

SOUTHERN ARC MINERALS INC.

CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE YEARS ENDED
JUNE 30, 2009 AND 2008**

(Expressed in Canadian Dollars)

Auditors' Report

To the Shareholders of Southern Arc Minerals Inc.

We have audited the consolidated balance sheets of Southern Arc Minerals Inc. as at June 30, 2009 and 2008, and the consolidated statements of operations, comprehensive loss 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 disclosure in these financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at June 30, 2009 and 2008, 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

**October 8, 2009, except as to Note 15 c) which
is as of October 23, 2009**

"MacKay LLP"

Chartered Accountants

SOUTHERN ARC MINERALS INC.
CONSOLIDATED BALANCE SHEETS
FOR THE YEARS ENDED JUNE 30
(Expressed in Canadian dollars)

	2009	2008
ASSETS		
Current		
Cash and cash equivalents	\$ 2,431,412	\$ 9,296,877
Receivables	13,246	16,605
Deposits, retainers and prepaids (Note 5)	<u>738,430</u>	<u>5,000</u>
	3,183,088	9,318,482
Equipment (Note 4)	13,842	17,302
Resource properties (Note 5)	15,483,236	13,152,613
Long-term investment (Note 6)	<u>816,703</u>	<u>1,200,222</u>
	<u>\$ 19,496,869</u>	<u>\$ 23,688,619</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	<u>\$ 91,713</u>	<u>\$ 491,194</u>
Non-controlling interest (Note 3)	<u>1,369,164</u>	<u>-</u>
Shareholders' equity		
Capital stock (Note 7)	26,565,067	26,549,808
Contributed surplus (Note 7)	5,604,310	5,540,446
Deficit	<u>(14,133,385)</u>	<u>(8,892,829)</u>
	<u>18,035,992</u>	<u>23,197,425</u>
	<u>\$ 19,496,869</u>	<u>\$ 23,688,619</u>

Nature and continuance of operations (Note 1)

Commitment (Note 12)

Subsequent events (Note 15)

On behalf of the Board:

“John Proust”

Director

“David Stone”

Director

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
FOR THE YEARS ENDED JUNE 30
(Expressed in Canadian dollars)

	2009	2008
EXPENSES		
Amortization	\$ 3,460	\$ 4,326
Consulting fees	78,500	55,700
Foreign exchange	(92,361)	(24,294)
Investor relations	59,929	95,872
Management fees	409,200	177,000
Office and miscellaneous	152,629	149,530
Professional fees	325,924	159,866
Property investigation costs	2,358	29,341
Rent	19,173	45,862
Resource properties written-off (Note 5)	8,066,801	-
Stock-based compensation (Note 7)	63,864	4,601,368
Transfer agent and filing fees	50,748	47,271
Travel	17,791	95,754
Loss before other items	<u>(9,158,016)</u>	<u>(5,437,596)</u>
OTHER ITEMS		
Interest income	37,155	240,057
Gain on diluted interest in subsidiary (Note 3)	201,920	-
Unrealized loss on long-term investment (Note 6)	(323,059)	(211,804)
	<u>(83,984)</u>	<u>28,253</u>
Loss for the year, before income taxes and non-controlling interest	(9,242,000)	(5,409,343)
Future income tax recovery (Note 10)	<u>764,000</u>	<u>-</u>
Loss before non-controlling interest	(8,478,000)	(5,409,343)
Non-controlling interest	<u>3,237,444</u>	<u>-</u>
Loss and comprehensive loss for the year	(5,240,556)	(5,409,343)
Deficit, beginning of year	<u>(8,892,829)</u>	<u>(3,483,486)</u>
Deficit, end of year	<u>\$ (14,133,385)</u>	<u>\$ (8,892,829)</u>
Basic and diluted loss per share	<u>\$ (0.07)</u>	<u>\$ (0.08)</u>
Weighted average number of shares outstanding	<u>71,410,906</u>	<u>65,569,043</u>

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30
(Expressed in Canadian dollars)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss for the year	\$ (5,240,556)	\$ (5,409,343)
Items not affecting cash:		
Stock-based compensation	63,864	4,601,368
Amortization	3,460	4,326
Gain on diluted interest in subsidiary	(201,920)	-
Unrealized loss on long-term investment	323,059	211,804
Future income tax recovery	(764,000)	-
Non-controlling interest	(3,237,444)	-
Accrued interest	-	(3,768)
Mineral property written-off	8,066,801	-
Foreign exchange on cash	(92,361)	-
Changes in non-cash working capital items:		
Increase (decrease) in receivables	3,399	(6,672)
Increase in deposits, retainers and prepaids	(733,430)	27,006
Increase (decrease) in accounts payable and accrued liabilities	<u>24,298</u>	<u>(22,207)</u>
Net cash used in operating activities	<u>(1,784,830)</u>	<u>(597,486)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to resource properties	(8,855,234)	(4,304,555)
Acquisition of Canada Nickel (Note 3)	(5,355,000)	-
Cash acquired on acquisition of Canada Nickel (Note 3)	5,669,935	-
Repayment of long-term investment	<u>60,460</u>	<u>-</u>
Net cash used in investing activities	<u>(8,479,839)</u>	<u>(4,304,555)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of shares	-	14,143,260
Share issue (costs) recovery	15,259	(823,330)
Issue of equity securities by Canada Nickel to non-controlling interests	3,291,584	-
Proceeds from shareholder loan (Note 9)	1,100,000	-
Repayment of shareholder loan (Note 9)	<u>(1,100,000)</u>	<u>-</u>
Net cash provided by financing activities	<u>3,306,843</u>	<u>13,319,930</u>
FOREIGN EXCHANGE ON CASH	<u>92,361</u>	<u>-</u>

- Continued -

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30
(Expressed in Canadian dollars)

	2009	2008
<i>Continued...</i>		
Change in cash during year	(6,865,465)	8,417,889
Cash and cash equivalents, beginning of year	<u>9,296,877</u>	<u>878,988</u>
Cash and cash equivalents, end of year	<u>\$ 2,431,412</u>	<u>\$ 9,296,877</u>
Cash paid for interest	\$ -	\$ -
Cash paid for income taxes	\$ -	\$ -
Cash and cash equivalents consist of:		
Cash on hand	\$ 1,831,324	\$ 187,922
Term deposits	<u>600,088</u>	<u>9,108,955</u>
	<u>\$ 2,431,412</u>	<u>\$ 9,296,877</u>

Supplemental disclosure with respect to cash flows (Note 8)

The accompanying notes are an integral part of these consolidated 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 and Canada. 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 resource 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 consolidated 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 consolidated 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

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its 43.56% owned Canadian subsidiary, Canada Nickel Corp. ("Canada Nickel") from the date of acquisition. Significant inter-company balances and transactions have been eliminated upon consolidation.

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 (at interest rates ranging from 0.05% per annum to 0.2% per annum) 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 long-term investments, impairment of resource properties and valuation of stock-based compensation. Actual results could differ from these estimates.

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

Equipment

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

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, long-term investments and receivables. 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 long-term 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.

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 conveying history characteristic of many resource properties. The Company has investigated titles 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.

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.

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

Asset retirement obligation

Asset retirement obligations are recognized for expected obligations related to the retirement of long-lived tangible assets that arise from the acquisition, construction, development or normal operation of such assets. A liability for an asset retirement obligation must be recognized in the period in which it is incurred and when a reasonable estimate of the fair value of the liability can be made. Furthermore, a corresponding asset retirement cost should be recognized by increasing the carrying value of the related long-lived asset. The asset retirement cost is subsequently charged to operations in a rational and systematic manner over the underlying asset's useful life. The initial fair value of the asset retirement liability is accreted, by charges to operations, to its estimated future value. The Company has determined that there are no significant asset retirement obligations at June 30, 2009 and 2008.

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, non-monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the historical rate. 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. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is complete or the date the performance commitment is reached or the date which the equity instruments are granted if they are fully vested and non-forfeitable. The Company has not incorporated an estimated forfeiture rate for stock options, rather the Company accounts for actual forfeitures as they occur. If and when the stock options are exercised, the applicable amounts of contributed surplus are transferred to share capital.

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

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.

Valuation of warrants

The Company has adopted the residual value method with respect to the valuation of warrants issued as part of a private placement unit. The residual value method allocates the net proceeds to the common shares up to their fair value, as determined by the current quoted trading price on the announcement date, and the balance, if any, to the attached warrants. The fair value attributed to the warrants, if any, is recorded as Warrants in the equity section.

Impairment of long lived assets

The Company has adopted the recommendations of CICA Handbook Section 3063 "Impairment of Long-lived Assets" and abstract EIC 174, "Mining Exploration Costs" ("EIC 174") of the Emerging Issues Committee on a prospective basis. Section 3063 requires that long-lived assets and intangibles to be held and used by the Company be reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If changes in circumstance indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, future cash flows expected to result from the use of the asset and its disposition must be estimated.

EIC 174 provides that an enterprise that is in the development stage with initially capitalized exploration costs but has not established mineral reserves objectively and therefore does not have a basis for preparing a projection of the estimated future net cash flow from the property, is not obliged to conclude that the capitalized costs have been impaired. However, such an enterprise should consider whether a subsequent write-down of capitalized exploration costs related to mining properties is required.

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

Flow-through shares

Canadian tax legislation permits a company to issue flow-through shares whereby the deduction for tax purposes relating to qualified resource expenditures is claimed by the investors rather than the Company. Recording these expenditures for accounting purposes gives rise to taxable temporary differences.

Effective March 19, 2004, the Emerging Issues Committee of the Canadian Institute of Chartered Accountants requires that, when flow-through expenditures are renounced, a portion of the future income tax assets that were not recognized in previous years, due to the recording of a valuation allowance, be recognized as a recovery of income taxes in the statement of operations.

Financial instruments

Effective July 1, 2007, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") under CICA Handbook Section 1530 "Comprehensive Income" ("Section 1530"), Section 3251 "Equity", Section 3855 "Financial Instruments – Recognition and Measurement" ("Section 3855"), Section 3861 "Financial Instruments – Disclosure and Presentation" and Section 3865 "Hedges". These new sections, which apply to fiscal years beginning on or after October 1, 2006, provide requirements for the recognition and measurement of financial instruments and on the use of hedge accounting. Section 1530 establishes standards for reporting and presenting comprehensive income which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with Canadian generally accepted accounting principles. Under Section 3855, all financial instruments are classified into one of five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives, except certain related party transactions, are initially measured in the balance sheet at fair value.

Subsequent measurement and changes in fair value will depend on their initial classification as follows: (1) held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; (2) available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired; (3) loans and receivables, held to maturity financial assets and other financial liabilities are measured at amortized cost; and (4) all derivative instruments, including embedded derivatives, are recorded in the balance sheet at fair value unless they qualify for the normal sale normal purchase exemption and changes in their fair value are recorded in income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income.

As a result of the adoption of these new standards, the Company has classified its cash and cash equivalents and long-term investments as held-for-trading. Receivables are classified as loans and receivables and accounts payable and accrued liabilities are classified as other financial liabilities, all of which are measured at amortized cost. The Company has elected to measure all derivatives and embedded derivatives at fair value and the Company has a policy not to use hedge accounting.

Section 3855 also provides guidance on accounting for transaction costs incurred upon the issuance of debt instruments or modification of a financial liability. Transaction costs are now deducted from the financial liability and are amortized using the effective interest method over the expected life of the related liability.

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

Accounting changes

Effective July 1, 2008, the Company adopted CICA Handbook Section 3862, *Financial Instruments – Disclosures*, which requires entities to provide disclosures in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

The principles in this section complement the principles for recognizing, measuring and presenting financial assets and financial liabilities in Section 3855, *Financial Instruments – Recognition and Measurement*, Section 3863, *Financial Instruments – Presentation*, and Section 3865, *Hedges*. This section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The adoption of Section 3862 did not have an impact on the Company's financial results.

Effective July 1, 2008, the Company adopted CICA Handbook Section 3863, *Financial Instruments – Presentation*, which is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. This section carries forward standards that were previously established in Section 3861 relating to the presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset. This section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The adoption of Section 3863 did not have an impact on the Company's financial results.

EIC-174, Mining Exploration Costs

On March 27, 2009, the Emerging Issues Committee of the CICA approved abstract EIC-174 "Mining Exploration Costs", which provides guidance on capitalization of exploration costs related to mining properties in particular and on impairment of long-lived assets in general. The Company has applied this new abstract for the year ended June 30, 2009 and there was no significant impact on its financial statements as a result of applying this abstract.

Assessing going concern

Effective July 1, 2008, the Company adopted the amended CICA Handbook Section 1400, to include requirements for management to assess and disclose an entity's ability to continue as a going concern. This section applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. This section relates to disclosures and did not have an impact on the Company's financial results.

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

Capital disclosures

Effective July 1, 2008, the Company adopted CICA Handbook Section 1535 "Capital disclosures". The section specifies the disclosure of (i) an entity's objectives, policies, and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. This section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. This section relates to disclosures and did not have an impact on the Company's financial results and disclosures are in Note 14.

Recent accounting pronouncements

The new primary sources of generally accepted accounting principles that have been issued that the Company has not adopted because there are not yet in effect are as follows:

International financial reporting standards ("IFRS")

In 2006, the AcSB published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of July 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended June 30, 2011. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

Goodwill and intangible assets

The Canadian Accounting Standards Board ("AcSB") issued CICA Handbook Section 3064 which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. Standards concerning goodwill remain unchanged from the standards included in the previous Section 3062. The section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008 and is not expected to have an impact on the Company's financial results.

Business combinations

In January 2009, the AcSB released Section 1582, which replaces Section 1581 "Business Combinations". It provides the Canadian equivalent to IFRS 3 "Business Combinations". For the Company, this section applies prospectively to business combinations for which the acquisition is subsequent to fiscal year 2011. Earlier application is permitted. Section 1582 must be applied together with Section 1601 and Section 1602 if it is implemented for a fiscal year beginning before February 1, 2011.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2009 AND 2008
(Expressed in Canadian dollars)

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

Recent accounting pronouncements (cont'd...)

Consolidated financial statements and non-controlling interests

In January 2009, the AcSB also released Section 1601 "Consolidated financial statements" and Section 1602 "Non-controlling interest", which replace Section 1600 "Consolidated Financial statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in the consolidated financial statements of the parent, subsequent to a business combination. Section 1602 is equivalent to the corresponding provisions of IAS 27, "Consolidated and Separate Financial Statements".

For the Company, these sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after February 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year. These sections must be applied together with Section 1582 "Business Combinations" if they are implemented for a fiscal year beginning before February 1, 2011.

3. INVESTMENT IN CANADA NICKEL CORP.

On July 7, 2008, the Company acquired 15,300,000 common shares of Canada Nickel, a related corporation by way of a common director, for a purchase price of \$5,355,000 (paid in cash) representing 59.77% of the outstanding shares of Canada Nickel at the time of acquisition. As a result of the share purchase, the Company acquired control of Canada Nickel and, accordingly, effective July 7, 2008, the Company consolidated the financial results of Canada Nickel.

The acquisition of Canada Nickel has been accounted for using the purchase method. The total purchase price of \$5,355,000 has been allocated as follows:

Cash	\$ 5,669,935
Receivables	40
Resource property	1,966,801
Accounts payable and accrued liabilities	(792)
Non-controlling interest	<u>(2,280,984)</u>
	<u>\$ 5,355,000</u>

During the year ended June 30, 2009, Canada Nickel issued additional common stock to third parties which diluted the Company's ownership percentage of Canada Nickel to 43.56%, and renounced flow-through shares, resulting in a gain on diluted interest in subsidiary of \$201,920. The Company maintains control over 66.6% of voting shares of Canada Nickel as a result of a voting agreement with a common director.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2009 AND 2008
(Expressed in Canadian dollars)

4. EQUIPMENT

	2009			2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telephone equipment	\$ 26,278	\$ 12,436	\$ 13,842	\$ 26,278	\$ 8,976	\$ 17,302

5. RESOURCE PROPERTIES

June 30, 2009	Lombok Property, Indonesia	Sumbawa Property, Indonesia	James Bay Project, Canada	Total
Acquisition costs				
Balance, beginning of year	\$ 1,051,254	\$ 450,537	\$ -	\$ 1,501,791
Option payment	-	-	5,000,000	5,000,000
Purchase price allocation (Note 3)	-	-	1,966,801	1,966,801
Written-off during the year	-	-	(6,966,801)	(6,966,801)
Balance, end of year	1,051,254	450,537	-	1,501,791
Deferred exploration costs				
Incurred during the year:				
Assaying, testing, surveying and analysis	63,876	9,836	-	73,712
Camp construction, supplies and accommodation	704,434	192,971	-	897,405
Drilling	558,805	1,879	-	560,684
Geological and other consulting	679,779	89,633	-	769,412
Geophysical survey	-	-	1,100,000	1,100,000
Travel	27,863	1,547	-	29,410
Written-off during the year	-	-	(1,100,000)	(1,100,000)
Total deferred exploration costs	2,034,757	295,866	-	2,330,623
Balance, beginning of year	7,982,732	3,668,090	-	11,650,822
Balance, end of year	10,017,489	3,963,956	-	13,981,445
Total resource property costs	\$11,068,743	\$ 4,414,493	\$ -	\$15,483,236

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2009 AND 2008
(Expressed in Canadian dollars)

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

June 30, 2008	Lombok Property, Indonesia	Sumbawa Property, Indonesia	Total
Acquisition costs			
Balance, beginning and end of year	\$ 1,051,254	\$ 450,537	\$ 1,501,791
Deferred exploration costs			
Incurred during the year:			
Assaying, testing, surveying and analysis	180,769	21,932	202,701
Camp construction, supplies and other	1,130,012	322,857	1,452,869
Drilling	1,778,072	-	1,778,072
Geological and other consulting	894,885	321,990	1,216,875
Travel	<u>38,245</u>	<u>20,064</u>	<u>58,309</u>
Total deferred exploration costs	4,021,983	686,843	4,708,826
Balance, beginning of year	<u>3,960,749</u>	<u>2,981,247</u>	<u>6,941,996</u>
Balance, end of year	<u>7,982,732</u>	<u>3,668,090</u>	<u>11,650,822</u>
Total resource property costs	\$ 9,033,986	\$ 4,118,627	\$13,152,613

Lombok and Sumbawa Properties, Indonesia

During the period ended June 30, 2005, 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.

Pursuant to the Option Agreement, the Company has acquired, directly from Indotan, 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. 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.

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

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

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 Mining Business License ("IUP"), previously stated as 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 an IUP, previously stated as 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.

Prior to the enactment of the new Mining Law No. 04/2009 the Lombok and Sumbawa properties comprised two separate applications to the Indonesian Government for CoWs 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 allowed the Company to conduct preliminary general survey work over the CoW application areas. With the advent of the new Mining Law enacted by the President of Indonesia on January 12, 2009 this effectively put an end to the CoW plan under which the Company had been operating since 2004. Based on clause 172 of this law the sanctity of CoW applications will be honoured by the Government, but must be transitioned into the new permit licensing system. For the law to take effect, the government will have to issue at least 20 implementing regulations. These are currently being drafted by the Department of Energy of Mineral Resources.

The Company is making the transition from the CoW application to the new permit licensing system or "IUP" with the establishment of suitable Singaporean and Indonesian corporate entities.

With respect to the West Nusa Tenggara provincial land utilization regulation No. 11, which disrupted the CoW application process for the Lombok property, the regulation has been revised by the provincial government and now only awaits endorsement from the central government and final approval from the local legislative body. With the revision of regulation No. 11, the Company believes that the provincial government will be required to issue retroactive permits to cover the 2006 to 2009 period.

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*.

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

James Bay Nickel Project, Canada

During the year ended June 30, 2009, the Company's 43.56% owned subsidiary, Canada Nickel, entered into an option agreement with Diamondex Resources Ltd. ("Diamondex") to earn up to 51% interest (10% earned) in the James Bay Nickel Project (the "Property"). The Property is located near Ogoki, Ontario, Canada and consists of 724 mineral claims comprising approximately 407,388 acres of mineral rights. In order to earn its interest, Canada Nickel must pay an aggregate \$5,000,000 in option payments (\$5,000,000 paid) and incur a total of \$20,000,000 of exploration expenditures (\$1,100,000 incurred), as follows:

Date	Cash Payments	Exploration Expenditures	Interest Earned
Execution of the Option Agreement (paid)	\$ 5,000,000	\$ -	10%
July 7, 2009	-	5,000,000	12%
July 7, 2010	-	7,000,000	14%
July 7, 2011	-	8,000,000	15%
	\$ 5,000,000	\$ 20,000,000	51%

The Company also committed to issue to Diamondex 250,000 warrants of Canada Nickel which will entitle Diamondex to purchase up to 250,000 common shares of Canada Nickel for a period of 24 months from the closing of Canada Nickel's Initial Public Offering (the "Offering"). The warrants will be issued on the date that Canada

Nickel completes the Offering and will be priced at the same price as Canada Nickel's shares issued in connection with the Offering.

During the year ended June 30, 2009, Canada Nickel commenced a legal action against Diamondex in connection with its option agreement on the Project.

Canada Nickel alleges that it entered into the option agreement and made a \$5 million option payment to Diamondex on the basis of representations that Diamondex had incurred \$5 million dollars in historical exploration expenditures on the Property and that the \$5 million payment was to reimburse Diamondex for those expenditures. Canada Nickel alleges that Diamondex's historical expenditures on the Property including acquisition costs were actually materially less than \$5 million as previously represented to Canada Nickel. Canada Nickel states that it has given notice of rescission of the Option Agreement and seeks the return of the \$5 million option payment, together with \$1.1 million in exploration expenditures paid under the Option Agreement.

During the year ended June 30, 2009, Diamondex provided notice to Canada Nickel that the failure to remit \$2 million of further exploration expenditures previously requested by Diamondex has resulted in the termination of the Option Agreement.

As a result of the above, the Company abandoned the James Bay Nickel Project and recognized an impairment loss of \$8,066,801 in the statement of operations.

At June 30, 2009, the Company had paid deposits and retainers of \$735,099 for expected legal fees.

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6. LONG-TERM INVESTMENT

At June 30, 2009, long-term investment included Master Asset Vehicle II notes received in exchange for Canadian third-party asset backed commercial paper (“ABCP”) that was held by the Company. These investments were designated as held-for-trading and are accounted for at their fair values.

The market for asset-backed commercial paper not sponsored by banks froze up in early August 2007 after issuers were unable to roll over maturing notes. A Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper (the “Committee”) was tasked with overseeing the restructuring of the ABCP. On January 12, 2009, the Ontario Superior Court approved a deal to swap essentially non-tradable, mortgage-backed debt for new securities. On January 21, 2009, the Committee announced the successful implementation of the restructuring plan (“the Plan”). Upon the restructuring old short-term ABCP notes were exchanged for longer-term notes of various classes with maturities that generally approximate those of the assets previously contained in the underlying conduits. The Committee also announced that interest payments in respect of interest accrued since the original liquidity disruption in August 2007 to August 31, 2008 (net of restructuring costs) would be made in two installments based on the ABCP note type.

As part of the Plan, the Company received new notes of various classes issued by trusts referred to as MAVII, including senior notes Class A-1, subordinated notes Class C, and ineligible tracking notes Class 13.

Upon the restructuring, the Company received the replacement notes as follows:

Notes	Maturity Date (1)	Interest Rate (2)	Face Value	Fair Value Estimate
MAV II Class A-1	December 2056	BA - 0.5%	\$ 1,187,185	\$ 794,402
MAV II Class C	December 2056	BA + 20%	36,717	3,671
MAV II Class 13 (Ineligible Asset Tracking Notes)			186,296	18,630
Total			\$ 1,410,198	\$ 816,703

(1) Maturity date reflects legal maturity date. Latest maturity date of underlying assets is December 2016.

(2) BA rate is Canadian dollar Bankers Acceptance interest rate with a maturity of 90 days.

Accounting for the exchange of the ABCP for new notes included removal of the ABCP from the Company’s balance sheet and recognition of the new notes at their fair value. The new notes are classified as held-for-trading under the Company’s Financial Instruments Policy which requires them to be fair valued at each period end with changes in fair value included in the statement of operations in the period in which they arise. The fair value is determined using a discounted cash flow approach based on the maximum use of inputs observed from the market on reporting dates.

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6. LONG-TERM INVESTMENT (cont'd...)

The fair value of the Class A-1 notes was established using a discounted cash flow approach based on the following inputs: the notes will pay interest at a rate 0.5% less than the bankers' acceptance ("BA") rate, prospective buyers of these notes were estimated to require premium yields 5% over the BA rate, average maturity of Class A -1 Notes was estimated to be 7.5 years. The Class C Notes are subordinated to the Class A and Class B Notes with respect to payment of interest and principal, and no amounts will be paid with respect to the Class C Notes until the Class A and Class B Notes are repaid in full. The Class C notes are viewed as highly speculative with regard to ultimate payment of principal at maturity in 2016. Accordingly, it is expected that Class C notes will trade at approximately 10% of face par value. The fair value of the sub-prime backed Class 13 Notes was calculated as 10% of par value. In conjunction with the note exchange, the Company received a payment of \$60,460 which was its share of the accumulated interest to June 30, 2009. The interest received to June 30, 2009 was accounted for as a reduction of the Company's investment. The estimated unpaid interest up to the restructuring date of January 21, 2009 is not material and was not included in the Company's fair value calculation. As a result of the notes exchange, the Company recorded the fair value of its new investments as \$816,703 and a provision for impairment of \$323,059 (\$211,804 impairment charge recognized in the fiscal 2008).

There is significant amount of uncertainty in estimating the amount and timing of cash flows associated with these notes. Until an active market develops for the MAV II notes, the fair value will be determined using a discounted cash flow approach based on the maximum use of inputs observed from market conditions on subsequent reporting dates. Therefore, the fair values may change materially in subsequent periods.

7. 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, 2007	56,554,933	\$ 12,277,578	\$ 1,580,928
Private placement	9,432,836	11,319,403	-
Bonus shares	210,000	266,700	-
Exercise of warrants	2,988,137	1,812,639	(53,532)
Exercise of options	2,225,000	2,065,218	(956,718)
Stock-based compensation	-	-	4,601,368
Share issuance costs	-	(823,330)	-
Agent warrants	-	(368,400)	368,400
	<u>-</u>	<u>(368,400)</u>	<u>368,400</u>
Balance as at June 30, 2008	71,410,906	26,549,808	5,540,446
Stock-based compensation	-	-	63,864
Share issuance cost recovery from December 2007 private placement	-	15,259	-
	<u>-</u>	<u>15,259</u>	<u>-</u>
Balance as at June 30, 2009	71,410,906	\$ 26,565,067	\$ 5,604,310

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

During the year ended June 30, 2008, the Company:

- a) completed a brokered private placement for 8,960,336 units at a price of \$1.20 per unit, with each unit being comprised of one common share and one-half of a transferable share purchase warrant. Each warrant may be exercised to purchase an additional common share of the Company at a purchase price of \$1.75 for a period of two years to December 18, 2009. The Company paid an aggregate of \$698,906 in cash commissions, \$124,424 in share issuance costs and issued an aggregate of 582,422 agent's warrants valued at \$368,400. Each agent's warrant is exercisable into one common share at an exercise price of \$1.20 per common share for a period of one year to December 18, 2008 (expired).
- b) completed a non-brokered private placement for 300,000 units at a price of \$1.20 per unit, with each unit being comprised of one common share and one-half of a transferable share purchase warrant. Each warrant may be exercised to purchase an additional common share of the Company at a purchase price of \$1.75 for a period of two years to December 18, 2009.
- c) completed a private placement for 172,500 units at a price of \$1.20 per unit. Each unit consists of one common share and one-half of a transferable share purchase warrant exercisable at \$1.75 per share until January 8, 2010.
- d) issued 210,000 common shares with a value of \$1.27 per share to consultants, geologists and field personnel for working on the Company's mineral properties. The shares are subject to hold periods whereby one-third of the shares become freely tradable every six months over a period of 18 months.

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 granted is presented below.

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

Stock options (cont'd...)

	Number of Options	Weighted Average Exercise Price
Outstanding, June 30, 2007	3,925,000	\$ 0.46
Granted (weighted average fair value, \$1.46)	3,215,000	1.56
Granted (weighted average fair value, \$1.59)	400,000	1.56
Exercised	<u>(2,225,000)</u>	0.50
Outstanding, June 30, 2008	5,315,000	1.19
Granted	250,000	0.30
Cancelled	<u>(790,000)</u>	0.69
Outstanding, June 30, 2009	4,775,000	\$ 1.23
Number of options currently exercisable	4,775,000	\$ 1.23

During the year ended June 30, 2009, the Company recorded stock-based compensation of \$63,864 (2008 - \$4,601,368) using the Black-Scholes Option Pricing model, as a result of 250,000 (2008 - 3,615,000) options granted. These amounts were recorded as contributed surplus on the balance sheet. The weighted average fair value of the options granted was \$0.26 (2008 - \$1.27) per option.

Option pricing models require the use of estimates and assumptions including the expected volatility. Changes in underlying assumptions can materially affect the fair value estimates.

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

	2009	2008
Risk-free interest rate	3.24%	4.28%
Expected life of options	5 years	5 years
Annualized volatility	108%	110%
Dividend rate	0.00%	0.00%

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

Warrants

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

	Number of Warrants	Weighted Average Exercise Price
Outstanding, June 30, 2007	6,388,403	\$ 0.60
Granted	5,298,840	1.69
Exercised	(2,988,137)	0.59
Expired	<u>(1,070,786)</u>	0.94
Outstanding, June 30, 2008	7,628,320	1.31
Expired	<u>(2,911,902)</u>	0.60
Outstanding, June 30, 2009	4,716,418	\$ 1.75

Share purchase options and warrants

At June 30, 2009, 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	650,000	\$ 0.25	June 30, 2010
	425,000	0.56	January 13, 2011
	3,050,000	1.56	September 26, 2012
	400,000	1.56	October 3, 2012
	<u>250,000</u>	0.30	July 31, 2013
	<u>4,775,000</u>		
Warrants	4,630,168	1.75	December 18, 2009
	<u>86,250</u>	1.75	January 8, 2010
	4,716,418		

8. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

The Company had the following significant non-cash transactions:

During the year ended June 30, 2009, the Company:

- a) allocated \$Nil (2008 – \$53,532) to capital stock from contributed surplus for agent warrants exercised during the period.
- b) allocated \$Nil (2008 – \$956,718) to capital stock from contributed surplus for stock options exercised during the period.
- c) issued Nil (2008 – 210,000) common shares valued at \$Nil (2008 - \$266,700) to consultants, geologists, and field personnel for working on the Company's resource properties.
- d) recorded share issuance costs of \$Nil (2008 - \$368,400), using the Black-Scholes option pricing model, as a result of Nil (2008 – 582,422) agents warrants granted. These amounts were recorded as contributed surplus on the balance sheet.

At June 30, 2009, the Company had included in accounts payable \$22,672 (2008 - \$447,283) of resource property costs.

9. RELATED PARTY TRANSACTIONS

During the year ended June 30, 2009, the Company entered into transactions with related parties as follows:

- a) Paid \$409,200 (2008 - \$177,000) for management fees and \$42,800 (2008 - \$18,000) for administration, recorded in office and miscellaneous expense, to a private company controlled by the Chief Executive Officer and director of the Company.
- b) Paid \$223,105 (2008 - \$220,780) 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 \$72,000 (2008 - \$55,700) for consulting fees to an officer of the Company.
- d) Paid \$84,505 (2008 - \$34,523) for legal fees, included in professional fees, to a firm in which a director of Canada Nickel is a partner of which \$4,104 is included in account payable.
- e) Repaid a \$1,100,000 loan to a private company controlled by the Chief Executive Officer and director of the Company for funds advanced to Diamondex pursuant to the James Bay Nickel Option Agreement (Note 5).

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.

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10. INCOME TAXES

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

	2009	2008
Loss before income tax recovery and non-controlling interest	\$ (9,242,000)	\$ (5,409,343)
Expected income tax recovery	\$ (2,795,705)	\$ (1,774,805)
Items not deductible for income tax purposes	68,757	1,683,691
Items deductible for tax	-	(110,410)
Effect of change in tax rate	290,779	249,131
Tax benefit not recognized	-	(47,607)
Change in valuation allowance recovery	<u>1,672,169</u>	<u>-</u>
Total income taxes	<u>\$ (764,000)</u>	<u>\$ -</u>

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

	2009	2008
Future income tax assets:		
Non-capital loss carry forwards	\$ 833,031	\$ 521,028
Share issuance costs	153,152	241,956
Financing costs	9,164	3,630
Cumulative exploration expenses	1,552,208	314,297
Equipment	3,109	2,334
Asset-backed commercial paper	<u>66,858</u>	<u>27,535</u>
	2,617,522	1,110,780
Valuation allowance	<u>(2,617,522)</u>	<u>(1,110,780)</u>
Net future income tax liability	<u>\$ -</u>	<u>\$ -</u>

During the year ended June 30, 2009, the Company's 43.56% owned subsidiary, Canada Nickel issued 10,633,685 flow-through shares for total proceeds of \$2,525,790. At June 30, 2009, the Company had spent \$1,100,000 of the flow-through expenditures and \$1,425,790 remains to be spent. The flow-through agreements require the Company to renounce certain deductions for Canadian exploration expenditures incurred on the Company's resource properties to the flow-through participants. The Company recognized a recovery of \$764,000 (2008 - \$Nil) of future income tax.

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

Canada Nickel entered into flow-through share subscription agreements during the year ended June 30, 2009 whereby it is committed to incur on or before February 12, 2010 a total of \$2,525,790 (of which \$1,100,000 had been incurred to June 30, 2009) of qualifying Canadian Exploration Expenses as described in the Income Tax Act of Canada. Commencing February 12, 2009, Canada Nickel is liable to pay a tax of approximately 5% per annum, calculated monthly on the unspent portion of the commitment.

The Company has available for deduction against future years' taxable income non-capital losses of approximately \$3,323,376. Non-capital losses expire as follows:

2025	\$ 403,890
2026	604,856
2027	486,895
2028	511,735
2029	<u>1,316,000</u>
	<u>\$ 3,323,376</u>

The Company has \$21,692,069 (2008 - \$14,361,447) of unclaimed resource expenses for Canadian income tax purposes which can be carried forward indefinitely and used to reduce taxable income in Canada.

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.

11. FINANCIAL INSTRUMENTS AND RISK

The Company's financial instruments consist of cash and cash equivalents, receivables, long term investments, and accounts payable and accrued liabilities. The fair value of these financial instruments approximates their carrying values, unless otherwise noted.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

Credit risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations.

At June 30, 2009, the Company had asset backed commercial paper with a fair value of \$816,703. As detailed in Note 6, the Company believes this is a credit risk.

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at June 30, 2009, the Company had a cash balance of \$2,431,412 (June 30, 2008 - \$9,296,877) to settle current liabilities of \$91,713 (June 30, 2008 - \$491,194). All of the Company's financial liabilities are classified as current and are anticipated to mature within the next fiscal period. The Company intends to settle these with funds from its positive working capital position.

11. FINANCIAL INSTRUMENTS AND RISK (cont'd...)

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

(a) Interest rate risk

The Company is exposed to interest rate risk to the extent that the cash maintained at the financial institutions is subject to floating rate of interest. The interest rate risks on cash and on the Company's obligations are not considered significant.

(b) Foreign 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, 2009, the Company had US\$27,003 (approximately CAD\$31,215) in cash and US\$9,109 (approximately CAD\$10,525) in accounts payable.

(c) Price risk

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company closely monitors commodity prices, individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company.

12. COMMITMENT

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

2010	\$ 10,480
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13. SEGMENTED INFORMATION

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

	2009	2008
Resource properties - Indonesia	\$ 15,483,236	\$ 13,152,613
Equipment – Canada	<u>13,842</u>	<u>17,302</u>
	<u>\$ 15,497,078</u>	<u>\$ 13,169,915</u>
Resource property write-down - Canada	<u>\$ 8,066,801</u>	<u>\$ -</u>

14. CAPITAL MANAGEMENT

The Company's objective when managing capital is to safeguard the entity's ability to continue as a going concern.

In the management of capital, the Company monitors its adjusted capital which comprises all components of equity (ie. share capital and retained earnings).

The Company sets the amount of capital in proportion to risk. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue common shares through private placements. The Company is not exposed to any externally imposed capital requirements.

There were no changes in the Company's approach to capital management during the year ended June 30, 2009.

15. SUBSEQUENT EVENTS

Subsequent to June 30, 2009, the Company:

- a) cancelled 3,450,000 stock options which were exercisable at \$1.56 per share;
- b) granted 3,500,000 stock options to purchase common shares at \$0.40 per share; and
- c) is currently in negotiations with Indotan in regards to the Lombok option agreement.