

**SOUTHERN ARC MINERALS INC.**  
**FORM 51-102F1**  
**MANAGEMENT DISCUSSION AND ANALYSIS**  
**SIX MONTH PERIOD ENDED JUNE 30, 2005**

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The following discussion is management's assessment and analysis of the results and financial condition of Southern Arc Minerals Inc. (the "Company") and should be read in conjunction with the accompanying audited financial statements for the six month period ended June 30, 2005 and related notes. The preparation of financial data is in accordance with Canadian generally accepted accounting principles and all figures are reported in Canadian dollars unless otherwise indicated.

Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com), including the Company's prospectus dated June 2, 2005 which was filed in connection with its Initial Public Offering ("IPO").

### **Description of Business**

The Company was incorporated under the provisions of the Company Act of British Columbia on August 19, 2004. During the six month period ended June 30, 2005, the Company completed an IPO and commenced trading on the TSX Venture Exchange.

The Company's business activities include the acquisition, exploration and development of resource properties in Indonesia. To date, the company has not generated significant revenues from operations and is considered to be in the development stage.

### **Forward Looking Statements**

Certain information included in this discussion may constitute forward-looking statements. Forward looking statements are based on current expectations and entail various risks and uncertainties. These risks and uncertainties could cause or contribute to actual results that are materially different from those expressed or implied.

### **Industry**

The Company is engaged in the acquisition and exploration of mineral properties, an inherently risky business, and there is no assurance that an economic mineral deposit will ever be discovered and subsequently put into production. Most exploration projects do not result in the discovery of commercially mineable deposits. The geological focus of the Company is on areas in which the geological setting is well understood by management.

## **SOUTHERN ARC MINERALS INC.**

### **Trends**

In recent years, the mineral exploration industry had been through a very difficult period, with low prices for both precious and base metals. Lack of interest led to low market capitalizations and large companies found it was easier to grow by purchasing companies or mines than to explore for them. This led to downsizing of large company exploration staffs and many professionals took early retirement or left the industry to pursue other careers. As a result of these trends, there were limited mining projects in the pipeline and a shortage of experienced explorationists. With improving metal prices and increasing demand, especially from Asia, there is a discernible need for development of exploration projects. Junior companies, like the Company, are a key participant in identifying properties of merit to explore and develop.

### **Risks and Uncertainties**

The Company is subject to a number of risk factors due to the nature of the mining business in which it is engaged, not least adverse movements in commodity prices, which are impossible to forecast. The Company seeks to counter this risk as far as possible by selecting exploration areas on the basis of their recognized geological potential to host economic deposits.

### **Gold and Metal Prices**

The price of gold is affected by numerous factors beyond the control of the Company including central bank sales, producer hedging activities, the relative exchange rate of the U.S. dollar with other major currencies, demand, political and economic conditions and production levels. In addition, the price of gold has been volatile over short periods of time due to speculative activities. The price of other metals and mineral products that the Company may explore for all have the same or similar price risk factors.

### **Resource Properties**

The Company's accounting policy is to record its resource properties at cost. Exploration and development expenditures relating to resource properties are deferred until either the properties are brought into production, at which time they are amortized on a unit of production basis, or until the properties are sold or abandoned, at which time the deferred costs are written off.

#### **Lombok and Sumbawa Properties**

Pursuant to an amended and restated Option Agreement, the Company holds an option to acquire all of Indotan Inc.'s 90% interest in each foreign direct investment company formed to enter into a Contract of Work ("COW") with respect to the Sumbawa Property or the Lombok Property. Pursuant to the JV Agreements, the Company can acquire up to a 95% interest in the Sumbawa joint venture or the Lombok joint venture. The Company's objective is to explore and develop the Sumbawa Property and the Lombok Property, along with any other property which the Company acquires, with a view to commencing commercial mining operations.

Refer to Note 3 to the June 30, 2005 financial statements for details of resource property expenditures.

## **SOUTHERN ARC MINERALS INC.**

### **Financing**

During the period from incorporation on August 19, 2004 to December 31, 2004, the Company issued 9,000,001 common shares at \$0.075 per share for proceeds of \$675,001 as seed capital financing.

During the six month period ended June 30, 2005, the Company:

- a) issued 12,500,000 common shares for the acquisition of resource properties.
- b) 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.
- c) 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 30, 2006. The agent also received 100,000 common shares value at \$25,000 as a corporate finance fee. The Company incurred additional share issue costs totalling \$199,489, \$86,301 of which was incurred at December 31, 2004.

The Company has not paid any dividends on its common shares. The Company has no present intention of paying dividends on its common shares, as it anticipates that all available funds will be invested to finance the growth of its business.

### **Results of Operations**

During the six month period ended June 30, 2005, the Company incurred a loss of \$479,791, compared to a loss of \$101,527 for the period from incorporation on August 19, 2004 to December 31, 2004, as a result of incurring various general and administrative expenses. The general and administrative expenses primarily consisted of consulting fees of \$71,200 (December 31, 2004 - \$46,200) and professional fees of \$70,876 (December 31, 2004 - \$23,416) for corporate oversight, administration and stewardship. Included in consulting fees was \$48,000 (December 31, 2004 - \$40,000) paid or accrued to a director of the Company. Included in professional fees was \$43,390 (December 31, 2004 - \$6,000) paid or accrued to a firm in which an officer is a partner. The remaining consulting and professional fees were incurred for a variety of administrative and accounting services and for general corporate counsel. Interest of \$4,164 and stock-based financing fees of \$67,456, related to the issuance of warrants, (December 31, 2004 - \$Nil), were incurred with respect to a \$400,000 loan, bearing interest at 5% per annum. The company also recognized stock-based compensation of \$187,205 (December 31, 2004 - \$Nil) in the statement of operations as a result of issuing incentive stock options.

## SOUTHERN ARC MINERALS INC.

### Summary of Results

	June 30, 2005	December 31, 2004
Total assets	\$ 3,726,995	\$ 659,394
Mineral properties and deferred costs	2,683,876	429,386
Working capital	817,479	57,787
Accumulated deficit	(581,318)	(101,527)
Net Loss	(479,791)	(101,527)
Basic and diluted earnings (loss) per share	(0.02)	(0.01)

### Liquidity

The Company has financed its operations to date primarily through the issuance of common shares.

The audited 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.

Net cash used in operating activities for the six month period ended June 30, 2005 was \$108,121 compared to net cash used of \$22,568 during the period from incorporation on August 19, 2004 to December 31, 2004. The cash used in operating activities for the periods consists primarily of the operating loss from the general and administrative expenditures and a change in non-cash working capital items.

Net cash used in investing activities for the six month period ended June 30, 2005 was \$1,266,990 compared to cash used of \$429,386 during the period from incorporation on August 19, 2004 to December 31, 2004. The cash used in investing activities for the periods consists entirely of the acquisition of resource properties.

Net cash provided by financing activities for the six month period ended June 30, 2005 was \$2,251,812 compared to \$588,700 during the period from incorporation on August 19, 2004 to December 31, 2004. The cash provided by financing activities consists of the issuance of common shares net of share issuance costs.

### Investor Relations

The Company has scheduled its annual general meeting for November 25, 2005. The Company has recently engaged one investor relations consultant and is in the process of engaging a second consultant in order to raise its profile with the investment community.

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### **Related Party Transactions**

During the six month period ended June 30, 2005, the Company entered into transactions with related parties as follows:

- a) Paid or accrued \$48,000 (period from incorporation on August 19, 2004 to December 31, 2004 - \$40,000) for consulting fees to a director of the Company.
- b) Paid or accrued \$43,390 (period from incorporation on August 19, 2004 to December 31, 2004 - \$6,000) for professional fees to a firm in which an officer is a partner.
- c) Paid or accrued \$58,652 (period from incorporation on August 19, 2004 to December 31, 2004 - \$58,626) in geological consulting fees included in resource properties to a Company controlled by an officer of the Company.

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.

### **Financial Instruments**

The carrying value of cash, receivables and accounts payable and accrued liabilities approximate fair value because of the short maturity of those instruments. It is management's opinion that the Company is not exposed to significant interest or credit risk arising from these financial instruments.

The Company's largest non-monetary assets are its mineral 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.

### **Commitment**

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

2006	\$ 34,000
2007	11,500

### **Off-balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

## **SOUTHERN ARC MINERALS INC.**

### **Critical Accounting Policies and Estimates**

A detailed summary of all the Company's significant accounting policies is included in Note 2 to the annual financial statements for the period ended June 30, 2005.

#### Stock-based compensation

The Company uses the Black-Scholes Option Pricing Model in determining the fair value of options granted for stock-based compensation. Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective price assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options granted/vested during the year.

#### **Subsequent Event**

On September 7, 2005, the Company entered into an arms-length letter agreement pursuant to which it can acquire a 75% interest in an Indonesian mineral property (the "Property") by paying \$25,000 and:

Upon execution of a formal agreement:

- Paying US\$100,000
- Issuing 100,000 common shares; and
- Paying US\$6,000 per month, increasing after one year to US\$10,000 per month.

Upon completion of the first 3,000 metres of drilling on the Property:

- Paying US\$200,000;
- Issuing 200,000 common shares; and

Upon commencement of commercial production:

- Paying US\$3,000,000 less previous advances.

## **SOUTHERN ARC MINERALS INC.**

### **Current Share Data**

As at October 21, 2005, the company has 34,773,276 common shares issued and outstanding and has the following stock options and warrants outstanding:

	Number of Shares	Exercise Price	Expiry Date
<b>Stock options</b>	3,400,000	\$ 0.25	June 30, 2010
<b>Agent option warrants</b>	1,426,725	\$ 0.25	June 30, 2006
<b>Warrants</b>	1,280,000	\$ 0.125	April 15, 2007

### **Outlook**

The Company continues to expand its portfolio of exploration properties across the Lombok, Sumbawa and Flores Islands in Indonesia. These recent acquisitions form part of the Company's strategy, which is to be an active junior mineral exploration company through the entire Sunda Banda Magmatic Arc of south-central Indonesia.