

**SOUTHERN ARC MINERALS INC.**  
**FORM 51-102F1**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2009**

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## **Introduction**

The following discussion, prepared as of February 15, 2010, is management's assessment and analysis of the results and financial condition of Southern Arc Minerals Inc. (the "Company" or "Southern Arc") and should be read in conjunction with the Company's interim unaudited consolidated financial statements for the period ended December 31, 2009 and related notes attached thereto. These interim consolidated financial statements should also be read together with the audited financial statements and the accompanying notes included in the Company's latest annual report. The preparation of financial data is in accordance with Canadian generally accepted accounting principles and all figures are reported in Canadian dollars unless otherwise indicated.

Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).

## **Forward-Looking Statements**

Certain of the statements made and information contained herein is "forward-looking information" within the meaning of the British Columbia Securities Act. These statements relate to future events or the Company's future performance. All statements, other than statements of historical fact, may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "predict", "propose", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon by investors as actual results may vary. These statements speak only as of the date of this MD&A and are expressly qualified, in their entirety, by this cautionary statement. In particular, this MD&A contains forward-looking statements, pertaining to the following: capital expenditure programs, development of resources, treatment under governmental and taxation regimes, expectations regarding the Company's ability to raise capital, expenditures to be made by the Company on its properties and work plans to be conducted by the Company. With respect to forward-looking statements listed above and contained in the MD&A, the Company has made assumptions regarding, among other things:

- uncertainties relating to receiving mining and exploration permits in Indonesia;
- uncertainties relating to receiving oil and gas permits in Alberta;
- the impact of increasing competition;
- unpredictable changes to the market prices for gold, copper, natural gas and oil;
- exploration and developments costs for its properties in Indonesia and Canada;
- availability of additional financing and farm-in or joint-venture partners;
- anticipated results of exploration and development activities;
- the Company's ability to obtain additional financing on satisfactory terms.

The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A and Company's Management's Proxy Circular which can be found on SEDAR website ([www.sedar.com](http://www.sedar.com)): volatility in the market price for minerals; uncertainties associated with estimating resources; geological, technical, drilling and processing problems; liabilities and risks, including environmental liabilities and risks, inherent in mineral and oil and gas operations; fluctuations in currencies and interest rates; incorrect assessments of the value of acquisitions; unanticipated results of exploration activities; competition for, amongst other things, capital, undeveloped lands and skilled personnel; lack of availability of additional financing and farm-in or joint venture partners and unpredictable weather conditions.

Investors should not place undue reliance on forward-looking statements as the plans, intentions or expectations upon which they are based might not occur. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. The Company does not undertake any obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

## **Description of Business**

The Company was incorporated in British Columbia on August 19, 2004 and is trading on the TSX Venture Exchange under symbol "SA". The Company is a natural resource company actively engaged in the acquisition and exploration of mineral properties in Indonesia. Southern Arc also owns 43.6% or 15.3 million shares in Nickel Oil & Gas Corp. (formerly Canada Nickel Corp.), a private company active in mineral and oil and gas exploration in Canada. To date, the Company has not generated revenues from operations and is considered to be in the exploration stage.

## **Industry**

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

## **Trends**

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

## **Outlook**

The Company's focus of current activities is the Selodong Intrusive Complex (SIC), a large, gold-rich copper porphyry prospect situated on Lombok Island in Indonesia. The Company has identified 15 porphyry Cu-Au drill target areas within the SIC and is currently evaluating the results of the recently completed drilling program. The Company will also continue its effort in finalizing the new permitting negotiation on its Indonesian properties.

## **Lombok Island and Sumbawa Island Properties, Indonesia**

### **Background**

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 Island property (“Lombok”) and the Sumbawa Island property (“Sumbawa”) (collectively the “Properties”) to the Company, which Sunda had obtained from 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 Inc. (“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 acquired all of Indotan’s rights to the Properties in consideration for 1,000,000 common shares of the Company, valued at \$125,000, and \$180,000 in cash. Indotan is still nominally in control of the properties by virtue of being the legal holder of applications to the Indonesian government for contracts of work respecting each property, but Indotan has assigned all beneficial rights respecting the ownership and conduct for such applications to the Company (see below for details). Under the terms of the option agreement, Indotan retained a 1% net smelter return royalty (“NSR”) in connection with the properties. The Company has an option, until February 2010, to acquire 50% of Indotan’s 1% NSR on the Properties in consideration for the payment of \$500,000. The Company acquired this option for \$60,000. 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.

In October 2009, the Company has agreed to acquire a wholly owned subsidiary of Indotan Inc (“Indotan”) and the name Indotan Inc. This agreement was prompted by the introduction of the new mining law in Indonesia, enacted earlier this year. Since March, 2005 the Company has been conducting exploration on two of its Indonesian properties, one on Lombok and one on Sumbawa, pursuant to powers of attorney granted by Indotan as holder of the related contract of work applications. The powers of attorney refer specifically to contracts of work which have been replaced with IUP mining licenses by the new mining law announced earlier this year. By acquiring the Indotan name and the subsidiary company the Company’ will have direct control over the applications for the IUP’s on Lombok and Sumbawa in Indonesia. In consideration for the assignment of the rights to the applications, the acquisition of the subsidiary and the name Indotan Inc., the Company will issue 3.5 million common shares to the parent company subject to two options in favour of the Company. The first option will entitle the Company to acquire 1.5 million of these shares at a price of \$0.90 per common share within a period of 18 months. The second option will entitle the Company to acquire 0.5 million of these shares at a price of \$0.50 per common share within a period of 8 months. All of the shares to be issued by the Company will be subject to a four month statutory hold period. In place of the existing 1% NSR’s on both the Sumbawa and Lombok Properties, the Company will grant a 2% NSR on the Sumbawa property and a 1% NSR on the Lombok Property, as those applications were originally described in March, 2005. In the case of the Lombok Property, the NSR does not apply to the Block 1 property (which encompasses all of Selodong, Mencanggih, and Pelangan prospects) acquired by the Company from Newmont in January, 2006.

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 permit 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. A number of these have recently been issued by the Department of Energy & Mineral Resources.

The Sumbawa SIPP was granted on January 2, 2004 for an initial 12 month period. A succession of SIPP and in-principle CoW approvals culminated in the successful negotiation of the terms and conditions of the CoW manuscript. With the introduction of the new mining law the CoW manuscript failed to complete the final central government administrative hurdle, and is currently being transitioned into an IUP license. Relevant Singaporean and Indonesian holding companies have either been established or are currently in the formation process and will act as the corporate entities that will hold the IUP licenses.

The Lombok SIPP was granted on December 4, 2002. Relevant SIPP extensions and expansions to the property area were granted until February 15, 2006, when the CoW application came into conflict with an unconstitutional provincial land utilization regulation. Because of both central and regency government support in the form of endorsement letters and instructions to the Governor to revise the conflicting regulation, the Company continued exploration activities unabated through to Q4 2008 where upon field operations were suspended because of the global economic downturn. The revision of the contentious land utilization regulation is in its final stages with only endorsement of the document by the Department of Home Affairs required before it’s enacted into law by the Governor of West Nusa Tenggara Province. Upon enactment of the revised regulation the West Lombok Project will lie within areas zoned for mining activities. It’s the Company’s understanding that retro-active permitting and IUP processing will immediately follow the enactment of the revised provincial land utilization regulation.

### **West Lombok Project**

This area was previously held by PT Newmont Nusa Tenggara, a subsidiary of the Newmont Mining Corporation. Through an agreement with Newmont, announced on January 11, 2006, Newmont relinquished the area and the Company incorporated it into its CoW application area. The area of interest comprises a 13-km long, northwest trending structural corridor of hydrothermal mineralization and alteration within which lie the Selodong porphyry Cu-Au Prospect, Mencanggah epithermal/porphyry District and Pelangan Epithermal Prospect.

### **Selodong Prospect**

Aside from rehabilitation of drill pads and access roads, on-going CSR responsibilities and laboratory analysis components of an in-progress environmental baseline study no exploration activities were undertaken during the reporting period.

The Company has completed Phase 1 drilling at Selodong with 30 holes (SLD001 to SLD030) totaling 17,859.30 metres completed in September 2008. These holes have tested seven of the 15 porphyry Cu-Au targets, with the majority having intersected broad zones (126.45 to 855.105 metres) of significant Cu-Au mineralization. Drill hole rationale and results have been detailed in previous Management Discussion and Analysis filed with SEDAR releases at [www.sedar.com](http://www.sedar.com).

In November 2009, the Company has purchased the 2.0 hectare block of land on which its main Selodong base camp facility is located. This facility is the main base camp for all of the West Lombok Properties. The Selodong base camp can accommodate up to 80 personnel and is the location from which the Company directs all exploration activities throughout the 18,650 hectare property. This acquisition reflects the Company's commitment to ensuring a smooth transition into the next stage of property development in West Lombok.

*Pelangan Prospect (Kayu Putih, Tanjung, Radja, Ratu and Lala mineralized structured breccia)*

Based on encouraging results and a concept of increasing gold grades with depth, together with the potential for high grade lode structures, a second phase of drilling commenced in August 2008, focusing initially on the *Central Raja* target.

The drilling program (2 holes totaling 371.8 m) was prematurely terminated because of Company restructuring in the face of the present recessionary period. Aside from laboratory analysis components of an in-progress environmental baseline study the project is currently on a care and maintenance basis.

*Mencanggah Prospect (West Lombok)*

On-going CSR responsibilities this period included completion of renovations to a second elementary school together with the provision of educational aids. Aside from laboratory analysis components of an in-progress environmental baseline study the project is currently on a care and maintenance basis.

**East Lombok Project**

No field activities were conducted during the reporting period.

**Sumbawa Island Properties**

**Taliwang Project (West Sumbawa)**

With the advent of the new Mining Law No. 4/2009 signed into law by the President on January 12, 2009 this effectively put an end to the CoW scheme under which the Company had been operating under since 2004. Whilst negotiations on the Taliwang property had reached a stage where the CoW manuscripts have been finalized and initialled by both negotiating team leaders, the enactment of the new Mining Law effectively put a halt to this process and has been replaced by a permit licensing system. Preliminary requirements for the issuing of the new Mining Business License or "IUP" including the establishment of an appropriate Indonesian holding company are in progress.

*Lemonga Gold Prospect (West Sumbawa)*

No field activities were reported this period.

*Ramit Prospect (West Sumbawa)*

No field activities were reported this period.

### Jereweh (J3 & J6)Prospects (West Sumbawa)

No field activities were reported this period.

### Sabalong KP (West Sumbawa)

The transition to the new licensing system was completed this period with the issuing of the IUP Exploration license on December 17, 2009 for a period of seven (7) years. The exploration stage permits the Company to pursue exploration activities through to the conclusion of a feasibility study. Upon the conclusion of the exploration stage, the IUP automatically converts to a second stage, permitting the Company to conduct commercial production on this property for a minimum of 20 years, with the potential for two further 10 year extension periods.

### East Elang KP (West Sumbawa)

The relevant IUP Exploration license for the property was issued by the Regent of Sumbawa on December 17, 2009. It is valid for seven (7) years and covers the period from General Survey through to Feasibility Study. The Company has the automatic right to conduct commercial production for 20 years and a further two 10 year extension periods if warranted.

With the issuing of the IUP license the obstacles to the processing of the outstanding forestry permit have been removed.

## **Central Java Island Properties**

### Karangtengah KP Property (Central Java)

The Regent of Wonogiri issued the relevant IUP exploration license on January 7, 2010. The license is valid for six (6) years and comprises two stages, with potential extensions. Over the period of 6 years, the exploration stage permits the Company to pursue exploration activities through to the conclusion of a feasibility study. Upon the conclusion of the exploration stage, the IUPs automatically convert to a second stage, permitting the Company to conduct commercial production on these properties for a minimum of 20 years, with the potential for two further 10 year extension periods.

### Tirtomoyo KP Property (Central Java)

As per the Karangtengah property the Company has received a IUP Exploration license which is valid for six (6) years.

Socialization of company exploration activities with the local government and communities will commence in February 2010, followed by a regional reconnaissance geologic mapping and sampling program.

## **Other Properties, Indonesia**

The Company is also aggressively pursuing other mineral opportunities within Indonesia. Along with research of the potential of historically reported mineral occurrences, negotiations are continually being carried out with various governmental and private entities with the aim of acquiring stakeholds, whether in the form of JVs, farm-in, or contract exploration agreements, in greenfield through to more advanced projects.

## Canada Nickel Corp.

Southern Arc owns 43.6% of 15.3 million shares in Canada Nickel Corp., a private company. During the year ended June 30, 2009, 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 had to 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:

| <b>Date</b>   | <b>Cash<br/>Payments</b> | <b>Exploration<br/>Expenditures</b> | <b>Interest<br/>Earned</b> |
|---|--------------------------|-------------------------------------|----------------------------|
| Execution of the Option Agreement (paid and earned) | \$ 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%                        |
|   | <u>\$ 5,000,000</u>      | <u>\$ 20,000,000</u>                | <u>51%</u>                 |

During the year ended June 30, 2009, Canada Nickel did not continue with the option agreement and recognized an impairment loss of \$8,066,801. Canada Nickel also commenced a legal action against Diamondex in relation to the option agreement.

In November 2009 Canada Nickel settled the legal action with Diamondex on the following terms:

1. Diamondex has paid to Canada Nickel the sum of \$250,000 (received);
2. Canada Nickel has transferred to Diamondex its 10% interest in the James Bay Lowlands Property;
3. Diamondex has granted to Canada Nickel a royalty equal to 1.5% of Net Smelter Returns (“NSR”) if the Property is put into commercial production;
4. Canada Nickel has granted to Diamondex an exclusive option to purchase two-thirds of this 1.5% NSR (namely, 1%), as follows: 0.33% for \$833,333 before November 26, 2014, an additional 0.33% for \$833,333 before November 26, 2014, and a further 0.34% for \$833,334 before the second anniversary of commercial production. In the event that Diamondex fully exercises the three parts of this option by paying \$2,500,000 to Canada Nickel, Canada Nickel’s NSR will be reduced to 0.5%.

The settlement of this matter enables Canada Nickel to pursue a new strategic direction while retaining the significant upside potential of the James Bay Lowlands project without any remaining funding obligations.

In November 2009, the Company announced Canada Nickel has entered into a joint venture agreement (the “Joint Venture”) with a Canadian intermediate oil and gas producer. The Joint Venture makes available to Canada Nickel a liquids rich gas prospect within established gas producing fairways in the Brewster Area of Alberta.

The Brewster farmout and option agreements granted Canada Nickel the right to earn the following interests in the petroleum and natural gas rights to the base of the Belly River Formation:

- (a) 20% interest in 43-13-W5M: Section 22 by paying 100% of the costs of completing a previously drilled well on Section 22;

- (b) 48% interest in 43-13-W5M: Section 26 by paying 100% of the costs of drilling and completing, capping or abandoning a well on Section 26; and
- (c) 48% interest in 43-13-W5M: Section 27 by paying 100% of the costs of drilling and completing, capping or abandoning a well on Section 27.

A joint venture party holding a 20% interest in both Section 22 and 26 elected not to participate in the operations described above and consequently has forfeited its 20% interest in production from the Section 22 and Section 26 wells until such time as the parties participating in the operation have collectively recovered a penalty equal to 400% of the operation costs associated with the drilling and completion of these Wells. As result, Canada Nickel effectively holds a 40% interest in Section 22 and a 68% interest in Section 26 until such time as the 400% penalty has been recovered.

In early December 2009, the previously drilled well on Section 22 was completed, earning Canada Nickel the interest in Section 22 described above. The Section 22 well is currently shut in. Canada Nickel also successfully drilled the well on Section 26 and completed it in two intervals of the Belly River formation, earning Canada Nickel the interests in Section 26 described above. Subject to financing, Canada Nickel intends to tie-in this well to a nearby pipeline in 2010.

In December 2009 Canada Nickel also entered into a farmout and option agreement with respect to the Pine Creek area, Alberta. This Agreement granted Canada Nickel the right to earn the following petroleum and natural gas rights:

- (a) 25% interest in 54-18-W5M: Section 29 to the base Notikewin, by paying 100% of the costs of re-entering and completing a previously drilled well on Section 29;
- (b) 60% interest in 55-18-W5M: Section 1 and Section 12 to the base Rock Creek by paying 100% of the costs of drilling and completing, capping or abandoning a well on either of Section 1 or Section 12; and
- (c) 60% interest in 55-18-W5M: Section 9 to the base Notikewin by paying 100% of the costs of drilling and completing, capping or abandoning a well on Section 9.

There is good well control in the Pine Creek area with recent success by other oil and gas companies and close proximity to infrastructure.

Subsequent to December 31, 2009, Canada Nickel changed its name to Nickel Oil & Gas Corp.

## **Results of Operations**

During the six-month period ended December 31, 2009 (“2009”), the Company had a loss of \$619,147 compared to an income of \$80,964 for the six-month period ended December 31, 2008 (“2008”). Increase in loss of \$700,111 in 2009 was mainly due to the non-cash items such as \$269,797 increase in stock based compensation and \$534,736 gain on diluted interest in Canada Nickel recorded in 2008 period and none in this year’s period. Significant fluctuations incurred in the following categories:

- a) Stock-based compensation of \$333,661 (2008 - \$63,864) increased as a result of a re-pricing and grant of stock options during the period. Stock-based compensation expense is accounted for at fair value as determined by the Black-Scholes Option Pricing Model using estimates that are believed to approximate the volatility of the trading price of the Company’s stock, the expected lives of awards of stock-based compensation, the fair value of the Company’s stock and risk-free interest rate;



- b) Management fees discussed in more detail in the related parties section;
- c) Foreign exchange loss of \$1,993 was realized during the period ended December 31, 2009 (2008 – gain \$94,392) due to the effect the fluctuation of the US\$/CAD foreign exchange rate had on the Canadian equivalent of the Company's holdings and transactions in \$US term deposits and a US\$ bank balance;
- d) Gain on diluted interest in subsidiary of \$Nil was recorded in the period ended December 31, 2009 (2008 - \$533,211). This year's decrease in gain was due to no financing undertaken by Canada Nickel in this year's period and additional financing in the last year's period by Canada Nickel;
- e) The Company spent \$2,440,001 cash in the 2009 period on resource properties, including \$1,792,682 spent by Canada Nickel on Brewster property. During the 2008 period the Company spent \$8,411,435 of cash on resource properties, including \$6,100,000 spent by Canada Nickel on James Bay project. The decrease in funds spent by the Company in Indonesia is mainly due to the Company working actively towards the receipt of the mining permits during this year's period, while the drilling program was in progress on West Lombok during the last year's period. During the 2009 period the Company issued 3,500,000 common shares with a value of \$2,415,000 for the acquisition of Indotan and recorded it as an addition to resource properties.
- f) During the 2009 period Canada Nickel received \$250,000 cash on settlement of its lawsuit with Diamondex, \$Nil in 2008.

### Summary of Quarterly Results and Second Quarter

|  | December 31,<br>2009 | September 30,<br>2009 | June 30,<br>2009 | March 31,<br>2009 |
|--|----------------------|-----------------------|------------------|-------------------|
| Total assets                           | \$ 23,434,431        | \$ 19,243,326         | \$ 19,496,869    | \$ 28,116,927     |
| Resource properties and deferred costs | 20,318,136           | 15,691,274            | 15,483,236       | 23,348,353        |
| Working capital                        | 1,652,957            | 1,898,933             | 2,356,276        | 2,728,992         |
| Accumulated deficit                    | (14,752,532)         | (14,679,954)          | (14,133,385)     | (9,157,886)       |
| Net Loss                               | (72,578)             | (546,569)             | (5,240,556)      | (346,021)         |
| Basic and diluted loss per share       | (0.00)               | (0.01)                | (0.07)           | (0.00)            |

  

|   | December 31,<br>2008 | September 30,<br>2008 | June 30,<br>2008 | March 31,<br>2008<br>(restated to<br>conform with<br>June 30, 2008<br>adjustment to<br>stock-based<br>compensation) |
|---|----------------------|-----------------------|------------------|---|
| Total assets                              | \$ 28,350,164        | \$ 28,564,629         | \$ 23,688,619    | \$ 23,352,866   |
| Resource properties and<br>deferred costs | 23,136,748           | 22,623,971            | 13,152,613       | 11,454,542  |
| Working capital                           | 3,136,051            | 4,539,075             | 8,827,288        | 10,607,080  |
| Accumulated deficit                       | (8,811,865)          | (8,705,652)           | (8,892,829)      | *(8,818,026)  |
| Net Income (loss)                         | (106,213)            | 187,177               | (82,803)         | (142,150)   |
| Basic and diluted income (loss) per share | (0.00)               | 0.00                  | (0.00)           | (0.00)  |

**Quarterly trend** (starting from the oldest quarter to current):

Total assets and Resource properties increased until June 30, 2009 as the Company spent most the cash from financing activities on deferred exploration expenditures. In June 30, 2009 the Company wrote-off its investment in the James Bay Lowlands property and accordingly the total assets decreased during that period.

Significant fluctuations in net loss and accumulated deficit are primarily due to the write-off of resource properties and the timing of stock-based compensation. The fluctuations in total assets, resource properties and working capital are primarily a result of acquisition of Canada Nickel Corp.

Quarterly results, starting with the September 30, 2008 quarter, include the consolidation of Canada Nickel Corp. acquired on July 7, 2008.

Financial results for the three months ended December 31, 2009 included the following significant events:

- \$250,000 cash was received by Canada Nickel on the settlement of legal action with Diamondex. Canada Nickel also received a return of legal deposits of \$735,100 upon discontinuation of the legal action;
- the Company issued 3,500,000 common shares with a value of \$2,415,000 which was recorded as addition to resource properties;
- received \$550,000 demand non-revolving bridge loan from its bank pending any possible long-term solution to the current liquidity issues affecting the Company's investment in ABCP. The bridge loan is secured by the Company's investment in ABCP. Interest on direct advances is paid at the Bank's prime rate plus 1% per annum;
- amended the exercise price of 4,716,418 share purchase warrants from to \$1.75 to \$0.70 and received \$1,175,359 cash from the exercise of warrants and \$30,000 cash from the exercise of options.

**Liquidity**

The Company's cash position at December 31, 2009 was \$2,269,910 a decrease of \$161,502 from June 30, 2008. The decrease is primarily due to resource property acquisition and exploration expenditures offset with proceeds from the exercise of warrants and \$250,000 cash received by Canada Nickel for the settlement of legal action.

As at December 31, 2009, the Company's working capital is \$1,652,957. Of this balance, approximately \$729,400 is Canada Nickel's and \$923,557 is Southern Arc's. In November 2009, Southern Arc received proceeds from a \$550,000 demand non-revolving bridge loan from its bank. The loan was provided by the bank pending any possible long-term solution to the current liquidity issues affecting the Company's investment in ABCP. The bridge loan is secured by the Company's investment in ABCP. Interest on direct advances is paid at the Bank's prime rate plus 1% per annum. The Company has financed its operations to date primarily through the issuance of common shares.

Net cash provided by operating activities for the six-month period ended December 31, 2009 was \$511,446 compared to net cash used of \$1,327,918 during the six-month period ended December 31, 2008. The cash from operating activities for 2009 consists primarily of a legal fees deposit of \$735,100 that was returned to the Company on the legal settlement, the operating loss from the general and administrative expenditures and a change in non-cash working capital items.

Net cash used in investing activities for the six-month period ended December 31, 2009 was \$2,428,307 compared to cash used of \$10,377,444 during the six-month period ended December 31, 2008. The cash used in investing activities for the period consists primarily of the acquisition and exploration of resource properties. 2008 period investing activities included \$6,100,000 expenditure by Canada Nickel on James Bay project, \$5,355,000 cash spent on the acquisition of Canada Nickel's investment and \$3,388,991 Company's share of Canada Nickel's cash.

Net cash provided by financing activities for the six months ended December 31, 2009 was \$1,755,359 compared to \$5,572,528 during the six-month period ended December 31, 2008. 2009 period financing activities included \$550,000 proceeds from the bank loan described in more detail above and \$1,205,359 cash received from the exercise of warrants and options. 2008 period financing activities consisted of \$5,572,528 representing the Company's share of Canada Nickel's equity raised during the period.

### Asset-backed Commercial Paper

At December 31, 2009, the Company held restructured asset-backed commercial papers ("ABCP") notes with a face value of \$1,410,198 and estimated fair value of \$805,009. These investments were designated as held-for-trading and are accounted for at their fair value.

On January 21, 2009, the Committee announced the successful implementation of the restructuring 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 assets.

Upon restructuring, the Company received new notes ("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. At the time of the restructuring, DBRS, a credit rating firm, assigned a rating "A" to the MAV II Class A-1 notes. The MAV II Class C and Class 13 notes have not been rated by DBRS.

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        | 794,401                 |
| MAV II Class C  | December 2056     | BA + 20%          | 36,717           | 3,671                   |
| MAV II Class 13<br>(Ineligible Asset<br>Tracking Notes) |                   |                   | 186,296          | 18,630                  |
| <b>Total</b>  |                   |                   | <b>1,410,198</b> | <b>816,703</b>          |

(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.

In fiscal Q4 2009, the Company settled the original notes and recognized the New Notes with the face value of \$1,410,198. The New Notes were measured at fair value on initial recognition. The Company estimated the fair value of these notes to be \$816,703 and recognized an additional impairment charge of \$323,059 (\$211,804 impairment charge recognized in the fiscal 2008). In conjunction with the notes exchange, the Company received a payment of \$60,460 which was its share of the accumulated interest to June 30, 2009. This amount was accounted for as a reduction of the Company's investment. Additional information on the Company's estimation of fair value is included in note 7 of the Company's audited financial statements for the year ended June 30, 2009.

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.

### **Investment in Indotan Lombok Pte. Ltd. and Indotan Sumbawa Pte. Ltd.**

During the period ended December 31, 2009, the Company acquired the right to the name Indotan Inc. as well as control over two companies (Indotan Lombok Pte. Ltd. and Indotan Sumbawa Pte. Ltd.) (“The Singapore Companies”). As consideration the Company issued 3,500,000 common shares with a value of \$2,415,000 subject to two options. The first option will entitle the Company to acquire 1,500,000 of these shares at a price of \$0.90 per common share within a period of 18 months. The second option will entitle the Company to acquire 500,000 of these shares at a price of \$0.50 per common share within a period of 8 months. All of the shares to be issued by the Company will be subject to a four-month statutory hold period. In place of the existing 1% NSR’s on both the Sumbawa and Lombok Properties, the Company will grant a 2% NSR on the Sumbawa property and a 1% NSR on the Lombok Property, as those applications were originally described in March, 2005. In the case of the Lombok Property, the NSR does not apply to the Block 1 property (which encompasses all of Selodong, Mencanggih, and Pelangan prospects) acquired by the Company from Newmont in January, 2006.

The shares of the Singapore Companies will be transferred to the Company once required permits have been granted to the Singapore Companies pursuant to the mining laws of Indonesia. Effective December 24, 2009, the Company consolidated the financial results of Singapore Companies.

The acquisition of Singapore Companies has been accounted for using the purchase method. The total purchase price of \$2,415,000 has been allocated to resource properties.

### **Investment in Canada Nickel**

On July 7, 2008, the Company acquired 15,300,000 common shares of Canada Nickel Corp (“Canada Nickel”), a related corporation through one common director, for a purchase price of \$5,355,000 representing a 59.77% of the outstanding shares of Canada Nickel at that time. As a result of the share purchase, the Company acquired control of Canada Nickel. The acquisition of Canada Nickel has been accounted for using the purchase method.

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 net gain of \$201,920. The Company maintained control over 66.6% of Canada Nickel shares as a result of a voting agreement with a common director. The voting agreement with a common director expired on January 7, 2010.

The financial results presented in this report include the results of operations of Canada Nickel from the date of acquisition.

## Related Party Transactions

During the period ended December 31, 2009, the Company entered into transactions with related parties as follows:

- a) paid \$201,000 (2008 - \$208,200) for management fees and \$21,000 (2008 - \$21,800) for administration, recorded in office and miscellaneous expense, to a private company controlled by the Chief Executive Officer and director of the Company. Management fees of \$209,000 include salaries of Southern Arc CEO, CFO and Canada Nickel's CEO, CFO and accounting staff. Administration fees of \$21,800 include fees for Corporate Secretary and administration for Southern Arc and Canada Nickel.
- b) paid \$2,283 (2008 - \$78,901) for legal fees, included in professional fees (2008 – share issuance costs), to a firm in which a director of Canada Nickel is a partner. The fees were higher in 2008 as Canada Nickel incurred legal fees in connection with the anticipated public offering last year.

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.

## Off-balance Sheet Arrangements

The Company has no off-balance sheet arrangements other than those disclosed and under resource properties.

## Stock-based compensation

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

## Commitment

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

| Unit | Commencement<br>Date | Term      | \$/ month | Remaining<br>Fiscal<br>2010 |
|------|----------------------|-----------|-----------|-----------------------------|
| 1522 | 1-Jan-09             | 25-Feb-10 | \$ 1,310  | \$ 6,550                    |

## Current Share Data

As at the date of this MD&A, the Company has 76,689,990 common shares issued and outstanding and has the following stock options:

|                | Number<br>of Shares | Exercise<br>Price | Expiry Date        |
|----------------|---------------------|-------------------|--------------------|
| <b>Options</b> | 650,000             | \$ 0.25           | June 30, 2010      |
|                | 425,000             | 0.56              | January 13, 2011   |
|                | 150,000             | 0.30              | July 31, 2013      |
|                | 3,500,000           | 0.40              | September 16, 2014 |

As at the date of this MD&A the Company does not have any warrants outstanding.

## Change in accounting policies

### *Principles of consolidation*

The consolidated financial statements include:

- i) the accounts of the Company;
- ii) its 43.56% owned Canadian subsidiary, Canada Nickel Corp. (“Canada Nickel”) from the date of acquisition; and
- iii) its wholly owned Singapore subsidiaries, Indotan Lombok Pte. Ltd. and Indotan Sumbawa Pte. Ltd.

Significant inter-company balances and transactions have been eliminated upon consolidation.

## Recent accounting pronouncements

### *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. The Company is currently engaged in the scoping phase of its conversion which involves a high level review of major differences between Canadian GAAP and IFRS, setting a timeline for resources and developing a project plan. This scoping phase is intended to provide direction to the Company’s management for the second phase of conversion project and will be disclosed in the Company’s annual financial statements and management’s discussion and analysis.

### *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.

### *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.

### **Financing**

The continuing operations of the Company are dependent upon its ability to raise adequate financing and to commence profitable operations in the future.

### **Risks and Uncertainties**

The Company is subject to a number of risk factors due to the nature of the mining business in which it is engaged, including political risk, risk of receiving mining permits in Indonesia and adverse movements in commodity prices, which are impossible to forecast. The Company seeks to counter this risk as much as possible by selecting exploration areas on the basis of their recognized geological potential to host economic deposits.

### **Financial Instruments and Risk**

The Company's financial instruments consist of cash, receivables, long term investments, and accounts payable and accrued liabilities. Loan payable and long-term investment. 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.

The Company is holding asset backed commercial paper with a fair value at December 31, 2009 of \$805,009. The credit risk associated with this investment is discussed in Note 8 of financial statements for the period ended December 31, 2009.

### *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 December 31, 2009, the Company had a cash balance of \$2,269,910 (June 30, 2009 - \$2,431,412) to settle current liabilities of \$645,871 (June 30, 2009 - \$91,713). 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.

### *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 foreign currency denominated cash or monetary assets or liabilities in Indonesia.

#### (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.

### **Gold and Metal Prices**

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



**Resource Properties**

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

**Investor Relations**

John Proust, President, CEO and Director, coordinates investor relations' activities.