

SOUTHERN ARC MINERALS INC.

CONSOLIDATED INTERIM FINANCIAL STATEMENTS

**FOR THE SIX MONTHS ENDED
DECEMBER 31, 2008 AND 2007**

*(Unaudited – Prepared by Management)
(Expressed in Canadian Dollars)*

UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

In accordance with National Instrument 51-102 released by the Canadian Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited consolidated financial statements for the period ended December 31, 2008.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Expressed in Canadian dollars)

	December 31, 2008	June 30, 2008
ASSETS		
Current		
Cash and cash equivalents	\$ 3,164,043	\$ 9,296,877
Receivables	75,018	16,605
Prepaid expense and deposit	<u>-</u>	<u>5,000</u>
	3,239,061	9,318,482
Deposits and retainers (Note 6)	758,561	-
Equipment (Note 5)	15,572	17,302
Resource properties (Note 6)	23,136,748	13,152,613
Investment (Note 7)	<u>1,200,222</u>	<u>1,200,222</u>
	<u>\$ 28,350,164</u>	<u>\$ 23,688,619</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	\$ 103,010	\$ 491,194
Non-controlling interest (Note 4)	<u>4,904,901</u>	<u>-</u>
Shareholders' equity		
Capital stock (Note 8)	26,549,808	26,549,808
Contributed surplus (Note 8)	5,604,310	5,540,446
Deficit	<u>(8,811,865)</u>	<u>(8,892,829)</u>
	<u>23,342,253</u>	<u>23,197,425</u>
	<u>\$ 28,350,164</u>	<u>\$ 23,688,619</u>

Basis of presentation (Note 1)
Nature and continuance of operations (Note 2)
Commitments (Notes 6 and 12)
Investment in Canada Nickel Corp. (Note 4)
Subsequent events (Note 15)

On behalf of the Board:

"John Proust"

Director

"David Stone"

Director

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE INCOME (LOSS) AND DEFICIT
(Unaudited)
(Expressed in Canadian dollars)

	Three Month Period Ended December 31, 2008	Three Month Period Ended December 31, 2007	Six Month Period Ended December 31, 2008	Six Month Period Ended December 31, 2007
EXPENSES				
Amortization	\$ 865	\$ 1,082	\$ 1,730	\$ 2,163
Consulting fees	21,000	10,700	36,000	25,700
Foreign exchange	(46,663)	-	(94,392)	-
Investor relations	15,026	28,372	52,929	50,872
Management fees	100,500	46,500	208,200	84,000
Office and miscellaneous	19,176	52,836	89,582	76,984
Professional fees	115,040	33,246	233,978	52,001
Property investigation costs	-	2,881	2,358	4,661
Rent	3,824	15,332	13,175	21,532
Stock-based compensation (Note 8)	-	570,489	63,864	4,609,368
Transfer agent and filing fees	24,812	16,540	42,316	18,851
Travel	2,755	37,695	12,077	76,894
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Loss before other items	<u>(256,335)</u>	<u>(815,673)</u>	<u>(661,817)</u>	<u>(5,023,026)</u>
OTHER ITEMS				
Interest income	63,265	32,046	75,154	42,440
Non-controlling interest	85,332	-	132,891	-
Gain on diluted interest in subsidiary (Note 4)	1,525	-	534,736	-
Unrealized loss on investment (Note 7)	-	-	-	(211,804)
	<u>150,122</u>	<u>32,046</u>	<u>742,781</u>	<u>(169,364)</u>
Income (loss) and comprehensive income (loss) for the period	<u>(106,213)</u>	<u>(783,627)</u>	<u>80,964</u>	<u>(5,192,390)</u>
Deficit, beginning of period	<u>(8,705,652)</u>	<u>(7,892,249)</u>	<u>(8,892,829)</u>	<u>(3,483,486)</u>
Deficit, end of period	<u>\$ (8,811,865)</u>	<u>\$ (8,675,876)</u>	<u>\$ (8,811,865)</u>	<u>\$ (8,675,876)</u>
Basic and diluted income (loss) per share	<u>\$ 0.00</u>	<u>\$ (0.01)</u>	<u>\$ 0.00</u>	<u>\$ (0.09)</u>
Weighted average number of shares outstanding	<u>71,410,906</u>	<u>62,158,940</u>	<u>71,410,906</u>	<u>59,868,063</u>

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

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

	Three Month Period Ended December 31, 2008	Three Month Period Ended December 31, 2007	Six Month Period Ended December 31, 2008	Six Month Period Ended December 31, 2007
CASH FLOWS FROM OPERATING ACTIVITIES				
(Loss) income for the period	\$ (106,213)	\$ (783,627)	\$ 80,964	\$ (5,192,390)
Items not affecting cash:				
Stock-based compensation	-	570,489	63,864	4,609,368
Amortization	865	1,082	1,730	2,163
Gain on diluted interest in subsidiary	(1,525)	-	(534,736)	-
Fair value adjustment of investment	-	-	-	211,804
Non-controlling interest	(85,332)	-	(132,891)	-
Changes in non-cash working capital items:				
Increase in receivables	(54,824)	(15,863)	(58,373)	(12,890)
Decrease in prepaid expense and deposit	17,498	15,462	5,000	21,983
(Decrease) increase in accounts payable and accrued liabilities	(83,077)	(40,012)	5,085	(45,123)
Advance to related party	-	318	-	-
Net cash used in operating activities	<u>(312,608)</u>	<u>(252,151)</u>	<u>(569,357)</u>	<u>(405,085)</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Additions to resource properties	(397,576)	(826,103)	(8,411,435)	(1,576,166)
Acquisition of Canada Nickel (Note 4)	-	-	(5,355,000)	-
Cash acquired on acquisition of Canada Nickel (Note 4)	-	-	3,388,991	-
Acquisition of investment	-	-	-	(1,412,026)
Proceeds from investment	-	-	-	1,408,258
Retainer for legal	<u>(758,561)</u>	<u>-</u>	<u>(758,561)</u>	<u>-</u>
Net cash used in investing activities	<u>(1,156,137)</u>	<u>(826,103)</u>	<u>(11,136,005)</u>	<u>(1,579,934)</u>
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from issuance of shares	-	12,167,704	-	13,834,584
Share issue costs	-	(816,085)	-	(815,185)
Issue of equity securities by Canada Nickel to non-controlling interests	3,500	-	5,572,528	-
Proceeds from shareholder loan (Note 10)	-	-	1,100,000	-
Repayment of shareholder loan (Note 10)	<u>-</u>	<u>-</u>	<u>(1,100,000)</u>	<u>-</u>
Net cash provided by financing activities	<u>3,500</u>	<u>11,351,619</u>	<u>5,572,528</u>	<u>13,019,399</u>

- Continued -

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

	Three Month Period Ended December 31, 2008	Three Month Period Ended December 31, 2007	Six Month Period Ended December 31, 2008	Six Month Period Ended December 31, 2007
<i>Continued...</i>				
Change in cash during period	(1,465,245)	10,273,365	(6,132,834)	11,034,380
Cash and cash equivalents, beginning of period	4,629,288	1,640,003	9,296,877	878,988
Cash and cash equivalents, end of period	\$ 3,164,043	\$ 11,913,368	\$ 3,164,043	\$ 11,913,368
Cash paid for interest	\$ -	\$ -	\$ -	\$ -
Cash paid for income taxes	\$ -	\$ -	\$ -	\$ -
Cash and cash equivalents consist of:				
Cash on hand	\$ 3,164,043	\$ 11,913,368	\$ 3,164,043	\$ 11,913,368
Term deposits	-	-	-	-
	\$ 3,164,043	\$ 11,913,368	\$ 3,164,043	\$ 11,913,368

Supplemental disclosure with respect to cash flows (Note 9)

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

1. BASIS OF PRESENTATION

The consolidated interim period financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles. All financial summaries included are presented on a comparative and consistent basis showing the figures for the corresponding period in the preceding year. The preparation of financial data is based on accounting principles and practices consistent with those used in the preparation of annual financial statements, except as noted below. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These consolidated interim period statements should be read together with the audited financial statements and the accompanying notes included in the Company's latest annual report. In the opinion of the Company, its unaudited consolidated interim financial statements contain all adjustments necessary in order to present a fair statement of the results of the interim periods presented.

2. NATURE AND CONTINUANCE OF OPERATIONS

The Company was incorporated in British Columbia on August 19, 2004. The Company is a natural resource company engaged in the acquisition and exploration of resource properties in Indonesia and Canada. To date, the Company has not generated significant revenues from operations and is considered to be in the exploration stage.

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

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

3. CHANGE IN ACCOUNTING POLICIES AND RESTATEMENT

Principles of consolidation

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

3. CHANGE IN ACCOUNTING POLICIES AND RESTATEMENT (cont'd...)

Financial instruments

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

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

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

Assessing going concern

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

Capital disclosures

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

Deferred share issue costs

Costs incurred relating to the Company's equity offerings are recorded as deferred share issue costs until completion of the offering at which time costs related to the offerings are offset against share capital.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

3. CHANGE IN ACCOUNTING POLICIES AND RESTATEMENT (cont'd...)

Flow-through shares

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

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

Restatement

As at June 30, 2008, the Company adjusted the non-cash fair value of stock options granted during the year ended June 30, 2008. The change resulted from an adjustment to volatility used in Black-Sholes Model calculation of the fair value of the stock options granted.

- Change to the September 30, 2007 quarterly figures
 - Volatility was changed to 110% (originally the Company used 162%).
 - Stock based compensation expense was adjusted to \$4,038,879 (previously stated as \$4,700,522).

- Change to the December 31, 2007 quarterly figures
 - Volatility was changed to 110% (originally the Company used 144%).
 - Stock based compensation expense was adjusted to \$570,489 (previously stated as \$636,193).

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 January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended June 30, 2011. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

3. CHANGE IN ACCOUNTING POLICIES AND RESTATEMENT (cont'd...)

Recent accounting pronouncements (cont'd...)

Goodwill and intangible assets

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

4. INVESTMENT IN CANADA NICKEL CORP.

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

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

Cash	\$ 3,388,991
Receivables	40
Resource property	1,966,801
Accounts payable and accrued liabilities	<u>(832)</u>
	<u>\$ 5,355,000</u>

During the period ended December 31, 2008, Canada Nickel issued additional common stock to third parties which diluted the Company’s ownership percentage of Canada Nickel to 43.56% resulting in a gain on diluted interest in subsidiary \$534,736. The Company maintains control over 66.6% of voting shares of Canada Nickel as a result of a voting agreement with a common director.

5. EQUIPMENT

	December 31, 2008			June 30, 2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telephone equipment	\$ 26,278	\$ 10,706	\$ 15,572	\$ 26,278	\$ 8,976	\$ 17,302

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

6. RESOURCE PROPERTIES

December 31, 2008	Lombok Property, Indonesia	Sumbawa Property, Indonesia	James Bay Project, Canada	Total
Acquisition costs				
Balance, beginning of period	\$ 1,051,254	\$ 450,537	\$ -	\$ 1,501,791
Option payment	-	-	5,000,000	5,000,000
Purchase price allocation (Note 4)	-	-	1,966,801	1,966,801
Balance, end of period	<u>1,051,254</u>	<u>450,537</u>	<u>6,966,801</u>	<u>8,468,592</u>
Deferred exploration costs				
Incurred during the period:				
Assaying, testing, surveying and analysis	61,097	9,836	-	70,933
Camp construction, supplies and accommodation	571,131	159,526	-	730,657
Drilling	549,864	-	-	549,864
Geological and other consulting	476,864	65,547	-	542,411
Geophysical survey	-	-	1,100,000	1,100,000
Travel	22,657	812	-	23,469
Total deferred exploration costs	1,681,613	235,721	1,100,000	3,017,334
Balance, beginning of period	<u>7,982,732</u>	<u>3,668,090</u>	<u>-</u>	<u>11,650,822</u>
Balance, end of period	<u>9,664,345</u>	<u>3,903,811</u>	<u>1,100,000</u>	<u>14,668,156</u>
Total resource property costs	\$ 10,715,599	\$ 4,354,348	\$ 8,066,801	\$ 23,136,748

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

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

Title to resource properties involves certain inherent risks due to the difficulties of determining the validity of certain resource property interests as well as the potential for problems arising from the frequently ambiguous conveying history characteristic of many resource properties. The Company has investigated titles to all of its resource property interests and, to the best of its knowledge, title to all of its resource property interests are in good standing.

Lombok and Sumbawa Properties, Indonesia

The Company entered into an agreement with Sunda Mining Corporation (“Sunda”) pursuant to which Sunda assigned its option to acquire certain rights on the Lombok property (“Lombok”) and the Sumbawa property (“Sumbawa”) (collectively the “Properties”) to the Company, which Sunda had obtained from Indotan Inc. (“Indotan”). In consideration for the assignment, the Company paid \$81,572 and issued 11,500,000 common shares valued at \$862,500 to Sunda. Effective February 25, 2005, the Company and Indotan entered into a settlement agreement with respect to certain outstanding matters related to the Properties. Pursuant to this settlement, the Company and Indotan entered into an amended and restated option agreement (the “Option Agreement”) which sets out all of the rights and responsibilities of the Company and Indotan with respect to the Properties.

Pursuant to the Option Agreement, the Company has acquired, directly from Indotan, all of its rights to the Properties in consideration for which the Company issued 1,000,000 common shares, valued at \$125,000, and paid \$180,000. The Company now has an option, until February, 2010 to acquire 50% of Indotan’s 1% net smelter returns royalty (“NSR”) on the Properties in consideration for the payment of \$500,000. All of the holders of the NSR agreed that the NSR only applies to the Properties as at July 21, 2004 and not to any additional property interests which the Company acquires after that date.

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 a 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.

Lombok and Sumbawa are currently comprised of two separate applications to the Indonesian Government for a CoW to conduct mining activities and earn mineral rights to certain mineral tenements. Upon the approval in principle of the CoW, preliminary general survey licenses (“SIPPs”) were granted for the properties. The SIPP permits the Company to conduct preliminary general survey work over the CoW application areas. The Sumbawa SIPP was granted on January 2, 2004 for an initial 12 month period. On April 19, 2005, an extension and expansion of the Sumbawa Property SIPP was granted until April 19, 2006 and on April 22, 2006, an extension was granted until April 22, 2007. A third 12 month extension to the SIPP period was granted by the local regional authorities on June 20, 2007. The Lombok SIPP was granted on December 4, 2002. On July 15, 2005, an extension and expansion of the Lombok Property SIPP was granted until February 15, 2006. A 12 month extension on the Lombok SIPP has been filed. The granting of a SIPP is not a guarantee that a CoW will be entered into.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

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

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

The Company entered into an agreement with PT Newmont Nusa Tenggara (“NNT”) regarding a property (“*Block 1*”) which is contiguous with the western boundary of the Company’s current Lombok Island SIPP license. The acquisition was completed through a relinquishment by NNT of *Block 1* area. The terms of the agreement include granting NNT a 2% net smelter return (“NSR”) on any mineral production from the area covered by *Block 1* together with a right of first refusal should the Company wish to introduce a new partner into any development within the area originally covered by *Block 1*.

James Bay Nickel Project, Canada

During the period ended December 31, 2008, the Company’s 43.65% owned subsidiary, Canada Nickel, entered into an option agreement with Diamondex Resources Ltd. (“Diamondex”) to earn up to 51% interest (10% earned) in the James Bay Nickel Project (the “Property”). The Property is located near Ogoki, Ontario, Canada and consists of 724 mineral claims comprising approximately 407,388 acres of mineral rights. In order to earn its interest, Canada Nickel must pay an aggregate \$5,000,000 in option payment (\$5,000,000 paid) and incur a total of \$20,000,000 of exploration expenditures (\$1,100,000 incurred), as follows:

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

The Company also committed to issue to Diamondex 250,000 warrants of Canada Nickel which will entitle Diamondex to purchase up to 250,000 common shares of Canada Nickel for a period of 24 months from the closing of Canada Nickel’s Initial Public Offering (the “Offering”). The warrants will be issued on the date that Canada Nickel completes the Offering and will be priced at the same price as Canada Nickel’s shares issued in connection with the Offering.

During the period ended December 31, 2008, Canada Nickel commenced a legal action against Diamondex in connection with its option agreement on the Project.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

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

James Bay Nickel Project, Canada (cont'd...)

Canada Nickel alleges that it entered into the option Agreement and made a \$5 million option payment to Diamondex on the basis of representations that Diamondex had incurred \$5 million dollars in historical exploration expenditures on the Property and that the \$5 million payment was to reimburse Diamondex for those expenditures. Canada Nickel alleges that Diamondex's historical expenditures on the Property including acquisition costs were actually \$3,538,768 and not \$5 million as represented to Canada Nickel. Canada Nickel states that it has given notice of rescission of the Option Agreement and seeks the return of the \$5 million option payment, together with \$1.1 million in exploration expenditures paid under the Option Agreement.

During the period ended December 31, 2008, Diamondex provided notice to Canada Nickel that the failure to remit \$2 million of further exploration expenditures previously requested by Diamondex has resulted in the termination of the Option Agreement.

At December 31, 2008, the Company had paid deposits and retainers of \$758,561 for expected legal fees.

7. LONG-TERM INVESTMENT

At December 31, 2008, the Company held Canadian Asset-Backed Commercial Paper ("ABCP") with a par value of \$1,417,000 and an estimated fair value of \$1,200,222.

The ABCP did not settle as it matured as a result of liquidity issues in the ABCP market. There has been no active trading of the ABCP since mid-August 2007.

On March 17, 2008, the Pan-Canadian Investors Committee (the "Committee") for ABCP filed proceedings for a plan of compromise and arrangement (the "Plan") under the *Companies' Creditors Arrangement Act* (Canada) ("CCAA") with the Ontario Superior Court (the "Court"). At the meeting of ABCP noteholders on April 25, 2008, noteholders approved the Plan by the required majorities. On June 5, 2008, the Court issued a sanction order and reasons for the decision approving the Plan as amended. On August 18, 2008, that decision was upheld by the Ontario Court of Appeal and, on September 19, 2008, the Supreme Court of Canada denied leave to appeal. On December 24, 2008, the Committee announced that an agreement had been reached with all key stakeholders, including the governments of Canada, Quebec, Ontario and Alberta, to provide additional margin facilities to support the Plan and finalized certain enhancements to the Plan.

There is a significant amount of uncertainty in estimating the amount and timing of cash flows associated with the ABCP.

The Company estimates the fair value of its ABCP by discounting expected future cash flows on a probability weighted basis considering the best available data at December 31, 2008. The assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the Committee.

The assumptions used in the valuation model at December 31, 2008 include:

Weighted average interest rate 4.59%

Weighted average discount rate 6%

Maturity of notes of 7 years

If these assumptions were to change, the fair value of ABCP could change significantly.

Note 15.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

8. CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Number of Shares	Capital Stock	Contributed Surplus
Authorized			
Unlimited common shares without par value			
Issued			
Balance as at June 30, 2007	56,554,933	\$ 12,277,578	\$ 1,580,928
Private placement	9,432,836	11,319,403	-
Bonus shares	210,000	266,700	-
Issued for cash	-	-	-
Exercise of warrants	2,988,137	1,812,639	(53,532)
Exercise of options	2,225,000	2,065,218	(956,718)
Stock-based compensation	-	-	4,601,368
Share issuance costs	-	(823,330)	-
Agent warrants	-	(368,400)	368,400
Balance as at June 30, 2008	71,410,906	26,549,808	5,540,446
Stock-based compensation	-	-	63,864
Balance as at December 31, 2008	71,410,906	\$ 26,549,808	\$ 5,604,310

The Company had no shares in escrow at December 31, 2008.

During the period ended December 31, 2008, the Company's 43.65% owned subsidiary, Canada Nickel issued 10,633,685 flow-through shares for total proceeds of \$2,525,790. At December 31, 2008, the Company had spent \$1,100,000 of the flow-through expenditures and \$1,425,790 remains to be spent in 2009.

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

- completed a brokered private placement for 8,960,336 units at a price of \$1.20 per unit, with each unit being comprised of one common share and one-half of a transferable share purchase warrant. Each warrant may be exercised to purchase an additional common share of the Company at a purchase price of \$1.75 for a period of two years to December 18, 2009. The Company paid an aggregate of \$698,906 in cash commissions, \$124,424 in share issuance costs and issued an aggregate of 582,422 agent's warrants valued at \$368,400. Each agent's warrant is exercisable into one common share at an exercise price of \$1.20 per common share for a period of one year to December 18, 2008.
- completed a non-brokered private placement for 300,000 units at a price of \$1.20 per unit, with each unit being comprised of one common share and one-half of a transferable share purchase warrant. Each warrant may be exercised to purchase an additional common share of the Company at a purchase price of \$1.75 for a period of two years to December 18, 2009.
- completed a private placement for 172,500 units at a price of \$1.20 per unit. Each unit consists of one common share and one-half of a transferable share purchase warrant exercisable at \$1.75 per share until January 8, 2010.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

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

- d) issued 210,000 common shares with a value of \$1.27 per share to consultants, geologists and field personnel for working on the Company's mineral properties. The shares are subject to hold periods whereby one-third of the shares become freely tradable every six months over a period of 18 months.

Stock options

The Company grants stock options in accordance with the policies of the TSX Venture Exchange ("TSXV"). The number of shares reserved for issuance under the plan shall not exceed 10% of the issued and outstanding common shares of the Company. The terms of the option, including the vesting terms and the option price are fixed by the directors at the time of grant subject to the price not being less than the market price of the Company's stock on the date of grant. The stock options granted are exercisable for a period of five years. A summary of the Company's outstanding stock options granted is presented below.

	Number of Options	Weighted Average Exercise Price
Outstanding, June 30, 2007	3,925,000	\$ 0.46
Granted (weighted average fair value, \$1.46)	3,215,000	1.56
Granted (weighted average fair value, \$1.59)	400,000	1.56
Exercised	<u>(2,225,000)</u>	0.50
Outstanding, June 30, 2008	5,315,000	1.19
Granted	<u>250,000</u>	0.30
Outstanding, December 31, 2008	5,565,000	\$ 1.15
Number of options currently exercisable	<u>5,565,000</u>	\$ 1.15

During the period ended December 31, 2008, the Company reported stock-based compensation of \$63,864, (2007 - \$4,609,368 (Note 3) using the Black-Scholes Option Pricing model, as a result of 250,000 (2007 - 3,615,000) options granted. These amounts were recorded as contributed surplus on the balance sheet. The weighted average fair value of the options granted was \$0.26 (2007 - \$1.28) per option.

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

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

Stock options (cont'd...)

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

	Six Month Period Ended December 31, 2008	Six Month Period Ended December 31, 2007
Risk-free interest rate	3.24%	4.29%
Expected life of options	5 years	5 years
Annualized volatility	108%	110%
Dividend rate	0.00%	0.00%

Warrants

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

	Number of Warrants	Weighted Average Exercise Price
Outstanding, June 30, 2007	6,388,403	\$ 0.60
Granted	5,298,840	1.69
Exercised	(2,988,137)	0.59
Expired	<u>(1,070,786)</u>	0.94
Outstanding, June 30, 2008	7,628,320	1.31
Expired	<u>(582,422)</u>	<u>1.20</u>
Outstanding, December 31, 2008	<u>7,045,898</u>	<u>\$ 1.32</u>

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

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

Share purchase options and warrants

At December 31, 2008, the Company had share purchase options and warrants outstanding enabling holders to acquire common shares as follows:

	Number of Shares	Exercise Price	Expiry Date
Options	900,000	\$ 0.25	June 30, 2010
	675,000	0.56	January 13, 2011
	125,000	0.70	April 13, 2011
	3,215,000	1.56	September 26, 2012
	400,000	1.56	October 3, 2012
	250,000	0.30	July 31, 2013
Warrants	2,329,480	0.45	March 28, 2009
	4,630,168	1.75	December 18, 2009
	86,250	1.75	January 8, 2010

9. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

The Company has the following significant non-cash transactions:

During the six month period ended December 31, 2008, the Company:

- included in accounts payable \$53,182 (2007 - \$193,425) of resource property costs.
- allocated \$Nil (2007 - \$43,255) to capital stock from contributed surplus for agent warrants exercised during the period.
- allocated \$Nil (2007 - \$956,718) to capital stock from contributed surplus for stock options exercised during the period.

10. RELATED PARTY TRANSACTIONS

During the six month period ended December 31, 2008, the Company entered into transactions with related parties as follows:

- Paid \$208,200 (December 31, 2007 - \$84,000) for management fees and \$21,800 (December 31, 2007 - \$9,000) for administration, recorded in office and miscellaneous expense, to a private company controlled by the Chief Executive Officer and director of the Company.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

10. RELATED PARTY TRANSACTIONS (cont'd...)

- b) Paid \$124,330 (December 31, 2007 - \$94,733) for geological consulting services included in resource properties to an officer of the Company and a company controlled by an officer of the Company.
- c) Paid \$36,000 (December 31, 2007 - \$25,700) for consulting fees to an officer of the Company.
- d) Paid \$53,000 (December 31, 2007 - \$36,500) for professional accounting fees to a firm in which an ex-officer is a partner.
- e) Paid \$78,901 (December 31, 2007 - \$Nil) for legal fees, included in share issue costs, to a firm in which a director of Canada Nickel is a partner.
- f) Repaid a \$1,100,000 loan to a private company controlled by the Chief Executive Officer and director of the Company for funds advanced to Diamondex pursuant to the James Bay Nickel Option Agreement (Note 6).

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.

11. FINANCIAL INSTRUMENTS AND RISK

The Company's financial instruments consist of cash, receivables, deposits and retainers, accounts payable and accrued liabilities 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 counterparty's inability to fulfill its payment obligations. The Company believes it has no significant credit risk.

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2008, the Company had a cash balance of \$3,164,043 (December 31, 2007 - \$11,913,368) to settle current liabilities of \$103,010 (December 31, 2007 - \$214,420). 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.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

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

Market risk (cont'd...)

(a) Interest rate risk

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

(b) Foreign currency risk

The Company's largest non-monetary assets are its resource interests in Indonesia. The Company could accordingly be at risk for foreign currency fluctuations and developing legal and political environments. The Company does not maintain significant cash or monetary assets or liabilities in Indonesia. At December 31, 2008, the Company had US\$43,492 (approximately CAD\$53,200) in accounts payable.

(c) Price risk

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

12. COMMITMENT

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

2009	\$ 7,860
2010	13,100

13. SEGMENTED INFORMATION

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

	December 31, 2008	June 30, 2008
Resource properties - Indonesia	15,069,947	13,152,613
Resource properties – Canada	8,066,801	-
Equipment – Canada	<u>15,572</u>	<u>17,302</u>
	<u>\$ 23,152,230</u>	<u>\$ 13,169,915</u>

14. CAPITAL MANAGEMENT

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

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

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

15. SUBSEQUENT EVENTS

Subsequent to December 31, 2008,

- i) Indonesia enacted a new Mining Law. This effectively put an end to the Contract of Work ("CoW") regime pursuant to which the Company had been operating since 2004. Although CoW negotiations regarding the Company's Taliwang property had reached a stage where the CoW manuscripts had been finalized and initialed by both negotiating team leaders, the enactment of the new Mining Law ended this process and replaced it with a permit licensing system.

In order for the law to take effect, the government will issue significant implementing regulations, which will be drafted with input from concerned industry parties. Both the Department of Energy and Mineral Resources (ESDM) minister and department senior staff have indicated that they have set a self-imposed goal of 3 to 4 months from when the new law was enacted to draft these regulations.

The Company is making the transition from the CoW application to the new permit licensing system. The Company is currently obtaining letters (Statements of Facts) from the West Nusa Tenggara governor (for the Lombok property) and the West Sumbawa regent (for the Taliwang property). The Company will submit the Statements of Fact along with the initialed Taliwang CoW manuscript to the ESDM in order to obtain confirmation from the ESDM that the Company's projects including West Lombok, Taliwang and the other KPs will transition automatically into a new mining business license (IUP) without the projects going to public tender.

With respect to the West Nusa Tenggara provincial land utilization regulation No. 11, which disrupted the CoW application process for the Lombok property, the regulation is currently in the process of being revised by the provincial government. If regulation No. 11 is revised, the Company believes that the provincial government will be required to issue retroactive permits for an in-principle CoW approval, along with SIPP (Preliminary General Survey) license extensions to cover the 2006 to 2008 period.

- ii) the Ontario Superior Court issued the final implementation order in the ABCP restructuring process. The restructuring closed on January 21, 2009. The exchange of restructured ABCP notes was completed on January 21, 2009. A first installment of interest for \$48,582 (to August 31, 2008) was also paid on the same day. The balance of the interest is to be paid in subsequent installments, and the amounts and timing are still to be determined. Restructuring fees already incurred and a reserve for additional restructuring fees were deducted from this first interest payment.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED NOTES TO THE FINANCIAL STATEMENTS
(Unaudited)
FOR THE SIX MONTH PERIOD ENDED DECEMBER 31, 2008
(Expressed in Canadian dollars)

15. SUBSEQUENT EVENTS (cont'd...)

Upon completion of the restructuring in January 2009 the Company received \$1,410,198 in new notes as follows:

- \$1,187,185 of senior Master Asset Vehicle MAV II Class A-1 Notes
- \$36,717 of Class C Notes
- \$186,296 of Class 13 Notes.