

SOUTHERN ARC MINERALS INC.

CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE THREE MONTHS ENDED
SEPTEMBER 30, 2010**

(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 September 30, 2010.

SOUTHERN ARC MINERALS INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited – Prepared by Management)
(Expressed in Canadian dollars)

	September 30, 2010	June 30, 2010
ASSETS		
Current		
Cash and cash equivalents	\$ 846,765	\$ 1,604,476
Receivables	61,175	29,668
Prepaid expense and deposit	15,164	7,534
Investment (Note 7)	<u>835,425</u>	<u>835,799</u>
	1,758,529	2,477,477
Equipment (Note 5)	10,520	11,074
Resource properties (Note 6)	<u>22,769,384</u>	<u>22,410,416</u>
	<u>\$ 24,538,433</u>	<u>\$ 24,898,967</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	\$ 502,817	\$ 383,246
Loans payable (Note 8)	<u>1,579,400</u>	<u>1,614,600</u>
	<u>2,082,217</u>	<u>1,997,846</u>
Shareholders' equity		
Capital stock (Note 9)	30,474,172	30,474,172
Contributed surplus (Note 9)	8,592,744	5,926,928
Reserve	216,785	221,008
Deficit	<u>(18,727,289)</u>	<u>(15,692,612)</u>
Capital and reserve attributable to shareholders of Southern Arc Minerals Inc.	20,556,412	20,929,496
Non-controlling interest (Note 4)	<u>1,899,804</u>	<u>1,971,625</u>
Total equity	<u>22,456,216</u>	<u>22,901,121</u>
	<u>\$ 24,538,433</u>	<u>\$ 24,898,967</u>

Nature and continuance of operations (Note 2)

Subsequent events (Note 16)

On behalf of the Board:

"John Proust"

Director

"David Stone"

Director

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
FOR THE THREE MONTHS ENDED SEPTEMBER 30
(Unaudited – Prepared by Management)
(Expressed in Canadian dollars)

	2010	2009
EXPENSES		
Amortization	\$ 554	\$ 692
Consulting fees	35,538	6,000
Foreign exchange	(15,371)	1,993
Management fees (Note 11)	100,500	106,500
Office and miscellaneous (Note 11)	60,340	26,770
Professional fees	159,314	96,731
Property investigation costs	74,302	-
Rent	4,086	3,930
Stock-based compensation (Note 9)	2,665,816	333,661
Transfer agent and filing fees	1,872	10,419
Travel	<u>12,813</u>	<u>3,779</u>
Loss before other items	<u>(3,099,764)</u>	<u>(590,475)</u>
OTHER ITEMS		
Interest income	<u>-</u>	<u>2,409</u>
Loss and comprehensive loss for the year	<u>\$ (3,099,764)</u>	<u>\$ (588,066)</u>
Loss and comprehensive loss attributable to:		
Shareholders of Southern Arc Minerals Inc.	\$ (3,034,677)	\$ (546,569)
Non-controlling interests	<u>(65,087)</u>	<u>(41,497)</u>
	<u>\$ (3,099,764)</u>	<u>\$ (588,066)</u>
Basic and diluted loss per share	<u>\$ (0.04)</u>	<u>\$ (0.01)</u>
Weighted average number of shares outstanding	<u>77,329,990</u>	<u>71,410,906</u>

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED SEPTEMBER 30
(Unaudited – Prepared by Management)
(Expressed in Canadian dollars)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss and comprehensive loss for the year	\$ (3,099,764)	\$ (588,066)
Items not affecting cash:		
Stock-based compensation	2,665,816	333,661
Amortization	554	692
Foreign exchange	(15,371)	1,993
Changes in non-cash working capital items:		
(Increase)/decrease in receivables	(31,507)	9,042
Prepaid expense and deposit	(7,630)	(10,678)
Decrease in accounts payable and accrued liabilities	<u>224,550</u>	<u>35,756</u>
Net cash used in operating activities	<u>(263,352)</u>	<u>(217,600)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to resource properties	(430,806)	(242,932)
Repayment of investment	<u>374</u>	<u>3,084</u>
Net cash used in investing activities	<u>(430,432)</u>	<u>(239,848)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Share issuance cost paid by Nickel Oil and Gas	<u>(44,098)</u>	<u>-</u>
Net cash provided by financing activities	<u>(44,098)</u>	<u>-</u>
FOREIGN EXCHANGE ON CASH	<u>(19,829)</u>	<u>(1,993)</u>
Change in cash during year	(757,711)	(459,441)
Cash and cash equivalents, beginning of year	<u>1,604,476</u>	<u>2,431,412</u>
Cash and cash equivalents, end of year	<u>\$ 846,765</u>	<u>\$ 1,971,971</u>
Cash paid for interest	\$ -	\$ -
Cash paid for income taxes	\$ -	\$ -
Cash and cash equivalents consist of:		
Cash on hand	\$ 846,765	\$ 1,671,935
Term deposits	<u>-</u>	<u>300,036</u>
	<u>\$ 846,765</u>	<u>\$ 1,971,971</u>

Supplemental disclosure with respect to cash flows (Note 10)

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

SOUTHERN ARC MINERALS INC.
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE THREE MONTH ENDED SEPTEMBER 30
(Unaudited – Prepared by Management)
(Expressed in Canadian dollars)

	Capital Stock	Contributed Surplus	Non- controlling interest reserve	Deficit	Total	Non-controlling interest	Total Equity
Balance at June 30, 2009	\$ 26,565,067	\$ 5,604,310	\$ -	\$ (14,133,385)	\$ 18,035,992	\$ 1,369,164	\$ 19,405,156
Comprehensive loss for the year	-	-	-	(1,559,227)	(1,559,227)	(53,859)	(1,613,086)
Private placement, net of transaction costs	-	-	-	-	-	977,703	977,703
Reimbursement of income taxes paid to flow-through shares subscribers	-	-	-	-	-	(100,375)	(100,375)
Gain on diluted interest in subsidiary (Note 4)	-	-	221,008	-	221,008	(221,008)	-
Stock-based compensation	-	333,661	-	-	333,661	-	333,661
Stock-based financing costs	-	117,713	-	-	117,713	-	117,713
Exercise of warrants	1,175,359	-	-	-	1,175,359	-	1,175,359
Exercise of options	318,746	(128,756)	-	-	189,990	-	189,990
Issued for acquisition of subsidiaries (Note 6)	2,415,000	-	-	-	2,415,000	-	2,415,000
	<u>3,909,105</u>	<u>322,618</u>	<u>221,008</u>	<u>(1,559,227)</u>	<u>4,452,731</u>	<u>656,320</u>	<u>5,109,051</u>
Balance at June 30, 2010	<u>30,474,172</u>	<u>5,926,928</u>	<u>221,008</u>	<u>(15,692,612)</u>	<u>20,929,496</u>	<u>1,971,625</u>	<u>22,901,121</u>
Comprehensive loss for the period	-	-	-	(3,034,677)	(3,034,677)	(65,087)	(3,099,764)
Share issuance costs	-	-	(4,223)	-	(4,223)	(6,734)	(10,957)
Stock-based compensation	-	2,665,816	-	-	2,665,816	-	2,665,816
	<u>-</u>	<u>2,665,816</u>	<u>(4,223)</u>	<u>-</u>	<u>2,661,593</u>	<u>(6,734)</u>	<u>2,654,859</u>
Balance at September 30, 2010	\$ 30,474,172	\$ 8,592,744	\$ 216,785	\$ (18,727,289)	\$ 20,556,412	\$ 1,899,804	\$ 22,456,216

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

SOUTHERN ARC MINERALS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
(Unaudited – Prepared by Management)
(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 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.

These financial statements are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") 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. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but not limited to, twelve months from the end of the reporting period. Management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

During the period ended September 30, 2010, the Company incurred a net loss of \$3,034,677 (2009 - \$546,569) and had working deficit of \$323,688 (2009 – working capital \$2,632,708). The Company does not generate sufficient cash flow from operations to adequately fund its future exploration activities and has relied principally upon issuance of securities and loans from related parties to fund its exploration and administrative expenditures. These conditions raise significant doubt regarding the Company's ability to continue as a going concern.

The Company will require additional capital to fund its future property acquisitions and exploration programs as well as for administrative purposes. If the management is unable to obtain new funding, the Company may be unable to continue its operations, and amounts realized for assets may be less than amounts reflected in these financial statements.

The financial statements do not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue operations.

3. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements include:

- i) the accounts of the Company;
- ii) its 38.54% owned Canadian subsidiary, Nickel Oil & Gas Corp. (“Nickel Oil & Gas”), formerly Canada Nickel Corp., from the date of acquisition; and
- iii) its wholly owned Singapore subsidiaries, Indotan Lombok Pte. Ltd., Indotan Sumbawa Pte. Ltd. and Pt. Selatan Arc Minerals.

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

Recent accounting pronouncements

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

International financial reporting standards (“IFRS”)

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 evaluating the impact of the conversion on the Company’s consolidated financial statements and is considering accounting policy choices available under IFRS.

4. INVESTMENT IN NICKEL OIL & GAS CORP.

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

During the year ended June 30, 2010, Nickel Oil & Gas issued additional common stock to third parties which diluted the Company’s ownership percentage of Nickel Oil & Gas to 38.54% (2009 – 43.56%), resulting in a gain on diluted interest in subsidiary of \$221,008 (2009 - \$201,920). The Company maintains control as a result of a common director.

SOUTHERN ARC MINERALS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
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5. EQUIPMENT

	September 30, 2010			June 30, 2010		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Telephone equipment	\$ 26,278	\$ 15,758	\$ 10,520	\$ 26,278	\$ 15,204	\$ 11,074

6. RESOURCE PROPERTIES

September 30, 2010	Brewster Area, Canada (Unproven)	Pine Creek Area, Canada (Unproven)	Lombok Property, Indonesia	Sumbawa Property, Indonesia	Total
Acquisition costs					
Balance, beginning and end of period	\$ -	\$ 1,691	\$ 2,427,299	\$ 1,736,682	\$ 4,165,672
Deferred exploration costs					
Incurred during the period:					
Assaying, testing, surveying and analysis	-	-	-	3,167	3,167
Camp construction, supplies and other	-	-	164,064	114,189	278,253
Drilling	-	-	147	-	147
Geological and other consulting	-	10,313	43,294	21,873	75,480
Travel	-	-	1,177	744	1,921
Total deferred exploration costs	-	10,313	208,682	139,973	358,968
Balance, beginning of period	1,813,635	1,439,481	10,773,410	4,218,218	18,244,744
Balance, end of period	1,813,635	1,449,794	10,982,092	4,358,191	18,603,712
Total resource property costs	\$ 1,813,635	\$ 1,451,485	\$13,409,391	\$ 6,094,873	\$22,769,384

SOUTHERN ARC MINERALS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
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6. RESOURCE PROPERTIES (cont'd...)

June 30, 2010	Brewster Area, Canada (Unproven)	Pine Creek Area, Canada (Unproven)	Lombok Property, Indonesia	Sumbawa Property, Indonesia	Total
Acquisition costs					
Balance, beginning of year	\$ -	\$ -	\$ 1,051,254	\$ 450,537	\$ 1,501,791
Cash	-	1,691	168,545	94,261	264,497
Shares	-	-	1,207,500	1,207,500	2,415,000
Written-off during the year	-	-	-	(15,616)	(15,616)
Balance, end of year	-	1,691	2,427,299	1,736,682	4,165,672
Deferred exploration costs					
Incurred during the year:					
Assaying, testing, surveying and analysis	-	-	34,721	167	34,888
Camp construction, supplies and other	-	-	268,821	117,557	386,378
Completion	968,367	-	-	-	968,367
Drilling	791,577	1,425,356	11,167	-	2,228,100
Geological and other consulting	53,691	14,125	416,299	132,519	616,634
Travel	-	-	24,913	4,019	28,932
Total deferred exploration costs	1,813,635	1,439,481	755,921	254,262	4,263,299
Balance, beginning of year	-	-	10,017,489	3,963,956	13,981,445
Balance, end of year	1,813,635	1,439,481	10,773,410	4,218,218	18,244,744
Total resource property costs	\$ 1,813,635	\$ 1,441,172	\$ 13,200,709	\$ 5,954,900	\$ 22,410,416

Oil and Gas Properties

Brewster Area, Canada

During the year ended June 30, 2010, the Company's 38.54% owned subsidiary, Nickel Oil & Gas, entered into a joint venture agreement (the "Joint Venture"). According to the Joint Venture agreement, Nickel Oil & Gas earned a 20% working interest in one section of land (640 acres) by paying 100% of the costs of completing a previously drilled well and a 48% working interest in a second section by paying 100% of the costs of drilling and completing a well. A party holding a 20% interest in both sections elected not to participate in the operations and consequently has forfeited its 20% interest in production 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 a result, Nickel Oil & Gas effectively holds a 40% interest in one section and a 68% interest in the second section until such time as the 400% penalty has been recovered. Nickel Oil & Gas has an option to earn a 48% interest in a third section at Brewster by paying 80% of drilling and completion.

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

Pine Creek Area, Canada

During the year ended June 30, 2010, the Company's 38.54% owned subsidiary, Nickel Oil & Gas, entered into a farmout and option agreement with respect to the Pine Creek area, Alberta. This agreement granted Nickel Oil & Gas the option to earn the following oil and gas rights:

- i) a 25% working interest in the first section by paying 100% of the costs of re-entering and completing a previously drilled well; and
- ii) a 60% working interest in the second section by paying 100% of the costs of drilling and completing, capping or abandoning a well; and
- iii) a 60% working interest in the third section by paying 100% of the costs of drilling and completing, capping or abandoning a well.

During the period ended September 30, 2010, Nickel Oil & Gas entered into an Amending Agreement with its joint venture partner on Pine Creek Property. Under the amending agreement, Nickel Oil & Gas earned a 60% working interest in two sections by funding 100% of the costs of drilling of the horizontal well. Nickel Oil & Gas had an obligation to pay 100% of the completion, equipping and tie-in costs. The horizontal well has been drilled and Nickel's joint venture partner solely funded the completion, equipping and tie-in costs of the well. According to the Amending Agreement, the joint venture partner shall receive 100% of all revenue from the well until it recoups 125% of the payout costs incurred.

Resource Properties

Lombok and Sumbawa Properties, Indonesia

During the period ended June 30, 2005, the Company entered into an agreement with Sunda Mining Corporation ("Sunda") pursuant to which Sunda assigned its option to acquire certain rights on the Lombok property ("Lombok") and the Sumbawa property ("Sumbawa")(collectively the "Properties") to the Company, which Sunda had obtained from Indotan Inc. ("Indotan"). In consideration for the assignment, the Company paid \$81,572 and issued 11,500,000 common shares valued at \$862,500 to Sunda. Effective February 25, 2005, the Company and Indotan entered into a settlement agreement with respect to certain outstanding matters related to the Properties. Pursuant to this settlement, the Company and Indotan entered into an amended and restated option agreement (the "Option Agreement") which sets out all of the rights and responsibilities of the Company and Indotan with respect to the Properties. Pursuant to the Option Agreement, the Company has acquired, directly from Indotan, all of its rights to the Properties in consideration for which the Company issued 1,000,000 common shares, valued at \$125,000, and paid \$180,000. Under the terms of the option agreement and revised agreement, the Company granted a 2% NSR on the Sumbawa property and a 1% NSR on the Lombok Property. In the case of the Lombok Property, the NSR does not apply to the Block 1 property acquired by the Company from Newmont in January 2006.

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

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

In accordance with a limited power of attorney granted by Indotan pursuant to the Option Agreement, the Company caused Indotan to enter into two joint venture agreements (the “JV Agreements”) with Indotan’s Indonesian partner, PT Puri Permata Mega (“PTPM”), on the Properties. The Company has an initial 90% interest in the Lombok joint venture (the “Lombok JV”) and the Sumbawa joint venture (the “Sumbawa JV”). At any time after a joint venture company is formed with respect to the Lombok JV and that company enters into a Mining Business License (“IUP”), previously stated as a Contract of Work (“CoW”), the Company can acquire a further 5% interest in the Lombok JV by providing funds to the Lombok JV in the amount of US\$700,000. At any time after a joint venture company is formed with respect to the Sumbawa JV and that company enters into an IUP, previously stated as a CoW, the Company can acquire a further 5% interest in the Sumbawa JV by providing funds to the Sumbawa JV in the amount of US\$300,000. The Company has funded 100% of the ongoing operations to each of the Lombok JV and Sumbawa JV.

The Company is making the transition for the Lombok property from the CoW application to the new permit licensing system or “IUP” with the establishment of suitable Singaporean (completed) and Indonesian (in-progress) corporate entities.

The Company has entered into an agreement with PT Newmount 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 of 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*.

During the year ended June 30, 2010, 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.) (“Singapore Companies”). As consideration the Company issued 3,500,000 common shares with a value of \$2,415,000 subject to two assignable options. The first option will entitle the Company to acquire 500,000 of these shares at a price of \$0.50 per common share until August 15, 2010 at a price of \$0.50 per common share (exercised subsequently). The second 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. 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 a portion of Lombok Property. In the case of the Lombok Property, the NSR does not apply to the Block 1 property (which encompasses all of Selodong, Mencangah, and Pelangan prospects).

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

James Bay Nickel Project, Canada

Nickel Oil & Gas holds a royalty equal to 1.5% of Net Smelter Returns (“NSR”) in the Nickel Bay Project, Ontario. Nickel Oil & Gas has granted 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 the three parts of this option are exercised, Nickel will receive \$2,500,000, and the NSR will be reduced to 0.5%.

SOUTHERN ARC MINERALS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
(Unaudited – Prepared by Management)
(Expressed in Canadian dollars)

7. INVESTMENT

	September 30, 2010	June 30, 2010
Plan Notes	\$ 835,425	\$ 835,799

At September 30, 2010, investments included Master Asset Vehicle II notes received in exchange for Canadian third-party asset backed commercial paper (“ABCP”) that was held by the Company.

The notes held by the Company are referred to as MAVII, including senior notes Class A-1, subordinated notes Class C, and ineligible asset tracking notes Class 13:

Notes	Maturity Date (1)	Interest Rate (2)	Face Value	Fair Value Estimate
MAV II Class A-1	July 2056	BA - 0.5%	\$ 1,187,185	\$ 835,425
MAV II Class C	July 2056	BA + 20%	36,717	-
MAV II Class 13 (Ineligible Asset Tracking Notes)	March 2014		186,296	-
Total			\$ 1,410,198	\$ 835,425

(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.

The notes are classified as held-for-trading under the Company’s Financial Instruments Policy which requires them to be fair valued at each period end with changes in fair value included in the statement of operations in the period in which they arise.

The fair value of the Class A-1 notes was established using a discounted cash flow approach based on the following inputs: the notes will pay interest at a rate 0.5% less than the bankers’ acceptance (“BA”) rate, prospective buyers of these notes were estimated to require premium yields 5% over the BA rate, average maturity of Class A -1 Notes were estimated to be 6.5 years. The Class C Notes are subordinated to the Class A and Class B Notes with respect to payment of interest and principal, and no amounts will be paid with respect to the Class C Notes until the Class A and Class B Notes are repaid in full.

The Class C and sub-prime backed Class 13 notes are viewed as highly speculative with regard to ultimate payment of principal at maturity. Accordingly, it is expected that Class C and sub-prime backed Class 13 notes will trade at \$Nil value. In conjunction with the note exchange, the Company received a payment of \$60,460 which was its share of the accumulated interest to June 30, 2009. The interest received to June 30, 2009 was accounted for as a reduction of the Company’s investment. The estimated unpaid interest up to the restructuring date of January 21, 2009 is not material and was not included in the Company’s fair value calculation.

During the period ended September 30, 2010, the Company received repayments of investment of \$373 (2009 - \$3,084).

SOUTHERN ARC MINERALS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2010
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8. LOANS PAYABLE

Loans payable consists of:

- i) a \$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 Plan Notes (Note 7). The bridge loan is secured by the Company's investment in Plan Notes. Interest on direct advances is paid at the Bank's prime rate plus 1% per annum. Subsequent to the period ended September 30, 2010, the bridge loan was repaid (Note 16); and
- ii) a US\$1,000,000 (CDN\$1,029,400) loan from a director of the Company. The loan is non-interest bearing, has a 3 month term, and is repayable before June 30, 2011. In consideration for granting the loan, the Company has assigned its option to acquire 500,000 of the Company's shares (Note 6) which are currently owned by Indotan Inc. A fair value of \$117,713 was allocated to stock-based financing costs and recorded to contributed surplus in connection with the assignment. During the period ended September 30, 2010, the director has exercised the option and acquired the mentioned shares.

9. 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, 2009	71,410,906	\$ 26,565,067	\$ 5,604,310
Stock-based compensation	-	-	333,661
Stock-based financing (Note 7ii)	-	-	117,713
Exercise of warrants	1,679,084	1,175,359	-
Exercise of options	740,000	318,746	(128,756)
Issued for acquisition of subsidiaries	<u>3,500,000</u>	<u>2,415,000</u>	<u>-</u>
Balance as at June 30, 2010	77,329,990	30,474,172	5,926,928
Stock-based compensation	<u>-</u>	<u>-</u>	<u>2,665,816</u>
Balance as at September 30, 2010	<u>77,329,990</u>	<u>\$ 30,474,172</u>	<u>\$ 8,592,744</u>

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 up to 10 years. A summary of the Company's outstanding stock options granted is presented below.

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

Stock options (cont'd...)

	Number of Options	Weighted Average Exercise Price
Outstanding, June 30, 2009	4,775,000	\$ 1.23
Exercised	(740,000)	(0.26)
Granted	3,500,000	0.40
Cancelled	(3,450,000)	(1.56)
Expired	(10,000)	(0.25)
Outstanding, June 30, 2010	4,075,000	0.41
Granted	3,650,000	0.80
Outstanding, September 30, 2010	7,725,000	\$ 0.60
Number of options currently exercisable	7,725,000	\$ 0.60

During the period ended September 30, 2010, the Company recorded stock-based compensation of \$2,665,816 (2009 - \$333,661) using the Black-Scholes Option Pricing model, as a result of 3,650,000 (2009 – 3,500,000) options granted. These amounts were recorded as contributed surplus on the balance sheet. The weighted average fair value of the options granted was \$0.73 (2009 - \$0.10) per option.

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

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

	Three Month Period Ended September 30, 2010	Three Month Period Ended September 30, 2009
Risk-free interest rate	2.37%	2.62%
Expected life of options	5 years	5 years
Annualized volatility	150.53%	121.25%
Dividend rate	0.00%	0.00%

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

At September 30, 2010, 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	* 425,000	\$ 0.56	January 13, 2011
	150,000	\$ 0.30	July 31, 2013
	3,500,000	\$ 0.40	September 16, 2014
	<u>3,650,000</u>	\$ 0.80	July 19, 2015
	7,725,000		

* Subsequent to the period ended September 30, 2010, options were exercised (Note 16 (ii))

Warrants

The Company does not have any warrants issued and outstanding

10. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

During the period ended September 30, 2010, the Company did not have any significant non-cash transactions.

At September 30, 2010, the Company had included in accounts payable \$29,474 of resource property costs and \$66,780 of share issue costs incurred by Nickel Oil and Gas Corp.

At June 30, 2010, the Company had the Company had included in accounts payable \$101,312 of resource property costs and \$99,921 of share issue costs incurred by Nickel Oil and Gas Corp.

11. RELATED PARTY TRANSACTIONS

During the period ended September 30, 2010, the Company entered into transactions with related parties as follows:

- a) paid \$100,500 (2009 - \$100,500) for management fees and \$30,000 (2009 - \$10,500) for administration, recorded in office and miscellaneous expense, to a private company controlled by the Chief Executive Officer and director of the Company.
- b) paid \$134,866 (2009 - \$Nil) 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 \$Nil (2009 - \$1,867) for legal fees, included in professional fees, to a firm in which a director of Nickel Oil & Gas is a partner.
- d) related party transactions also include a US\$1,000,000 (CDN\$1,029,400) (2009- \$Nil) loan from a director of the Company (Note 8 (ii))

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.

12. FINANCIAL INSTRUMENTS AND RISK

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

Concentration of credit risk

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

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

Fair value

The Company estimates the fair value of its financial instruments based on current interest rates, market value and pricing of financial instruments with comparable terms. Unless otherwise indicated, the carrying value of these financial instruments approximates their fair market value because of the near maturity of those instruments.

As at September 30, 2010 and June 30, 2010, the carrying amount of current financial assets and liabilities approximated the fair value because of the near maturity of those instruments and the carrying value of the demand non-revolving bridge loan (Note 8(ii)) is considered to approximate fair value since it bears interest at current rates for similar types of borrowing arrangements.

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

Fair value (cont'd...)

Financial instruments measured at fair value on the balance sheet are summarized in levels of fair value hierarchy as follows:

	Level 1	Level 2	Level 3
Assets			
Cash and cash equivalents	\$ 846,765	\$ -	\$ -
Long-term investment	\$ -	\$ -	\$ 835,425

Credit risk

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

The Company is holding Plan Notes with a fair value at September 30, 2010 of \$835,425 (June 30, 2009 - \$835,799). As detailed in Note 7, the Company believes this is a credit risk.

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at September 30, 2010, the Company had a cash balance of \$846,765 (June 30, 2010 - \$1,604,476) to settle current liabilities of \$2,082,217 (June 30, 2010 - \$1,997,846). All of the Company's financial liabilities are classified as current and are anticipated to mature within the next fiscal period.

Market risk

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

(a) Interest rate risk

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

(b) Foreign currency risk

The Company's largest non-monetary assets are its resource interests in Indonesia. The Company could accordingly be at risk for foreign currency fluctuations and developing legal and political environments. The Company does not maintain significant cash or monetary assets or liabilities in Indonesia. At September 30, 2010, the Company had US\$796,038 (approximately CAD\$815,859) in cash, US\$91,872 (approximately CAD\$94,160) in accounts payable and US\$1,000,000 (CAD\$1,024,900) in loans payable. As at September 30, 2010, US\$ amounts were converted at a rate of US\$1 to CAD\$1.0249.

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

(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.

13. COMMITMENT

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

Unit	Commencement Date	Term	\$/ month	Remaining Fiscal 2011
1522	1-Mar-10	28-Feb-11	\$1,362	\$6,810

14. SEGMENTED INFORMATION

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

	September 30, 2010	June 30, 2010
Oil and gas properties – Canada	\$ 3,265,120	\$ 3,254,807
Resource properties - Indonesia	19,504,264	19,155,609
Equipment – Canada	<u>10,520</u>	<u>11,074</u>
	\$ 22,793,559	\$ 22,421,490
Resource property write-down-Canada	\$ -	\$ -
Resource property write-down-Indonesia	\$ -	\$ 15,616

15. 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 of components of equity (ie. share capital, contributed surplus and retained earnings).

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

There were no changes in the Company's approach to capital management during the period ended September 30, 2010.

16. SUBSEQUENT EVENTS

Subsequent to the period ended September 30, 2010:

- i) the Company disposed all of its holdings in the MAV Plan Notes (Note 7) and received \$890,277. Concurrently; the Company repaid the banks bridge loan of \$550,000 (Note 8).
- ii) 325,000 options were exercised for proceeds of \$182,000.
- iii) the Company and Newcrest Mining Limited ("Newcrest") announced the signing of a Heads of Agreement ("Agreement") involving a joint venture investment in the Taliwang property. The Agreement (which is non-binding other than relationship of parties, exclusivity, confidentiality, access and governing law provisions) includes the following commercial terms:
 - a. Newcrest will solely fund expenditures of US\$4 million on the Taliwang project during the first two years of the Agreement by way of a convertible loan;
 - b. Upon completion of the Minimum Spend Obligation, Newcrest may convert its loan into shares equal to 75% of the shares of the Singapore company that will have an 85% interest in the Taliwang mining permit (IUP);
 - c. Following its acquisition of the shares in the Singapore company, Newcrest may retain its interest in the Taliwang project by solely funding additional expenditures to a maximum of US\$46 million or to a completed feasibility study, whichever occurs first, with a minimum expenditure of US\$2 million per annum; and
 - d. During the period of the Minimum Spend Obligation, a joint technical committee comprised of representatives of both parties and controlled by Newcrest, will supervise and direct the exploration programs.

If Newcrest fully complies with the funding terms of the Agreement, it will earn an effective 63.75% interest in the Taliwang project, leaving Southern Arc with an effective 21.25% interest. The remaining interest is held by the West Sumbawa Regency government (10%) and PT. Puri Permata Mega (5%).