#### Transfer Agent & Registrar

Central Guaranty Trust  
Company  
Vancouver, B.C.

#### Co-Transfer Agent

General Transfer  
Company  
Spokane, Washington  
The Chase Manhattan Bank, N.A.  
New York, New York

#### Auditors

Coopers & Lybrand  
1111 West Hastings St.  
Vancouver, B.C. V6E 3R2  
Coopers & Lybrand  
1600 Seafirst Financial Center  
Spokane, WA 99201

#### Solicitors

Shearman & Sterling  
Four Embarcadero Center  
San Francisco, CA 94111  
Lawson, Lundell, Lawson  
& McIntosh  
2800 Vancouver Centre  
650 West Georgia Street  
Vancouver, B.C. V6B 4R7  
Davies, Ward & Beck  
P.O. Box 63, 44th Floor  
1 First Canadian Place  
Toronto, Ontario  
Canada M5X 1B1

For further information and a  
copy of the Company's 10K,  
contact:

Michael G. Arneth,  
*Manager, Investor Relations*  
N. 9 Post Street, Suite 400  
Spokane, WA 99201  
(509) 624-4653

The 1989 Annual Meeting of  
Shareholders of Record on  
March 31, 1989 will be held on  
May 26, 1989 at 10:30 a.m. in  
the Governor General Suite B,  
Pan Pacific Vancouver Hotel,  
Vancouver, B.C., Canada.





CORPORATE HEADQUARTERS  
North 9 Post Street, Suite 400, Spokane, WA 99201, (509) 624-4653