

**SOUTHERN ARC MINERALS INC.**

**FINANCIAL STATEMENTS**

**JUNE 30, 2007**

## **Auditors' Report**

### **To the Shareholders of Southern Arc Minerals Inc.**

We have audited the balance sheets of Southern Arc Minerals Inc. as at June 30, 2007 and 2006 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, 2007 and 2006 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 25, 2007**

***"MacKay LLP"***

**Chartered Accountants**

**SOUTHERN ARC MINERALS INC.**  
**BALANCE SHEETS**  
**AS AT JUNE 30**

	2007	2006
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 878,988	\$ 2,723,873
Prepaid expense and deposit	32,006	19,117
Receivables	9,933	10,506
Due from related party (Note 7)	-	10,880
Investment (Note 12)	<u>1,408,258</u>	<u>-</u>
	2,329,185	2,764,376
<b>Equipment</b> (Note 3)	21,628	9,103
<b>Resource properties</b> (Note 4)	<u>8,443,787</u>	<u>5,382,679</u>
	<u>\$ 10,794,600</u>	<u>\$ 8,156,158</u>

**LIABILITIES AND SHAREHOLDERS' EQUITY**

<b>Current</b>		
Accounts payable and accrued liabilities	<u>\$ 375,830</u>	<u>\$ 261,979</u>
<b>Shareholders' equity</b>		
Capital stock (Note 5)	12,277,578	8,813,046
Share subscriptions received	43,750	-
Contributed surplus (Note 5)	1,580,928	1,546,833
Deficit	<u>(3,483,486)</u>	<u>(2,465,700)</u>
	<u>10,418,770</u>	<u>7,894,179</u>
	<u>\$ 10,794,600</u>	<u>\$ 8,156,158</u>

**Nature and continuance of operations** (Note 1)

**Commitments** (Notes 4 and 10)

**On behalf of the Board:**

\_\_\_\_\_  
 "John G. Proust"

Director

\_\_\_\_\_  
 "Douglas A. Leishman"

Director

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

**SOUTHERN ARC MINERALS INC.**  
**STATEMENTS OF OPERATIONS AND DEFICIT**  
**FOR THE YEAR ENDED JUNE 30**

	2007	2006
<b>EXPENSES</b>		
Amortization	\$ 3,639	\$ 1,011
Consulting fees	79,299	116,613
Investor relations	65,788	44,602
Management fees	150,000	109,580
Office and miscellaneous	89,365	84,072
Professional fees	162,710	138,518
Property investigation costs	22,682	5,800
Rent	39,505	32,935
Stock-based compensation (Note 5)	66,113	1,263,238
Transfer agent and filing fees	31,922	32,994
Travel	23,985	54,816
	<u>(735,008)</u>	<u>(1,884,179)</u>
<b>Loss before other items</b>		
<b>OTHER ITEMS</b>		
Interest income	64,441	23,594
Resource property written-off (Note 4)	(347,219)	(23,797)
	<u>(282,778)</u>	<u>(203)</u>
<b>Loss for the year</b>	(1,017,786)	(1,884,382)
<b>Deficit, beginning of year</b>	<u>(2,465,700)</u>	<u>(581,318)</u>
<b>Deficit, end of year</b>	<u>\$ (3,483,486)</u>	<u>\$ (2,465,700)</u>
<b>Basic and diluted loss per share</b>	<u>\$ (0.02)</u>	<u>\$ (0.05)</u>
<b>Weighted average number of shares outstanding</b>	<u>48,646,536</u>	<u>39,086,443</u>

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

**SOUTHERN ARC MINERALS INC.**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEAR ENDED JUNE 30**

	2007	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Loss for the year	\$ (1,017,786)	\$ (1,884,382)
Items not affecting cash:		
Stock-based compensation	66,113	1,263,238
Amortization	3,639	1,011
Resource property written-off	347,219	23,797
Changes in non-cash working capital items:		
Decrease in receivables	573	19,166
Increase in prepaid expense and deposit	(12,889)	(19,117)
Increase (decrease) in accounts payable and accrued liabilities	46,586	(39,475)
Net cash used in operating activities	<u>(566,545)</u>	<u>(635,762)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Additions to resource properties	(3,341,062)	(2,646,786)
Acquisition of equipment	(16,164)	(10,114)
Investments	<u>(1,408,258)</u>	<u>-</u>
Net cash used in investing activities	<u>(4,765,484)</u>	<u>(2,656,900)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from issuance of shares	3,529,684	5,330,000
Share issue costs	(97,170)	(316,032)
Subscriptions received	43,750	-
Advance (to) from related party	<u>10,880</u>	<u>(10,880)</u>
Net cash provided by financing activities	<u>3,487,144</u>	<u>5,003,088</u>
<b>Change in cash during year</b>	<b>(1,844,885)</b>	<b>1,710,426</b>
<b>Cash and cash equivalents, beginning of year</b>	<b><u>2,723,873</u></b>	<b><u>1,013,447</u></b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 878,988</b>	<b>\$ 2,723,873</b>
<b>Cash paid for interest</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Cash paid for income taxes</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Cash and cash equivalents consist of:</b>		
Cash on hand	\$ 878,988	\$ 2,109,134
Term deposits	<u>-</u>	<u>614,739</u>
	<b>\$ 878,988</b>	<b>\$ 2,723,873</b>

**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. The Company is a natural resource company engaged in the acquisition and exploration of resource properties in Indonesia. To date, the Company has not generated significant revenues from operations and is considered to be in the exploration stage.

The Company is in the process of exploring and developing its resource 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.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which presume the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The company's ability to continue as a going concern is dependent upon achieving profitable operations and upon obtaining additional financing. The outcome of these matters can not be predicted at this time. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the company be unable to continue in business.

## **2. SIGNIFICANT ACCOUNTING POLICIES**

### **Basis of presentation**

The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").

### **Cash and cash equivalents**

Cash and cash equivalents consist of cash in the bank, less outstanding cheques and short-term deposits which are readily convertible into a known amount of cash, are subject to an insignificant risk of change in value and have a maturity of three months or less when purchased.

### **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. Significant areas requiring the use of management estimates include assessment of carrying values of short-term investments, impairment of resource properties and valuation of stock-based compensation. 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.

### **Investment**

Investment consists of Canadian Asset-Backed Commercial Paper maturing between 3 and 12 months from the date of the initial investment and bearing an annual interest rate of 4.59%.

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

**Concentration of credit risk**

Financial instruments that potentially subject the Company to a significant concentration of credit risk due to the potential for counterparties to default on their contractual obligations consist primarily of cash and cash equivalents, investments, receivable, prepaid expense and deposits. The maximum potential loss on these financial instruments is equal to the carrying amounts of these items. The Company limits its exposure to credit loss by placing its cash and cash equivalents and investments with major financial institutions and by dealing with counterparties it believes to be creditworthy.

**Resource properties**

All costs related to the acquisition, exploration and development of resource 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 resource property is impaired, that property is written down to its estimated fair value. A resource property is reviewed for impairment annually and whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

The amounts shown for resource 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.

**Joint interest**

A portion of the Company's 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 significant asset retirement obligations at June 30, 2007 and 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.

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

**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. The fair value of option grants is generally established at the date of grant using the Black-Sholes option pricing model and the expense is recognized over the vesting period, with offsetting amounts recorded as contributed surplus.

**Measurement uncertainty**

The amounts recorded for amortization of equipment and the future recovery of the recorded cost of the properties are based on estimates. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

**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.

**Share issue costs**

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

**Comparative figures**

Certain comparative figures have been reclassified to conform with the current year's presentation.

**3. EQUIPMENT**

	2007			2006		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telephone equipment	\$ 26,278	\$ 4,650	\$ 21,628	\$ 10,114	\$ 1,011	\$ 9,103

**SOUTHERN ARC MINERALS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

**4. RESOURCE PROPERTIES**

June 30, 2007	Lombok Property Indonesia	Sumbawa Property Indonesia	Flores Property Indonesia	Total
<b>Acquisition costs</b>				
Balance, beginning of year	\$ 1,051,254	\$ 450,537	\$ 17,941	\$ 1,519,732
Written-off during the year	-	-	(17,941)	(17,941)
Balance, end of year	1,051,254	450,537	-	1,501,791
<b>Deferred exploration costs</b>				
Incurred during the year:				
Assaying, testing, surveying and analysis	196,992	48,434	31,922	277,348
Camp construction, supplies and accommodation	879,507	217,898	73,539	1,170,944
Drilling	509,865	79,702	1,320	590,887
Geological and other consulting	806,108	326,781	188,909	1,321,798
Travel	30,406	8,223	8,721	47,350
Written-off during the year	-	-	(329,278)	(329,278)
Total deferred exploration costs	2,422,878	681,038	(24,867)	3,079,049
Balance, beginning of year	1,537,871	2,300,209	24,867	3,862,947
Balance, end of year	3,960,749	2,981,247	-	6,941,996
<b>Total resource property costs</b>	<b>\$ 5,012,003</b>	<b>\$ 3,431,784</b>	<b>\$ -</b>	<b>\$ 8,443,787</b>

June 30, 2006	Lombok Property Indonesia	Sumbawa Property Indonesia	Flores Property Indonesia	Other Property Indonesia	Total
<b>Acquisition costs</b>					
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	1,051,254	450,537	17,941	-	1,519,732

- Continued -

**SOUTHERN ARC MINERALS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

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

June 30, 2006	Lombok Property Indonesia	Sumbawa Property Indonesia	Flores Property Indonesia	Other Property Indonesia	Total
<i>Continued...</i>					
<b>Deferred exploration costs</b>					
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>
<b>Total resource property costs</b>	<b>\$2,589,125</b>	<b>\$2,750,746</b>	<b>\$ 42,808</b>	<b>\$ -</b>	<b>\$5,382,679</b>

Title to resource properties involves certain inherent risks due to the difficulties of determining the validity of certain resource property interests as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many resource 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 (\$60,000 paid). 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 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. A third 12 month extension to the SIPP period was granted by the local regional authorities on June 20, 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 I*") 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 I* 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 I* 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 I*.

**Flores Property, Indonesia**

The Company has been granted four new exploration licenses over part of West Flores Island. The licenses were granted for Longo on October 4, 2005 (12 month extension granted February 24, 2007), Tebedo on August 1, 2005 (12 month extension granted March 5, 2007). The licenses were granted for twelve months.

During the year ended June 30, 2007, the Company abandoned the licenses and wrote-off \$347,219 of resource property assets to operations.

**SOUTHERN ARC MINERALS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

**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 wrote off \$23,797 of resource 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 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
Issued for cash	7,000,000	2,100,000	-
Exercise of warrants	3,062,049	1,451,525	(56,841)
Exercise of options	50,000	57,511	(22,511)
Stock-based compensation	-	-	66,113
Share issuance costs	-	(97,170)	-
Agent warrants	-	(47,334)	47,334
Balance as at June 30, 2007	56,554,933	\$ 12,277,578	\$ 1,580,928

The Company had 4,177,781 shares in escrow at June 30, 2007.

During the year ended June 30, 2007, the Company:

- a) completed a non-brokered private placement of 7,000,000 units at a price of \$0.30 per unit for gross proceeds of \$2,100,000. Each unit consists of one common share and one-half of a non-transferable share purchase warrant. Each whole warrant may be exercised to purchase an additional common share of the Company at a purchase price of \$0.45 for a period of two years to March 28, 2009. If the weighted daily average trading price of the Company's common shares on the TSX exceeds \$0.70 for 10 consecutive trading days, the Company may give 30 days written notice to the holders of warrants that the warrants will expire. Share issue costs of \$144,504 were incurred in connection with the private placement, including 259,010 agent warrants with a fair value of \$47,334.

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

- b) issued 50,000 common shares for proceeds of \$35,000 pursuant to the exercise of options.
- c) issued 3,062,049 common shares for proceeds of \$1,394,684 pursuant to the exercise of warrants.

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 \$0.56 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.

**Stock options**

The Company grants stock options in accordance with the policies of the TSX Venture Exchange ("TSXV"). 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 terms of the option, including the vesting terms and the option price are fixed by the directors at the time of grant subject to the price not being less than the market price of the Company's stock on the date of grant. The stock options granted are exercisable for a period of five years. A summary of the Company's outstanding stock options and the changes during the years ended June 30, 2007 and 2006 is presented below.

**SOUTHERN ARC MINERALS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

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

	Number of Options	Weighted Average Exercise Price
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	4,225,000	0.47
Cancelled	(250,000)	0.60
Exercised	<u>(50,000)</u>	0.70
Outstanding, June 30, 2007	3,925,000	0.46
Number of options currently exercisable	3,925,000	\$ 0.46

During the year ended June 30, 2007, the Company reported stock-based compensation of \$66,113, using the Black-Scholes option-pricing model, as a result of vested options that were granted previously. These amounts were recorded as contributed surplus on the balance sheet.

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 options subject to vesting provisions of one quarter vesting every three months.

**Warrants**

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

**SOUTHERN ARC MINERALS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

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

	Number of Warrants	Weighted Average Exercise Price
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
Granted	3,759,010	0.45
Exercised	<u>(3,062,049)</u>	0.46
Outstanding, June 30, 2007	6,388,403	\$ 0.60

During the year ended June 30, 2007, the Company granted 259,010 agent warrants resulting in share issue costs, using the Black-Scholes option-pricing model, of \$47,334. This amount was also recorded as contributed surplus on the balance sheet. The weighted average fair value of the agent warrants granted during the period was \$0.18.

**Share purchase options and warrants**

The following weighted average assumptions were used for the Black-Scholes valuation of stock options and agent warrants granted during the year:

	2007	2006
Risk-free interest rate	3.96%	3.88%
Expected life of options/warrants	1 year	4.67 years
Annualized volatility	100.92%	75.64%
Dividend rate	0.00%	0.00%

At June 30, 2007, the Company had share purchase options and warrants outstanding enabling holders to acquire common shares as follows:

	Number of Shares	Exercise Price	Expiry Date
<b>Options</b>	1,400,000	\$ 0.25	June 30, 2010
	2,275,000	0.56	January 13, 2011
	250,000	0.70	April 13, 2011
<b>Warrants</b>	1,165,750	0.50	December 28, 2007
	71,406	0.56	December 28, 2007
	1,526,787	1.00	March 24, 2008
	105,450	0.70	March 24, 2008
	250,010	0.45	March 28, 2008
	3,269,000	0.45	March 28, 2009

**SOUTHERN ARC MINERALS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

---

**6. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS**

The Company has the following significant non-cash transactions:

During the year ended June 30, 2007, the Company:

- a) included in accounts payable \$309,712 of resource property costs (June 30, 2006 - \$242,448).
- b) granted 259,010 agent warrants valued at \$47,334 for share issue costs using the Black-Scholes option pricing model. This amount was also recorded as contributed surplus on the balance sheet.
- c) allocated \$56,841 to capital stock from contributed surplus for agent warrants exercised during the year.
- d) allocated \$22,511 to capital stock from contributed surplus for stock options exercised during the year.

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

- a) issued warrants, valued at \$86,734, as a consideration for financing fees.
- b) allocated \$124,800 to capital stock from contributed surplus for agent warrants exercised during the year.
- c) allocated \$57,800 to capital stock from contributed surplus for stock options exercised during the year.

**7. RELATED PARTY TRANSACTIONS**

The Company entered into transactions with related parties as follows:

- a) Paid \$150,000 (June 30, 2006 - \$109,500) for management services and \$18,000 (June 30, 2006 - \$7,500) for administration, recorded in office expense, to a private company controlled by the Chief Executive Officer of the Company.
- b) Paid \$193,405 (June 30, 2006 - \$158,768) for geological consulting services included in resource properties to an officer of the Company and a company controlled by an officer of the Company.
- c) Paid \$33,410 (June 30, 2006 - \$Nil) for engineering consulting services to an officer of the Company.
- d) Paid \$50,046 (June 30, 2006 - \$62,600) and recorded in accounts payable and accrued liabilities an additional \$37,154 (June 30, 2006 - \$7,500) for professional accounting fees 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 party are as follows:

	June 30, 2007	June 30, 2006
Due (to) from director and officer or a corporation owned by a 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.

**SOUTHERN ARC MINERALS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2007**

**8. INCOME TAXES**

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

	2007	2006
Loss before income tax recovery	\$ (1,017,786)	\$ (1,884,382)
Expected income tax recovery	\$ 357,446	\$ 699,483
Items not deductible for income tax purposes	(24,986)	(531,519)
Items deductible for tax	60,354	58,446
Change in valuation allowance	(392,814)	(230,980)
<b>Total income taxes</b>	<b>\$ -</b>	<b>\$ -</b>

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

	2007	2006
Future income tax assets:		
Non-capital loss carry forwards	\$ 470,482	\$ 318,103
Share issuance costs	133,757	98,554
Financing costs	8,145	15,778
Cumulative exploration expenses	246,326	51,593
Equipment	1,550	313
	860,260	484,341
Valuation allowance	(860,260)	(484,341)
<b>Net future income tax assets</b>	<b>\$ -</b>	<b>\$ -</b>

The Company has available for deduction against future years' taxable income non-capital losses of approximately \$1,500,000. Unless utilized, these losses will expire through 2027. 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 and cash equivalents, investment, deposit, receivables 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. At June 30, 2007, the Company had US\$292,374 (approximately CAD\$309,712) in accounts payable.

