

RARE ELEMENT RESOURCES LTD.
(formerly Spartacus Capital Inc.)

CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended September 30, 2004 and 2003

(UNAUDITED)

Management has compiled the unaudited consolidated interim financial information of Rare Element Resources Ltd. consisting of the interim consolidated balance sheet as at September 30, 2004. This financial information has not been audited or reviewed by an accounting firm. Readers are cautioned that these statements may not be appropriate for their purposes.

**NOTICE OF NO AUDITOR REVIEW OF
INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3 (3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Targeting Rare Earths Metals

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RARE ELEMENT RESOURCES LTD.

CONSOLIDATED BALANCE SHEETS

(Expressed in US Dollars)

(Unaudited)

	<u>September 30, 2004</u>	<u>June 30, 2004</u> (Audited)
ASSETS		
CURRENT		
Cash	\$ 364,912	\$ 214,805
Accounts receivable	14,825	9,869
Prepaid expenses	34,256	9,302
	<hr/> 413,993	<hr/> 233,976
Reclamation bonds(Note 5)	10,000	-
Mineral properties and deferred exploration costs (Note 4)	241,051	167,127
	<hr/> \$ 665,044	<hr/> \$ 401,103

LIABILITIES

CURRENT		
Accounts payable and accrued liabilities	\$ 59,014	\$ 16,906
Due to related parties (Notes 8)	14,008	-
Promissory note payable (Notes 7 and 8)	-	10,000
	<hr/> 73,022	<hr/> 26,906

SHAREHOLDERS' EQUITY

SHARE CAPITAL (Note 6)	2,481,060	2,243,574
CONTRIBUTED SURPLUS (Note 6(e))	59,620	45,147
DEFICIT	(1,948,658)	(1,914,524)
	<hr/> 592,022	<hr/> 374,197
	<hr/> \$ 665,044	<hr/> \$ 401,103

APPROVED BY THE BOARD OF DIRECTORS:

"Norman W. Burmeister"

Norman W. Burmeister

"Mark T. Brown"

Mark T. Brown

See accompanying notes to financial statements

RARE ELEMENT RESOURCES LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
FOR THE THREE MONTHS ENDED SEPTEMBER 30
(Expressed in US Dollars)
(Unaudited)

	<u>2004</u>	<u>2003</u>
EXPENSES		
Audit and legal	\$ 282	\$ 4,527
Communication and delivery	-	21
Foreign exchange loss (gain)	(16,491)	1,451
Bank charges and interest	60	374
Management, accounting and secretarial	13,750	11,055
Office and miscellaneous	3,562	290
Transfer and listing fees	5,424	5,848
Investor relations	12,996	5,064
Rent	-	435
Stock based compensation	14,473	-
Interest expense	78	1,509
	<u>34,134</u>	<u>30,574</u>
NET LOSS	\$ (34,134)	\$ (30,574)
DEFICIT, BEGINNING OF PERIOD	<u>(1,914,524)</u>	<u>(1,722,051)</u>
DEFICIT, END OF PERIOD	<u>\$ (1,948,658)</u>	<u>\$ (1,752,625)</u>
LOSS PER SHARE	<u>\$ (0.00)</u>	<u>\$ (0.00)</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	<u>13,975,281</u>	<u>9,688,273</u>

See accompanying notes to financial statements

RARE ELEMENT RESOURCES LTD.

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED SEPTEMBER 30**

(Expressed in US Dollars)
(Unaudited)

	2004	2003
CASH PROVIDED BY (USED IN)		
OPERATIONS		
Net loss	\$ (34,134)	\$ (30,574)
Items not involving cash		
Stock-based compensation	14,473	-
	<u>(19,661)</u>	<u>(30,574)</u>
Changes in non-cash working capital items:		
Accounts receivable	(4,956)	114
Prepaid expenses	(24,954)	(21,435)
Accounts payable and accrued liabilities	42,108	(17,189)
Due to/from related parties	14,008	(23,547)
	<u>6,545</u>	<u>(92,631)</u>
INVESTING ACTIVITIES		
Deferred exploration costs	(73,924)	(2,600)
Reclamation bonds	(10,000)	-
	<u>(83,924)</u>	<u>(2,600)</u>
FINANCING ACTIVITIES		
Advance of promissory note	-	110,737
Promissory note payable	(10,000)	-
Cash received for common shares	237,486	67,965
	<u>227,486</u>	<u>178,702</u>
Cash acquired in capital transaction	-	218,798
INCREASE IN CASH	150,107	302,269
CASH, BEGINNING OF PERIOD	<u>214,805</u>	<u>3,324</u>
CASH, END OF PERIOD	<u>\$ 364,912</u>	<u>\$ 305,593</u>

*Supplemental disclosure of non-cash investing and financing activities:
Refer to notes 3 and 5
Interest paid during three-months ended September 30, 2004: \$1,692*

See accompanying notes to financial statements

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 and 2003
(Expressed in US Dollars)
(Unaudited)

1. NATURE OF OPERATIONS

Rare Element Resources Ltd. (“Rare Element” or “the Company”, formerly Spartacus Capital Inc., “Spartacus”) was incorporated under the laws of the Province of British Columbia on June 3, 1999.

The Company acquired all of the outstanding common shares of Paso Rico Resources Ltd. (“Paso Rico”), a British Columbia private company primarily engaged in the acquisition and exploration of mineral properties, in consideration for the issuance to the shareholders of Paso Rico of 6,977,501 common shares of the Company. On July 25, 2003 the Company changed its name to Rare Element upon the formal completion of the Qualifying Transaction (“QT”) with Paso Rico. Refer to notes 2 and 3.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation and principles of consolidation

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are inclusive of the accounts of the Company and Paso Rico, together with those of Paso Rico’s wholly-owned subsidiaries, Minera Santa Regina, S.A. de C.V. and Paso Rico (USA) Inc. These interim consolidated financial statements follow the same accounting policies and methods of their application as the annual consolidated financial statements and do not include in all respects the annual disclosure requirements of generally accepted accounting principles and should be read in conjunction with the most recent annual consolidated statements.

Reverse take-over accounting

The formal closing of the acquisition of Paso Rico occurred immediately subsequent to June 30, 2003. As the former shareholders of Paso Rico, through the share exchange, controlled the consolidated entity immediately subsequent to the completion of the QT, this transaction has been accounted for in these consolidated financial statements as a reverse takeover. Accordingly, under the principles applicable to these transactions, the QT is considered to be a capital transaction by Paso Rico, whereby Paso Rico, legally the Company’s wholly-owned subsidiary, has acquired the assets and liabilities of Spartacus and is considered to be the continuing entity for accounting purposes. Consequently, the comparative figures presented are those of Paso Rico. Refer also to note 3.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 and 2003
(Expressed in US Dollars)
(Unaudited)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

Foreign currency translation

The Company's reporting currency is the US Dollar. The Company's Canadian and Mexican operations are considered to be integrated operations with foreign currency transactions translated into US Dollars as follows:

- monetary assets and liabilities at the rates of exchange prevailing at the balance sheet dates;
- other assets and liabilities at the applicable historical exchange rates;
- revenues and expenses at the average rates of exchange for the year, and;
- gains and losses arising from the conversion of foreign currency balances and transactions are reported in income as they occur.

Use of Estimates

The preparation of these consolidated financial statements requires the use of estimates and assumptions that effect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from these estimates.

Mineral properties and deferred exploration costs

The cost of mineral properties and related exploration expenditures are deferred until the properties are placed into production, sold or abandoned. These deferred costs will be amortized over the estimated useful life of the properties following the commencement of production or written-off if the properties are sold, allowed to lapse, or abandoned.

Cost includes the cash consideration and the fair market value of shares issued for the acquisition of mineral properties. Properties acquired under option agreements are recorded in the accounts at such time as payments are made. Proceeds from options granted are applied to the cost of the related property and any excess is included in income for the year.

The recorded amounts of mineral claim acquisition costs and their related deferred exploration costs represent actual expenditures incurred and are not intended to reflect present or future values.

The Company reviews capitalized costs on its mineral properties on a periodic basis and will recognize an impairment in value based upon current exploration results and upon management's assessment of the future probability of profitable revenues from the property or from the sale of the property. Management's assessment of the property's estimated current fair market value may also be based upon a review of other property transactions that have occurred in the same geographic area as that of the property under review.

Administrative costs are expensed as incurred.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

Loss per share

The loss per share is computed using the weighted average number of shares outstanding during the period. Diluted loss per share is not presented as the effect on the basic loss per share would be anti-dilutive.

Income taxes

The Company accounts for and measures future tax assets and liabilities in accordance with the liability method where future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively-enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of the change. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the future benefit is taken and no asset is recognized. Such an allowance applies fully to all potential income tax assets of the Company.

Stock-based compensation

Effective July 1, 2002, the Company adopted the new Recommendations of the Canadian Institute of Chartered Accountants ("CICA") relating to the accounting for stock-based compensation and other stock-based payments. Under the new standard, payments to non-employees and to employees that are direct awards of stock, that call for settlement in cash or other assets, or that are stock appreciation rights which call for settlement by the issuance of equity instruments, are accounted for using the fair value method and are included in operations, with an offset to contributed surplus. During the comparative fiscal period, compensation expense in respect to options granted to employees was disclosed on a pro-forma basis only. Upon the issuance of additional CICA guidance in this area, the Company began expensing these amounts effective on July 1, 2003.

Prior to the adoption of these new standards, no compensation expense was calculated, recorded or otherwise disclosed when the Company granted stock-based incentives to individuals. A transaction was recorded only when the consideration paid by those exercising stock options was credited to shareholders' equity and the shares subject to option were issued.

These new Recommendations are applied prospectively and therefore the in adoption new standard has resulted in no changes to amounts previously reported. In connection with the recorded and disclosed amounts calculated utilizing the fair value method, the Company recognizes the expense as the options vest with the recipients.

RARE ELEMENT RESOURCES LTD.
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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

Financial instruments

The Company's financial instruments include amounts receivable, and accounts payable and accrued liabilities. The fair market values of these financial instruments approximate their carrying value due to their short-term natures.

Comparative figures

Certain of the prior period's figures have been reclassified in conformity with the current period's financial statement presentation.

3. CAPITAL TRANSACTION

As described in Note 2, these consolidated financial statements are inclusive of the completion of the QT, recorded in the period, whereby Paso Rico, the continuing entity for accounting purposes, is considered to have acquired the assets and liabilities of Spartacus in a capital transaction.

The cost of the acquisition was allocated to the net identifiable assets of Rare Element at July 1, 2003 as follows:

Cash	\$ 218,798
Other working capital	(21,753)
Deferred financing costs	22,330
Promissory note	(18,549)
Debts being settled (Notes 6(b))	(83,521)
Net assets acquired	<u>\$ 117,305</u>

4. MINERAL PROPERTIES AND DEFERRED EXPLORATION COSTS

The amounts shown represent costs incurred to date, and do not necessarily represent present or future values as they are entirely dependant upon the economic recovery of current and future ore reserves. A breakdown of carrying values by property is as follows:

	<u>September 30, 2004</u>	<u>June 30, 2004</u>
Bear Lodge Property	<u>\$ 241,051</u>	<u>\$ 167,127</u>

RARE ELEMENT RESOURCES LTD.
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4. MINERAL PROPERTIES AND DEFERRED EXPLORATION COSTS, Continued

A breakdown of the deferred expenditures is as follows:

	<u>Total</u>
Balance as at June 30, 2003	\$ 164,526
Property Costs	<u>2,601</u>
Balance as at June 30, 2004	\$ 167,127
Assessments and taxes	\$ 3,250
Drilling	48,806
Geological consulting	16,085
Staking	816
Overhead expenses	350
Travel expenses	<u>4,617</u>
	<u>73,924</u>
Balance as at September 30, 2004	<u>\$ 241,051</u>

All costs have been incurred on the Bear Lodge property.

Bear Lodge project

During March of 2000, the Company signed a Mineral Lease and Option agreement with Phelps Dodge Mining Company to explore certain unpatented lode mining claims in the Bear Lodge Mining District of Crook County, Wyoming, USA. The Company was committed to spending a minimum of \$1,750,000 over a period of five years to earn a 100% interest and the property would be subject to a net smelter royalty of 2% once the Company has earned its interest in the property. On August 27, 2002, Phelps Dodge Mining Company agreed to assign the Company the claims outright subject only to a 2% net smelter royalty. There are no further work commitments under this new arrangement.

All claims are located on federal lands and are subject to a \$125 per year annual maintenance fee payable to the United States Bureau of Land Management.

5. RECLAMATION BONDS

Under the law, the Company is required to have a reclamation deposit, which covers the cost to reclaim the ground disturbed. The Company was required to post its own security to guarantee performance under the Reclamation Bond. On July 23, 2004, the amount of \$10,000 was transferred to the Wyoming Department of Environmental Quality for the required bond covering the proposed drilling work.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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6. SHARE CAPITAL

Authorized - 100,000,000 common shares without par value

Issued and outstanding:	<u>Number of Shares</u>	<u>Amount</u>
Balance as at June 30, 2003	2,605,000 *	\$ 233,579
Elimination of the book value of the Company's share capital pursuant to the purchase of the Company by Paso Rico for accounting purposes	-	* (233,579)
Adjustment to increase in book value of the Company's share capital to that of Paso Rico, the continuing entity for accounting purposes, immediately prior to the QT	-	1,844,975
Issuance of common shares of the Company to acquire the outstanding share capital of Paso Rico	6,977,501	117,305
Shares issued in private placement for qualifying transaction (net of share issue costs of \$22,330) (Note 8(a))	1,825,589	45,635
Shares issued for debt (Notes 3 and 6(b))	375,235	83,521
Issued for cash, private placement (Note 6(c))	<u>950,000</u>	<u>152,138</u>
Balance as at June 30, 2004	12,733,325	\$ 2,243,574
Issued for cash, private placement (Note 6(d))	1,535,000	230,693
Shares issued through exercise of stock options	<u>45,000</u>	<u>6,793</u>
Balance as at September 30, 2004	<u><u>14,313,325</u></u>	<u><u>\$2,481,060</u></u>

* translated from \$348,095 CDN

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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6. SHARE CAPITAL, Continued

- (a) During fiscal 2004, the Company completed a private placement financing of 1,825,589 units at \$0.22CDN per unit, with each unit consisting of one common share and one warrant to purchase an additional common share at a price of \$0.35CDN and expire on July 22, 2005.

To June 30, 2003, \$310,000 CDN had been received by Spartacus and has been recorded within the amount of net assets acquired by the Company upon completion of the reverse take-over. Refer also to Note 3.

- (b) During May 2002, the Company reached agreements with its major related and unrelated creditors to settle an aggregate of \$83,521 (\$112,570 CDN) in debt by the issuance of 375,235 common shares. These shares were issued in July 2003.
- (c) During fiscal 2004, the Company completed two financings for a total of \$152,138 (\$200,000 CDN). The first financing was for 200,000 units at a price of \$0.25 CDN per unit. Each unit consists of one common share and one share purchase warrant which allows the holder to purchase one common share at a price of \$0.35 CDN and expire on July 26, 2005. The second financing was for 750,000 units at a price of \$0.20 CDN per unit. Each unit consists of one common share and one share purchase warrant which allows the holder to purchase one common share at a price of \$0.35 CDN and expire on July 26, 2005.
- (d) During the three months ended September 30, 2004, the Company completed a non-brokered private placement of 1,535,000 units at a price of \$0.20 CDN for gross proceeds of \$307,000 CDN. Each unit comprises one common share and one 18-month non-transferable warrant. The warrants are exercisable for one common share at a price of \$0.30 CDN per share. In connection with this private placement \$3,819 (\$5,000 CDN) of share issue costs occurred.
- (e) The fair value of options reported as compensation expense in the current period has been estimated using the Black-Scholes Option Pricing Model using the following assumptions: a risk free interest rate of 2.00% (June 30, 2004 – 2.75%), expected life of 5 years; an expected volatility of 100.74% and no expectation for the payments of dividends. Based on these variables, stock-based compensation expense of \$14,473 (June 30, 2004 – \$45,147) was recorded during the current period.

Option pricing models requires the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Changes in these assumptions can materially affect the fair value estimate and therefore it is management's view that the existing models do not necessarily provide a single reliable measure of the fair value of the Company's stock option grants.

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6. SHARE CAPITAL, Continued

Escrowed Shares

1,000,000 shares were placed in escrow in accordance with the escrow agreement dated August 25, 1999 amended on July 17, 2003. On October 22, 2003, 100,000 shares were released and on January 17, 2004, 150,000 shares were released leaving a balance of 750,000 shares held in escrow.

1,336,000 shares were placed in escrow in accordance with escrow agreements dated December 10, 2002. On August 7, 2003, 133,600 shares were released and on January 17, 2004, 200,400 shares were released leaving a balance of 1,002,000 shares held in escrow.

The total number of shares held in escrow at September 30, 2004 is 1,752,000.

Stock Options

The following table summarizes the Company's stock option activity for the period ended September 30, 2004:

	Number of Shares	Weighted Average Exercise Price (CDN\$)	Weighted Average Remaining Contractual Life
Outstanding, June 30, 2004	1,202,500	\$ 0.33	3.80
Granted	100,000	0.25	
Exercised	(45,000)	0.20	
Outstanding, September 30, 2004	1,257,500	\$ 0.33	3.78

Expiry Date	Number of Options	Exercise Price (CDN\$)
November 15, 2004	117,500*	0.20
October 31, 2008	1,040,000	0.35
August 10, 2009	100,000	0.25

* Subsequent to the three month period ended September 30, 2004, 117,500 options were exercised.

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(Expressed in US Dollars)
(Unaudited)

6. SHARE CAPITAL, Continued

Warrants

At September 30, 2004, the following warrants were outstanding:

Expiry Date	Number of Warrants	Exercise Price (CDN\$)
July 22, 2005	1,825,589	\$ 0.35
July 26, 2005	950,000	\$ 0.35
January 19, 2006	1,535,000	\$ 0.30

7. PROMISSORY NOTE PAYABLE

During fiscal 2004, the Company issued a promissory note to Pacific Opportunity Capital Ltd., a private company controlled by a director, for \$18,549 (\$25,000 CDN) due on June 25, 2005. The note bears simple interest at 10% per annum. During fiscal 2004, the Company repaid \$8,549 (\$11,500 CDN) of the promissory note. During the period ended September 30, 2004, the Company repaid of the promissory note of \$10,000 (\$13,500 CDN) and accrued interest in full.

8. RELATED PARTY TRANSACTIONS

Related party transactions not disclosed elsewhere in these statements are as follows:

During the three month ended September 30, 2004 the Company paid, or made provision for the future payment of the following amounts to related parties:

- \$13,750 (2003 - \$13,435) for rent, management, accounting and secretarial services provided by a private company controlled by one of the directors. At the end of the period the amount of \$6,399 (June 30, 2004 - \$10,000 (see Note 7)) owed to this private company;
- \$1,348 (June 30, 2004 - \$NIL) is owed to a director of the Company for administrative expenses occurred on behalf of the company; and
- \$11,460 (June 30, 2004 - \$NIL) was incurred to a director of the Company for geological consulting. On September 30, 2004 the amount of \$6,260 is outstanding.

The amounts bear no interest and are unsecured with no repayment terms.

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9. POTENTIAL ENVIRONMENTAL CONTINGENCY

The Company's mining and exploration activities are subject to various federal, provincial and state laws and regulations governing the protection of the environment. These laws and regulations are continually changing and generally becoming more restrictive. The Company conducts its operations so as to protect public health and the environment and believes its operations are materially in compliance with all applicable laws and regulations. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations. The ultimate amount of reclamation and other future site restoration costs to be incurred for existing mining interests is uncertain.
