



CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE YEARS ENDED
JUNE 30, 2014 AND 2013**

(Expressed in Canadian dollars)



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Independent Auditors' Report

To the Shareholders of Southern Arc Minerals Inc.

We have audited the accompanying consolidated financial statements of Southern Arc Minerals Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at June 30, 2014 and June 30, 2013, and the consolidated statements of comprehensive loss, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Southern Arc Minerals Inc. and its subsidiaries as at June 30, 2014 and June 30, 2013 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without modifying our opinion, we draw attention to Note 1 to the consolidated financial statements which describes the material uncertainty that may cast significant doubt about the ability of Southern Arc Minerals Inc. to continue as a going concern.

"Crowe MacKay LLP"

**Chartered Accountants
Vancouver, British Columbia
October 24, 2014**

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in Canadian dollars)

| As at | June 30, 2014 | June 30, 2013 |
|--|----------------------|----------------------|
| Assets | | |
| Current | | |
| Cash | \$ 1,643,966 | \$ 12,866,306 |
| Receivables | 13,601 | 16,233 |
| Prepaid expenses | 31,086 | 76,648 |
| Assets held for sale (Note 12) | 1,188,021 | 3,664,305 |
| | 2,876,674 | 16,623,492 |
| Investment in associates (Note 3) | 6,258,639 | - |
| Deposit (Note 4) | 18,731 | 865,000 |
| Property, plant and equipment (Note 5) | 58,736 | 181,246 |
| Exploration properties (Note 6) | 102,068 | 102,068 |
| Loans receivable (Note 6) | 108,831 | 420,480 |
| Total assets | \$ 9,423,679 | \$ 18,192,286 |
| Liabilities | | |
| Current | | |
| Accounts payable and accrued liabilities | \$ 282,729 | \$ 549,727 |
| Accounts payable and accrued liabilities (Note 12) | 112,118 | 13,403 |
| Total liabilities | 394,847 | 563,130 |
| Shareholders' equity | | |
| Capital stock (Note 7) | 74,891,487 | 74,891,487 |
| Treasury stock (Note 7) | (1,170,000) | (1,170,000) |
| Share-based payment reserve (Note 7) | 11,922,405 | 11,841,937 |
| Deficit | (74,448,441) | (65,932,857) |
| Capital and reserve attributable to shareholders of Southern Arc Minerals Inc. | 11,195,451 | 19,630,567 |
| Non-controlling interest | (2,166,619) | (2,001,411) |
| Total shareholders' equity | 9,028,832 | 17,629,156 |
| Total liabilities and shareholders' equity | \$ 9,423,679 | \$ 18,192,286 |

Nature and continuance of operations (Note 1)

Subsequent events (Note 16)

Approved by the Board of Directors and authorized for issue on October 24, 2014:

On behalf of the Board of Directors

"John G. Proust" Director

"David Stone" Director

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Expressed in Canadian dollars)

| For the years ended | June 30, 2014 | June 30, 2013 |
|--|-----------------------|------------------------|
| Expenses | | |
| Depreciation (Note 5) | \$ 25,066 | \$ 29,850 |
| Office and miscellaneous (Note 10) | 553,943 | 674,278 |
| Share-based compensation (Note 7 and 9) | 80,468 | 343,022 |
| Management fees (Note 9) | 979,800 | 824,500 |
| Exploration property write-off (Note 6) | 1,464,312 | 36,179,601 |
| Foreign exchange gain | (63,094) | (81,647) |
| General exploration | 42,759 | 104,118 |
| Investor relations | 75,916 | 67,993 |
| Professional fees | 238,122 | 391,581 |
| Rent | 84,129 | 101,007 |
| Transfer agent and filing fees | 72,075 | 57,637 |
| Travel | 88,774 | 86,391 |
| Property, plant and equipment write-down (Note 5) | - | 51,443 |
| Loss before other items | (3,642,270) | (38,829,774) |
| Other items | | |
| Interest income | 60,313 | 175,684 |
| Impairment of other advances (Note 6) | (337,059) | - |
| Loss on equity investment (Note 3) | (903,215) | - |
| Gain on disposition of equipment | 2,255 | - |
| Write-down of equity investment (Note 3) | (1,971,720) | - |
| Re-measurement of assets held for sale (Note 12) | (1,889,096) | (3,291,080) |
| | (5,038,522) | (3,115,396) |
| Net and comprehensive loss for the year | \$ (8,680,792) | \$ (41,945,170) |
| Comprehensive loss attributable to: | | |
| Shareholders of Southern Arc Minerals Inc. | \$ (8,515,584) | \$ (39,677,608) |
| Non-controlling interests | (165,208) | (2,267,562) |
| | \$ (8,680,792) | \$ (41,945,170) |
| Basic and diluted loss per share | \$ (0.08) | \$ (0.38) |
| Weighted average number of shares outstanding | 109,214,510 | 109,214,510 |

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in Canadian dollars)

| For the years ended | June 30, 2014 | June 30, 2013 |
|---|----------------------|----------------------|
| Cash flows from operating activities | | |
| Comprehensive loss for the year | \$ (8,680,792) | \$ (41,945,170) |
| Items not affecting cash: | | |
| Depreciation | 25,066 | 29,850 |
| Share-based compensation | 80,468 | 343,022 |
| Exploration property write-off | 1,464,312 | 36,179,601 |
| Loss on equity investment | 903,215 | - |
| Write-down of equity investment | 1,971,720 | - |
| Remeasurement of held for sale assets | 1,889,096 | 3,291,080 |
| Gain on disposition of equipment | (2,255) | - |
| Rent | 32,974 | - |
| Impairment of advances | 337,059 | - |
| Property, plant and equipment write-down | - | 51,443 |
| Foreign exchange gain | (63,094) | (81,647) |
| Changes in non-cash working capital items: | | |
| Receivables | 2,632 | 24,468 |
| Prepaid expense | 45,562 | 40,632 |
| Accounts payable and accrued liabilities | (260,832) | 492,617 |
| Net cash used in operating activities | (2,254,869) | (1,574,104) |
| Cash flows from investing activities | | |
| Investment in exploration properties | (1,329,807) | (7,093,371) |
| Purchase of investment in associates | (8,268,574) | - |
| Proceeds received from asset held for sale | 667,800 | - |
| Deposit | - | (865,000) |
| Proceeds from disposal (acquisition) of property, plant and equipment | 24,769 | (2,445) |
| Net cash used in investing activities | (8,905,812) | (7,960,816) |
| Effect of exchange rate changes on cash | (61,659) | (40,341) |
| Change in cash during the year | (11,222,340) | (9,575,261) |
| Cash, beginning of the year | 12,866,306 | 22,441,567 |
| Cash, end of the year | \$ 1,643,966 | \$ 12,866,306 |

Supplemental disclosure with respect to cash flows (Note 8)

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Expressed in Canadian dollars)

Attributable to shareholders of Southern Arc Minerals Inc.

| | Capital Stock | Treasury Stock | Share-based Payment Reserve | Deficit | Total | Non-controlling Interest | Total Equity |
|------------------------------------|----------------------|-----------------------|--------------------------------|------------------------|----------------------|-----------------------------|----------------------|
| Balance, June 30, 2013 | \$ 74,891,487 | \$ (1,170,000) | \$ 11,841,937 | \$ (65,932,857) | \$ 19,630,567 | \$ (2,001,411) | \$ 17,629,156 |
| Comprehensive loss for the year | - | - | - | (8,515,584) | (8,515,584) | (165,208) | (8,680,792) |
| Share-based compensation | - | - | 80,468 | - | 80,468 | - | 80,468 |
| | - | - | 80,468 | (8,515,584) | (8,435,116) | (165,208) | (8,600,324) |
| Balance, June 30, 2014 | \$ 74,891,487 | \$ (1,170,000) | \$ 11,922,405 | \$ (74,448,441) | \$ 11,195,451 | \$ (2,166,619) | \$ 9,028,832 |
| Balance, June 30, 2012 | \$ 74,891,487 | \$ (1,170,000) | \$ 11,498,915 | \$ (26,255,249) | \$ 58,965,153 | \$ 354,923 | \$ 59,320,076 |
| Comprehensive loss for the year | - | - | - | (39,677,608) | (39,677,608) | (2,267,562) | (41,945,170) |
| Share-based compensation | - | - | 343,022 | - | 343,022 | - | 343,022 |
| Change in non-controlling interest | - | - | - | - | - | (88,772) | (88,772) |
| | - | - | 343,022 | (39,677,608) | (39,334,586) | (2,356,334) | (41,690,920) |
| Balance, June 30, 2013 | \$ 74,891,487 | \$ (1,170,000) | \$ 11,841,937 | \$ (65,932,857) | \$ 19,630,567 | \$ (2,001,411) | \$ 17,629,156 |

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

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Expressed in Canadian dollars)

1. NATURE AND CONTINUANCE OF OPERATIONS

Southern Arc Minerals Inc. (“Southern Arc” or “the Company”) was incorporated in British Columbia, Canada on August 19, 2004. The Company is a natural resource company engaged in the acquisition and exploration of resource properties. To date, the Company has not generated revenues from operations and is considered to be in the exploration stage. The Company’s head office is located at Suite 1680 - 200 Burrard Street, Vancouver, British Columbia, Canada, V6C 3L6.

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

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a “going concern”, which assumes that the Company will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. Based on current plans, budgeted capital expenditures, and cash requirements, the Company has sufficient cash to finance its planned activities for the twelve months from the date of approval of the consolidated financial statements. However, the Company recognizes that planned expenditures may change as new information and opportunities become available and, as a result, it may be required to obtain additional financing. While the Company has been successful at securing financing in the past, there can be no assurance that it will be able to do so in the future. These material uncertainties cast significant doubt upon the Company’s ability to continue as a going concern. 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 business.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board (“IASB”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”).

These consolidated financial statements are presented on a historical cost basis, except for financial instruments classified as available-for-sale or fair value through profit or loss (“FVTPL”). In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

These consolidated financial statements were approved for issuance by the Company’s Board of Directors on October 24, 2014.

Principles of consolidation

These consolidated financial statements include the accounts of the Company and

- i) its wholly-owned Canadian subsidiary West Indonesia Mining Holdings Inc.;
- ii) its wholly-owned Singapore subsidiaries: Indotan Lombok Pte. Ltd., Indotan Sumbawa Pte. Ltd., East Indonesia Mining Pte. Ltd. and Southern Sunda Mining Pte. Ltd.;
- iii) its wholly-owned Indonesian subsidiary PT. Selatan Arc Minerals;
- iv) its wholly-owned Japanese subsidiary Southern Arc Minerals Japan KK;
- v) its 90%-owned Indonesian subsidiaries: PT. Indotan Lombok Barat Bangkit and PT. Indotan Sumbawa Barat; and
- vi) its 70%-owned Indonesian subsidiary PT. Selatan Bengkulu Minerals.

Significant intercompany balances and transactions have been eliminated upon consolidation.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Significant accounting judgements and estimates

The preparation of these consolidated financial statements requires management to make certain estimates, judgements and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. These consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical accounting estimates

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of the reporting period, that could result in a material adjustment to the carrying amounts of assets and liabilities in the event that actual results differ from assumptions made, relate to, but are not limited, to the following:

- i) The estimated fair value of the Company's financial assets and liabilities are by their nature, subject to measurement uncertainty.
- ii) The calculation of share-based compensation requires estimates of volatility, forfeiture rates and market prices surrounding the issuance of share options. These estimates impact share-based compensation expense and share-based payment reserve.
- iii) The collectability of loans receivable which may impact bad debt expense.
- iv) The estimated rehabilitation provision.
- v) The estimated fair value of the Company's assets held for sale.

Critical accounting judgements

Critical accounting judgements are accounting policies that have been identified as being complex or involving subjective judgements or assessments.

- i) A deferred income tax asset is recognized to the extent that it is probable that future income tax profits will be available against which the asset can be used. To the extent that management does not consider it probable that a deferred income tax asset will be recovered, a deferred income tax asset is not recognized.
- ii) The application of the Company's accounting policy for exploration expenditure requires judgement in determining whether it is likely that future economic benefits will flow to the Company, which may be based on assumptions about future events or circumstances. Estimates and assumptions made may change if new information becomes available. If, after an expenditure is capitalized, information becomes available suggesting that the recovery of the expenditure is unlikely, the amount capitalized is written off in profit or loss in the year the new information becomes available.
- iii) The determination of a subsidiary's functional currency often requires significant judgement where the primary economic environment in which the subsidiary operates may not be clear. This can have a significant impact on the consolidated results of the Company based on the foreign currency translation method.
- iv) To classify a Company's asset as held for sale requires judgement in determining whether the asset is available for immediate sale in its present condition subject only to terms that are usual and customary for a sale of such assets, and whether the sale of the asset is highly probable.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment

Telephone equipment is recorded at cost and amortized using the declining balance method at 20% per year. Vehicles, furniture, computers, field equipment and leasehold improvements are recorded at cost and amortized on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives are as follows:

| | |
|--|----------|
| Vehicles, furniture, computers and field equipment | 4 years |
| Leasehold improvements | 10 years |

Depreciation of vehicles, computers (field) and field equipment are allocated to exploration properties.

Exploration properties

Exploration properties

Once the legal right to explore a property has been acquired, costs directly related to exploration and evaluation are recognized and capitalized by geographical area, in addition to the acquisition costs by geographical area. These direct expenditures include such costs as materials used, surveying costs, drilling costs, payments made to contractors, and depreciation on plant and equipment during the exploration phase. Costs not directly attributable to exploration activities, including general administrative overhead costs, are expensed in the period in which they occur.

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 an exploration property is impaired, that property is written down to its estimated fair value. An exploration property is reviewed for impairment annually and whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

As the Company currently has no operational income, any incidental revenues earned in connection with exploration activities are applied as a reduction to capitalized exploration costs.

The amounts shown for exploration 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 property development, and future profitable production or proceeds from the disposition thereof.

Title and permits to exploration properties involve certain inherent risks due to the difficulties of determining the validity of certain exploration property interests as well as the potential for problems arising from the frequently ambiguous conveying characteristics of many exploration properties. The Company has investigated title to all of its exploration property interests and, to the best of its knowledge, title to all of its exploration property interests are in good standing. The Company is in various stages of applying for permits for ongoing exploration activities related to the exploration properties.

Joint interest

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

The Company does not record any exploration expenditures made by the joint venture partner on its account. It also does not recognize any gain or loss on its option and joint venture agreement arrangement, but re-designates any costs previously capitalized in relation to the whole interest as relating to the partial interest retained. Exploration advances received from a joint venture partner in accordance with the terms of the option and joint venture agreement are recorded as current liabilities until the exploration expenditure is incurred.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Exploration properties (continued)

Rehabilitation provision

The Company is subject to various government laws and regulations relating to environmental disturbances caused by exploration and evaluation activities. The Company records the present value of the estimated costs of legal and constructive obligations required to restore the exploration sites in the period in which the obligation is incurred. The nature of the rehabilitation activities includes restoration, reclamation and re-vegetation of the affected exploration sites.

The rehabilitation provision generally arises when the environmental disturbance is subject to government laws and regulations. When the liability is recognized, the present value of the estimated costs is capitalized by increasing the carrying amount of the related mining assets. Over time, the discounted liability is increased for the changes in present value based on current market discount rates and liability specific risks.

Additional environmental disturbances or changes in rehabilitation costs will be recognized as additions to the corresponding assets and rehabilitation liability in the period in which they occur.

Foreign currency transactions

The functional and reporting currency of the Company and its subsidiaries is the Canadian dollar. Transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on dates of transactions. Monetary assets and liabilities that are denominated in foreign currencies are translated at the rates prevailing at each reporting date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are re-translated to functional currency at the exchange rate at the date the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not re-translated. Foreign currency translation differences are recognized in profit or loss.

Loss per share

The Company presents basic per share data for its common shares, calculated by dividing the net loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted loss per share is determined by adjusting the loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares. In reporting periods when a loss is incurred, potential issuance of shares would be anti-dilutive and, therefore, basic and diluted loss per share are the same.

Investment

Investments in companies over which the Company can exercise significant influence are accounted for using the equity method. When there is a loss in value of an investment that is other than a temporary decline, the investment is written down to recognize the loss in the determination of comprehensive income or loss.

Share-based payment transactions

The share option plan allows the Company to grant options to its employees and consultants. The fair value of options granted is recognized as a share-based payment expense with a corresponding increase in share-based payment reserve. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee.

The fair value for employee options is measured at grant date and each tranche is recognized on a graded-vesting basis over the period during which the options vest. The fair value of the options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. At

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Share-based payment transactions (continued)

each financial position reporting date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest.

Equity-settled share-based payment transactions with non-employees are measured at the fair value of the goods or services received. However, if the fair value cannot be estimated reliably, the share-based payment transaction is measured at the fair value of the equity instruments granted at the date the non-employee provides the goods or the services.

Income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in net income (loss) except to the extent that they relate to a business combination or items recognized directly in equity or in other comprehensive loss/income.

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting nor taxable profit or loss.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be applied. At the end of each reporting period, the Company reassesses unrecognized deferred tax assets. The Company recognizes a previously unrecognized deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Financial instruments

On initial recognition, all financial assets and financial liabilities are recorded at fair value plus directly attributable transaction costs, other than financial assets and liabilities classified as at fair value through profit or loss. All transactions related to financial instruments are recorded on a trade date basis. The directly attributable transaction costs of financial assets and liabilities classified as at fair value through profit or loss are expensed in the period they are incurred.

Subsequent measurement

Financial assets

The Company classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Fair value through profit or loss - This category comprises derivatives, or assets acquired or incurred principally for the purpose of selling or repurchasing it in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in profit or loss. Cash is classified as fair value through profit or loss.

Loans and receivables - These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at amortized cost using the effective interest method less any provision for impairment. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Receivables and loans receivable are classified as loans and receivables.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

Subsequent measurement (continued)

Financial assets (continued)

Held-to-maturity investments - These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in profit or loss. The Company has not classified any financial assets as held-to-maturity.

Available-for-sale - Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized directly in other comprehensive income (loss). Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in profit or loss. The Company has not classified any financial assets as available-for-sale.

All financial assets except for those recognized at fair value through profit or loss are subject to review for impairment at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, which are described above.

Financial liabilities

The Company classifies its financial liabilities into one of two categories. The Company's accounting policy for each category is as follows:

Fair value through profit or loss - This category comprises derivatives, or liabilities acquired or incurred principally for the purpose of selling or repurchasing it in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in profit or loss. The Company has not classified any financial liabilities as fair value through profit or loss.

Other financial liabilities - This category includes accounts payable and accrued liabilities, which are recognized at amortized cost at the settlement date using the effective interest method of amortization. Accounts payable and accrued liabilities are classified as other financial liabilities.

Investments in associates

Associates are all entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The Company's investment in associates includes goodwill identified on acquisition.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognized in other comprehensive income is reclassified to profit or loss where appropriate.

The Company's share of post-acquisition profit or loss is recognised in the income statement, and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Company's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Company does

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

(Expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments in associates (continued)

not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Company determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Company calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to share of profit/(loss) of associates in profit or loss.

Profits and losses resulting from upstream and downstream transactions between the Company and its associates are recognised in the Company's consolidated financial statements only to the extent of unrelated investors' interests in the associates. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company. Dilution gains and losses arising in investments in associates are recognised in the income statement.

New standards, amendments and interpretations implemented

The accounting policies followed by the Company are consistent with those of the previous financial year except for certain new standards, interpretations and amendments to existing standards issued by the IASB or IFRIC that took effect as of January 1, 2013 and were adopted by the Company effective July 1, 2013, following the Company's June 30, 2013 fiscal year-end.

- **IFRS 10 - Consolidated Financial Statements.** In May 2011, the IASB issued IFRS 10, which replaces IAS 27 - Consolidated and Separate Financial Statements and SIC-12 Consolidation - Special Purpose Entities. IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Company has determined that there is no impact on its consolidated financial statements arising from this standard.
- **IFRS 11 - Joint Arrangement.** In May 2011, the IASB issued IFRS 11, which replaces IAS 31 - Interests in Joint Ventures and SIC-13 Jointly Controlled Entities - Non-monetary Contributions by Venturers. IFRS 11 focuses on the rights and obligations of an arrangement rather than its legal form, as is currently the case. The standard distinguishes between joint operations, where the joint operator accounts for the assets, liabilities, revenues, and expenses relating to its involvement, and joint ventures, which must be accounted for using the equity method. The Company has determined that there is no impact on its consolidated financial statements arising from this standard.
- **IFRS 12 - Disclosure of Interest in Other Entities.** IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint operations, joint ventures, associates and unconsolidated structured entities. The Company has determined that there is no impact on its consolidated financial statements arising from this standard.
- **IFRS 13 - Fair Value Measurement.** IFRS 13 is a new standard that applies to both financial and non-financial items measured at fair value. It defines fair value, sets out a single framework for measuring fair value and requires disclosures about fair value measurements. Previously, a variety of fair value techniques and disclosures were possible under the requirements of separate applicable IFRSs. The Company has determined that there is no impact on its consolidated financial statements arising from this standard.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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(Expressed in Canadian dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

New accounting standards and pronouncements issued

The following is an overview of accounting standard changes that the Company will be required to adopt in future years. The Company does not expect to adopt any of these standards before their effective dates. The Company continues to evaluate the impact of these standards on its consolidated financial statements.

Effective January 1, 2014:

- IAS 32 - Financial Instruments: Presentation. The amendments to IAS 32 pertain to the application guidance on the offsetting of financial assets and financial liabilities. The changes focus on four main areas: the meaning of “currently has a legally enforceable right of set-off”, the application of simultaneous realization and settlement, the offsetting of collateral amounts, and the unit of account for applying the offsetting requirements. The Company concluded that the adoption of this standard does not have a material impact on its consolidated financial statements.
- IAS 36 - Impairment of Assets. The amendments to IAS 36 outline the additional disclosures that will be required with regards to the recoverable amount of impaired assets. The Company concluded that the application of this IAS did not have any material impact on the disclosures for the current or prior years, but may affect the disclosures of future transactions or arrangements.
- International Financial Reporting Interpretations Committee Interpretation (IFRIC) 21 - Levies. This interpretation clarifies the accounting treatment for a liability to pay a levy, where a levy is an outflow of economic benefits imposed by governments on entities in accordance with legislation. The Company concluded that the application of this IFRIC did not have any material impact on its consolidated financial statements.

Effective January 1, 2018:

- IFRS 9 - Financial Instruments. This IFRS introduces new requirements for classifying and measuring financial assets and liabilities and carries over from the requirements of IAS 39 - Financial Instruments: Recognition and measurement, derecognition of financial assets and financial liabilities.

3. INVESTMENT IN ASSOCIATES

Eagle Hill Exploration Corporation

On August 14, 2013, the Company invested \$7,324,050 (inclusive of an \$865,000 deposit paid in June 2013) to acquire 97,654,000 units of Eagle Hill Exploration Corporation (“Eagle Hill”) by way of private placement at a price of \$0.075 per unit. Each unit comprises one common share of Eagle Hill and one half share purchase warrant, with each whole warrant entitling the Company to acquire a further common share of Eagle Hill at a price of \$0.10 per share for a period of four years. Eagle Hill is a mineral exploration company focused on advancing the Windfall Lake Gold Project located in the Abitibi Gold Belt in Quebec, Canada. Eagle Hill is listed on the TSX Venture Exchange (“EAG”) and on the OTCQX International Exchange (“EHECF”).

On April 8, 2014, the Company invested an additional \$526,316 in Eagle Hill by purchasing 7,518,797 units at \$0.07 per unit as part of Eagle Hill’s flow-through unit offering. Each unit consists of one common share of Eagle Hill and one share purchase warrant where each warrant entitles the Company to acquire one share of Eagle Hill at a price of \$0.10 until April 8, 2016.

On May 9, 2014, the Company purchased an additional 20,000,000 units at \$0.05 per unit for an investment of \$1,000,000. Each unit consists of one common share of Eagle Hill and one share purchase warrant where each warrant entitles the Company to acquire one share of Eagle Hill at a price of \$0.08 until May 8, 2016.

SOUTHERN ARC MINERALS INC.

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3. INVESTMENT IN ASSOCIATES (continued)**Eagle Hill Exploration Corporation (continued)**

At the year ended June 30, 2014, the Company held a 26.25% (125,172,797 common shares) equity interest in Eagle Hill, which is accounted for using the equity method, and 76,345,797 warrants entitling the Company to acquire an additional 76,345,797 shares of Eagle Hill. Summarized financial information for Eagle Hill is as follows:

| | June 30, 2014 |
|--|----------------------|
| Revenue from August 15, 2013 to June 30, 2014 | \$ - |
| Net loss from August 15, 2013 to June 30, 2014 | (3,458,854) |
| Assets | 37,721,768 |
| Liabilities | (4,321,039) |

| | 2014 |
|---------------------------------|--------------|
| Balance - beginning of the year | \$ - |
| Acquisition of investment | 8,850,366 |
| Acquisition-related costs | 283,208 |
| Share of loss for the period | (903,215) |
| Write-down on equity investment | (1,971,720) |
| Balance - end of the year | \$ 6,258,639 |

Although Eagle Hill is accounted for as an equity investment by the Company, it is subject to evaluation of significant and prolonged declines in value. The quoted market value of the Company's investment in Eagle Hill at June 30, 2014 was \$6,258,639 based on the publicly traded closing share price of Eagle Hill at \$0.05. As such, the Company recorded a write-down of \$1,971,720 and will carry its investment in Eagle Hill at market value until such time that the market price rises above the Company's approximate current investment cost. At that time, the Company will determine whether a recovery can be related objectively to an event occurring after the impairment was recognized and only then will the Company record a recovery of the impairment in Eagle Hill in the Statement of Comprehensive Loss.

Nickel Oil and Gas Corp.

At December 31, 2011, the Company concluded that the decline in the value of its equity investment in Nickel Oil & Gas Corp. ("Nickel"), due to continued low natural gas prices, was other than temporary. Therefore, the Company wrote the remaining value of the investment down to \$nil and recorded an impairment loss of \$305,582 during the year ended June 30, 2012. As at June 30, 2014 and June 30, 2013, the Company held 15.3 million Nickel shares (37.6% of Nickel's outstanding shares) with a carrying value of \$nil (June 30, 2013 and June 30, 2012: \$nil).

4. DEPOSIT

During the year ended June 30, 2013, the Company advanced \$865,000 to Eagle Hill in the form of a promissory note (the "Deposit") repayable by June 26, 2014 with an annual interest rate of 8%. On August 14, 2013, the Company invested \$7,324,050 (inclusive of the \$865,000 Deposit paid in June 2013) to acquire 97,654,000 units of Eagle Hill by way of private placement at a price of \$0.075 per unit (Note 3). The Company has a remaining refundable deposit of \$18,731 relating to a license outstanding as at June 30, 2014 (June 30, 2013 - \$nil).

SOUTHERN ARC MINERALS INC.

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5. PROPERTY, PLANT AND EQUIPMENT

| | Telephone equipment | Vehicles | Furniture | Computer | Field equipment | Leasehold improvement | Total |
|---|------------------------|--------------------|--------------------|--------------------|--------------------|--------------------------|---------------------|
| Costs | | | | | | | |
| Balance, June 30, 2012 | \$ 26,278 | \$ 122,664 | \$ 32,939 | \$ 107,307 | \$ 148,919 | \$ 34,716 | \$ 472,823 |
| Additions | - | - | - | 2,445 | - | - | 2,445 |
| Reclassified as assets held for sale | - | - | - | (12,220) | (7,873) | - | (20,093) |
| Impairment | (26,278) | - | (6,482) | (13,336) | (13,091) | (34,716) | (93,903) |
| Balance, June 30, 2013 | - | 122,664 | 26,457 | 84,196 | 127,955 | - | 361,272 |
| Dispositions | - | (57,007) | (6,839) | (14,318) | (12,778) | - | (90,942) |
| Balance, June 30, 2014 | \$ - | \$ 65,657 | \$ 19,618 | \$ 69,878 | \$ 115,177 | \$ - | \$ 270,330 |
| Accumulated depreciation | | | | | | | |
| Balance, June 30, 2012 | \$ (19,192) | \$ (22,241) | \$ (8,942) | \$ (33,030) | \$ (40,868) | \$ (3,760) | \$ (128,033) |
| Depreciation for the year | - | (30,657) | (4,761) | (20,430) | (31,215) | (2,313) | (89,376) |
| Reclassified as assets held for sale | - | - | - | 7,085 | 5,033 | - | 12,118 |
| Impairment | 19,192 | - | - | - | - | 6,073 | 25,265 |
| Balance, June 30, 2013 | - | (52,898) | (13,703) | (46,375) | (67,050) | - | (180,026) |
| Depreciation for the year | - | (17,375) | (5,339) | (14,191) | (30,117) | - | (67,022) |
| Recapture from dispositions | - | 24,662 | 4,580 | - | 6,212 | - | 35,454 |
| Balance, June 30, 2014 | \$ - | \$ (45,611) | \$ (14,462) | \$ (60,566) | \$ (90,955) | \$ - | \$ (211,594) |
| Net carrying value | | | | | | | |
| Balance, June 30, 2013 | \$ - | \$ 69,766 | \$ 12,754 | \$ 37,821 | \$ 60,905 | \$ - | \$ 181,246 |
| Balance, June 30, 2014 | \$ - | \$ 20,046 | \$ 5,156 | \$ 9,312 | \$ 24,222 | \$ - | \$ 58,736 |

During the year ended June 30, 2014, \$41,956 of depreciation (2013: \$59,526) was capitalized to exploration properties.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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6. EXPLORATION PROPERTIES

| | Lombok Property, Indonesia | Sumbawa Properties, Indonesia | Total |
|--|----------------------------------|-------------------------------------|----------------------|
| Balance, June 30, 2012 | \$ 29,702,681 | \$ 7,727,943 | \$ 37,430,624 |
| Deferred exploration costs incurred during the year: | | | |
| Assaying, surveying and analysis | - | 16,814 | 16,814 |
| Camp construction and other | 1,632,357 | 15,263 | 1,647,620 |
| Drilling | 1,288,717 | 198,785 | 1,487,502 |
| Geological and other consulting | 1,044,485 | 147,519 | 1,192,004 |
| Labour | 1,134,881 | 319,634 | 1,454,515 |
| Total deferred exploration costs | 5,100,440 | 698,015 | 5,798,455 |
| Transfer between subsidiaries | 183,691 | (183,691) | - |
| Deposit for Taliwang transaction | - | (105,120) | (105,120) |
| Exploration property write-down | (34,986,812) | (1,192,789) | (36,179,601) |
| Reclassified as assets held for sale (Note 12) | - | (3,551,210) | (3,551,210) |
| Re-measurement of assets held for sale | - | (3,291,080) | (3,291,080) |
| Balance, June 30, 2013 | - | 102,068 | 102,068 |
| Deferred exploration costs incurred during the year: | | | |
| Camp construction and other | 272,577 | 99,913 | 372,490 |
| Geological and other consulting | 331,395 | 15,200 | 346,595 |
| Labour | 732,862 | 12,365 | 745,227 |
| Total deferred exploration costs | 1,336,834 | 127,478 | 1,464,312 |
| Exploration property write-down | (1,336,834) | (127,478) | (1,464,312) |
| Balance, June 30, 2014 | \$ - | \$ 102,068 | \$ 102,068 |

West Lombok property

The Company holds a 90% interest in the West Lombok property located on Lombok Island, Indonesia. During the year ended June 30, 2013, the Company conducted a review of the value of its West Lombok property and determined that its value had been impaired. As a result, the Company wrote down the property value to \$nil and recorded an impairment of \$34,986,812 for the year ended June 30, 2013.

For the year ended June 30, 2014, the Company wrote down an additional \$1,336,834 of exploration costs relating to the West Lombok property that were incurred during the year.

Taliwang property

In December 2012, the Company agreed to sell its 90% interest in the Taliwang project. This transaction was renegotiated on August 31, 2013 whereby the purchaser, a prominent Indonesian business man (the "Purchaser"), agreed to purchase the Taliwang project for a cash payment of US\$3.5 million, of which US\$100,000 was received as a non-refundable deposit. As a result of the expected value upon completion of this sale, during the year ended June 30, 2013 the Company recognized a \$3,291,080 impairment provision against the carrying value of the Taliwang property and reclassified its estimated fair value of \$3,551,210 as assets held for sale.

The transaction was again revised in February 2014 to change the purchase price to a cash payment of US\$1.6 million and the granting of a 5% net smelter royalty ("NSR") to Southern Arc. The Purchaser has the option to buy back 3% of the NSR by paying Southern Arc US\$3,000,000. As a result of the change in purchase price, the Company recorded an

SOUTHERN ARC MINERALS INC.

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6. EXPLORATION PROPERTIES (continued)

Taliwang property (continued)

impairment provision of \$1,889,096 against the assets held for sale. For the year ended June 30, 2014, the Company wrote down an additional \$127,478 of exploration costs relating to Taliwang property that were incurred during the year. The Purchaser had made payments totalling US\$700,000 as at June 30, 2014.

Subsequent to June 30, 2014, the Company amended the sale agreement and closed the sale of its interest in the Taliwang project (see Note 16). Pursuant to the terms of the final agreement, the Company sold its 90% share of the Indonesian company that owns the Taliwang project to the Purchaser. The Purchaser paid US\$1,000,000 and granted a 5% NSR to Southern Arc. The Purchaser has the option to buy back 3% of the NSR by paying the Company US\$3,000,000. The Purchaser is required to make additional payments to the Company to fulfill the agreed purchase price of US\$1.6 million. The Purchaser will pay the Company 40% of gross revenue generated from the Taliwang project, after payment of the Southern Arc NSR, until the aggregate amount of such payments equals US\$750,000. Alternatively, the Purchaser has the option of making a one-time payment of US\$600,000 if the payment is made before January 12, 2015.

The Company has advanced loans receivable of \$552,650 (US\$500,000) (June 30, 2013: \$525,600 (US\$500,000)) on an unsecured basis and without interest to the Indonesian subsidiary companies as capital contributions on behalf of the Indonesian shareholders, and these funds are to be repaid to the Company from future revenues of the subsidiaries. Of this amount, \$106,760 (US\$100,000) (June 30, 2013: \$105,120) is classified as assets held for sale (Note 12). During the year ended June 30, 2014, the Company impaired \$337,059 related to these advances as it was considered to be uncollectible (June 30, 2013: \$nil). The remaining \$108,831 is loans receivable outstanding as at June 30, 2014.

East Elang property

In October 2010, the Company entered into an option and joint venture agreement with Vale International S.A. ("Vale"), a wholly-owned subsidiary of Vale S.A., regarding the East Elang property. To exercise its option in the East Elang property, Vale has to fully fund the advancement of East Elang, through to and including the completion of a bankable feasibility study, at no cost to the Company as follows:

- a) Phase 1 – Vale will fund US\$1,200,000 of exploration expenditures within one year from the date the Company receives an exploration activities permit from the Ministry of Forestry for the East Elang property. Vale can then elect to proceed to;
- b) Phase 2 minimum program – Vale will fund at least US\$2,500,000 of additional exploration expenditures within two years of commencing Phase 2;
- c) Phase 2 full program – Vale may proceed to completion of a pre-feasibility study or fund further exploration expenditures of at least US\$10,000,000 within four years of commencing Phase 2;
- d) Upon completing the Phase 2 full program, Vale may elect to solely fund the completion of a bankable feasibility study within seven years of commencing Phase 2.

If Vale completes a bankable feasibility study within the permitted time frame, Vale will be entitled to receive a 75% interest in the Company's subsidiary PT. Selatan Arc Minerals ("PT SAM"), which holds the exploration permit ("IUP") for East Elang.

The East Elang property is held by the Company's wholly-owned Indonesian subsidiary, PT SAM. Funds advanced to PT SAM by Vale are recorded as cash and as accounts payable and accrued liabilities in the Company's accounts until such time as the funds are expended on approved exploration activities. As at June 30, 2014, PT SAM held US\$17,738 (June 30, 2013: US\$93,022) of funds advanced by Vale.

SOUTHERN ARC MINERALS INC.

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7. CAPITAL STOCK AND RESERVES

| | Number of Common Shares | Capital Stock | Number of Treasury Shares | Treasury Stock | Share-based Payment Reserve |
|---|----------------------------|----------------------|------------------------------|-----------------------|-----------------------------------|
| Authorized - an unlimited number of common shares without par value | | | | | |
| Balance as at June 30, 2012 | 109,214,510 | \$ 74,891,487 | (1,300,000) | \$ (1,170,000) | \$ 11,498,915 |
| Share-based compensation | - | - | - | - | 343,022 |
| Balance as at June 30, 2013 | 109,214,510 | 74,891,487 | (1,300,000) | (1,170,000) | 11,841,937 |
| Share-based compensation | - | - | - | - | 80,468 |
| Balance as at June 30, 2014 | 109,214,510 | \$ 74,891,487 | (1,300,000) | \$ (1,170,000) | \$ 11,922,405 |

Share options

The Company grants share options in accordance with its share option plan and the policies of the TSX Venture Exchange. 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 shares on the date of grant. The share options granted are exercisable for a period of up to 10 years. A summary of the Company's outstanding share options granted is presented in the following table.

| | Number of Options | Weighted Average Exercise Price |
|---|----------------------|---------------------------------------|
| Outstanding at June 30, 2012 (remaining contractual life is 3.05 years) | 9,080,000 | \$ 0.82 |
| Granted | 850,000 | 0.25 |
| Cancelled | (150,000) | 0.80 |
| Forfeited | (490,000) | 0.86 |
| Outstanding at June 30, 2013 (remaining contractual life is 2.03 years) | 9,290,000 | 0.76 |
| Granted | 760,000 | 0.10 |
| Expired | (768,750) | 0.54 |
| Forfeited | (6,250) | 0.90 |
| Outstanding at June 30, 2014 (remaining contractual life is 1.34 years) | 9,275,000 | \$ 0.73 |
| Number of options exercisable at June 30, 2014 | 8,440,000 | \$ 0.79 |

SOUTHERN ARC MINERALS INC.

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7. CAPITAL STOCK AND RESERVES (continued)**Share options (continued)**

During the year ended June 30, 2014, the Company recorded share-based compensation of \$80,468 (2013: \$343,022) fair valued using the Black-Scholes option pricing model, as a result of the vesting of options granted. These amounts were recorded as share-based payment reserve on the statement of financial position.

During the year ended June 30, 2014, the Company granted 500,000 and 260,000 options for a total of 760,000 options at a weighted average fair value of \$0.06. The weighted average fair value of the options granted during the year ended June 30, 2013 was \$0.18 per option.

Option pricing models require the input of subjective assumptions including the expected price volatility and expected option life. Management has calculated expected price volatility using data from the historical share prices of the Company. Changes in underlying assumptions can materially affect the fair value estimates.

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

| | 2014 | 2013 |
|--------------------------|---------|---------|
| Risk-free interest rate | 1.47% | 1.17% |
| Expected life of options | 5 years | 5 years |
| Annualized volatility | 115.49% | 123.27% |
| Share price | \$0.08 | \$0.21 |
| Forfeiture rate | 0.00% | 0.00% |
| Dividend rate | 0.00% | 0.00% |

At June 30, 2014, the Company had share options outstanding as follows:

| | Number of Options | Exercise Price | Expiry Date |
|----------------|----------------------|-------------------|--------------------|
| Options | 3,050,000 | \$ 0.40 | September 16, 2014 |
| | 2,650,000 | \$ 0.80 | July 19, 2015 |
| | 240,000 | \$ 2.00 | October 31, 2014 |
| | 160,000 | \$ 2.00 | January 18, 2016 |
| | 300,000 | \$ 1.85 | February 11, 2016 |
| | 300,000 | \$ 1.70 | June 22, 2016 |
| | 200,000 | \$ 1.71 | July 11, 2016 |
| | 200,000 | \$ 1.11 | August 17, 2016 |
| | 300,000 | \$ 0.90 | November 7, 2014 |
| | 565,000 | \$ 0.90 | November 14, 2016 |
| | 300,000 | \$ 0.25 | July 18, 2017 |
| | 250,000 | \$ 0.25 | May 10, 2018 |
| | 500,000 | \$ 0.10 | November 7, 2018 |
| | 260,000 | \$ 0.10 | March 3, 2019 |
| | 9,275,000 | | |

On April 1, 2014, the Company's Board of Directors agreed to re-price 7,935,000 incentive stock options issued to certain directors, officers, employees and consultants of the Company. The options were originally granted with exercise prices ranging from \$0.25 to \$2.00, and the Company will reduce the exercise price to \$0.10. Except for the amendment of the exercise price, all original terms of the options will remain in effect. The Company has received approval from the TSX Venture Exchange for the re-pricing. The Company intends to obtain disinterested shareholder approval for the amendment to the exercise price of the stock options granted to insiders at the Company's 2014 annual general meeting. Insiders may not exercise options at the new price until such approval is obtained. As at June 30, 2014, these options had not yet been re-priced.

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7. CAPITAL STOCK AND RESERVES (continued)**Warrants**

At June 30, 2014 and June 30, 2013, the Company had no share purchase warrants outstanding.

| | Number of Warrants | Weighted Average Exercise Price |
|---------------------------------------|--------------------|---------------------------------|
| Outstanding at June 30, 2012 | 1,064,325 | \$ 1.60 |
| Expired | (1,064,325) | 1.60 |
| Outstanding at June 30, 2013 and 2014 | - | \$ - |

8. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

The Company had the following significant non-cash transactions during the year:

- At June 30, 2014, the Company included in accounts payable \$106,360 (June 30, 2013: \$13,811) of exploration expenditures.
- During the year ended June 30, 2014, the Company received \$60,313 (June 30, 2013: \$175,248) of interest income from operating activities.
- During the year ended June 30, 2014, the Company exchanged \$32,974 of property, plant and equipment for rent.
- During the year ended June 30, 2014, the Company paid \$nil (June 30, 2013: \$nil) of income taxes.

9. RELATED PARTY TRANSACTIONS**Key management and personnel compensation**

Key management personnel include the Directors and other officers of the Company. Key management compensation consists of the following:

| | 2014 | 2013 |
|-----------------------------------|------------|--------------|
| Management fees | \$ 979,800 | \$ 824,500 |
| Consulting services (exploration) | \$ 265,728 | \$ 393,713 |
| Geological services | \$ 113,719 | \$ 1,465,593 |
| Share-based compensation | \$ 45,226 | \$ 283,134 |

During the year ended June 30, 2014, the Company paid \$979,800 (2013: \$824,500) in management fees to a private company controlled by the Chief Executive Officer and Chairman of the Company. This fee is inclusive of administrative, finance, accounting, investor relations and management consulting fees, as well as certain office expenses.

During the year ended June 30, 2011, the Company entered into a contract with a company controlled by a director and officer of the Company for drilling and geological services at the Company's West Lombok property. This contract was awarded under a competitive bidding process and all charges under the contract are considered to be at market rates. During the year ended June 30, 2014, the Company paid a total of \$113,719 (2013: \$1,465,593) for geological services pursuant to the contract.

The above transactions occurred in the normal course of operations and are recorded at the consideration established and agreed to by the related parties.

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10. OFFICE AND MISCELLANEOUS EXPENSES

| | 2014 | 2013 |
|---------------------------|------------|------------|
| Administrative | \$ 120,247 | \$ 197,129 |
| Consulting | 136,601 | - |
| Office expenses | 233,717 | 386,699 |
| Insurance | 45,085 | 44,263 |
| Interest and bank charges | 9,235 | 28,606 |
| Corporate promotion | 684 | 814 |
| Telephone | 6,497 | 8,985 |
| Meals and entertainment | 1,877 | 7,782 |
| | \$ 553,943 | \$ 674,278 |

11. FINANCIAL INSTRUMENTS

The nature of the Company's operations exposes the Company to credit risk, liquidity risk and market risk, which may have a material effect on cash flows, operations and comprehensive income.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and to monitor market conditions and the Company's activities. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework and policies.

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. Financial instruments that potentially subject the Company to credit risk consist primarily of cash and accounts receivable. The maximum exposure to credit risk is equal to the fair value or carrying value of the financial assets. The Company reduces its credit risk by maintaining its bank accounts at large financial institutions. Receivables are amounts receivable from the Canadian federal government for the refundable GST amounts. The credit risk on these amounts is minimal.

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due. All of the Company's financial liabilities are classified as current and are anticipated to mature within the next fiscal year. The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. See also Note 1.

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. The Company is exposed to interest rate risk to the extent that the cash maintained at the financial institutions is subject to a floating rate of interest. The interest rate risk on the Company's cash is minimal. The Company is exposed to market risk as the ability of the Company to develop or market its properties and the future profitability of the Company is related to the market price of certain minerals.

Foreign exchange risk - The Company's largest non-monetary assets are its exploration interests in Indonesia. The Company could accordingly be at risk for foreign currency fluctuations and risks associated with legal and political issues in a developing-country environment. The Company minimizes cash and monetary assets or liabilities in Indonesia.

At June 30, 2014, the Company had US\$308,766 (approximately CDN\$329,638), Japanese Yen ("Yen") 1,997,499 (approximately CDN\$20,974) and Indonesian Rupiah ("Rph") 245,177,040 (approximately CDN\$21,330) in cash, and US\$320,383 (approximately CDN\$342,041), Yen 1,256,432 (approximately CDN\$13,193) and Rph 221,676,601 (approximately CDN\$19,286) in accounts payable and accrued liabilities. As at June 30, 2014, US\$ amounts were converted at a rate of US\$0.9367 to CDN\$1, Yen 95.24 to CDN\$1, and Rph amounts were converted at a rate of Rph 11,494 to CDN\$1.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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(Expressed in Canadian dollars)

11. FINANCIAL INSTRUMENTS (continued)

At June 30, 2013, the Company had US\$303,817 (approximately CDN\$319,373) and Rph 356,087,367 (approximately CDN\$37,745) in cash, and US\$430,344 (approximately CDN\$452,377) and Rph 120,419,406 (approximately CDN\$12,764) in accounts payable and accrued liabilities. As at June 30, 2013, US\$ amounts were converted at a rate of US\$0.9513 to CDN\$1 and Rph amounts were converted at a rate of Rph 9,434 to CDN\$1.

Fair value

IFRS requires disclosure about fair market value measurements for financial instruments and liquidity risk using a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. The three-level hierarchy is as follows:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 - Inputs that are not based on observable market data.

The Company's financial instruments are recognized at fair value on a recurring basis. Financial instruments measured at fair value on June 30, 2014 and June 30, 2013 are summarized in levels of fair value hierarchy as follows:

| June 30, 2014 | Level 1 | Level 2 | Level 3 |
|---------------|---------------|---------|---------|
| Assets | | | |
| Cash | \$ 1,643,966 | \$ - | \$ - |
| June 30, 2013 | | | |
| Assets | | | |
| Cash | \$ 12,866,306 | \$ - | \$ - |

The fair value of the Company's Level 1 financial instruments is approximated by their carrying value as at June 30, 2014 and June 30, 2013 due to their short-term nature.

12. ASSETS HELD FOR SALE

At June 30, 2014 and 2013, the assets relating to the Taliwang property have been presented as held for sale following the Company's announcement to sell its 90% interest in the Taliwang property.

Assets of the Taliwang project classified as held for sale are as follows:

| | 2014 | 2013 |
|-------------------------------|--------------|--------------|
| Exploration properties | \$ 1,078,309 | \$ 3,551,210 |
| Property, plant and equipment | 2,952 | 7,975 |
| Loans receivable | 106,760 | 105,120 |
| Total | \$ 1,188,021 | \$ 3,664,305 |

Liabilities of the Taliwang project classified as held for sale are as follows:

| | 2014 | 2013 |
|--|------------|-----------|
| Accounts payable and accrued liabilities | \$ 112,118 | \$ 13,403 |
| Total | \$ 112,118 | \$ 13,403 |

SOUTHERN ARC MINERALS INC.

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13. INCOME TAXES

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

| | 2014 | 2013 |
|--|----------------|-----------------|
| Loss for the year, before income taxes | \$ (8,680,792) | \$ (41,945,170) |
| Expected income tax recovery | (2,257,006) | (10,591,155) |
| Items not deductible for income tax purposes | 484,167 | 223,757 |
| Effect of change in tax rate | - | (63,420) |
| Effect of tax rates in other jurisdictions | 68,831 | 26,127 |
| Tax benefits unrecognized | 1,704,008 | 10,404,691 |
| Total income taxes | \$ - | \$ - |

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

| | 2014 | 2013 |
|---------------------------------|--------------|--------------|
| Deferred income tax assets: | | |
| Non-capital loss carry forwards | \$ 6,368,414 | \$ 4,727,953 |
| Capital loss carry forwards | 8,281 | 8,281 |
| Share issuance costs | 158,034 | 315,937 |
| Cumulative exploration expenses | 7,528,804 | 7,554,502 |
| Equipment | 6,832 | 2,585 |
| Long-term investment | 1,069,891 | 696,150 |
| | 15,140,256 | 13,305,408 |
| Tax benefits unrecognized | (15,140,256) | (13,305,408) |
| Net deferred income tax assets | \$ - | \$ - |

The Company has available for deduction against future years' Canadian taxable income non-capital losses of approximately \$19,638,429. Non-capital losses expire as follows:

| | |
|------|----------------------|
| 2015 | \$ 403,890 |
| 2016 | 604,856 |
| 2027 | 486,895 |
| 2028 | 511,735 |
| 2029 | 886,865 |
| 2030 | 2,938,228 |
| 2031 | 3,597,090 |
| 2032 | 3,763,442 |
| 2033 | 3,103,710 |
| 2034 | 3,341,718 |
| | <u>\$ 19,638,429</u> |

In addition, the Company has \$9,856,500 (2013: \$12,168,519) of unclaimed resource expenses for Canadian income tax purposes that 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 consolidated financial statements.

SOUTHERN ARC MINERALS INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2014

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14. SEGMENTED INFORMATION

The Company conducts its business as a single operating segment focused on the acquisition and exploration of resource properties.

| | Canada | Japan | Singapore | Indonesia | Total |
|------------------------------------|---------------|-----------|------------|--------------|---------------|
| June 30, 2014 | | | | | |
| Exploration properties | \$ - | \$ - | \$ - | \$ 102,068 | \$ 102,068 |
| Total assets | \$ 7,748,739 | \$ 23,423 | \$ 73,764 | \$ 1,577,753 | \$ 9,423,679 |
| June 30, 2013 | | | | | |
| Exploration properties | \$ - | \$ - | \$ - | \$ 102,068 | \$ 102,068 |
| Total assets | \$ 13,476,335 | \$ - | \$ 663,584 | \$ 4,052,367 | \$ 18,192,286 |
| For the year ended June 30, | | | | 2014 | 2013 |
| Net loss for the year – Canada | | | | \$ 4,595,572 | \$ 1,662,841 |
| Net loss for the year – Japan | | | | 83,016 | - |
| Net loss for the year – Singapore | | | | 560,747 | 285,298 |
| Net loss for the year – Indonesia | | | | 3,441,457 | 39,997,031 |
| Net loss for the year | | | | \$ 8,680,792 | \$ 41,945,170 |

15. CAPITAL MANAGEMENT

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going-concern in order to pursue the exploration and development of unproven mineral properties, and to maintain a flexible capital structure. The capital structure of the Company consists of shareholders' equity attributable to common shareholders comprising issued capital, share-based payment reserve and deficit. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

The Company currently does not produce any revenue and has relied on existing cash balances, equity issuances and advances from related parties to fund its operations. The Company is currently not subject to externally imposed capital requirements.

There were no changes in the Company's approach to capital management in the year ended June 30, 2014.

16. SUBSEQUENT EVENTS

On July 24, 2014, the Company announced that it had amended the sale agreement and closed the sale of its interest in the Taliwang project. Pursuant to the terms of the agreement, the Company has sold its 90% share of the Indonesian company that owns the Taliwang project to a third party (the "Purchaser"). The Purchaser has paid US\$1,000,000 and granted a 5% net smelter royalty ("NSR") to Southern Arc. The Purchaser has the option to buy back 3% of the NSR by paying the Company US\$3,000,000.

The Purchaser is required to make additional payments to the Company to fulfill the agreed purchase price. The Purchaser will pay the Company 40% of gross revenue generated from the Taliwang project, after payment of the Southern Arc NSR, until the aggregate amount of such payments equals US\$750,000. Alternatively, the Purchaser has the option of making a one-time payment of US\$600,000 if the payment is made before January 12, 2015.

On September 16, 2014, 3,050,000 of the Company's share options with an exercise price of \$0.40 expired without exercise.