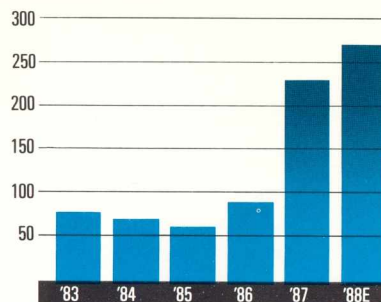


1987 ANNUAL REPORT

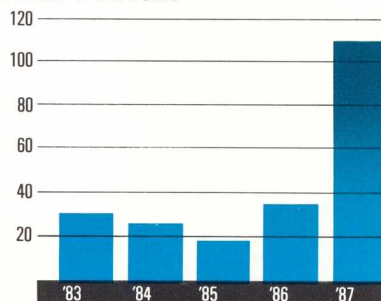
Gold Production

In Thousands of Ounces



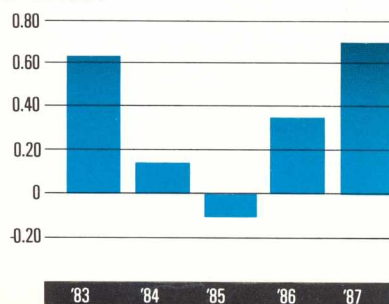
Sales

In Millions of U.S. Dollars



Earnings Per Share

In U.S. Dollars



Highlights

Fourth Quarter:

Record gold production for the year of 228,000 ounces

Record Net earnings for 1987 of \$14,492,000, a three fold increase over 1986

Record earnings per share for 1987 of \$0.70, double 1986 earnings

Development of the Beal Project, Montana announced with forecast annual production of 38,000 ounces of gold in 1989

Zortman/Landusky produces a record 107,000 ounces of gold for the year

Dividend of \$0.10 per share declared

Third Quarter:

Company raises \$67.9 million through a successful equity offering of 3,450,000 shares at \$21.125 per share

Montana Tunnels revised process flow design

Record earnings for the quarter of \$0.30 per share

Second Quarter:

Montana Tunnels officially opened

First gold poured at Montana Tunnels

Zortman/Landusky successfully commences operation of the new carbon plant

First Quarter:

James H. Foreman appointed Chief Executive Officer

1987 gold production forecast at 225,000 ounces

Ore introduced into the process plant at Montana Tunnels on March 27, 1987

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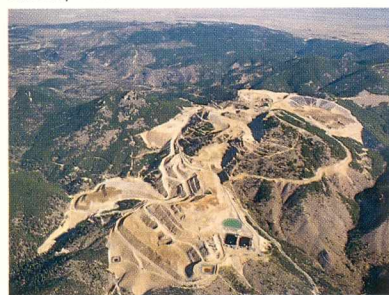
Montana Tunnels Mine - MT



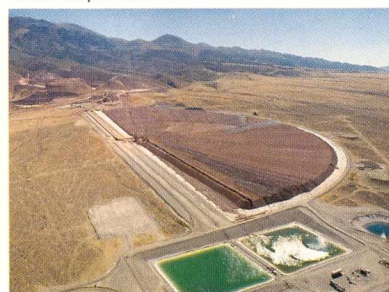
Zortman Mine - MT



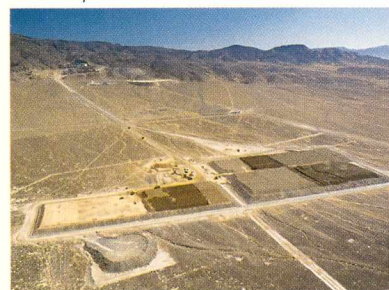
Landusky Mine - MT



Florida Canyon Mine - NV



Relief Canyon Mine - NV



Corporate Profile

Pegasus Gold Inc. is a British Columbia, Canada, corporation created in 1984 by the amalgamation of Pegasus Gold Ltd. and Montoro Gold Inc. The Company produces gold and silver using open pit mining methods, heap leaching technology, and conventional milling practices, to process precious metal ores into gold and silver bullion and precious metal bearing lead and zinc concentrates. Pegasus Gold Inc. is the parent company of Pegasus Gold Corporation, the wholly owned U.S. subsidiary, with executive offices in Spokane, Washington.

Since operations began in 1979, at the Zortman/Landusky mine in Montana, Pegasus has become a major precious metal and base metal producer. In 1987, Pegasus mined over 17 million tons of ore from four mines. Production in all products totalled 228,100 ounces of gold, 778,300 ounces of silver, 14.4 million pounds of zinc, and 8.6 million pounds of lead. Pegasus is a leader in the field of heap leaching technology and the mining and processing of low grade ores. Pegasus has further demonstrated expertise at processing a complex metallurgical ore at Montana Tunnels utilizing conventional milling and recovery processes.

1987 was a record year for net earnings, at \$14.5 million, a three fold increase over 1986, with earnings per share in 1987 of \$0.70, double 1986 earnings. Assets increased to \$268 million and the long-term debt to equity ratio was reduced to 0.20:1 from 1.20:1 in 1986.

In 1988, using a \$400 gold price, reserves are approximately 4.6 million ounces of contained gold and gold equivalents.

Pegasus has a major interest in USMX, INC., a successful exploration and development company based in Denver, Colorado, and a smaller interest in an Australian gold producer, Pan Australian Mining Ltd.

Management was strengthened during the year both at the operating properties and in the Corporate Office to take advantage of present and future opportunities.

The Company has focused on precious metals and will continue to do so for the near future. Production comes from the Zortman/Landusky mine in north central Montana, the Montana Tunnels mine in west central Montana, the Florida Canyon mine near Winnemucca, Nevada, and the Relief Canyon mine near Lovelock, Nevada. The Beal property near Anaconda, Montana is in an advanced permitting stage with construction scheduled for 1988. In addition to the operating mines, the Company has an aggressive exploration and acquisitions group working in North America and abroad.

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Letter To Shareholders:

In all respects, 1987 was a milestone year for Pegasus Gold. The Company achieved record production, record net earnings, and dramatic reduction in long-term debt. In addition, Pegasus continued its aggressive program of exploration and acquisition culminating in the new Beal mine, slated for construction beginning in mid-1988. All combined, the year has seen Pegasus Gold strengthen and enhance its position as a highly productive and profitable multi-mine operation.

Zortman/Landusky, our base mine operating since 1979, produced a record 106,900 ounces of gold in 1987. Florida Canyon and Relief Canyon, the two new mines brought into production late in 1986, added 89,400 ounces of gold for the year. To add to this success, Montana Tunnels was brought on line in 1987. By year-end, the mine had contributed 31,800 ounces of gold in addition to significant silver, lead, and zinc production. Although normal startup problems of the complex mill circuit delayed full-scale operations, the mine is currently operating as planned.

The addition of the three new mines to Zortman/Landusky's production gave us record gold production of 228,100 ounces, a two and a half fold increase over the 92,400 ounces produced in 1986. The Montana Tunnels mine should obtain full gold production potential in 1988, at which time the forecast cash cost per ounce of \$120 (after byproduct credits) should be realized. Company production for 1988 is forecast at 270,000 ounces of gold at an operating cash cost of \$228. Pending issuance of operating permits, our new Beal mine, near Anaconda, Montana, will commence construction in mid-1988, with a 1989 production forecast of 38,000 ounces at a cash cost of \$210 per ounce. The operating personnel at the Company's properties have done an outstanding job to achieve so much in such a short time period.

Together with record production came record net earnings of \$14.5 million, a three-fold increase over 1986. Earnings per share at \$0.70 were double those of 1986, even as weighted average common shares outstanding increased from 13.3 million to 20.8 million. Cash flow from operations increased to \$30 million during the year from \$10 million in 1986.

Coupled with the strong performance of the Company's operations and the significant growth in profitability, long-term debt was reduced by over one-half from \$79.0 million to \$36.3 million. The strength of the operations enabled Pegasus to access equity capital markets, and in July 1987, 3,450,000 shares of common stock were issued, bringing net proceeds to the Company of \$67.6 million. As a result of this transaction and internally generated funds, the Company's balance sheet has been significantly transformed with over \$103 million in cash, receivables, and investments at year-end. As a result of the strong operational and financial success achieved by your Company during the year, the Board of Directors announced in December 1987 a \$0.10 per share dividend. The balance of the Company's significant cash position has been reserved for future potential acquisitions.

Investments were doubled in 1987, increasing to \$31 million. The largest increase was in Pan Australian Mining Ltd. stock when Pegasus' equity interest was at a high of 10% reduced to 8% by a sale of shares in the third quarter. This reflects the commitment to involvement in Australia, further demonstrated in February 1988 when an office was opened in Melbourne. Pegasus' holdings in USMX, INC. were increased during the year subsequent to the signing of a revised Standstill Agreement, expiring in September 1989, which permits Pegasus to increase equity participation to 35%. At year-end, 26.4% of USMX, INC. was owned by Pegasus.

With current operations and the addition of Beal in 1989, the Company will be able to sustain almost 300,000 ounces of gold production annually. Aggressive exploration will continue around the operating mines to further add to existing significant reserves, which at year-end stood at 4.6 million ounces of gold and gold equivalents. To add to this production and these reserves, the exploration and acquisitions department continues aggressive programs, which I am confident will result in continued growth for the Company.

As the Company has grown, the complexity and requirements of management have also grown. A number of significant changes in management have occurred within Pegasus to position the Company for continued success. Byrne McNamara accepted the position of Vice President Finance and Chief Financial Officer, Jim Moore was promoted to Controller, and Eric Kinneberg was appointed as Treasurer. Alan Richardson, previously General Manager at Montana Tunnels, was appointed to the Vice President Corporate Affairs position. In addition, the legal, exploration, business and project development, and human resources areas were all strengthened during the year. The Company has an exceptionally experienced and talented operating and management team to further optimize existing operations and to develop new opportunities.

Your Board of Directors, providing leadership and guidance to the affairs of the Company, also had a number of changes during the year. At the 1987 Annual Meeting, the size of the Board was increased from five to seven, and two new members were elected: Dr. William Gross and Dr. Lindsay Norman. Regrettably, Dr. Gross was only able to contribute his outstanding talent and ability for a short time before his sudden death. Mr. M. Norman Anderson of Vancouver, British Columbia, was subsequently appointed to bring the Board up to strength.

Your Company is in excellent hands with a dynamic, experienced Board and management team. I am confident that your Company will continue to grow and prosper, utilizing the combination of people, financial, and natural resources available to us.

On Behalf of the Board,



James H. Foreman, *President and Chief Executive Officer*



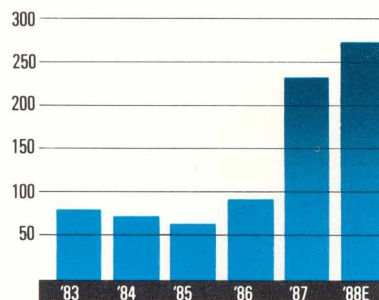
Seated left to right: Lyle F. Beaudoin - Vice President, Business Development; James H. Foreman - President and Chief Executive Officer; Stanton B. Bennett - Vice President, Chief Legal Counsel and Secretary.

Standing left to right: Alan H. Richardson - Vice President, Corporate Affairs; C.J. Byrne McNamara - Vice President, Finance and Chief Financial Officer; Michael L. Clark - Vice President, Operations.

Operations Overview

Gold Production

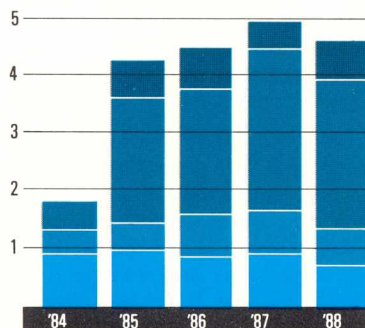
In Thousands of Ounces



Ore Reserves

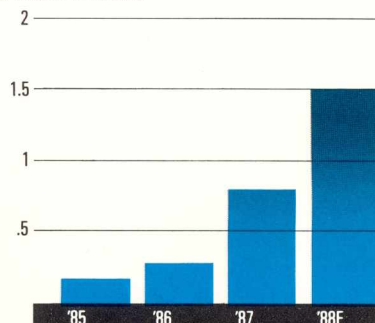
Contained Gold & Gold Equivalents at the Beginning of Each Year in Millions of Ounces.

■ Beal Property
■ Montana Tunnels
■ Florida Canyon
■ Zortman/Landusky



Silver Production

In Millions of Ounces



In 1987, Pegasus produced 228,100 ounces of gold compared to 92,400 ounces of gold in 1986, and 778,300 ounces of silver compared to 214,000 ounces of silver in 1986. The average cash cost in 1987 was \$276 per ounce of gold.

Production in 1988, with a full year from the four producing mines, will be approximately 270,000 ounces of gold, 1.5 million ounces of silver, in addition to 14 million pounds of lead and 37 million pounds of zinc.

Gold Production

	Ounces	Cash Cost Per Ounce
Montana Tunnels	31,800	\$157
Zortman/Landusky	106,900	\$278
Florida Canyon	47,800	\$333
Relief Canyon	41,600	\$283
Total	228,100	\$276

Ore Reserves - Proven and Probable

Contained Gold & Gold Equivalents

Montana Tunnels	2,604,000
Zortman/Landusky	719,000
Florida Canyon	527,000
Relief Canyon	99,000
Beal	637,000
Total	4,586,000

Highlights of 1987 were:

Zortman/Landusky, Montana

- Record production of 106,900 ounces of gold
- Successful start-up and operation of the new carbon adsorption plant
- Significant advances in winter leaching technology

Montana Tunnels, Montana

- Construction completed three months ahead of schedule, first ore milled in March, 1987
- Successful revisions to the process flow design

Florida Canyon, Nevada

- Automated ore stacking conveyor highly successful
- Geothermal heating of leaching solutions assists winter leaching
- Crushed ore production target attained

Relief Canyon, Nevada

- Exceptional year with better than expected results in all areas.

Beal, Montana

- Drilling of large diameter core for metallurgical test work complete.
- Metallurgical test work indicates that heap leaching is the most economic gold recovery alternative.
- Engineering and design well advanced
- Environmental Permit Application filed in February, 1988
- Projecting 38,000 ounces of gold production in 1989

*Mining operations at Zortman/
Landusky.*



*Flotation area in the Montana
Tunnels Concentrator.*

Montana Tunnels, Montana

The Montana Tunnels mine, located 15 miles south of Helena, Montana, commenced milling operations on March 25, 1987. Ore is mined by open pit methods followed by crushing, grinding and flotation to produce gold and silver bearing lead and zinc concentrates.

In 1987 the mine produced 31,800 ounces of gold, 529,300 ounces of silver, 8.6 million pounds of lead and 14.4 million pounds of zinc.

The ore reserves at Montana Tunnels, at year end stood at 50.3 million tons grading 0.025 ounces gold, 0.49 ounces silver, 0.25% lead and 0.65% zinc.

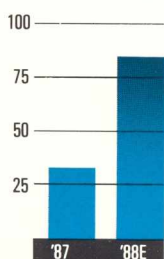
1988 forecast production at Montana Tunnels is 85,000 ounces of gold, 1,250,000 ounces of silver, 14 million pounds of lead and 37 million pounds of zinc.

Early in 1987, Pegasus acquired a 100 percent working interest in Montana Tunnels from USMX, INC. subject to a 5 percent net profits interest during payback of Pegasus' development costs and a 50 percent net profits interest payable to USMX, INC. thereafter. Payback is anticipated in mid to late 1991. Pegasus owns an equity interest in USMX, INC. of 26.4 percent which may be increased to 35 percent pursuant to agreements in place with USMX, INC.

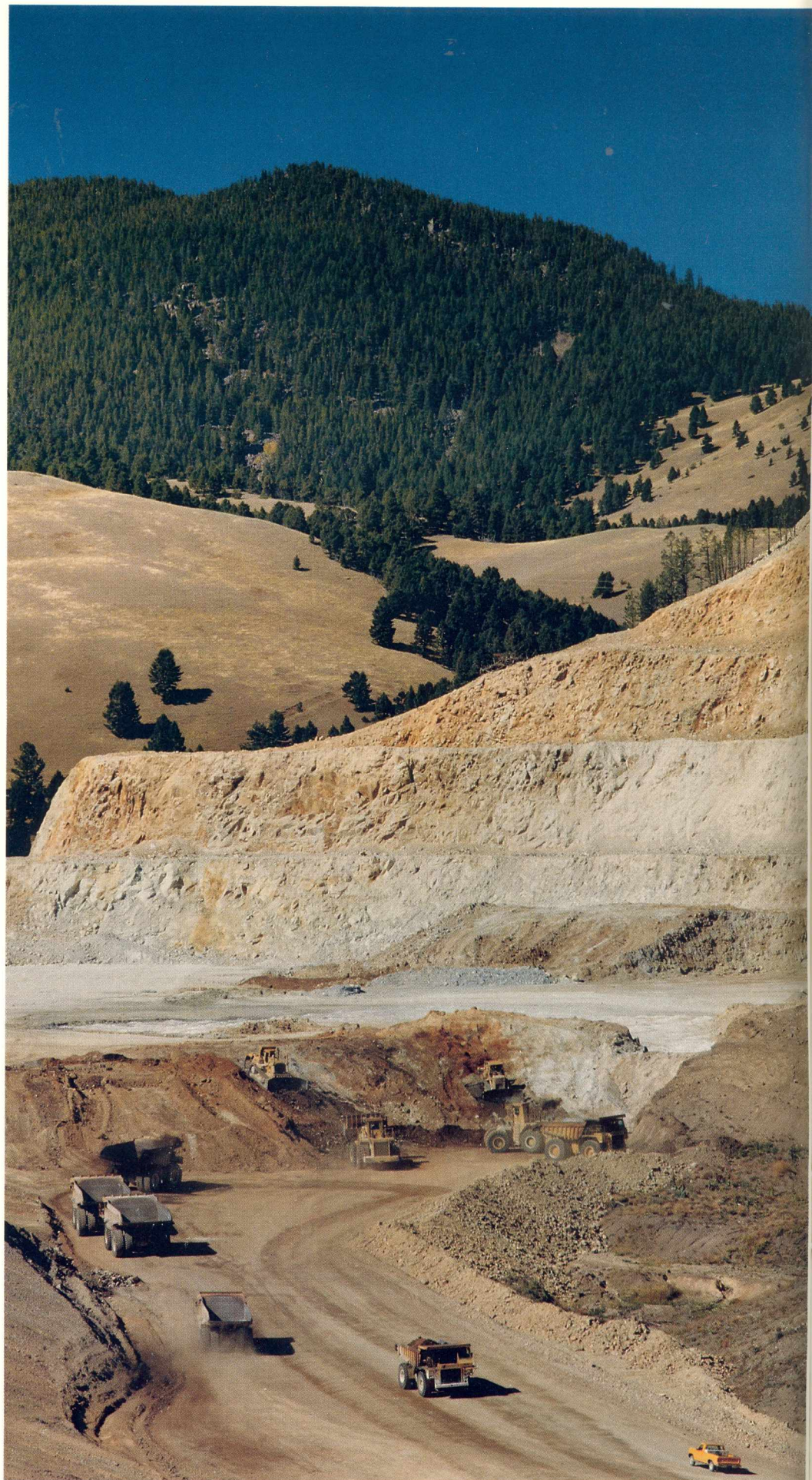
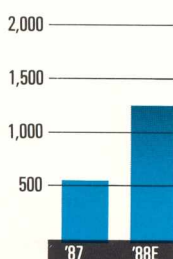
Under the General Management of Tom Weitz and his staff, Montana Tunnels will be a major contributor to the future success of the Company.

Montana Tunnels Gold Production

In Thousands of Ounces



Silver Production



Mining operation at Montana Tunnels.

Zortman/Landusky, Montana

Zortman/Landusky, under the able management of Steve Banning and his staff, broke all records in 1987. Over 9.6 million tons of ore were mined and loaded onto the leach pads resulting in the production of 106,900 ounces of gold and 202,600 ounces of silver. This is the ninth year of operation for the mine and at year-end reserves stood at 32.6 million tons grading 0.020 ounces gold per ton. A continuing aggressive exploration program in 1988 is expected to add to the reserves during the year.

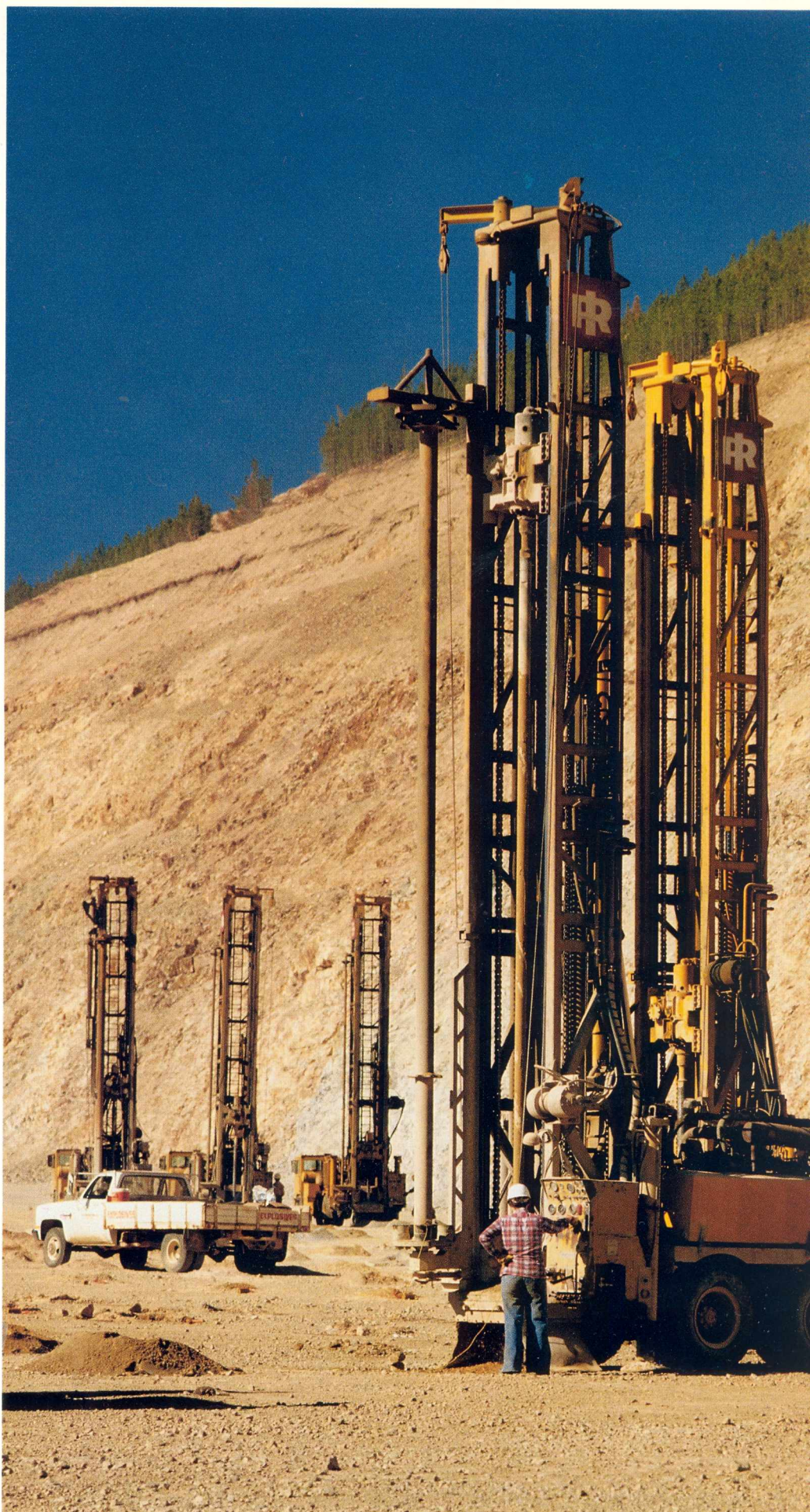
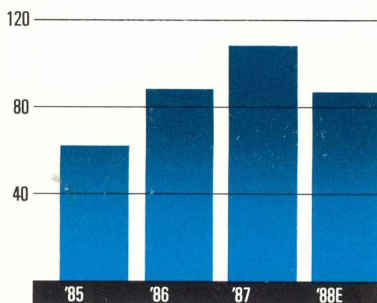
In order to achieve these record production levels a carbon adsorption plant was installed to increase process recovery plant capacity, and technological advances were made to lengthen the leaching season. Leaching is now possible eleven months of the year although at reduced levels in the winter months.

The Zortman/Landusky mines are open pit mines with the mined ore being dumped on large leach pads with no crushing or agglomeration. The ore is then sprinkled with dilute sodium cyanide to dissolve the gold and silver prior to recovery from the cyanide solutions.

Production of 85,000 ounces of gold per year is projected in 1988 and beyond.

Zortman/Landusky Gold Production

In Thousands of Ounces



Blast hole drilling at Zortman/Landusky.

Florida Canyon, Nevada

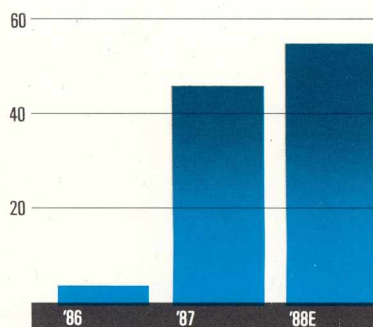
The Florida Canyon mine, located 40 miles southwest of Winnemucca Nevada, commenced production in late 1986 and by year-end 4,200 ounces of gold had been produced. The operation was still in a start-up mode early in 1987, and in the first quarter a number of problems relating to ore crushing and handling had to be resolved. Under the direction of John Rice, General Manager, and his staff, these problems were overcome and by year-end 1987 the operation had produced 47,800 ounces of gold with projected 1988 production of 55,000 ounces.

Ore reserves at year-end 1987 stood at 22 million tons grading 0.024 ounces gold per ton. An active exploration program underway in 1988 is expected to add to these reserves.

The ore from the open pit mine at Florida Canyon is crushed, agglomerated with cement, lime and conveyed on an automated stacker conveying system to a large, semi-circular leach pad. The crushed, agglomerated ore is sprinkled with dilute cyanide solution to dissolve the gold after which the gold is recovered from the solution which is then returned to the leach pad.

Florida Canyon Gold Production

In Thousands of Ounces



Loading crushed agglomerated ore on the leach pad at Florida Canyon.

Relief Canyon, Nevada

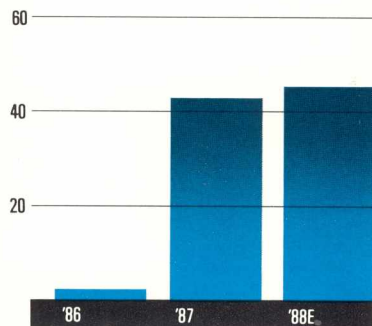
The Relief Canyon mine was acquired from Lacana Mining Inc. in July of 1986 and put into production in the fourth quarter of 1986, producing 1,800 ounces of gold that year. Under the capable management of Jim Geyer and his staff, Relief Canyon exceeded all expectations, producing 41,600 ounces of gold in 1987 and projecting 45,000 ounces in 1988.

The Relief Canyon open pit mine and recovery plant is located 20 miles east of Lovelock, Nevada. The crushed, agglomerated ore is loaded onto leach pads and sprinkled with dilute cyanide solution. The gold is recovered from the cyanide in a carbon plant before being cast into dore.

Ore reserves at Relief Canyon at year-end 1987 were 3.3 million tons grading 0.030 ounces of gold per ton.

Relief Canyon Gold Production

In Thousands of Ounces



Sprinkling leaching solution on the Relief Canyon leach pad.

Exploration

Pegasus' exploration and business development (acquisition activities) are under the direction of Lyle Beaudoin, Vice President Business Development. The exploration department is managed by James B. Lincoln and the acquisition department is managed by Richard J. Hall; all are located in the Spokane, Washington corporate offices.

Exploration has focused on maintaining and increasing reserves at existing operating mines and locating new reserves for future development and long term corporate growth. The acquisition activity is designed to

completed 1987 with 19 ongoing projects (40,000 acres).

In 1987 seven properties were drilled for a total of 36,000 feet. In 1988, first stage and follow-up drill programs are presently planned for 17 projects in Nevada, Montana, California and Idaho.

During 1987, exploration conducted at the various mining operations was successful in locating additional reserves which, in effect, increased the operating life of three of Pegasus' mines. At the Florida Canyon and Relief Canyon Mines, Nevada, 2.5 million tons grading 0.024 ounces per ton gold and 400,000 tons grading 0.030 ounces per ton gold were located. At the Zortman/Landusky operation, 6.1 million tons grading 0.019 ounces per ton gold were located.

Pegasus is also involved in three exploration joint ventures:

1. Winchester Gold Joint Venture; which comprises four gold properties in Nevada whereby Pegasus has the right to earn a 70% interest in any mine development.
2. USMX INC. Joint Venture; the venture comprises two properties hosting ore grade gold occurrences located in White Pine County, Nevada. Pegasus holds a 49% interest.
3. Pan Australian Mining Ltd. Joint Venture; which explores for and evaluates gold properties in the Charters Towers area of Queensland, Australia. Pegasus is a 50% participant in this venture.

Exploration in 1988 will continue to focus on locating and acquiring large tonnage gold deposits which can be mined by open pit methods. Exploration will also seek to locate and test high grade gold deposits for underground mining and large gold placer properties capable of supporting significant annual gold production. In addition, Pegasus will increase its exposure to precious metal opportunities in various other locations outside of the United States, particularly Canada.



Exploration diamond drilling in Idaho.

bring new reserves to the company at a more advanced, lower risk stage. Such reserves are generally more expensive, but offer development and production at an accelerated rate. In past years, Pegasus has increased its reserves substantially by acquisition and development of existing reserves.

In 1987, Pegasus' exploration and acquisition expenditures totalled \$3.9 million. The exploration department began the year with six projects, acquired 16 new projects during the year, abandoned three properties and

Development

The Beal Property, located south of Anaconda, Montana, has reached the development stage. Mineable ore reserves at an 0.02 ounce per ton gold cut off grade are approximately 11 million tons grading 0.05 ounces of gold per ton at a stripping ratio of approximately 1.4 tons of waste for each ton of ore.

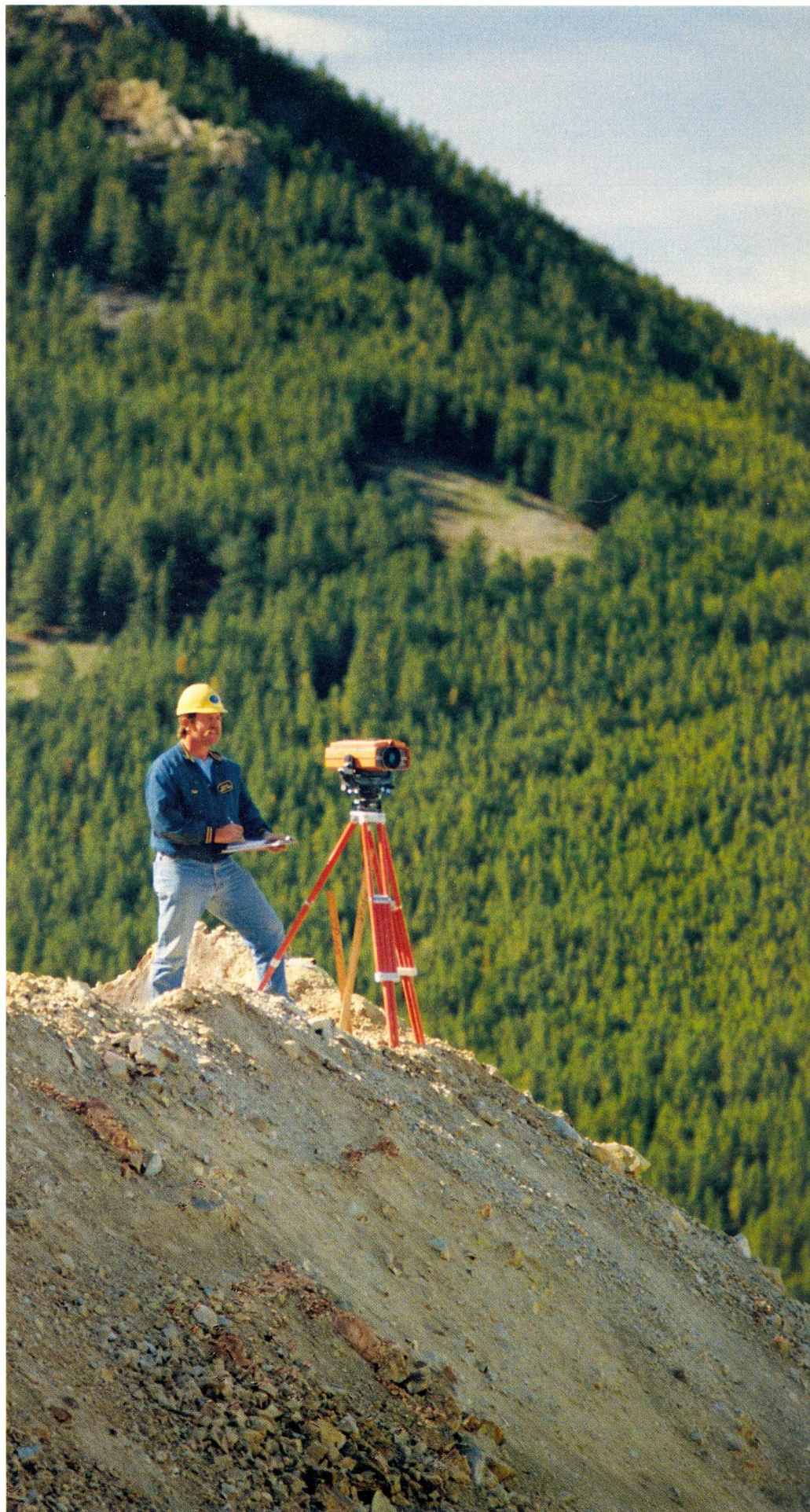
The operating permit application was submitted to the State of Montana in February 1988, approval of which is anticipated in mid 1988. If approved, development and construction of an open pit and associated heap leach pad and facilities will commence, with completion anticipated in 1988.

The operating plan calls for mining, crushing and agglomerating the ore prior to loading on leach pads. The ore will be sprinkled with a weak alkaline sodium cyanide solution to dissolve the gold. This gold bearing solution is then passed through columns of activated carbon which adsorbs the gold; the cyanide solution is returned to the process for further leaching of the ore pile. The carbon is stripped of its contained gold which is then electroplated onto wire wool before being melted and cast as dore. The carbon is reactivated and returned to the process.

Production in 1989 is forecast at 38,000 ounces of gold.

In 1987 a large diameter core drilling program provided samples for metallurgical test work both at Pegasus' laboratories and at consultant's facilities, confirming the viability of the proposed flowsheet.

Pegasus has developed at its mine sites considerable expertise and facilities to permit rapid metallurgical evaluation of ore types from both exploration and development projects in addition to extensive capability for mine design and ore reserve determinations.

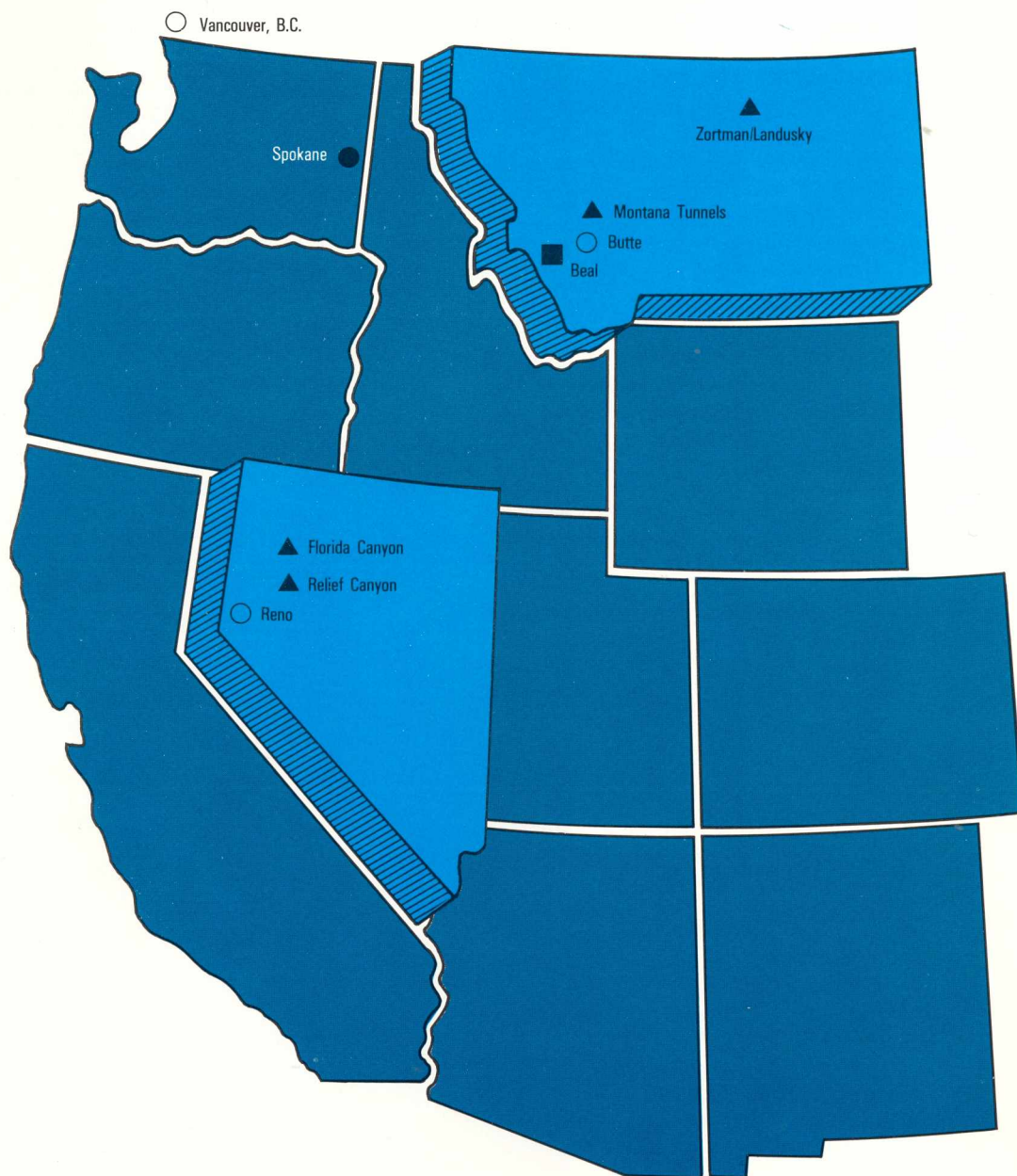


Surveying for mine development.

Property & Office Locations

Legend

- Executive Office
- Offices
- ▲ Mine
- Projects Under Construction



Consolidated Highlights

For the years ended December 31.

	1987	1986	1985	1984	1983
	<i>(In thousands of U.S. dollars, except per share amounts)</i>				
Statement of Operations Data:					
Sales of gold and other metals	\$ 110,435	\$ 35,054	\$ 18,015	\$ 25,231	\$ 29,640
Cost of goods sold	84,085	26,281	16,025	21,003	18,400
Other expenses, net	8,932	4,541	4,314	3,204	4,556
Total expenses	93,017	30,822	20,339	24,207	22,956
Earnings (loss) before income taxes	17,418	4,232	(2,324)	1,024	6,684
Net earnings (loss)	\$ 14,492	\$ 4,654	\$ (1,167)	\$ 1,299	\$ 5,188
Net earnings (loss) per common share:					
Primary	\$0.70	\$0.35	\$(0.11)	\$0.14	\$0.63
Fully diluted	\$0.70	\$0.32	\$(0.11)	\$0.14	\$0.60
Cash dividends per common share	\$0.10				\$0.24

	1987	1986	1985	1984	1983
	<i>(In thousands of U.S. dollars)</i>				
Balance Sheet Data:					
Working capital	\$ 88,034	\$ 37,788	\$ 29,869	\$ 13,896	\$ 16,533
Total assets	267,764	191,059	80,184	40,531	41,041
Long-term debt	36,256	79,040	23,450	176	204
Deferred revenue	3,845	9,437	-	-	-
Other deferred credits	3,793	1,882	1,190	1,324	688
Shareholders' equity	203,562	72,743	50,322	35,017	32,976

	1987	1986	1985	1984	1983
Statistical Data:					
Shares outstanding at year end	23,508,773	14,948,593	11,802,472	8,925,612	8,588,181
Number of shareholders ..	4,650	5,417	5,500	4,400	3,800
Market Price — High	\$26.37	\$11.25	\$10.25	\$14.00	\$14.25
Low	\$10.75	\$ 5.38	\$ 6.13	\$ 5.88	\$ 8.88
December 31	\$16.25	\$11.25	\$ 6.75	\$ 6.75	\$13.13

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

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

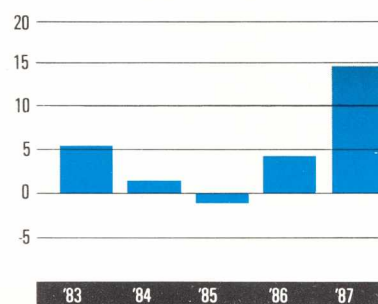
Results of Operations

Introduction

Historically, the Company's results of operations have been influenced primarily by the price of gold and by the extent to which the Company has been able to meet its production and cost goals at the Zortman/Landusky Mine. With the opening of the Florida Canyon, Relief Canyon and Montana Tunnels Mines, the Company's results are less dependent on the results of operations at a single mine. In addition, year-round production at the new mines should diminish the seasonality of the Company's revenues, which have historically been higher in the second and third quarters and lower in the first and fourth quarters. The Company's revenues will continue to be directly related to the price of gold, although the prices of by-products, silver, lead and zinc, will become more important as the Montana Tunnels Mine reaches full production. The costs of production, however, are relatively fixed in the short-term, although subject to the same inflationary pressures experienced by the economy generally.

Net Earnings

In Millions of U.S. Dollars



1987 Compared to 1986

Net earnings for the year ended December 31, 1987 were \$14,492,000, compared to net earnings 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%	24.7%

*Includes sales of 1,192,000 ounces of silver, 4,225 tons of lead and 7,076 tons of zinc in 1987. There were no sales of silver, lead or zinc during 1986.

The significant increase in sales of gold is the result of an increase of 144% in the number of ounces of gold sold and a 13% 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 Zortman/Landusky.

Although gross profit increased 200% over 1986 as a result of higher production, gross margin declined slightly, from 24.7% in 1986 to 23.9% in 1987, due primarily to higher costs incurred at Florida Canyon and Montana Tunnels during start-up and process modifications, and the adoption of a more conservative recovery profile at the Landusky mine.

General and administrative expenses increased \$2,882,000 over the prior year, principally as a result of increased salary, public relations and travel expenses, certain one-time costs incurred in connection with a special investigation by the Board of Directors and costs incurred in connection with the 1987 proxy solicitation. 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.

Net interest expense increased from \$1,880,000 in 1986 to \$2,788,000 in 1987. The increase 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.

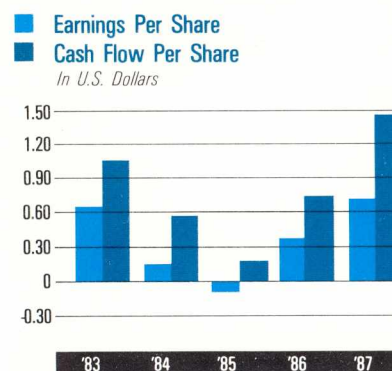
In 1987, the Company sold 1,000,000 shares in Pan Aust and other securities and realized gains of \$2,452,000, compared to a gain of \$624,000 realized in 1986.

The income tax provision increased between the periods as a result of the increase in earnings 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.

1986 Compared to 1985

Net income for 1986 was \$4,654,000, compared to the net loss of \$1,167,000 for 1985. The following table highlights specific financial items:

	1986	1985
Sales of gold	\$35,054,000	\$18,015,000
Average gold price realized per ounce	\$381	\$312
Gold ounces sold	92,000	57,700
Gross profit	\$8,773,000	\$1,990,000
Gross margin	24.7%	11%

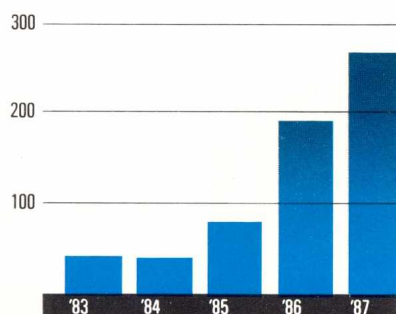


During 1986, the price of gold improved significantly over 1985 levels. This improvement in the gold price, together with increased production, resulted in a significant increase in revenues during 1986. The higher level of gold production in 1986 compared to 1985 is principally attributable to the temporary suspension of gold and silver recovery operations caused by a slippage of ore on one of the leach pads in 1985, the unusually late commencement of mining operations in 1985 due to colder spring weather and to the longer period required in 1985 for the construction and loading of the larger capacity leach pad on the Zortman property.

Cost of sales in 1986 increased 5% more than the percentage increase in ounces of gold sold, due to increased operating costs, principally at the Landusky Property.

Assets

In Millions of U.S. Dollars



General and administrative expenses increased \$1,012,000 in 1986 over 1985, principally due to increased management and labor expenses, expenses incurred in connection with arranging financing for the Montana Tunnels, Florida Canyon and Relief Canyon Mines, and other corporate activities. Royalty expense declined \$538,000 between 1985 and 1986 as a result of the acquisition of the Zortman Property in June 1986. In 1986, exploration expense increased \$379,000 over 1985 due primarily to increased general exploration activities.

Interest and other income for 1986 increased by \$920,000 over 1985 levels due principally to the increased cash available for short-term investment. However, net interest expense increased from \$1,356,000 in 1985 to \$1,880,000 in 1986. The increase resulted principally from a full year's interest accrued on the bonds issued in August 1985, and additional interest accrued on the bonds issued in May and October 1986. Also, in 1986 the Company recorded a gain on the sale of Pan Aust shares in the amount of \$624,000, which was largely offset by the loss on the translation of the 5-3/4% Swiss Franc convertible bond obligation into U.S. dollars in the amount of \$424,000 and the Company's proportionate share in the net loss recorded by USMX.

Income tax benefit declined from \$1,157,000 in 1985 to \$422,000 in 1986, principally as a result of the change in earnings (loss) before income taxes. The tax benefit in 1986 was not proportional to the earnings before income taxes, principally due to the percentage depletion deduction.

Liquidity and Capital Resources

At December 31, 1987, cash and cash equivalents amounted to \$54,212,000, representing an increase of \$25,582,000 over December 31, 1986. In addition, the long-term debt to equity ratio declined from 1.2 to 1 at December 31, 1986, to .2 to 1 at December 31, 1987, as a result of the conversion of \$45,484,000 of long-term debt into common shares and the issuance of common shares.

Major sources of cash flows include net cash provided by operations (net of depreciation, amortization, and other non-cash items) and the issuance of 3,450,000 Common Shares for net proceeds of \$67,609,000. Development costs associated with the Montana Tunnels Mine, other additions to property, plant and equipment, and the acquisition of shares in Pan Aust represented the principal uses of cash in 1987.

Included in inventory at December 31, 1987, are costs associated with ore under leach of \$29,772,000, which will be charged to cost of sales when the gold in the heaps is recovered and sold.

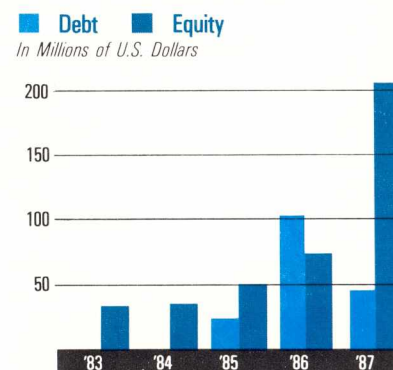
Capital Project Requirements

The Company has an ongoing capital expenditure program in connection with the expansion of leach pad capacity and other capital expenditures at its operating mines. These expenditures are generally funded out of cash flow from operations. The Company expects to commence the development of the Beal Project in 1988. In addition, the Company intends to purchase additional shares of USMX common stock in order to bring its ownership interest in USMX up to 35%. The Company expects to finance these costs from internally generated funds and available cash and cash equivalents.

Line of Credit

The Company has a firm commitment from a bank for a general financing facility under which it can borrow up to the gold equivalent of \$50,000,000 (which amounts to over 110,000 ounces at the current gold price), for general corporate purposes (including the satisfaction of obligations pursuant to any conversions of the gold-convertible bonds). Under terms of the commitments, any amounts borrowed would be repayable in installments beginning no earlier than one year from the date borrowed, and bear interest at an annual rate based on the average market value of the ounces of gold outstanding.

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



Consolidated Balance Sheets December 31, 1987 and 1986 in thousands of U.S. Dollars

	1987	1986
Assets		
Current assets:		
Cash and cash equivalents	\$ 54,212	\$ 28,630
Due from sales of product	17,135	3,188
Other receivables	635	1,739
Inventories	34,401	27,561
Other current assets	1,959	4,627
Total current assets	108,342	65,745
Investments	31,332	16,531
Property, plant and equipment, net	121,461	103,533
Deferred charges and other assets, net	6,629	5,250
Total assets	\$267,764	\$191,059
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 6,302	\$ 11,923
Mining taxes payable	2,703	858
Royalties payable	443	106
Accrued interest	1,511	2,458
Income taxes payable	1,351	206
Current portion of long-term debt	55	6,814
Current portion of deferred revenue	5,592	5,592
Dividends payable	2,351	
Total current liabilities	20,308	27,957
Long-term debt	36,256	79,040
Deferred revenue	3,845	9,437
Deferred reclamation costs	1,522	1,065
Deferred income taxes	2,271	817
Total liabilities	64,202	118,316
Shareholders' Equity		
Class A preferred stock, \$10 par value:		
Authorized - 20,000,000 shares; none issued		
Common stock, no par value:		
Authorized - 50,000,000 shares; issued and outstanding -		
1987 - 23,508,773 shares; 1986 - 14,948,593 shares	177,792	61,537
Retained earnings	26,598	14,457
Less:		
Net unrealized loss on investments	(371)	
Foreign currency translation adjustment	(457)	(542)
Notes receivable from sale of common stock		(2,709)
Total shareholders' equity	203,562	72,743
Total liabilities and shareholders' equity	\$267,764	\$191,059



Director



Director

Consolidated Statements of Changes in Shareholders' Equity

For the Years Ended December 31, 1987, 1986 and 1985 in Thousands of U.S. Dollars

	Common Stock		Retained Earnings	Net Unrealized Loss on Investments	Foreign Currency Translation Adjustment	Notes Receivable from Sale of Common Stock
	Number of Shares	Amount				
Balance, December 31, 1984	8,925,612	\$ 24,911	\$10,970	\$ -0-	\$(621)	\$ (244)
Net loss			(1,167)			
Common stock issued for:						
Cash	675,000	4,983				
Acquisition of subsidiary	1,656,374	11,632				
Stock option plan	535,460	2,540				
Employee savings plan and other	10,026	76				
Other net changes ..				(294)	(40)	(2,424)
Balance, December 31, 1985	11,802,472	44,142	9,803	(294)	(661)	(2,668)
Net earnings			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 earnings			14,492			
Cash dividend			(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	<u>23,508,773</u>	<u>\$177,792</u>	<u>\$26,598</u>	<u>\$(371)</u>	<u>\$(457)</u>	<u>\$ -0-</u>

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

Consolidated Statements of Operations

For the Years Ended December 31, 1987, 1986 and 1985 in Thousands of U.S. Dollars,
Except Share and Per Share Amounts

		1987	1986	1985
Sales	Sales of gold and other metals	<u>\$110,435</u>	<u>\$35,054</u>	<u>\$18,015</u>
	Cost of sales and other direct production costs	<u>68,962</u>	<u>21,379</u>	<u>13,321</u>
	Depreciation, depletion and amortization . .	<u>15,123</u>	<u>4,902</u>	<u>2,704</u>
		<u>84,085</u>	<u>26,281</u>	<u>16,025</u>
Gross profit		<u>26,350</u>	<u>8,773</u>	<u>1,990</u>
	General and administrative expense	<u>6,349</u>	<u>3,467</u>	<u>2,455</u>
	Royalties	<u>2,807</u>	<u>137</u>	<u>675</u>
	Depreciation and amortization	<u>196</u>	<u>214</u>	<u>284</u>
	Exploration expense	<u>2,304</u>	<u>790</u>	<u>411</u>
		<u>11,656</u>	<u>4,608</u>	<u>3,825</u>
Earnings (loss) from operations		<u>14,694</u>	<u>4,165</u>	<u>(1,835)</u>
	Interest and other income	<u>2,512</u>	<u>1,813</u>	<u>893</u>
	Interest expense:			
	Total interest cost	<u>(5,109)</u>	<u>(3,891)</u>	<u>(1,461)</u>
	Less amount capitalized	<u>2,321</u>	<u>2,011</u>	<u>105</u>
		<u>(2,788)</u>	<u>(1,880)</u>	<u>(1,356)</u>
	Gain on sale of investments	<u>2,452</u>	<u>624</u>	
	Gain (loss) on foreign currency transactions	<u>1,182</u>	<u>(424)</u>	<u>(26)</u>
	Equity in net loss of affiliate	<u>(285)</u>	<u>(66)</u>	
	Other expenses	<u>(349)</u>		
		<u>2,724</u>	<u>67</u>	<u>(489)</u>
Earnings (loss) before income taxes		<u>17,418</u>	<u>4,232</u>	<u>(2,324)</u>
	Income tax provision (benefit):			
	Current	<u>1,472</u>	<u>215</u>	<u>(752)</u>
	Deferred	<u>1,454</u>	<u>(637)</u>	<u>(405)</u>
		<u>2,926</u>	<u>(422)</u>	<u>(1,157)</u>
Net earnings (loss)		<u>\$ 14,492</u>	<u>\$ 4,654</u>	<u>\$ (1,167)</u>
Share data	Primary earnings (loss) per share	<u>\$0.70</u>	<u>\$0.35</u>	<u>\$(0.11)</u>
	Fully diluted earnings (loss) per share	<u>\$0.70</u>	<u>\$0.32</u>	<u>\$(0.11)</u>
	Cash dividend per share	<u>\$0.10</u>		
	Weighted average common shares outstanding	<u>20,822,247</u>	<u>13,273,063</u>	<u>10,155,047</u>

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

Consolidated Statements of Cash Flows

For the years ended December 31, 1987, 1986 and 1985 In Thousands of U.S. Dollars

		1987	1986	1985
Operating Activities	Net earnings (loss)	\$14,492	\$ 4,654	\$ (1,167)
	Noncash expenses, revenues, losses and gains included in income:			
	Depreciation and amortization	15,319	5,493	3,050
	Deferred reclamation costs	457	137	270
	Deferred income taxes	1,454	(636)	(405)
	Interest on debt converted to equity	1,531		
	Gain on sale of investments	(2,452)	(624)	
	(Gain) loss on foreign currency transactions	(1,160)	422	
	Equity in net loss of affiliate	285	66	
	Other	481		(134)
	Cash provided by operations	30,407	9,512	1,614
	Change in receivables	(12,843)	(2,100)	(1,968)
	Change in inventories	(6,840)	(8,170)	(3,934)
	Change in accounts payable and accrued liabilities	(3,241)	13,238	1,116
	Change in other current assets	(921)	(366)	10
	Other, net	92	27	(551)
	Net cash provided by (applied to) operating activities	6,654	12,141	(3,713)
Investing activities	Proceeds from sale of investments	4,939	1,026	
	Additions to property, plant and equipment	(34,152)	(63,449)	(4,294)
	Purchase of investments	(17,039)	(7,311)	(6,336)
	Other, net	(389)	(1,626)	
	Net cash applied to investing activities	(46,641)	(71,360)	(10,630)
Financing activities	Proceeds from issuance of long-term debt and deferred revenue	13,674	77,027	21,616
	Payments of long-term debt and deferred revenue	(21,455)		(116)
	Proceeds from issuance of common stock	70,771	2,077	5,115
	Repayments of loans to purchase stock	2,709		
	Debt issuance costs	(130)	(3,098)	(1,358)
	Net cash provided by financing activities	65,569	76,006	25,257
Change in cash and cash equivalents	Net increase in cash and cash equivalents	25,582	16,787	10,914
	Cash and cash equivalents, beginning of year	28,630	11,843	929
	Cash and cash equivalents, end of year	\$54,212	\$28,630	\$11,843
Supplemental disclosures of cash flow information	Cash paid during the year for:			
	Interest (net of amount capitalized)	\$ 1,452	\$ 398	\$ 381
	Income taxes	36	5	

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

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 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 three 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 corporation, presents all financial statements in United States dollars and under generally accepted accounting principles as practiced in the United States.
- (d) In October, 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 95 (SFAS No. 95), which requires a statement of cash flows as part of a full set of financial statements in place of a statement of changes in financial position. Although SFAS No. 95 is effective for annual financial statements for fiscal years ending after July 15, 1988, the Company has elected to apply its provisions in 1987. Accordingly, the consolidated financial statements for 1987 include a consolidated statement of cash flows. As encouraged by SFAS No. 95, the consolidated statements of changes in financial position for the years ended December 31, 1986 and 1985 have been restated to present consolidated statements of cash flows.

2. Summary of significant accounting policies

(a) Basis of consolidation

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

Pegasus Gold Corporation
Centennial Minerals Ltd.
Zortman Mining, Inc.
Florida Canyon Mining, Inc.
Montana Tunnels Mining, Inc.
Peggold Overseas Limited

Accounts of purchased subsidiaries (see note 3) 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. Interest costs incurred during the development of mining properties and other qualifying assets are capitalized as additional development costs. 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.

(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 charged to operations. Depreciation is provided using the straight-line and accelerated methods over the lesser of estimated useful lives of the related assets or the mine life. Leach pads, property and mineral rights and development costs are amortized using units-of-production methods over the estimated ore reserves benefited.

(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 (rather than sold to smelters) are 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 principally from depreciation and mine development expenses which are deferred and amortized for financial purposes and deducted currently for income tax purposes. Investment tax credits are recognized on a flow-through basis.

(g) Foreign currencies

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

(h) Earnings (loss) per share

Earnings (loss) per share is calculated based upon the weighted average number of shares outstanding during each period, plus common stock equivalents, such as common stock options and warrants, unless they are anti-dilutive. Primary earnings per share is computed as if common stock options and warrants were exercised at the beginning of the period, and as if the funds obtained thereby were used to purchase common stock of the Company at the average market price during the period. Fully diluted earnings per share is calculated as if the proceeds from the exercise of common stock options and warrants were used to purchase the Company's common stock at its average market price during the period or its market value at the end of the period, whichever is higher. Fully diluted earnings per share also assumes that all bonds convertible into the Company's common stock were converted at the beginning of each period, with earnings 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 less than 20 percent are recorded at the lower of cost or market value. Investments in marketable equity securities representing an ownership interest of 20 percent or more are accounted for using the equity method. The cost of marketable equity securities sold is determined based upon specific identification. Realized gains and losses on investments are included in operations in the period in which they occur. Unrealized losses on noncurrent marketable equity securities are accumulated as a separate component of shareholders' equity.

(j) Options

Premiums received by the Company for writing call options on its gold production are deferred until such time as the option is exercised or expires. The carrying value of the premiums deferred is adjusted to the market value of the written options at each reporting date, and the resulting gain or loss is included in operations. Included in sales of gold and other metals for the year ended December 31, 1986 is \$511,000 of premium income recognized from writing call options (of which \$178,000 resulted from adjusting deferred premiums on open options to their market value at December 31, 1986). Included in accounts payable and accrued liabilities at December 31, 1986 is \$101,000 of deferred premiums on open call option positions.

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 statement of cash flows, the Company considers all highly liquid debt instruments 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.

3. Acquisitions

(a) On April 10, 1986, the Company acquired all of the outstanding shares of Gold Reserve Montana, Inc. (GRM), which owns a 30 percent net profits royalty interest in the Zortman property, and Nevada Reserve Corporation (NRC), which owns a 15 percent working interest in the Florida Canyon property, in exchange for 1,240,000 shares of the Company's common stock. These two companies were formerly wholly-owned subsidiaries of Gold Reserve Corporation (see note 13(b)).

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

Current assets	\$2,282
Noncurrent assets	1,793
Noncurrent liabilities (deferred income taxes)	1,193
Net noncurrent assets acquired	600
Net book value of GRM and NRC at April 10, 1986	<u>\$2,882</u>

Current assets acquired were comprised solely of royalty and interest receivable by GRM from the Company relative to the Zortman property. As a result of the acquisition, the Company was not required to pay \$2,282,000, and accordingly, offset the current payable it previously recorded against the acquired receivable.

(b) On September 29, 1986, the Company purchased the mineral rights and property, plant and equipment of the Relief Canyon mine from Lacana Mining, Inc. by issuing 325,000 shares of its common stock with a market value of \$2,539,000 and making a cash payment of \$200,000.

(c) 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 exercisable on or before October 3, 1988. During 1987, sufficient warrants were exercised to purchase 1,640 common shares of the Company.

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

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

4. Inventories

Inventories consist of the following:

	1987	1986
Refined gold and silver	\$ 1,555	\$ 4,106
Concentrates and other metal products	1,391	
Deferred costs associated with ore under leach	29,772	23,455
Materials and supplies	1,683	
	<u>\$34,401</u>	<u>\$27,561</u>

Costs associated with ore under leach are deferred and amortized based on the estimated gold and silver to be recovered. Gold and silver are recovered over approximately a five-year period at the Zortman and Landusky mines, and over substantially shorter periods at the Florida Canyon and Relief Canyon mines. Approximately 67 percent of the total expected recovery at the Zortman and Landusky mines occurs during the first year ore is added to the leach pads. At December 31, 1987, approximately 35 percent of the remaining gold to be recovered from the ore already in place on the leach pads at all mines is expected to be recovered in the next 12 months. The Company continuously evaluates and refines certain estimates used in determining the amortization of these deferred costs. Concentrates and other metal products are produced at the Montana Tunnels mine using conventional milling and recovery methods.

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

	1987	1986	1985
Balance, beginning of year	\$23,455	\$16,083	\$12,298
Additional costs deferred	53,248	27,292	16,082
Amount charged to cost of sales	(46,931)	(19,920)	(12,297)
Balance, end of year	<u>\$29,772</u>	<u>\$23,455</u>	<u>\$16,083</u>

During 1987, the Company received an insurance settlement of \$550,000 to recover costs incurred to rehabilitate a leach pad resulting from an ore shift on one of the Zortman leach pads in 1985. The costs of approximately \$542,000 incurred to rehabilitate the pad were recorded as deferred mining costs and amortized accordingly due to the uncertainty of recovery under the Company's insurance policies. The settlement amount has been offset against deferred mining costs to the extent of the unamortized pad rehabilitation costs remaining therein. The remainder of the settlement amount has been offset against cost of sales.

5. Property, plant and equipment

Property, plant and equipment consists of the following:

	1987	1986
Property and mineral rights	\$ 19,832	\$ 20,057
Development costs	59,759	29,928
Buildings	4,229	3,252
Machinery and equipment	41,545	15,056
Leach ponds	2,579	2,579
Leach pads	25,017	19,981
Roads	2,640	1,446
Power line costs	924	1,007
Furniture and fixtures	589	440
	<u>157,114</u>	<u>93,746</u>
Less accumulated depreciation, depletion and amortization	<u>37,207</u>	<u>21,391</u>
	119,907	72,355
Construction in progress	276	29,997
Land	1,278	1,181
	<u>\$121,461</u>	<u>\$103,533</u>

6. Investments

Investments consist of the following:

	1987	1986
Accounted for using the equity method:		
3,627,000 (1986 - 3,564,000) common shares of USMX, Inc. (USMX), at cost (market value - \$17,455,000 and \$13,811,000, respectively)	\$15,987	\$15,683
Less accumulated amortization of excess carrying value of investment over proportionate share of USMX net assets	(532)	
Less accumulated equity in net losses of USMX	(351)	(66)
	<u>15,104</u>	<u>15,617</u>
Accounted for at the lower of cost or market:		
6,520,400 (1986 - 1,000,000) common shares of Pan Australian Mining Ltd. (Pan Aust), at cost (market value - \$13,663,000 and \$1,007,000, respectively)	15,181	914
540,000 common shares of Gold Reserve Corporation (Gold Reserve), at cost (market value - \$2,565,000) (see note 13(b))	1,418	
	<u>16,599</u>	<u>914</u>
Less valuation allowance (to record the investments at the lower of cost or market) included in shareholders' equity	(371)	
	<u>16,228</u>	<u>914</u>
Total investments	<u>\$31,332</u>	<u>\$16,531</u>

During 1986, the Company purchased 2,400,000 of the outstanding common shares of USMX by making two \$3,000,000 cash payments and issuing 760,000 shares of its common stock with a market value of \$5,938,000. During 1987, the Company purchased an additional 63,000 shares at a cost of \$304,000, bringing its ownership interest in USMX to 26.4% at December 31, 1987.

USMX is engaged in the exploration and development of mineral properties. Its most significant property interest, 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 \$12,571,000. 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 over the estimated ore reserves benefited.

During 1987, the Company purchased an additional 4,267,000 common shares of Pan Aust for a cash payment of \$13,674,000. During 1986, the Company sold 1,000,000 common shares of Pan Aust and realized a gain of \$624,000. During 1987, the Company sold an additional 1,000,000 common shares of Pan Aust and realized a gain of \$2,254,000. The Company's ownership interest in Pan Aust was approximately 8% at December 31, 1987. As of February 12, 1988, the market value of the Company's investment in Pan Aust was approximately \$10,107,000.

The Company's ownership interest in Gold Reserve was approximately 11% at December 31, 1987.

7. Long-term debt

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

	1987	1986
8-1/2 percent convertible bonds due 1992	\$ 6,362	\$15,000
5 percent secured gold-convertible bonds due 1993	5,899	6,656
10 percent convertible debentures due 1989		1,449
7-1/2 percent gold-convertible bonds due 1993	23,798	25,047
5-3/4 percent convertible bonds, 60,000,000 Swiss francs, due 1996		37,267
Other borrowings with various interest rates and maturities	252	435
	<u>36,311</u>	<u>85,854</u>
Less current portion	55	6,814
	<u>\$36,256</u>	<u>\$79,040</u>

(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 107-1/2 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 1987, \$8,638,000 of these bonds were voluntarily converted by the bondholders into 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. As of December 31, 1987, the Company could be obliged to deliver up to the equivalent of approximately 17,700 ounces of gold pursuant to the issuance of the Peggold bonds. If the price of gold reaches \$600 per troy ounce, the Company may request bondholders to exchange their bonds for payment in gold at that time. The principal repayment of the Peggold bonds is collateralized by a senior security interest in an investment in zero coupon notes, whose face value at maturity will equal the principal amount of the Peggold bonds. Interest is payable annually in arrears on the anniversary date of the bonds. During 1987, \$757,000 of these bonds were voluntarily converted by the bondholders into gold or cash equivalent payments in lieu of gold.

(d) The 10 percent convertible subordinated debentures due in 1989 were convertible into common shares of the Company at a conversion price of Canadian \$17.00 per share. Interest was payable semi-annually in May and November. During 1987, all of these bonds were voluntarily converted by the bondholders into 117,647 common shares of the Company.

(e) 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, 1987, the Company could be obliged to deliver up to the equivalent of approximately 63,200 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 1987, \$1,249,000 of these bonds were voluntarily converted by the bondholders into gold or cash equivalent payments in lieu of gold.

(f) The 5-3/4 percent convertible bonds due in 1996 were negotiable bearer bonds convertible into common shares of the Company at a conversion price of \$9.607 per share (or 314 common shares for each Swiss franc 5,000 bond). On March 13, 1987, the average market price of the Company's common stock exceeded \$12.49 for thirty consecutive trading days, and in accordance with the terms of the bonds, the Company called all outstanding bonds for redemption at 100 percent of their purchase price, plus accrued interest to the date of redemption. Upon notice of redemption, the bondholders had the right to convert the bond into common shares of the Company at the fixed conversion price for a limited period. During 1987, all of the bonds were voluntarily converted by the bondholders into 3,768,000 common shares of the Company. Prior to their conversion, the Company recognized foreign currency transaction gains related to these bonds totalling \$1,068,000 during 1987.

(g) 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, 1987, 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. The Company has firm commitments from a consortium of banks for a general financing facility under which it can borrow up to 110,000 ounces of gold (or \$50,000,000) for general corporate purposes (including satisfying requests for conversion of the gold-convertible bonds). Under terms of the commitments, any amounts borrowed would be repayable in installments beginning no earlier than one year from the date borrowed, and bear interest at an annual rate based on the average market value of the ounces of gold outstanding. Because of the commitments as to the availability of this financing facility, the gold-convertible bonds have been classified as noncurrent liabilities at December 31, 1987.

(h) At December 31, 1987, long-term debt matures as follows:

1988.....	\$ 55
1992.....	6,362
Thereafter.....	29,894
	<u>\$36,311</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 will be repaid from the Company's future gold production and, accordingly, the proceeds received have been recorded as deferred revenue. Interest on the loan is payable monthly at an annual rate of 2-1/2 percent of the average market value of the ounces of gold outstanding during the preceding month. The remaining unpaid ounces are scheduled for repayment as follows:

	Ounces of Gold to be Repaid	Deferred Revenue to be Recognized
1988	16,000	\$5,592
1989	11,000	3,845
	<u>27,000</u>	<u>\$9,437</u>

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

9. Incentive stock option agreements

Under the 1987 stock option plan adopted in May, 1987, both incentive and nonqualified options to purchase up to a total of 600,000 common shares can be granted to officers and key employees. At December 31, 1987, 287,500 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 nonqualified 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, 1984	540,870	\$3.10 - \$13.00	
Cancelled	(232,410)	11.37 - 13.00	
Granted	457,500	8.13	February 12, 1995
Granted	11,000	11.63	September 10, 1995
Granted	20,000	8.63	November 7, 1988
Exercised	(535,460)	3.10 - 12.63	
Expired	(55,000)	8.13	
Balance, December 31, 1985	206,500	8.13 - 12.63	
Cancelled	(35,000)	8.13 - 9.00	
Granted	60,000	9.38	January 6, 1996
Granted	66,000	9.00	March 12, 1996
Granted	285,000	8.00	June 6, 1996
Granted	37,500	11.00	August 8, 1996
Exercised	(30,260)	8.00 - 11.63	
Expired	(20,000)	9.00	
Balance, December 31, 1986	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	<u>553,540</u>	8.00 - 30.25	

The Company formerly had a financial assistance plan to enable key employees to purchase common stock of the Company. This plan was terminated in February 1987, and all amounts owing thereunder were repaid during 1987. The amounts receivable under the plan from key employees were shown as a reduction of shareholders' equity. Included in interest and other income for the years ended December 31, 1986 and 1985 is \$243,000 and \$123,000, respectively, representing interest charged on these loans. Included in other receivables at December 31, 1986 is accrued interest receivable of \$241,000 relating to these loans.

The activity in notes receivable from the sale of common stock is as follows:

	1987	1986	1985
Balance, beginning of year	\$2,709	\$2,668	\$ 244
Additions		236	2,449
Payments	(2,445)	(12)	
Loans offset by bonuses	(264)	(183)	(25)
Balance, end of year	\$ -0-	\$2,709	\$2,668

10. Income taxes

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

	1987	1986	1985
Currently payable (refundable)			
Federal	\$1,472	\$ 280	\$ (667)
State		(65)	(85)
	<u>1,472</u>	<u>215</u>	<u>(752)</u>
Deferred provision (benefit)			
Federal	1,209	(603)	(325)
State	245	(34)	(80)
	<u>1,454</u>	<u>(637)</u>	<u>(405)</u>
	<u>\$2,926</u>	<u>\$(422)</u>	<u>\$(1,157)</u>

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

	1987		1986		1985	
	Amount	%	Amount	%	Amount	%
Income tax provision (benefit)						
computed at statutory rate	\$6,967	40	\$1,946	46	\$(1,069)	(46)
State income taxes, net of						
federal benefit	158	1	(53)	(1)	(89)	(4)
Investment tax credits			(12)		(298)	(13)
Percentage depletion, net of						
preference tax	(3,768)	(22)	(2,441)	(58)	125	5
Original issue discount on						
convertible bonds	(259)	(1)	(328)	(8)		
Effect of a subsidiary's loss						
producing no current benefit					114	5
Stock offering expenses deductible						
for Canadian income tax purposes	(1,372)	(8)				
Additional tax resulting from						
alternative minimum tax	1,035	6				
Adjustment of prior years' tax						
estimate and other	165	1	466	11	60	3
Income tax provision (benefit)	<u>\$2,926</u>	<u>17</u>	<u>\$(422)</u>	<u>(10)</u>	<u>\$(1,157)</u>	<u>(50)</u>

In 1987, the Canadian parent company's taxable income was entirely offset by deductible stock offering costs.

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

	1987	1986	1985
Development and exploration costs	\$ (332)	\$5,724	\$1,010
Tax depreciation over book depreciation	591	176	493
Deferred royalty expense			34
Reinstatement (reversal) of deferred taxes through			
utilization (application) of net operating losses and			
investment tax credits	1,003	(6,485)	(1,860)
Foreign currency transaction			
gain	473		
Amortization of USMX excess			
investment basis	(213)		
Other	(68)	(52)	(82)
Deferred tax provision (benefit)	<u>\$1,454</u>	<u>\$(637)</u>	<u>\$(405)</u>

The Canadian parent company files a separate Canadian income tax return. All of the Company's U.S. subsidiaries except Montana Tunnels Mining, Inc. are part of a consolidated group and file a single consolidated income tax return. Effective December 31, 1986, all U.S. subsidiaries changed their year-end for income tax purposes from June 30 to December 31.

As of December 31, 1987, the Company and its U.S. subsidiaries have tax basis net operating loss carryforwards for Canadian and U.S. income tax purposes of approximately \$5,173,000 (Canadian dollars) and \$25,959,000, 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 (net of a 35% reduction attributable to carryforward periods) available to offset future regular or alternative minimum income taxes payable. Certain of these carryforwards can only be used to offset the taxable income and income taxes payable of the subsidiary which generated the carryforwards. In addition, certain of these carryforwards were acquired as part of the Centennial purchase; therefore, any tax benefit realized from utilizing these carryforwards would reduce property and mineral rights.

The carryforwards expire as follows:

	Canada	United States	
	Non-Capital Losses	Net Operating Losses	Investment Tax Credits
	(In Canadian Dollars)		
1990	\$ 948		
1991	802		
1992	559		
1993	32		
1994	2,832		
1996		\$ 576	
1997		467	
1998		1,672	
1999		5,337	
2000		2,785	\$ 84
2001		13,910	250
2002		1,212	
	<u>\$5,173</u>	<u>\$25,959</u>	<u>\$334</u>

Included in the United States net operating loss carryforward amounts above is \$12,140,000 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. During the year ended December 31, 1987, an alternative minimum tax credit of approximately \$820,000 was generated. This credit will be available to offset future regular income taxes to the extent that they exceed the alternative minimum tax.

The 1987 income tax provision considers all applicable changes of the Tax Reform Act of 1986. Changes included in the legislation which significantly affected the Company, beginning January 1, 1987, are: reduction of the maximum corporate tax rate from 46 percent to 34 percent over a one-year period beginning July 1, 1987 (Company's "blended" tax rate for the year ended December 31, 1987 is 40 percent); reduction of investment tax credit carryforwards by 17-1/2 percent if utilized in 1987 and 35 percent if utilized thereafter; and creation of a new corporate alternative minimum tax based on adjusted regular taxable income (increased by defined preference items, including percentage depletion, and other adjustments, including exploration and development costs), using a minimum tax rate of 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 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, 1989. The effects of adopting this new standard cannot be reasonably estimated at this time.

11. Related party transactions

Fees for rent and legal, engineering and consulting services totalling \$254,000 for the year ended December 31, 1987 (1986-\$226,000, 1985-\$491,000) have been paid to firms in which certain current and former officers, directors and employees of the Company are partners or owners. During the year ended December 31, 1985, the Company incurred royalty and interest expense of \$664,000 and \$395,000, respectively, associated with a Gold Reserve Corporation mineral lease. The former president and chief financial officer of the Company are also the president and treasurer, respectively, of Gold Reserve Corporation.

Included in other receivables at December 31, 1987 are an account receivable of \$62,000 (1986-\$22,000) from Gold Reserve Corporation, and advances to officers for relocation and certain other expenses of \$27,000 (1986-\$116,000).

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

As a result of the Committee's investigation, the Company believes that two former officers and a former consultant had substantial beneficial ownership interests in ATI which had not been disclosed to the Board of Directors of the Company. On February 10, 1987, the Company, with the approval of the Committee, entered into a settlement agreement with ATI and these former officers and former consultant. Pursuant to this agreement, ATI conveyed its interest in the Florida Canyon property to the company in exchange for a cash payment by the Company of \$387,000 in lieu of the 435,625 shares of common stock (with a market value of approximately \$5,800,000 on February 10, 1987) that would have been required to be delivered under the terms of the Company's previous agreements with ATI. The cash payment represents an approximation of the investment made in ATI by the two former officers and former consultant, after adjustment for certain transactions and the time value of money. Pursuant to this agreement, ATI also transferred to the Company as part of the settlement 540,000 shares of Gold Reserve Corporation, with a market value of approximately \$1,418,000. The market value of the Gold Reserve Corporation common shares received, net of the cash payment made by the Company, has been offset against the cost of property and mineral rights of the Florida Canyon property.

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 6 percent of their base salary and the Company will make a matching contribution equal to 50 percent of the employee's contribution up to a maximum of \$100 a month. 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, 1987, 1986 and 1985, the Company contributed \$197,000, \$97,000 and \$117,000, respectively, to the plan. During the years ended December 31, 1987, 1986 and 1985, the plan purchased 3,382, 11,861 and 6,026 shares, respectively, of the Company's common stock to satisfy employees' investment designations.

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 an adequate provision for any additional income taxes and interest that may become payable at the time of any settlement with the Internal Revenue Service.

(b) On December 4, 1987, the Company entered into an agreement to acquire all of the common stock of Gold Reserve Corporation ("Gold Reserve"), an affiliated company through former common management and intercompany stock ownership, in exchange for 1,278,416 common shares of the Company. Under the terms of the agreement, the holders of the 4,191,527 Gold Reserve common shares not currently owned by the Company will receive .305 common shares of the Company for each Gold Reserve share held. The transaction is subject to the approval of the shareholders of Gold Reserve, and the receipt of a favorable ruling from the Internal Revenue Service that the transaction results in a tax-free exchange of stock to the shareholders of Gold Reserve.

(c) At December 31, 1987, the Company has outstanding gold forward sale contracts with metals brokers requiring delivery of 65,000 ounces of gold in 1988 and 30,900 ounces of gold in 1989. The Company will realize an average of \$416.18 per ounce, or a total of approximately \$39,911,000, upon the delivery of the gold.

The Company has arrangements with its metals dealers that a margin call will not occur until the market exposure exceeds \$21,500,000 with these dealers. At that time, the Company could cover the excess amount of market exposure with silver or gold bullion carried in inventory or cash. At December 31, 1987, the Company did not have any market exposure in excess of the above described limits relating to these contracts.

(d) At December 31, 1987, the Company has outstanding a number of gold option contracts with two 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 outstanding options expire as follows:

	Ounces of Gold	
	Puts	Calls
1988	120,000	36,000
1989	60,000	18,000
	<u>180,000</u>	<u>54,000</u>

The average exercise price of the above puts and calls was \$418 per ounce and \$539 per ounce, respectively.

(e) At December 31, 1987, a total of 3,693,304 shares of authorized common stock are reserved for the following:

Incentive stock options (see note 9)	553,540
Warrants (see note 3(c))	1,269,661
Convertible bonds (see note 7(b))	591,687
Acquisition of Gold Reserve Corporation	<u>1,278,416</u>
	3,693,304
Less common shares of the Company to be acquired with Gold Reserve acquisition	<u>(1,403,555)</u>
	<u>2,289,749</u>

14. Shareholders' equity

(a) On July 27, 1987, the Company sold, through underwriters in the United States and Europe, 3,450,000 shares of common stock at a price of \$21.125 per share. Total net proceeds to the Company, after underwriting discounts and offering expenses of \$5,272,000, were \$67,609,000.

(b) On October 29, 1987, the Company announced that it may purchase up to 1,000,000 shares of its own common stock, which constituted 4.26% of the issued and outstanding shares on that date. Any such purchases, if made, will be on the open market from time to time through the Toronto Stock Exchange, before November 2, 1988. No such purchases had yet been made at December 31, 1987.

15. Quarterly data (unaudited)

Selected unaudited quarterly data for the year ended December 31, 1987 is as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Sales of gold and other metals	\$6,263	\$28,927	\$34,176	\$41,069	\$110,435
Earnings (loss) from operations	\$ (943)	\$ 5,806	\$ 6,672	\$ 3,159	\$ 14,694
Net earnings (loss)	\$ (273)	\$ 4,304	\$ 7,029	\$ 3,432	\$ 14,492
Earnings (loss) per share	\$(0.02)	\$0.22	\$0.30	\$0.14	\$0.70

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

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

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

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

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

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

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

	<u>1987</u>	<u>1986</u>	<u>1985</u>
United States Generally Accepted Accounting Principles			
Shareholders' equity			
Common stock	\$177,792	\$61,537	\$44,142
Retained earnings	26,598	14,457	9,803
Other equity accounts	(371)	(2,709)	(2,962)
Equity adjustment from foreign currency translation	(457)	(542)	(661)
	<u>\$203,562</u>	<u>\$72,743</u>	<u>\$50,322</u>
Net earnings (loss)	<u>\$ 14,492</u>	<u>\$ 4,654</u>	<u>\$ (1,167)</u>
Primary earnings (loss) per share	<u>\$0.70</u>	<u>\$0.35</u>	<u>\$(0.11)</u>
Fully diluted earnings (loss) per share	<u>\$0.70</u>	<u>\$0.32</u>	<u>\$(0.11)</u>
Canadian Generally Accepted Accounting Principles			
Shareholders' equity			
Common stock	\$181,569	\$65,314	\$44,105
Retained earnings	26,354	14,588	9,655
Other equity accounts	(371)	(2,709)	(2,962)
	<u>\$207,552</u>	<u>\$77,193</u>	<u>\$50,798</u>
Net earnings (loss)	<u>\$ 14,118</u>	<u>\$ 4,932</u>	<u>\$ (904)</u>
Basic earnings (loss) per share	<u>\$0.69</u>	<u>\$0.37</u>	<u>\$(0.09)</u>
Fully diluted earnings (loss) per share	<u>\$0.66</u>	<u>\$0.37</u>	<u>\$(0.09)</u>

Auditors' Report to the Shareholders

We have examined the consolidated balance sheets of Pegasus Gold Inc. and subsidiaries as of December 31, 1987 and 1986 and the consolidated statements of operations, changes in shareholders' equity and cash flows for the years ended December 31, 1987, 1986 and 1985. 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, 1987 and 1986, and the consolidated results of their operations and their cash flows for the years ended December 31, 1987, 1986 and 1985 in accordance with generally accepted accounting principles in the United States applied on a consistent basis.

Coopers & Lybrand

*Vancouver, B.C., Canada
Spokane, Washington, U.S.A.
February 12, 1988*

Corporate Information

Directors

M. Norman Anderson
Vancouver, B.C.

Stanton B. Bennett
Spokane, Washington

John J. Crabb
Pender Harbour, B.C.

James H. Foreman
Spokane, Washington

Peter R. Kutney
Calgary, Alberta

Dr. Lindsay D. Norman
Butte, Montana

Robert A. Watts
Vancouver, B.C.

Officers

James H. Foreman
*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*

Alan H. Richardson
*Vice President,
Corporate Affairs*

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
Imlay, NV 89418

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
NASDAQ - PGULF

Warrants
Toronto Stock Exchange
- PGUWT
NASDAQ - PGUWF
Expiration date -
October 3, 1988

Bonds
8½% Guaranteed
Convertible Bonds
Due 1992
Luxembourg

7½% Guaranteed Bonds
Due 1993
Luxembourg

5% Secured Bonds
Due 1993
Luxembourg

Transfer Agent & Registrar

Guaranty Trust Company of
Canada
Vancouver, B.C.

Co-Transfer Agent

General Transfer Company
Spokane, Washington

Auditors

Coopers & Lybrand
1111 West Hastings Street
Vancouver, B.C. V6E 3R2

Coopers & Lybrand
1600 Seafirst Financial
Center
Spokane, Washington 99201

Solicitors

Shearman & Sterling
Four Embarcadero Center
San Francisco, CA 94111

Lawson, Lundell, Lawson
& McIntosh
2800 Vancouver Centre
650 W. Georgia Street
Vancouver, B.C. V6B 4R7

For further information and
a copy of the Company's
10K and Corporate Profile
contact:
Alan H. Richardson
Vice President,
Corporate Affairs
N. 9 Post Street, Suite 400
Spokane, Washington 99201
(509) 624-4653

The 1988 Annual Meeting
of Shareholders of Record
on April 15, 1988 will be
held on May 20, 1988 at
10:30 a.m. in the
Pavilion B Room
Pan Pacific
Vancouver Hotel
Vancouver
British Columbia, Canada



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