

SOUTHERN ARC MINERALS INC.

FINANCIAL STATEMENTS

JUNE 30, 2006

**CHARTERED
ACCOUNTANTS**

MacKay LLP

1100 – 1177 West Hastings Street
Vancouver, BC V6E 4T5
Tel: (604) 687-4511
Fax: (604) 687-5805
Toll Free: 1-800-351-0426
www.MacKayLLP.ca

mackay.ca

Auditors' Report

**To the Directors of
Southern Arc Minerals Inc.**

We have audited the balance sheets of Southern Arc Minerals Inc. as at June 30, 2006 and 2005 and the statement of operations and deficit, and cash flows for the years then ended. 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 audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. 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 financial statements present fairly, in all material respects, the financial position of the company as at June 30, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**Vancouver, Canada
September 27, 2006**

***“MacKay LLP”*
Chartered Accountants**

SOUTHERN ARC MINERALS INC.
BALANCE SHEETS
AS AT JUNE 30

	2006	2005
ASSETS		
Current		
Cash and cash equivalents	\$ 2,723,873	\$ 1,013,447
Prepaid expense and deposit	19,117	-
Receivables	10,506	29,672
Due from related party (Note 7)	<u>10,880</u>	<u>-</u>
	2,764,376	1,043,119
Equipment (Note 3)	9,103	-
Resource properties (Note 4)	<u>5,382,679</u>	<u>2,683,876</u>
	<u>\$ 8,156,158</u>	<u>\$ 3,726,995</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	<u>\$ 261,979</u>	<u>\$ 225,640</u>
Shareholders' equity		
Capital stock (Note 5)	8,813,046	3,703,212
Contributed surplus (Note 5)	1,546,833	379,461
Deficit	<u>(2,465,700)</u>	<u>(581,318)</u>
	<u>7,894,179</u>	<u>3,501,355</u>
	<u>\$ 8,156,158</u>	<u>\$ 3,726,995</u>

Nature and continuance of operations (Note 1)

Commitments (Notes 4, 5 and 10)

On behalf of the Board:

_____ Director _____ Director

The accompanying notes are an integral part of these financial statements.

SOUTHERN ARC MINERALS INC.
STATEMENTS OF OPERATIONS AND DEFICIT

	Year Ended June 30, 2006	Period From Incorporation on August 19, 2004 to June 30, 2005
EXPENSES		
Amortization	\$ 1,011	\$ -
Consulting fees	226,193	117,400
Interest and financing fees	-	71,620
Investor relations	44,602	-
Office and miscellaneous	84,072	61,864
Professional fees	138,518	94,292
Property investigation costs	5,800	12,418
Rent	32,935	17,500
Stock-based compensation (Note 5)	1,263,238	187,205
Transfer agent and filing fees	32,994	-
Travel	<u>54,816</u>	<u>19,019</u>
Loss before other items	(1,884,179)	(581,318)
OTHER ITEMS		
Interest income	23,594	-
Mineral property written-off (Note 4)	<u>(23,797)</u>	<u>-</u>
	<u>(203)</u>	<u>-</u>
Loss for the period	(1,884,382)	(581,318)
Deficit, beginning of period	<u>(581,318)</u>	<u>-</u>
Deficit, end of period	<u>\$ (2,465,700)</u>	<u>\$ (581,318)</u>
Basic and diluted loss per share	<u>\$ (0.05)</u>	<u>\$ (0.03)</u>
Weighted average number of shares outstanding	<u>39,086,443</u>	<u>14,850,160</u>

The accompanying notes are an integral part of these financial statements.

SOUTHERN ARC MINERALS INC.
STATEMENTS OF CASH FLOWS

	Year Ended June 30, 2006	Period From Incorporation on August 19, 2004 to June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss for the period	\$ (1,884,382)	\$ (581,318)
Items not affecting cash:		
Stock-based compensation	1,263,238	187,205
Amortization	1,011	-
Stock-based financing fees	-	67,456
Mineral property written-off	23,797	-
Changes in non-cash working capital items:		
Advance to related party	(10,880)	-
(Increase) decrease in receivables	19,166	(29,672)
Increase in prepaid expense and deposit	(19,117)	-
Increase (decrease) in accounts payable and accrued liabilities	(39,475)	59,006
Net cash used in operating activities	(646,642)	(297,323)
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to resource properties	(2,646,786)	(1,529,742)
Acquisition of equipment	(10,114)	-
Net cash used in investing activities	(2,656,900)	(1,529,742)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of shares	5,330,000	3,200,001
Share issue costs	(316,032)	(359,489)
Net cash provided by financing activities	5,013,968	2,840,512
Change in cash during period	1,710,426	1,013,447
Cash and cash equivalents, beginning of period	1,013,447	-
Cash and cash equivalents, end of period	\$ 2,723,873	\$ 1,013,447
Cash paid for interest	\$ -	\$ 4,164
Cash paid for income taxes	\$ -	\$ -
Cash and cash equivalents consist of:		
Cash on hand	\$ 2,109,134	\$ 1,013,447
Term deposits	614,739	-
	<u>\$ 2,723,873</u>	<u>\$ 1,013,447</u>

Supplemental disclosure with respect to cash flows (Note 6)

The accompanying notes are an integral part of these financial statements.

1. NATURE AND CONTINUANCE OF OPERATIONS

The Company was incorporated in British Columbia on August 19, 2004. To date, the Company has not generated significant revenues from operations and is considered to be in the exploration stage.

The Company completed an Initial Public Offering ("IPO") on June 2, 2005 and its common shares commenced trading on the TSX Venture Exchange ("TSX-V") on June 30, 2005.

The Company is in the process of exploring and developing its mineral properties and has not yet determined whether the properties contain ore reserves that are economically recoverable. The recoverability of the amounts shown for mineral properties and related deferred exploration costs are dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves and upon future profitable production.

These financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to commence profitable operations in the future.

2. SIGNIFICANT ACCOUNTING POLICIES

Cash and equivalents

Cash and equivalents include cash on deposit and term investments that are cashable.

Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates.

Equipment

Telephone equipment is recorded at cost and is being amortized using the declining balance method at 20% per year.

Resource properties

All costs related to the acquisition, exploration and development of mineral properties are capitalized by property. If economically recoverable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the unit of production method. When a property is abandoned, all related costs are written off to operations. If, after management review, it is determined that the carrying amount of a mineral property is impaired, that property is written down to its estimated net realizable value. A mineral property is reviewed for impairment annually and whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The recovery of recorded costs is subject to measurement uncertainty, and it is reasonably possible that changes in future conditions in the near term could require a material change in the recorded amount.

The amounts shown for mineral properties do not necessarily represent present or future values. Their recoverability is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete the development, and future profitable production or proceeds from the disposition thereof.

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Joint interests

A portion of the Company's exploration and development activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

Asset retirement obligation

The Company records a liability at its fair value for the obligation associated with the retirement of a tangible long-lived asset. A corresponding asset retirement cost would be added to the carrying amount of the related asset and amortized to expense over the useful life of the asset. The Company has determined that there are no asset retirement obligations at June 30, 2006.

Future income taxes

Future income taxes are recorded using the asset and liability method. Under the asset and liability method, future 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 when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

Foreign currency translation

Transactions denominated in foreign currencies are translated into Canadian dollars at exchange rates in effect at the related transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Exchange gains and losses arising on translation are included in the results of operations.

Stock-based compensation

The Company accounts for its stock-based compensation programs using the fair value method. Under this method, compensation expense related to these programs is recorded in the statement of operations over the vesting period.

Loss per share

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the period. For the periods presented, this calculation proved to be anti-dilutive.

Basic loss per share is calculated using the weighted-average number of common shares outstanding during the period.

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Share issue costs

Share issue costs incurred on the issue of the Company's shares are charged directly to share capital.

3. EQUIPMENT

	June 30, 2006			June 30, 2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telephone equipment	\$ 10,114	\$ 1,011	\$ 9,103	\$ -	\$ -	\$ -

4. RESOURCE PROPERTIES

June 30, 2006	Lombok Property Indonesia	Sumbawa Property Indonesia	Flores Property Indonesia	Other Property Indonesia	Total
Acquisition costs					
Balance, beginning of year	\$1,025,852	\$ 439,651	\$ -	\$ -	\$1,465,503
Additions	25,402	10,886	17,941	23,797	78,026
Written-off during the year	-	-	-	(23,797)	(23,797)
Balance, end of year	<u>1,051,254</u>	<u>450,537</u>	<u>17,941</u>	<u>-</u>	<u>1,519,732</u>
Deferred exploration costs					
Incurred during the year:					
Assaying, testing, surveying and analysis	101,597	185,769	2,551	-	289,917
Camp construction, supplies and accommodation	348,939	486,394	10,014	-	845,347
Geological and other consulting	389,455	443,412	11,564	-	844,431
Drilling	17,699	624,329	-	-	642,028
Travel	<u>9,756</u>	<u>12,357</u>	<u>738</u>	<u>-</u>	<u>22,851</u>
Total deferred exploration costs	867,446	1,752,261	24,867	-	2,644,574
Balance, beginning of year	<u>670,425</u>	<u>547,948</u>	<u>-</u>	<u>-</u>	<u>1,218,373</u>
Balance, end of year	<u>1,537,871</u>	<u>2,300,209</u>	<u>24,867</u>	<u>-</u>	<u>3,862,947</u>
Total resource property costs	<u>\$2,589,125</u>	<u>\$2,750,746</u>	<u>\$ 42,808</u>	<u>\$ -</u>	<u>\$5,382,679</u>

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

4. RESOURCE PROPERTIES (cont'd...)

June 30, 2005	Lombok Property, Indonesia	Sumbawa Property, Indonesia	Total
Acquisition costs			
Balance, August 19, 2004	\$ -	\$ -	\$ -
Additions	<u>1,025,852</u>	<u>439,651</u>	<u>1,465,503</u>
Balance, end of period	<u>1,025,852</u>	<u>439,651</u>	<u>1,465,503</u>
Deferred exploration costs			
Incurred during the year:			
Assaying, testing and analysis	103,758	39,374	143,132
Camp construction, supplies and accommodation	215,448	191,659	407,107
Geological and other consulting	227,426	200,646	428,072
Drilling	58,216	88,879	147,095
Geophysical survey	60,642	25,990	86,632
Travel	<u>4,935</u>	<u>1,400</u>	<u>6,335</u>
Total deferred exploration costs	670,425	547,948	1,218,373
Balance, August 19, 2004	<u>-</u>	<u>-</u>	<u>-</u>
Balance, end of period	<u>670,425</u>	<u>547,948</u>	<u>1,218,373</u>
Total resource property costs	<u>\$ 1,696,277</u>	<u>\$ 987,599</u>	<u>\$ 2,683,876</u>

Title to resource properties involves certain inherent risks due to the difficulties of determining the validity of certain mineral property interests as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its resource property interests and, to the best of its knowledge, title to all of its resource property interests are in good standing.

Lombok and Sumbawa Properties, Indonesia

The Company entered into an agreement with Sunda Mining Corporation (“Sunda”) pursuant to which Sunda assigned its option to acquire certain rights on the Lombok property (“Lombok”) and the Sumbawa property (“Sumbawa”)(collectively the “Properties”) to the Company, which Sunda had obtained from Indotan Inc. (Indotan). In consideration for the assignment, the Company paid \$81,572 and issued 11,500,000 common shares valued at \$862,500 to Sunda. Effective February 25, 2005, the Company and Indotan entered into a settlement agreement with respect to certain outstanding matters related to the Properties. Pursuant to this settlement, the Company and Indotan entered into an amended and restated option agreement (the “Option Agreement”) which sets out all of the rights and responsibilities of the Company and Indotan with respect to the Properties.

4. **RESOURCE PROPERTIES** (cont'd...)

Lombok and Sumbawa Properties, Indonesia (cont'd...)

Pursuant to the Option Agreement, the Company has the option, directly with Indotan, to acquire all of its rights to the Properties in consideration for which the Company issued 1,000,000 common shares, valued at \$125,000, and paid \$180,000. The Company now has an option, until February, 2010 to acquire 50% of Indotan's 1% net smelter returns royalty ("NSR") on the Properties in consideration for the payment of \$500,000. Concurrently with the signing of the Option Agreement, the Company received an option to acquire the remaining 50% of the 1% NSR, held by Indotan, on the Properties in consideration for \$60,000 (paid) and \$500,000, which can be paid prior to the expiry of the option in February, 2010. All of the holders of the NSR agreed that the NSR only applies to the Properties as at July 21, 2004 and not to any additional property interests which the Company acquires after that date. In accordance with the terms of the Option Agreement, the Company filed a listing application with the TSX-V and filed a prospectus for a public offering which has been completed.

In accordance with a limited power of attorney granted by Indotan pursuant to the Option Agreement, the Company caused Indotan to enter into two joint venture agreements (the "JV Agreements") with Indotan's Indonesian partner, PT Puri Permata Mega ("PTPM"), on the Properties. The Company has an initial 90% interest in the Lombok joint venture (the "Lombok JV") and the Sumbawa joint venture (the "Sumbawa JV"). At any time after a joint venture company is formed with respect to the Lombok JV and that company enters into a Contract of Work ("COW"), the Company can acquire a further 5% interest in the Lombok JV by providing funds to the Lombok JV in the amount of US\$700,000. At any time after a joint venture company is formed with respect to the Sumbawa JV and that company enters into a COW, the Company can acquire a further 5% interest in the Sumbawa JV by providing funds to the Sumbawa JV in the amount of US\$300,000. The Company has funded the respective amounts to each of the Lombok JV and Sumbawa JV.

Lombok and Sumbawa are currently comprised of two separate applications to the Indonesian Government for a COW to conduct mining activities and earn mineral rights to certain mineral tenements. Upon the approval in principle of the COW, preliminary general survey licenses ("SIPPs") were granted for the properties. The SIPP permits the Company to conduct preliminary general survey work over the COW application areas. The Sumbawa SIPP was granted on January 2, 2004 for an initial 12 month period. On April 19, 2005, an extension and expansion of the Sumbawa Property SIPP was granted until April 19, 2006 and on April 22, 2006, an extension was granted until April 22, 2007. The Lombok SIPP was granted on December 4, 2002. On July 15, 2005, an extension and expansion of the Lombok Property SIPP was granted until February 15, 2006. A 12 month extension on the Lombok SIPP has been filed. The granting of a SIPP is not a guarantee that a COW will be entered into.

The Company entered into an agreement with PT Newmont Nusa Tenggara ("NNT") regarding a property ("*Block 1*") which is contiguous with the western boundary of the Company's current Lombok Island SIPP license. The acquisition was completed through a relinquishment by NNT of *Block 1* area. The terms of the agreement include granting NNT a 2% net smelter return ("NSR") on any mineral production from the area covered by *Block 1* together with a right of first refusal should the Company wish to introduce a new partner into any development within the area originally covered by *Block 1*.

Flores Property, Indonesia

The Company has been granted four new exploration licenses over part of West Flores Island through its locally controlled Indonesian entity. The licenses were granted for Bolol on September 8, 2005, Longo on October 4, 2005, Tebedo and Dalong on August 1, 2005. The licenses were granted for twelve months and can be extended for a further twelve months.

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

4. RESOURCE PROPERTIES (cont'd...)

Other Property, Indonesia

On September 7, 2005, the Company entered into an arms-length letter agreement pursuant to which it could acquire a 75% interest in an Indonesian mineral property (the "Property").

During the year ended June 30, 2006, the Company abandoned the agreement and has written-off \$23,797 of mineral property assets to operations.

5. CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Number of Shares	Capital Stock	Contributed Surplus
Authorized			
Unlimited common shares without par value			
Issued			
Balance as at August 19, 2004	\$ -	\$ -	\$ -
Issued for cash	22,000,001	3,200,001	-
Issued for resource properties	12,500,000	987,500	-
Agent shares	100,000	25,000	-
Stock-based financing fees	-	-	67,456
Stock-based compensation	-	-	187,205
Share issuance costs	-	(384,489)	-
Agent warrants	-	(124,800)	124,800
Balance as at June 30, 2005	34,600,001	3,703,212	379,461
Issued for cash	8,242,883	4,430,000	-
Exercise of warrants	1,600,000	524,800	(124,800)
Exercise of options	2,000,000	557,800	(57,800)
Stock-based compensation	-	-	1,263,238
Share issuance costs	-	(316,032)	-
Agent warrants	-	(86,734)	86,734
Balance as at June 30, 2006	46,442,884	\$ 8,813,046	\$ 1,546,833

5. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

The Company had 9,191,125 shares in escrow at June 30, 2006.

During the year ended June 30, 2006, the Company:

- a) issued 1,600,000 common shares at \$0.25 per share for total proceeds of \$400,000 pursuant to the exercise of agent option warrants previously granted.
- b) completed a private placement of 4,000,000 units at \$0.35 per unit. Each unit consists of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at \$0.50 for a period of two years. Share issue costs of \$18,323 were paid in connection with the private placement.
- c) re-priced 228,500 units included in the private placement pursuant to TSX-V terms. These units, originally issued at \$0.35, were adjusted to 142,812 units at \$0.56. Each re-priced unit consists of one common share and one-half of one common share purchase warrant, where one whole warrant entitles the holder to acquire one additional common share at \$0.66 for a period of two years. The total proceeds from the private placement were unchanged by the adjustment.
- d) completed a private placement of 4,328,571 units at \$0.70 per unit. Each unit consists of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to acquire one additional common share at \$1.00 for a period of two years. The agent received a cash commission of \$152,250, and warrants to acquire 290,000 common shares, exercisable at \$0.70 per share until March 24, 2008. In addition to the commission, share issuance costs of \$145,459 were paid in connection with the private placement.
- e) issued 2,000,000 common shares at \$0.25 pursuant to the exercise of options previously granted, of which 1,750,000 were issued to related parties.

During the period from incorporation on August 19, 2004 to June 30, 2005, the Company:

- a) issued 9,000,001 common shares at \$0.075 per share for proceeds of \$675,001.
- b) issued 12,500,000 common shares for the acquisition of resource properties (Note 4).
- c) issued 2,000,000 common shares at \$0.075 per share and 3,000,000 common shares at \$0.125 per share for total proceeds of \$525,000 as seed capital financing.
- d) completed an IPO of 8,000,000 common shares at \$0.25 per share for gross proceeds of \$2,000,000. The agent received a cash commission of \$160,000, and warrants to acquire 1,600,000 common shares, exercisable at \$0.25 per share until June 28, 2006. The agent also received 100,000 common shares valued at \$25,000 as a corporate finance fee.

The Company incurred additional share issue costs totalling \$199,489.

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

5. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

Stock options

The Company has a rolling stock option plan whereby, from time to time, at the discretion of the Board of Directors, stock options are granted to directors, officers and certain consultants. The number of shares reserved for issuance under the plan shall not exceed 10% of the issued and outstanding common shares of the Company. The exercise price of each option is based on the market price of the Company's common stock at the date of the grant less an applicable discount. The options can be granted for a maximum term of 5 years and may be subject to vesting provisions.

The Company has granted directors, officers and consultants stock options to purchase common shares. A summary of the stock options granted is presented below.

	Number of Options	Weighted Average Exercise Price
Outstanding, August 19, 2004	-	\$ -
Granted	<u>3,400,000</u>	0.25
Outstanding, June 30, 2005	3,400,000	0.25
Granted (weighted average fair value, \$0.31)	75,000	0.35
Granted (weighted average fair value, \$0.48)	2,275,000	0.56
Granted (weighted average fair value, \$0.45)	475,000	0.70
Exercised	<u>(2,000,000)</u>	0.25
Outstanding, June 30, 2006	<u>4,225,000</u>	\$ 0.47
Number of options currently exercisable	<u>3,787,500</u>	\$ 0.44

During the year ended June 30, 2006, the Company reported stock-based compensation of \$1,263,238 as a result of:

- a) 100,000 options granted June 29, 2005, vesting as to 50,000 on June 30, 2006 and 50,000 on June 30, 2007.
- b) 75,000 options granted on October 12, 2005, vesting as to 25,000 on December 12, 2005, 25,000 on February 12, 2006, 12,500 on July 12, 2006 and 12,500 on October 12, 2006.
- c) 2,275,000 options granted on January 13, 2006 with 250,000 subject to vesting provisions of one quarter vesting every three months.
- d) 475,000 options granted on April 13, 2006 with 125,000 subject to vesting provisions of one quarter vesting every three months.

The fair value of compensatory options granted is estimated on the grant date using the Black-Scholes option pricing model.

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

5. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

Warrants

The Company granted warrants to purchase common shares. A summary of warrants granted is presented below:

	Number of Warrants	Weighted Average Exercise Price
Outstanding, August 19, 2004	-	\$ -
Granted	<u>2,880,000</u>	0.19
Outstanding, June 30, 2005	2,880,000	0.19
Granted	4,411,442	0.76
Exercised	<u>(1,600,000)</u>	0.25
Outstanding, June 30, 2006	5,691,442	\$ 0.62

During the period from incorporation on August 19, 2004 to June 30, 2005, the Company, the Company granted option warrants as consideration for financing fees, to acquire 1,280,000 common shares exercisable at \$0.125, expiring April 15, 2007, valued at \$67,456 using the Black-Scholes option pricing model.

Share purchase options and warrants

At June 30, 2006, the Company had share purchase options and warrants outstanding enabling holders to acquire common shares as follows:

	Number of Shares	Exercise Price	Expiry Date
Options	1,400,000	\$ 0.25	June 30, 2010
	75,000	0.35	October 12, 2010
	2,275,000	0.56	January 13, 2011
	475,000	0.70	April 13, 2011
Warrants	1,280,000	0.125	April 15, 2007
	1,885,750	0.50	December 28, 2007
	71,406	0.56	December 28, 2007
	2,164,286	1.00	March 24, 2008
	290,000	0.70	March 24, 2008

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

5. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

The weighted average assumptions used for the Black Scholes valuation of stock options and agent's warrants granted were as follows:

	2006 Agent Warrants	2006 Stock Options	2005 Agent Warrants	2005 Stock Options
Expected dividend yield	0.00%	0.00%	0.0%	0.0%
Expected volatility	75%	76%	75%	75%
Risk-free interest rate	3.91%	3.95	3.15%	3.44%
Expected term in years	2 years	5 years	1.4 years	5 years

6. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Significant non-cash transactions during the period ended June 30, 2006 included:

- a) issuance of warrants, valued at \$86,734, as a consideration for financing fees.
- b) mineral property costs of \$242,448 included in accounts payable.

Significant non-cash transactions during the period ended June 30, 2005 included:

- a) issuance of 12,500,000 common shares, valued at \$987,500, for the acquisition of resource properties.
- b) issuance of agents shares and warrants valued at a total of \$149,800.
- c) issuance of warrants, valued at \$67,456, as a consideration for financing fees.

7. RELATED PARTY TRANSACTIONS

The Company entered into transactions with related parties as follows:

- a) Paid or accrued \$109,500 (period from incorporation on August 19, 2004 to June 30, 2005 - \$98,000) for consulting fees to a company controlled by a director of the Company.
- b) Paid or accrued \$7,500 (period from incorporation on August 13, 2004 to June 30, 2005 - \$NIL) for administration fees, in office expense, to a company controlled by a director of the Company.
- b) Paid or accrued \$158,768 (period from incorporation on August 19, 2004 to June 30, 2005 - \$117,278) for geological consulting fees included in resource properties to an officer of the Company and a company controlled by an officer of the Company.

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

7. RELATED PARTY TRANSACTIONS (cont'd...)

- d) Paid or accrued \$70,100 (period from incorporation on August 19, 2004 to June 30, 2005 - \$49,390) for professional fees to a firm in which an officer is a partner.

- e) Accounts payable includes \$7,500 (period from incorporation on August 19, 2004 to June 30, 2005 - \$18,190) for professional fees owing to a firm in which an officer is a partner.

These transactions were in the normal course of operations and were measured at the exchange value, which represented the amount of consideration established and agreed to by the related parties.

The amounts due from related parties are as follows:

	2006	2005
Due from director and officer	\$ 10,880	\$ -

The fair value of the amounts due to or from related parties is not determinable as they have no fixed terms of repayment, do not bear interest and are unsecured.

8. INCOME TAXES

A reconciliation of income taxes at statutory rates with reported taxes is as follows:

	Year Ended June 30, 2006	Period From Incorporation on August 19, 2004 to June 30, 2005
Loss before income tax recovery	\$ (1,884,382)	\$ (581,318)
Expected income tax recovery	\$ 699,483	\$ 200,255
Item not deductible for income tax purposes	(531,519)	(86,890)
Share issuance costs	58,446	22,715
Financing costs	4,570	3,637
Unrecognized benefit of non-capital losses	(230,980)	(139,717)
Total income taxes	\$ -	\$ -

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

8. INCOME TAXES (cont'd...)

The significant components of the Company's future income tax assets are as follows:

	June 30, 2006	June 30, 2005
Future income tax assets:		
Non-capital loss carry forwards	\$ 318,103	\$ 137,808
Share issuance costs	98,554	108,473
Financing costs	15,778	17,366
Cumulative exploration expenses	51,593	-
Equipment	<u>313</u>	<u>-</u>
	484,341	263,647
Valuation allowance	<u>(484,341)</u>	<u>(263,647)</u>
Net future income tax assets	<u>\$ -</u>	<u>\$ -</u>

The Company has available for deduction against future years' taxable income non-capital losses of approximately \$1,026,000. Unless utilized, these losses will expire through 2016. Future tax benefits, which may arise as a result of these losses and resource expenditures, have not been recognized in these financial statements and have been offset by a valuation allowance.

9. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, deposit, receivables, due from related party, and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values unless otherwise noted.

Currency risk

The Company's largest non-monetary assets are its resource interests in Indonesia. The Company could accordingly be at risk for foreign currency fluctuations and developing legal and political environments.

The Company does not maintain significant cash or monetary assets or liabilities in Indonesia.

10. COMMITMENT

The Company has committed to rent office space for the following annual amounts:

2007	\$31,300
2008	9,100

SOUTHERN ARC MINERALS INC.
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

11. SEGMENTED INFORMATION

The Company operates in one industry segment, being the exploration of resource properties. Geographic information is as follows:

	2006	2005
Income (loss) for the period		
Canada	\$ (1,884,382)	\$ (581,318)
Resource properties:		
Indonesia	\$ 5,382,679	\$ 2,683,876