

PATENT ENFORCEMENT AND ROYALTIES LTD.

CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE SIX MONTHS ENDED DECEMBER 31, 2004
AND THE YEAR ENDED JUNE 30, 2004**

AUDITORS' REPORT

**To the shareholders of
Patent Enforcement and Royalties Ltd.:**

We have audited the consolidated balance sheets of Patent Enforcement and Royalties Ltd. as at December 31, 2004 and June 30, 2004 and the consolidated statements of operations, deficit and cash flows for the six month period ended December 31, 2004 and for the year ended June 30, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. These 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 December 31, 2004 and June 30, 2004 and the results of its operations and cash flows for the six month period ended December 31, 2004 and for the year ended June 30, 2004 in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario
January 29, 2005

Wasserman Ramsay

Chartered Accountants

PATENT ENFORCEMENT AND ROYALTIES LTD.

CONSOLIDATED BALANCE SHEETS (Canadian dollars)

	<u>Note</u>	December 31, 2004	June 30, <u>2004</u> (restated)
ASSETS			
Current			
Cash and cash equivalents		\$ 798,642	\$ 157,910
Accounts receivable		<u>2,653</u>	<u>1,691</u>
		801,295	159,601
Investment in Kinbauri Gold Corp.	4	32,000	167,451
Deposit on mining property	5	75,000	-
Capital assets		<u>2,046</u>	<u>2,407</u>
		<u>\$ 910,341</u>	<u>\$ 329,459</u>
LIABILITIES			
Current			
Accounts payable and accrued liabilities		\$ 109,296	\$ 63,889
Convertible debentures	7	<u>-</u>	<u>200,000</u>
		<u>109,296</u>	<u>263,889</u>
SHAREHOLDERS' EQUITY			
Common shares	8	5,040,580	4,640,580
Contributed surplus		27,607	27,607
Deficit		<u>(4,267,142)</u>	<u>(4,602,617)</u>
		<u>801,045</u>	<u>65,570</u>
		<u>\$ 910,341</u>	<u>\$ 329,459</u>

Approved by the Board:

"John Cocomile"
John Cocomile, Director

"Ian McDonald"
Ian McDonald, Director

The accompanying notes form an integral part of these consolidated financial statements

PATENT ENFORCEMENT AND ROYALTIES LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Canadian dollars)

	<u>Note</u>	Six months ended December 31, 2004	Year ended June 30, 2004 (restated)
Revenue			
Dividend income	4	\$ 651,285	\$ -
Interest income		<u>-</u>	<u>1,686</u>
		<u>651,285</u>	<u>1,686</u>
Direct costs of intellectual property lawsuits	6	<u>164</u>	<u>146,343</u>
General and administrative expenses			
Management fees	9	30,000	54,000
Interest on debentures		8,795	11,205
Office and general		54,095	42,259
Depreciation		361	1,032
Professional fees		22,749	21,461
Transfer agents fees		2,983	4,126
Investor relations		3,030	5,180
Stock-based compensation expense		-	8,600
Wages and benefits		<u>58,183</u>	<u>173,010</u>
		<u>180,196</u>	<u>320,873</u>
Net income (loss) before the following		470,925	(465,530)
Write down of investment in Kinbauri Gold Corp.	4	<u>135,450</u>	<u>-</u>
Net income (loss)		<u>\$ 335,475</u>	<u>\$ (465,530)</u>
Basic and diluted income (loss) per share		<u>\$ 0.02</u>	<u>\$ (0.02)</u>
Weighted average number of shares outstanding			
- basic and diluted		<u>19,478,672</u>	<u>18,914,738</u>

CONSOLIDATED STATEMENTS OF DEFICIT

(Canadian dollars)

	Six months ended December 31, 2004	Year ended June 30, 2004 (restated)
Balance as previously stated, beginning of period	\$ (4,602,617)	(4,118,080)
Effect of accounting change	<u>-</u>	<u>(19,007)</u>
Balance as restated, beginning of year	(4,602,617)	(4,137,087)
Net income (loss)	<u>335,475</u>	<u>(465,530)</u>
Deficit, end of period	<u>\$ (4,267,142)</u>	<u>(4,602,617)</u>

The accompanying notes form an integral part of these consolidated financial statements

PATENT ENFORCEMENT AND ROYALTIES LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Canadian dollars)

	<u>Note</u>	Six months ended December 31, 2004	Year ended June 30, 2004 (restated)
OPERATING ACTIVITIES			
Net income (loss)		\$ 335,475	\$ (465,530)
Items not requiring cash:			
Depreciation		361	1,032
Stock-based compensation expense		-	8,600
Write down of investment in Kinbauri Gold Corp.		135,450	-
Change in non-cash working capital	10	44,446	(19,535)
Cash generated by (used in) operating activities		515,732	(475,433)
INVESTING ACTIVITIES			
Deposit on mining property		(75,000)	-
Cash used in investing activities		(75,000)	-
FINANCING ACTIVITIES			
Proceeds of private placement		400,000	-
Proceeds of debenture financing		-	200,000
Proceeds on exercise of warrants		-	180,000
Repayment of debentures		(200,000)	-
Cash generated by financing activities		200,000	380,000
Change in cash and cash equivalents		640,732	(95,433)
Cash and cash equivalents, beginning of period		157,910	253,343
Cash and cash equivalents, end of period		\$ 798,642	\$ 157,910

The accompanying notes form an integral part of these consolidated financial statements

PATENT ENFORCEMENT AND ROYALTIES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 AND THE YEAR ENDED JUNE 30, 2004

1. Nature of business

The Company was in the business of acquiring interests in patents, copyrights or other intellectual properties which were being infringed for the purpose of litigating and participating in any successful judgments or settlement resulting from litigation and continuing royalties. The Company lost the Gaus/Conair case during the year ended June 30, 2004 and management decided to change the Company's business focus to mining and wind down the patent enforcement business. Management of the Company will be seeking shareholder approval to change its business to the resource sector, change its name and reorganize its board of directors at the next shareholders meeting. See also note 5.

2. Principles of consolidation

The consolidated financial statements include the accounts of Patent Enforcement and Royalties Ltd. ("PEARL") and its wholly owned subsidiary Patent Enforcement and Royalties of New Jersey, Ltd.

3. Significant accounting policies

a) Revenue recognition

Revenue from intellectual property lawsuits is recognized when the case is settled or a successful judgment is issued and collectability is reasonably assured. Revenue from judgments which are subject to appeal is recognized when the appeal has been disposed. Direct costs incurred on intellectual property lawsuits are expensed as incurred.

b) Capital assets

Capital assets, which consist of computer equipment, are carried at cost and depreciated using the declining balance method of depreciation at an annual rate of 30%.

c) Investment in Kinbauri Gold Corp.

The investment in Kinbauri Gold Corp. ("Kinbauri") is carried at estimated net realizable value (see note 4). The investment was written down in the current year to reflect a permanent decline in value.

d) Stock-based compensation plan

Effective July 1, 2004 the Company adopted the recommendations for fair value accounting of employee stock option grants under section 3870 Stock-Based Compensation of Canadian Institute of Chartered Accountants Handbook. These recommendations require compensation costs, for stock options granted to employees, be recorded in earnings based on the fair value of the options on the grant date. Previously, these costs were disclosed in the notes to the consolidated financial statements. This policy change was adopted on a retroactive basis and expenses of \$8,600 and \$19,007 were recorded in June 30, 2004 and June 30, 2003 respectively.

e) Earnings per share

Effective January 1, 2002, the Company adopted the new recommendations of the CICA Handbook section 3500, Earning per Share ("EPS"). The revised section requires the presentation of both basic and fully diluted EPS on the face of the income statement regardless of the materiality of the difference between them. In addition, the new recommendations require the use of the treasury stock method to compute the dilutive effects of options, warrants and similar instruments as opposed to the previous method used which was the imputed earnings approach. The outstanding options and warrants as disclosed in Note 8 have had no effect on the weighted average number of shares disclosed because their effect is anti-dilutive. The section also requires the disclosure of a reconciliation of the difference, if any, between basic and fully diluted EPS.

f) Cash and cash equivalents

Cash and cash equivalents include cash, and those short-term money market instruments that are readily convertible to cash with an original term of less than 91 days.

PATENT ENFORCEMENT AND ROYALTIES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 AND THE YEAR ENDED JUNE 30, 2004

g) Foreign currency translation

The Company uses the temporal method to convert foreign currency denominated transactions under which current monetary assets and current monetary liabilities in foreign funds are translated to Canadian funds at the rate of exchange applicable at the balance sheet date and revenues and expenses in foreign funds are translated to Canadian funds using the actual average rate of exchange during the year.

h) Dividend Policy

The Company previously had a dividend policy which called for the distribution to shareholders of a portion of net revenue received from any settlement or judgment of an intellectual property case. To date the Company has not paid any dividends.

Effective with the change in business focus to mining the Company has repealed the above-noted dividend policy and has no plans to pay dividends.

i) 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 amount of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results may differ from those estimates.

j) Financial instruments

The Company's financial instruments recognized in the balance sheet consists of amounts receivable and current liabilities. The fair value of these financial instruments approximate their carrying value due to the short maturity or current market rate associated with these instruments.

4. Investment in Kinbauri Gold Corp.

The Company owns 773,003 Series B convertible preferred shares. These shares are convertible into common shares under certain circumstances and will pay dividends on a sliding scale basis based on Kinbauri's cash flow to April 2005. In December 2004 dividends in the amount of \$651,285 were received.

During the current period management has determined that it was appropriate to write down the investment to \$32,000 to reflect estimated realizable value.

5. Deposit on mining property

On November 16, 2004 the Company signed an agreement with Fundamental Resources Corporation and Donald Alexander Davidson, to acquire a 100% working interest in the Yorke-Hardy molybdenum project located near Smithers, British Columbia. Under the terms of the agreement, the Company can purchase a 100% working interest in the property by paying the owners a non-refundable deposit of \$75,000 upon signing the agreement in principle, which has been paid, followed by a payment of \$950,000 within 150 days. The Company can extend this deadline by up to three months by paying the owners a penalty of \$25,000 per month. Subsequent to this, the Company will be required to make advance royalty payments to the property owners ranging between \$100,000 and \$500,000 per year, based on the world price for molybdenum. The property will also be subject to a 2.75% net smelter royalty.

Plans for a feasibility study have began subject to closing this transaction and arranging suitable financing. Completion of the transaction is subject to a number of conditions, including but not limited to Exchange acceptance and disinterested Shareholder approval. Should the transaction not close for any reason, the deposit will be written off.

PATENT ENFORCEMENT AND ROYALTIES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 AND THE YEAR ENDED JUNE 30, 2004

6. Direct costs of intellectual property lawsuits

The Company has an interest in the following intellectual property cases.

a. The Gaus/Conair Case

This case was tried in January 2002, resulting in a judgment in favour of Dr. Harry Gaus for approximately US\$46 million. Conair appealed the judgment to the Court of Appeals for the Federal Circuit. On April 1, 2004, the appeal court found in favour of Conair on the issue of infringement and overturned the judgment. A subsequent request for reconsideration and leave application to the US Supreme Court were unsuccessful. No further action is being pursued.

b. The Billings Case

The Company purchased a 10.5% carried interest in any proceeds of the litigation from a U.S. Patent issued in 1987 covering aspects of local area network technology. Litigation was stayed in 1994 pending patent re-examination proceedings. The results of the re-examination were unfavourable and a review was sought and declined in the Court of Appeal for the Federal Circuit in May 2004. No further action is anticipated.

On July 7, 1999, with respect to both lawsuits acquired from IPRC, the Company entered into an option agreement to purchase 80% of the issued and outstanding shares of IPRC for \$10. In addition, if the option is exercised the Company has committed to pay to the optionor an amount equal to the first US\$500,000 and the one-third amount IPRC would have been entitled to, if and when any proceeds are received. The option to purchase the shares expires on July 7, 2009.

c. The UFIL Unified Data Technologies Ltd. Case

The Company agreed, under the terms of a funding agreement with UFIL Unified Data Technologies Ltd. ("UDTL"), to assist in the enforcement of UDTL's U.S. Patent No. 5,684,985 covering technology that allows different forms of stored digital documents to be searched and accessed more efficiently on the internet. In return for assisting in enforcing the patent, the Company will receive 50% of any revenues, after legal cost, derived from a list currently comprised of 44 potential infringing parties.

d. The Carberry/Pordy Case

The Company entered into an agreement with Carberry Corporation and William T. Pordy M.D. ("Carberry/Pordy") to assist in the enforcement of Carberry/Pordy's patents covering a low fat, low cholesterol and low calorie dairy lightener. PEARL has signed an agreement with Dr. Pordy and Carberry Corporation entitling PEARL to receive 50% of any recovery from the lawsuit, including future licensing revenue or royalties, after legal costs in return for assisting with the enforcement of the patents.

In December 2001 in the Southern District of New York, a jury verdict was rendered in favour of Dr. William Pordy in the amount of US\$3,000,000, finding Land O'Lakes' infringement to be willful. Following the verdict, post trial motions were filed with the court. In an unusual move, the trial judge reversed the factual findings embraced in the jury verdict, and found in disregard of the jury findings and in favour of the Defendant, Land O'Lakes, Inc.

In December 2002, a notice of appeal was filed on behalf of the plaintiffs. The United States Court of Appeals rendered a decision in April 2004, affirming the district court's claim construction, reversed the effective filing date of the patent and remanded the case to the district court for a new trial limited to the issue of anticipation. Timing with respect to the processing of the balance of this litigation is unclear at this time.

PATENT ENFORCEMENT AND ROYALTIES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 AND THE YEAR ENDED JUNE 30, 2004

6. Direct costs of intellectual property lawsuits (continued)

e. The Flex-rest/Ambrose Case

The Company entered into an agreement with Flex Rest and Frederic Ambrose ("Flex Rest/Ambrose") to assist in the enforcement of Flex Rest/Ambrose's patents related to the design and positioning of ergonomic trays that mount computer keyboards to office desks. Litigation including allegations of patent infringement was brought against Steelcase Corporation, and at the trial in early 2004, there was a jury finding of non-infringement. Although an appeal was subsequently filed by Flex-rest/Ambrose, a date for the appeal has not yet been scheduled.

The Company has no further financial obligations in this litigation against Steelcase, yet retains a 15% interest in any recovery, including future licensing revenue or royalties, after legal costs.

7. Convertible debentures

On December 9, 2003 the Company issued \$200,000 in unsecured convertible debentures bearing interest at a rate of 10% per annum payable at the earlier of the conversion date and the maturity date of December 9, 2004. The debentures were convertible into common shares of the Company at the rate of one common share for each \$0.40 of principal amount of debt converted. The debentures were repaid in December 2004.

8. Common shares

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preference shares in one or more series. The directors are authorized to fix the number of preference shares and their designation, rights, privileges and conditions attached to the shares of each series. No preference shares have been issued as of December 31, 2004.

The Company has issued common shares as follows:

	<u># shares</u>	<u>\$ value</u>
At June 30, 2003	18,659,000	\$ 4,460,580
Warrants exercised	<u>600,000</u>	<u>180,000</u>
Balance June 30, 2004	19,259,000	4,640,580
Private placement	<u>4,000,000</u>	<u>400,000</u>
Balance December 31, 2004	<u>23,259,000</u>	<u>\$ 5,040,580</u>

In December 2004 the Company completed a private placement for 4,000,000 common share at \$0.10 per share for proceeds of 400,000. The common shares issued are restricted from trading until April 8, 2005.

Stock-based compensation plan

The Company has a common share purchase option plan (the "Plan") for directors, officers, and employees. Options granted under the Plan have a five-year term and vest immediately. Options are granted at a price no lower than the market price of the common shares at the time of the grant.

In determining stock-based compensation expense, the fair value of the options were estimated using the Black-Scholes option pricing model with the following weighted average assumptions used for grants as follows: dividend yield of 0%, expected volatility of 50%, risk-free interest rate of 3.5% and expected life of 36 months.

PATENT ENFORCEMENT AND ROYALTIES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 AND THE YEAR ENDED JUNE 30, 2004

8. Capital stock (continued)

A summary of the Company's options at December 31, 2004 and June 30, 2004 and the changes for the periods then ended is presented below:

	Options Outstanding	Weighted-Average Exercise price
At June 30, 2003	1,775,000	\$ 0.29
Granted	100,000	0.28
Expired	<u>(705,000)</u>	<u>0.20</u>
At June 30, 2004	1,170,000	0.29
Expired	<u>(10,000)</u>	<u>0.40</u>
At December 31, 2004	<u><u>1,160,000</u></u>	<u><u>\$ 0.29</u></u>

The following table summarizes information about the options outstanding at December 31, 2004:

Exercise Price	Options outstanding and exercisable	Remaining contractual life
\$ 0.15	380,000	1.8 years
\$ 0.28	100,000	1.8 years
\$ 0.41	<u>680,000</u>	<u>2.5 years</u>
	<u><u>1,160,000</u></u>	<u><u>2.3 years</u></u>

Share purchase warrants

A summary of the Company's warrants at December 31, 2004 and June 30, 2004 and changes for the periods then ended is presented below:

	Warrants Outstanding	Weighted-Average Exercise price
At June 30, 2003	1,225,000	\$ 0.40
Exercised	(600,000)	0.30
Expired	<u>(625,000)</u>	<u>0.50</u>
At December 31, 2004 and June 30, 2004	<u><u>-</u></u>	<u><u>\$ -</u></u>

9. Related party transactions and balances

Office administration fees of \$30,000 (June 30, 2004 - \$54,000) were incurred from a company related through common directors and management for rent and various office services. Included in accounts payable at December 31, 2004 is \$83,718 (June 30, 2004 - \$38,520) owing to this company.

Management and directors subscribed for \$280,900 of the \$400,000 private placement during the period.

PATENT ENFORCEMENT AND ROYALTIES LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 AND THE YEAR ENDED JUNE 30, 2004

10. Supplementary cash flow information

Change in non-cash working capital:

	Six months ended December 31, 2004	Year ended June 30, 2004
Accounts receivable	(962)	\$ 505
Prepaid expenses	-	1,525
Accounts payable and accrued liabilities	<u>45,408</u>	<u>(21,565)</u>
	<u>44,446</u>	<u>(19,535)</u>
 Cash paid for interest	 <u>\$ 20,000</u>	 <u>\$ -</u>

11. Income taxes

The Company has available approximately \$4,351,900 in non-capital loss carry-forwards which can be used to reduce future taxable income in Canada. The potential benefit of these losses has not been recognized in these financial statements and will expire, if unused, as follows:

2006	\$ 271,000
2007	1,443,000
2008	391,400
2009	1,056,000
2010	559,000
2011	451,500
2011	<u>180,000</u>
	<u>\$ 4,351,900</u>

The Company has future income tax assets (liabilities) on temporary deductible or taxable differences as follows:

	Six months ended December 31, 2004	Year ended June 30, 2004
Non capital losses	\$ 1,523,000	\$ 1,541,000
Investments	47,400	-
Capital assets	2,700	2,700
Less: Valuation allowance	<u>(1,573,100)</u>	<u>(1,543,700)</u>
Future income tax recognized in the financial statements	<u>\$ -</u>	<u>\$ -</u>