AMERICAN GEM CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1998

(Expressed in United States Dollars)

AMERICAN GEM CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1998

(Expressed in United States Dollars)

AUDITORS' REPORT

To the Shareholders of
American Gem Corporation

We have audited the consolidated balance sheet of American Gem Corporation as at March 31, 1998 and the consolidated statements of operations and deficit and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 1998 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

The consolidated financial statements for the year ended March 31, 1997 were audited by another firm of chartered accountants who expressed an opinion without reservation on those financial statements.

McGOVERN, HURLEY, CUNNINGHAM

Signed "McGovern, Hurley, Cunningham"

Chartered Accountants

NORTH YORK, Canada
July 17, 1998

AMERICAN GEM CORPORATION
CONSOLIDATED BALANCE SHEETS
AS AT MARCH 31

(Expressed in United States Dollars)	1998 $	1997 $
ASSETS		
CURRENT		
Cash and cash equivalents	285,601	841,725
Accounts receivable	372,995	176,378
Note receivable	100,000	345,046
Inventory (Note 3)	1,500,000	3,000,000
	2,258,596	4,363,149
PROPERTY		
Mining properties (Note 5)	2,805,774	7,755,379
Mining plant and equipment (Note 6)	1,724,515	3,117,985
	4,530,289	10,873,364
INVENTORY (Note 3)	-	3,487,164
HEAT TREATMENT TECHNOLOGY (Note 4)	100,000	2,064,408
RECLAMATION BOND AND OTHER DEPOSITS	107,373	195,767
BOND ISSUANCE COSTS, net	-	449,733
	6,996,258	21,433,585

APPROVED ON BEHALF OF THE BOARD:

"Victor P. Alboini" , Director

"Douglas A. Harris" , Director

See Accompanying Notes to the Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS
AS AT MARCH 31

(Expressed in United States Dollars)	1998 $	1997 $
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	408,657	1,094,504
Deferred revenue	-	125,000
Current portion of long-term debt (Note 7)	306,869	893,370
	715,526	2,112,874
LONG-TERM DEBT (Note 7)	24,258	9,099,756
DEFERRED FOREIGN EXCHANGE GAIN	-	241,725
	739,784	11,454,355
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 8)	31,109,940	25,772,026
CONVERTIBLE DEBENTURES - Equity portion	-	2,119,834
DEFICIT	(24,853,466)	(17,912,630)
	6,256,474	9,979,230
	6,996,258	21,433,585

AMERICAN GEM CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
FOR THE YEAR ENDED MARCH 31

(Expressed in United States Dollars)	1998 $	1997 $
REVENUES		
Sapphire sales	1,415,811	1,372,556
Jewelry sales	122,390	64,757
Heat treatment revenue	8,272	2,843
	1,546,473	1,440,156
OPERATING EXPENSES		
Cost of goods sold	509,561	655,137
Mine operations	393,771	307,275
Exploration	767,188	229,391
Loss on abandonment of mining properties	2,428,536	155,024
Loss on sale of assets	107,333	-
Write-down of inventory (Note 3)	4,462,834	4,396,696
Selling, general and administrative	1,336,459	2,473,225
Loss on settlement of note receivable	194,581	-
Write-down of heat treatment technology (Note 4)	1,955,069	-
Interest expense, net	297,271	995,603
Research and development	180,687	283,349
Amortization	340,990	100,480
Amortization of bond issuance costs	104,958	146,744
(Gain) on conversion of debentures - debt portion	(3,480,275)	-
	9,598,963	9,742,924
NET (LOSS) FOR THE YEAR	(8,052,490)	(8,302,768)
(DEFICIT), beginning of year	(17,912,630)	(9,609,862)
	(25,965,120)	(17,912,630)
Less: Gain on conversion of debentures - equity portion	1,111,654	-
(DEFICIT), end of year	(24,853,466)	(17,912,630)
(LOSS) PER SHARE - Basic	(0.14)	(0.24)

See Accompanying Notes to the Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED MARCH 31

(Expressed in United States Dollars)	1998 $	1997 $
CASH WAS PROVIDED BY (USED IN):		
OPERATING ACTIVITIES:		
Net (loss) for the year	(8,052,490)	(8,302,768)
Charges to income not involving cash:		
Gain on conversion of debentures - debt portion	(3,480,275)	-
Amortization	445,948	247,224
Amortization of bond discount	-	418,359
Loss on abandonment of mining properties	2,428,536	155,024
Loss on write-off of deposits	62,000	29,570
Write-down of heat treatment technology	1,955,069	-
Write-down of inventory	4,462,834	4,396,696
Loss on sale of assets	107,333	8,706
Loss on settlement of note receivable	194,581	-
Changes in non-cash working capital balances:		
Accounts receivable	(196,617)	(77,444)
Inventories	524,330	(3,808,777)
Accounts payable and accrued liabilities	(685,847)	363,842
Deferred revenue	(125,000)	125,000
	(2,359,598)	(6,444,568)
INVESTING ACTIVITIES:		
Decrease in note receivable	50,465	41,887
Proceeds from sale of interest in mining properties	-	203,770
Acquisition of interest in mining properties	-	(224,473)
Acquisition of mining plant and equipment	-	(679,086)
Payments from reclamation bond and other deposits	26,394	-
Proceeds from sale of mining plant and equipment	803,426	-
	880,285	(657,902)

AMERICAN GEM CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED MARCH 31

(Expressed in United States Dollars)	1998 $	1997 $
FINANCING ACTIVITIES:		
Issuance of debt on acquisition of plant and equipment	-	27,367
Proceeds from issuance of common stock	1,036,549	2,620,343
Principal payments on capital lease obligations	-	(64,345)
Principal payments on long-term debt	(113,360)	(507,031)
Deferred foreign exchange gain	-	129,371
	923,189	2,205,705
(Decrease) in cash and cash equivalents	(556,124)	(4,896,765)
Cash and cash equivalents, beginning of year	841,725	5,738,490
Cash and cash equivalents, end of year	285,601	841,725

See Accompanying Notes to the Consolidated Financial Statements

1. **GOING CONCERN**

The consolidated financial statements for the Company have been prepared on a going concern basis. Based on the continuing operating losses, shrinking working capital balances, and the Company's inability to find sufficient profitable markets to sell its gems, its ability to continue operations in the normal course is uncertain. The Company must raise additional capital to be able to attempt to develop a market for the gems they are mining, or align itself with a strategic partner. If the Company is unable to achieve a level of profitability, the Company may be unable to realize its assets and discharge its liabilities in the normal course of business and accordingly, further losses may result.

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies of the Company are in accordance with generally accepted accounting principles and are consistent with that of the previous year. Outlined below are those policies considered particularly significant.

Organization and Nature of Business:

These consolidated financial statements include the accounts of the Company and all its subsidiaries. The Company's subsidiaries are American Gem, Square One, American Gem Processing, Inc. and American Gem Limited.

The Company is engaged in the business of mining sapphire-bearing properties, acquiring sapphire rough and heat treating, cutting and marketing sapphires. Since inception, the Company has had limited operating revenues from its intended sapphire operations and it has not been determined whether the Company's mining properties contain reserves that are economically recoverable. The recoverability of capitalized costs related to inventories, mining properties, mining plant and equipment and heat treatment technology is dependent upon the discovery of economically recoverable reserves, confirmation of the Company's interest in the mining properties, the ability of the Company to obtain the necessary financing to complete the development of the properties, and ultimate realization of profits through the production and sale of sapphires.

Continued...

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Cash and Cash Equivalents:

The Company considers all highly liquid debt instruments with an original maturity date of twelve months or less to be cash equivalents. Substantially all of the Company's cash and cash equivalents are held in banks in Toronto, Ontario, Canada and Helena, Montana.

Inventory:

Historically, inventory, which is composed of sapphires, has been stated at the lower of average cost or net realizable value. The cost of sapphires includes mining, processing, heat treatment and cutting costs, including depreciation, depletion and amortization, and the cost of purchased sapphire rough. (Note 3)

Mining Properties:

Expenditures related to the acquisition of mining properties, deeded property and options on mineral properties are capitalized by project area. The capitalized costs associated with each such project area are assessed periodically for impairment. Any impairment identified, as well as all costs associated with abandoned projects or project areas, are charged against income in the year they are identified or abandoned. Capitalized costs, net of residual values, are depleted on the units of production method based on the property's measured and indicated sapphire resource. Exploration and administrative expenditures are expensed as incurred. Costs incurred to maintain mineral claims are expensed as incurred as a component of exploration expense.

The Company evaluates the recoverability of proved mining properties based on the expected undiscounted future net revenues from the property's measured and indicated sapphire resource. An impairment loss will be recorded if the unamortized costs exceed the expected undiscounted future net revenues from the related property. The impairment loss recognized will equal the excess of the unamortized costs over the expected discounted future net revenues.

Environmental Protection and Site Restoration:

Expenditures related to environmental protection and site restoration undertaken during mining development and operations are expensed as incurred.

Mining Plant and Equipment and Equipment Under Capital Leases:

Mining plant and equipment are recorded at cost and depreciated, net of residual value, using the straight line method based on the estimated useful lives of the assets or the term of the capital lease. The estimated useful lives of the mining plant range from 5 to 10 years and for mine equipment from 3 to 7 years.

Repair and maintenance expenditures are charged to operations; major improvements and replacements which extend the useful life of an asset are capitalized and depreciated over the remaining estimated useful life of that asset. Upon the sale or retirement of mining plant and equipment, any gain or loss on disposition is reflected in the statement of operations and the related asset cost and accumulated depreciation are removed from the respective accounts.

Continued...

2. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Reclamation Bond Deposits:

Reclamation bond deposits are held in the Company's name in escrow until the related reclamation activities are completed.

Loss Per Share Calculation:

Loss per share is calculated by dividing the loss by the weighted average shares outstanding during each year. The existence of stock options and convertible debentures may effect the calculation of loss per share on a fully diluted basis. As the effect of this dilution is to reduce the reported loss per share, fully diluted loss per share has not been disclosed.

Foreign Currency Translation:

The Company's mining operations are located in the United Stated and its functional and reporting currency is U.S. dollars. Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the rate of exchange prevailing at the statement date. Capital assets are translated at the rates prevailing at the dates of acquisition. Long-term monetary assets and liabilities with a fixed or ascertainable life are translated at the statement date rate; any resulting gain or loss thereon is amortized over the life of the item. Revenue and expense items, other than amortization, are translated at the average rate of exchange for the year. An exchange gain or loss that arises on translation or settlement of a foreign currency denominated monetary item is included in the determination of net income for the period.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

Financial Instruments:

The carrying amounts for cash and cash equivalents, accounts receivable, note receivable and accounts payable and accrued liabilities on the balance sheet approximate fair value because of the limited term of these instruments. Long-term debt approximates fair value because the Company's current borrowing rate for similar debt instruments of comparable maturity is not materially different.

Fair value estimates are made at the balance sheet date, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgement, and therefore, cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

Continued...

(Expressed in United States dollars)

3. **INVENTORY**

Inventory consists of the following:

	1998 $	1997 $
Raw material	1,074,556	1,464,090
Work in process	2,156,148	1,643,000
Finished sapphire stones	4,549,637	5,119,000
Finished jewelry	157,493	236,074
Allowance for obsolete jewelry inventory	(25,000)	(25,000)
Allowance for obsolete inventory	(6,412,834)	(850,000)
	1,500,000	7,587,164
Current portion of inventory	(1,500,000)	(3,000,000)
	-	4,587,164
Discount on non-current inventory	-	(1,100,000)
	-	3,487,164

In 1997, the Company recorded an allowance in the amount of $850,000 for costs to be incurred in processing and sorting the finished goods inventory and for sapphires which may be obsolete or sold below cost. Also in 1997, a portion of the inventory was reclassified as non-current based upon prior sales experience and future expectations. The Company estimated the non-current inventory would be sold within approximately two years after the sale of the current inventory. In 1997, the non-current inventory was reduced by $1.1 million which represents a discount resulting from the delay expected before this inventory is sold and the cash received.

Since one of management's objectives is an orderly liquidation of the inventory, the allowance for all obsolete inventory was increased by $4,462,834 to $6,437,834 as an estimate of the possible future loss and as an estimate necessary to adjust the value of this investment to its probable net realizable value based on past performance and likely future events.

Continued...

(Expressed in United States dollars)

4. **HEAT TREATMENT TECHNOLOGY**

Pursuant to an agreement dated February 26, 1998, the Company cancelled the previous purchase and consulting agreements with the vendors of the heat treatment technology. This agreement releases the vendors from the non-competitioncovenants and allows the vendors to commercially exploit this technology.

Management estimates the fair value of the right to use the technology retained to be $100,000 which will be amortized over three years commencing in 1999.

5. **MINING PROPERTIES**

Mining properties consist of the following:

	1998 $	1997 $
Gem Mountain	4,780,625	5,393,193
Eldorado Bar	163,382	2,527,897
Dry Cottonwood Creek	37,162	2,009,684
Other	39,501	39,501
	5,020,670	9,970,275
Less: Accumulated depletion	(2,214,896)	(2,214,896)
	2,805,774	7,755,379

As of March 31, 1998 the Company has identified, measured and indicated sapphire resources on portions of each of the major properties noted above.

During the year the company abandoned significant land holdings in the Eldorado Bar and Dry Cottonwood Creek areas of interest.

6. **MINING PLANT AND EQUIPMENT**

Mining plant and equipment consists of the following:

	1998 $	1997 $
Mining plant and equipment	2,406,951	3,711,712
Office equipment	190,879	308,445
	2,597,830	4,020,157
Less: Accumulated amortization	(873,315)	(902,172)
	1,724,515	3,117,985

Continued...

(Expressed in United States dollars)

7. LONG-TERM DEBT

Long-term debt, having a carrying amount which approximates fair value, consists of the following:

	1998 $	1997 $
Contracts for deeds, collateralized by properties in the Dry Cottonwood and Eldorado Bar areas of interest. During the year, the Company abandoned the mining properties in settlement of the amounts outstanding.	-	2,688,373
Note payable, collateralized by equipment. Subsequent to the year end, the Company returned the equipment in settlement of the amount outstanding.	90,300	199,418
Contract for deed, due in monthly instalments of $2,597 until September 20, 2000, at which time all outstanding principal and interest is payable in full; interest at 9%; collateralized by a building.	-	172,064
Contract for deed, due in monthly instalments of $2,100 until October 16, 1998, one payment of $30,000 on July 16, 1998 (paid) and a final payment of principal and interest on October 16, 1998; interest at 10%; collateralized by a building which is currently listed for sale.	116,464	135,356
Contract for deed, due in two annual instalments of $90,000 beginning July 7, 1996, collateralized by the Gem Mountain property interest purchased in July 1995, paid subsequent to the year end.	90,000	90,000
Series A unsecured convertible debentures, ($11,000,000 Canadian) due April 28, 2000, interest at 5% payable semi-annually; convertible into common shares of the Company at a conversion price of $2.68 (Note 8(a)).	-	6,636,603
Other	34,363	71,312
Total	331,127	9,993,126
Less: Current portion	(306,869)	(893,370)
	24,258	9,099,756

Continued...

(Expressed in United States dollars)

8. CAPITAL STOCK

a) Common shares:

Authorized:
Unlimited number of common shares
2,000,000 voting, convertible, redeemable preference shares

Issued:

102,832,725 Common shares	$31,109,940

Transactions during the year are as follows:

	Shares #	Amount $
Balance, March 31, 1997	36,421,022	25,772,026
Issued on conversion of debentures	58,000,000	4,043,180
Issued on exercise of warrants	308,000	67,812
Issued for cash	4,400,000	968,737
Issued for services	3,703,703	258,185
Balance, March 31, 1998	102,832,725	31,109,940

b) Stock Options and Warrants:

As at March 31, 1998, the Board of Directors have granted stock options to certain directors, officers and employees of the Company as follows:

Date of Grant	Date of Expiry	Options Granted	Exercise Price	Vesting Provision
February 12, 1998	February 12, 2003	2,535,000	$0.065	Vests immediately
February 12, 1998	February 12, 2003	360,000	$0.065	1/3 vests immediately, 1/3 December 31, 1998, 1/3 December 31, 1999
December 9, 1996	December 9, 2006	50,000	$1.45	10% on December 9, 1997, and 10% on each December 9 thereafter, with the balance of 20% vesting on the ninth anniversary

On April 28, 1995, American Gem Corporation issued $11,000,000 in bonds and 3,030,303 in common share purchase warrants ("warrants") offered in units consisting of $1,000 bonds and 276 warrants at a unit value of $1,000. The warrants are exercisable any time until April 28, 2000 at a price of $3.63 per share (Canadian).

Continued...

9. **INCOME TAXES**

Management believes that the company has substantial tax losses in both Canada and the United States that under certain circumstances may be carried forward to offset future taxable income; however, the amount, which cannot be reasonably estimated at this time, and conditions that they may be utilized is currently under review by management and their tax advisors. Any future benefit that may be realized from the utilization of these losses would not be recognized in the accounts as at March 31, 1998.

10. **COMMITMENTS AND CONTINGENCIES**

Pursuant to an agreement dated as of November 26, 1993, the Company sold a royalty interest for $262,500. The net proceeds of $223,673 (after payment of legal and other fees of $41,827) were reflected as a reduction in the carrying value of mining properties held as of November 26, 1993. The royalty is applicable to (a) sales of all minerals that are produced from any properties held at the date of the agreement by the Company or its affiliates, (b) sales of minerals that are produced from properties acquired after the date of the agreement by the Company or its affiliates, where sapphires are the primary mineral that is, has been or will be mined from the particular property, and (c) sales of all other sapphires by the Company or its affiliates. The royalty is at a rate of 3% of the aggregate of all such sales, until such time as the cumulative royalty paid equals $262,500, at which time the rate is reduced to 1.5%.

An investigation is being conducted by the United States Attorney's Office for the District of Montana ("USAO") focused on the mining claim practices of the Company and two former senior officers for the years 1994 through 1997. The practices at issue involve 2,174 unpatented mining claims for federal public lands concerning the Gem Mountain, Dry Cottonwood Creek and Eldorado Bar areas of interest that were submitted to the Bureau of Land Management by the Company and such former officers. The investigation does not involve the Company's Gem Mountain freehold properties on which the mining operations have been conducted. The USAO has questioned the validity of these claims and has stated that their submission raises issues under the False Claims Act. The USAO has not informed the Company as to how or whether it intends to proceed. Consequently, it is not possible at this time to predict the outcome of this investigation. The Company does not intend to renew the remaining 1,093 unpatented mining claims held by the Company. Accordingly, the Company has written off the carrying cost of the above claims.

A former employee of the Company has filed a claim for damages of approximately $31,000 arising from an alleged breach of contract. Management of the Company is confident it will be successful in its defense of this claim.

11. **SUBSEQUENT EVENT**

On July 15, 1998, the Board of Directors granted 3,500,000 stock options to certain directors and officers of the Company at an exercise price of $0.035 per share which expire July 15, 2008.