



**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FOR THE THREE AND SIX MONTHS ENDED  
DECEMBER 31, 2015 AND 2014**

**SOUTHERN ARC MINERALS INC.**  
**Management's Discussion and Analysis**  
**For the Three and Six Months Ended December 31, 2015 and 2014**

*This Management's Discussion and Analysis ("MD&A"), prepared as of February 26, 2016, should be read in conjunction with the audited consolidated annual financial statements of Southern Arc Minerals Inc. ("Southern Arc" or the "Company") for the year ended June 30, 2015, and the unaudited condensed consolidated interim financial statements for the three and six months ended December 31, 2015 and related notes thereto, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts are stated in Canadian dollars unless otherwise indicated. Additional information related to the Company can be found on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.southernarcminerals.com](http://www.southernarcminerals.com).*

*Statements in this MD&A that are not historical facts are "forward-looking statements" that are subject to risk factors set out in a cautionary note contained herein. Readers are cautioned not to put undue reliance on forward-looking statements.*

**COMPANY OVERVIEW**

Southern Arc, through its subsidiaries (collectively "Southern Arc" or "the Company"), is a mineral exploration company exploring for gold and copper-gold. The Company's current portfolio includes two exploration-stage projects with epithermal gold and copper-gold porphyry prospects on the Lombok and Sumbawa islands in Indonesia, a substantial investment in a Canadian junior mining company exploring for gold in Canada's Abitibi Gold Belt, and applications pending government review for 80 prospecting rights licenses in Northern Japan.

Southern Arc was incorporated in British Columbia, Canada on August 19, 2004. The Company's exploration efforts to date have been focused primarily in Indonesia. At the Company's West Lombok project, which hosts several gold-rich copper porphyry and epithermal gold vein prospects, Southern Arc has completed approximately 47,720 metres of drilling and in July 2013 completed a resource estimate for the project. The Company's East Elang project is a grassroots exploration property located adjacent to Newmont's Elang copper-gold deposit.

In December 2012, following a strategic review of the Company's projects and exploration strategy, Southern Arc announced plans to diversify its portfolio by potentially selling or partnering its Indonesian properties while also looking for opportunities to invest in resource properties outside of Indonesia. Southern Arc conducted an extensive search worldwide for high-quality properties, and invested a total of \$8.85 million to acquire a 26.25% in Eagle Hill Exploration Corporation ("Eagle Hill"), a TSX Venture Exchange listed company. Eagle Hill owned the high-grade Windfall Lake Gold Deposit ("Windfall Lake") in Quebec, Canada. In August 2015, Eagle Hill was acquired by Oban Mining Corporation ("Oban") for a 258% premium over Eagle Hill's trading price in a four-company business combination.

Further to its diversification strategy, in July 2014 Southern Arc finalized the sale of its Taliwang project (Sumbawa Island, Indonesia) and on December 8, 2014 announced a binding Memorandum of Agreement with PT Genesis Sumber Energi to advance the Company's West Lombok project (Lombok Island, Indonesia).

In 2015, Southern Arc applied for 80 prospecting rights licenses in Northern Japan and in November 2015 received notice that all 80 applications had been accepted for further review.

Southern Arc trades on the TSX Venture Exchange under the symbol "SA" and, until December 31, 2014, also traded on the OTCQX International Exchange under the symbol "SOACF". To date, the Company has not generated revenues from operations and is considered to be in the exploration stage. The Company conducts its activities through wholly-owned subsidiaries, limited liability companies, partnerships and joint ventures.

**FINANCIAL SNAPSHOT**

	<b>December 31, 2015</b>	<b>June 30, 2015</b>	<b>June 30, 2014</b>
Total assets	\$ 5,283,640	\$ 5,685,639	\$ 9,423,679
Exploration properties	-	102,068	102,068
Working capital	4,540,039	(386,509)	2,677,476
Comprehensive loss	(787,119)	(3,967,266)	(8,680,792)
Basic and diluted loss per share	\$ (0.02)	\$ (0.36)	\$ (0.78)

At the date of this MD&A, Southern Arc had approximately \$3,453,000 in working capital.

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**RECENT EVENTS**

On February 4, 2016, Southern Arc announced that Vale International S.A. would not be proceeding with a potential joint venture at the East Elang property, as contemplated by the option and joint venture agreement signed by the parties on October 3, 2010. As a result, the Company wrote off the remaining \$102,068 costs previously capitalized to the project. Vale has funded all exploration and community engagement efforts at the property to date. However, repeated extensions to the Indonesian forestry moratorium have continued to delay the start of full-scale exploration at this property.

On January 26, 2016, Southern Arc closed a private placement whereby the Company sold 4,166,667 units (the "Units") at a price of \$0.24 per Unit, for gross proceeds to the Company of \$1,000,000. Each Unit consists of one common share and one non-transferable share purchase warrant (the "Warrants"). Each Warrant entitles the holder to purchase one common share of the Company for a period of five years at an exercise price of \$0.32. Under applicable Canadian securities laws, the common shares are subject to a four-month and one day hold period, expiring on May 26, 2016. No finder fees were paid in connection with the financing. The proceeds of the private placement will be used for general working capital.

On November 27, 2015, the Company granted 959,000 stock options to directors, officers, employees and consultants with an exercise price of \$0.32 with an expiry period of five years. These options vested 25% immediately, with the remainder to vest 25% every six months thereafter.

On November 13, 2015, Southern Arc announced that all 80 of its prospecting rights license applications in Northern Japan have been accepted for further review. Southern Arc has applied for prospecting rights licenses through its subsidiary, Southern Arc Minerals Japan KK ("SAMJ"). This application acceptance effectively reserves the application areas for SAMJ pending completion of a multi-step process of government consultation and review that may result in a decision by the Japanese Ministry of Economy Trade & Industry to grant prospecting rights licenses to Southern Arc. Since the prospecting rights license applications have been accepted by the concerned prefectural government offices, SAMJ may now commence low impact forms of exploration such as mapping, surface sampling and geophysics. This will enable SAMJ to prioritize its activities and exploration budget on the most prospective areas. More advanced forms of exploration such as drilling may commence once the prospecting licenses are granted.

On September 17, 2015, the Company announced a proposed share consolidation of the Company's common shares on a ten for one (10:1) basis, which was subsequently approved by the TSX Venture Exchange effective October 1, 2015. The Company had 109,215,510 common shares issued and outstanding prior to the consolidation, and at the date of this MD&A has 10,921,451 common shares issued and outstanding. All share and per share amounts in this MD&A have been adjusted to reflect the share consolidation.

**PROPERTY REVIEW AND OUTLOOK**

**Indonesia**

*West Lombok Property (Lombok Island)*

The West Lombok project covers a 13-km long by 7-km wide structural corridor of mineralization and alteration hosting porphyry copper-gold and epithermal gold deposits. Southern Arc has completed 26,477 metres of drilling to date on epithermal gold mineralization in the Pelangan and Mencanggih prospects, confirming broad zones of low-grade mineralization throughout the property, high-grade events typical of epithermal boiling zones and several high-grade shoots. At the Selodong porphyry copper-gold intrusive complex in the southeastern end of the property, Southern Arc has completed 20,046 metres of drilling to date with the majority of drill holes intersecting broad zones of significant copper-gold mineralization. In 2011, the Company completed an airborne geophysical survey of the West Lombok project at 50-metre spacings to define both near-surface and buried copper-gold porphyry targets. All drill results and details regarding the prospective study are available on the Company's website and on SEDAR.

On July 11, 2013, Southern Arc released the first resource estimate for the West Lombok project (see July 11, 2013 press release). SRK Consulting (Canada) Inc. estimated an inferred resource totaling 1.49 million ounces of gold, 1.82 million ounces of silver and 397.3 million pounds of copper from three open-pitiable epithermal gold deposits and one porphyry copper deposit. The Raja, Bising and Tibu Serai epithermal gold deposits are estimated to contain 11,783,000 tonnes averaging 1.5 g/t gold for contained metal of 567,820 ounces of gold, with an additional 1.82 million ounces of silver in the Raja deposit. The

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Selodong porphyry copper mineralization is estimated to contain 66,750,000 tonnes averaging 0.43 g/t gold and 0.27% copper for contained metal of 922,800 ounces of gold and 397,324,000 pounds of copper within two zones: Montong Botek and Blongas.

On December 8, 2014 the Company announced that it had entered into a binding Memorandum of Agreement (“Agreement”) with PT Genesis Sumber Energi (“PT GSE”) to advance the West Lombok project. Under the terms of the Agreement, PT GSE can earn a 25% interest in the subsidiary which holds the exploration permit for the West Lombok project by funding and obtaining Government approval of an environmental impact study and feasibility study for small-scale underground gold mines and processing plants on the property. PT GSE must also obtain Government approval to convert the West Lombok exploration permit into an exploitation permit, thereby securing tenure on the property for a further 20 years with the option to extend. PT GSE has not yet completed the required activities to earn the 25% interest. Upon receipt of the exploitation permit, Southern Arc will enter into an Integrated Service and Support Agreement with PT GSE (the “ISS Agreement”) to conduct small-scale mining on the West Lombok Project using traditional methods to a maximum depth of 100 metres. Profits from the sale of gold and other minerals produced from such artisanal mining activities will be split 25% to Southern Arc, 65% to PT GSE and 10% to the Local Government. Southern Arc and PT GSE can continue to explore for deeper gold and porphyry targets on the property, when market sentiment warrants the expenditure. Should the partners choose to mine deeper targets on the property (deeper than 100 metres), profits will be split 65% to Southern Arc, 25% to PT GSE and 10% to the Local Government.

Under the Agreement, PT GSE has assumed all field costs associated with the West Lombok project as well as costs associated with administration of the project, including financial, environmental and technical reporting to the respected Government agencies to maintain all permits in good standing. As a result, Indonesian costs has been reduced to approximately US\$20,000 per month, allowing the Company to protect its treasury while still participating in upside at West Lombok. The ISS Agreement shall be for a term of two years, unless terminated earlier in accordance with the terms of the agreement. Southern Arc also retains the right to terminate the ISS Agreement should it wish to proceed with the construction of an open-pit or underground mine on the West Lombok project.

The West Lombok exploration permit (“IUP”) was due for expiry on January 5, 2016. Prior to this date, Southern Arc submitted an application to the Indonesian Department of Mines for a one-year suspension of the IUP to allow PT GSE to complete the environmental impact study and feasibility study required to convert the IUP into an exploitation permit.

*East Elang Property (Sumbawa Island)*

The East Elang project covers 9,670 hectares immediately to the east of Newmont’s Elang property, which hosts a large copper-gold porphyry deposit. In October 2010, the Company entered into an option and joint venture agreement with Vale to advance the East Elang project pursuant to which Vale could earn a 75% interest in PT. Selatan Arc Minerals by funding exploration through to completion of a bankable feasibility study within an agreed-upon time frame. On February 4, 2016, Southern Arc announced that Vale would not be proceeding with the potential joint venture. As a result, the Company wrote off the remaining \$102,068 costs previously capitalized to the project.

Vale has funded all exploration and community engagement efforts at the property to date. However, repeated extensions to the Indonesian forestry moratorium have continued to delay the start of full-scale exploration at this property. On the East Elang property, 60.3% of the area is designated primary forest, 34.2% is designated production forest and 5.5% has no forestry classification. The Indonesian government has imposed a moratorium on exploration and mining activities in areas designated as primary forest. Until reclassification is granted or the moratorium lifted, the Company cannot commence any significant exploration activities on the property.

In October 2014 Southern Arc received a one-year suspension of the exploration IUP “clock” at the East Elang project, effectively extending its exploration tenure to December 2018. The exploration IUP was granted on December 17, 2009 for a period of eight years. In May 2015 the forestry moratorium was extended for another two years, and is now expected to expire in May 2017. As a result of the moratorium extension, in October 2015 Southern Arc made a request to the provincial government for an additional one year suspension. This suspension has been agreed to verbally with provincial officials; however, an official letter granting suspension has not yet been provided.

*Taliwang Property (Sumbawa Island)*

In December 2012, following a strategic review of the Company’s projects and exploration strategy, the Company decided to sell its 90% interest in the Taliwang project. On July 15, 2014, the Company amended the sale agreement and closed the sale

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of its interest in the Taliwang project. Pursuant to the terms of the final agreement, the Company sold its 90% share of the Indonesian company that owns the Taliwang project to the purchaser. The purchaser paid US\$1,000,000 and granted a 5% net smelter royalty ("NSR") to Southern Arc. The purchaser has the option to buy back 3% of the NSR by paying the Company US\$3,000,000. The purchaser is required to make additional payments to the Company to fulfill the agreed purchase price of US\$1.75 million. The purchaser will pay the Company 40% of gross revenue generated from the Taliwang project, after payment of the Southern Arc NSR, until the aggregate amount of such payments equals US\$750,000.

Since July 2014, the purchaser has completed and received Government approval for an environmental impact study and feasibility study for the development of small-scale gold mining and processing, and converted the exploration IUP into an exploitation IUP, thereby securing property tenure for a further 20 years with the option to extend. Local miners have been organized into a cooperative to mine and supply ore to the first of potentially several 50 tonne-per-day CIL processing plants, and in early December 2014 the purchaser produced a small amount of gold at Taliwang. Testing and commissioning continues at the processing plant.

### **Japan**

Further to its diversification strategy announced in December 2012, Southern Arc has been searching for resource exploration and investment opportunities in stable jurisdictions. Japan is regarded by Southern Arc's management as highly prospective but largely underexplored, despite a history of significant gold production and known mineral occurrences. Based on a desktop review of historical gold production and Japan's extensive geoscientific database, Southern Arc was able to pinpoint areas that are very compelling from a geological perspective and applied for exploration licenses through SAMJ. SAMJ lodged 38 contiguous exploration applications in Northern Hokkaido targeting high-grade epithermal gold "Hishikari-type" deposits (see Southern Arc news release dated May 20, 2015). Subsequently, SAMJ lodged another 42 prospecting rights license applications throughout Hokkaido and Northern Honshu targeting other prospective epithermal gold areas and areas of gold-bearing advanced argillic alteration, which could indicate the presence of a porphyry mineral environment. The combined area under application by SAMJ currently comprises 27,153 hectares over eight target areas.

All 80 of its prospecting rights license applications in Northern Japan have been accepted for further review, effectively reserving the application areas for SAMJ pending completion of a multi-step process of government consultation and review that may result in a decision by the Japanese Ministry of Economy Trade & Industry to grant prospecting rights licenses to Southern Arc. SAMJ may now commence low impact forms of exploration such as mapping, surface sampling and geophysics. This will enable SAMJ to prioritize its activities and exploration budget on the most prospective areas. More advanced forms of exploration such as drilling may commence once the prospecting licenses are granted.

### **Windfall Lake Gold Project (Quebec, Canada) – Oban Mining Investment**

In August 2013, following an extensive search worldwide for high-quality properties, the Company partnered with Dundee Corporation to take control of Eagle Hill, ultimately investing a total of \$8.85 million to acquire a 26.25% in Eagle Hill. In August 2015, Eagle Hill was acquired by Oban for a 258% premium over Eagle Hill's trading price in a four-company business combination. Pursuant to the completion of Oban's court approved plan of arrangement involving Eagle Hill, Ryan and Corona, the Company received a total of 3,129,319 common shares of Oban and Oban warrants exercisable into 1,564,660 common shares at \$3.00 per share for a period of three years in exchange for its common shares of Eagle Hill. Southern Arc also holds 76,345,797 Eagle Hill warrants which can be exercised into 1,908,644 Oban common shares at a weighted average exercise price of \$3.79 for a weighted average period of 1.66 years.

At the date of this MD&A, Southern Arc holds 2,475,000 Oban common shares and 31,293,195 Oban warrants. Southern Arc also holds 76,345,797 Eagle Hill warrants which can be exercisable into 1,908,644 Oban common shares. Southern Arc is holding its securities in Oban for investment purposes. Southern Arc may, depending on market and other conditions, increase or decrease its beneficial ownership of Oban's securities, whether in the open market, by privately negotiated agreements or otherwise, subject to a number of factors including general market conditions and other available investment and business opportunities.

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**SUMMARY OF QUARTERLY RESULTS**

	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015
Total assets	\$ 5,283,640	\$ 6,809,915	\$ 5,685,639	\$ 4,005,145
Exploration properties	-	102,068	102,068	102,068
Working capital	4,540,039	5,915,712	(386,509)	876,818
Net income (loss)	(1,504,397)	1,245,292	1,389,548	(3,832,018)
Basic and diluted income (loss) per share	(0.14)	0.11	0.13	(0.35)

	December 31, 2014	September 30, 2014	June 30, 2014	March 31, 2014
Total assets	\$ 7,783,759	\$ 8,361,344	\$ 9,423,679	\$ 12,574,176
Exploration properties	102,068	102,068	102,068	102,068
Working capital	1,154,798	1,685,532	2,677,476	4,579,738
Net loss	(645,314)	(879,482)	(3,162,716)	(765,358)
Basic and diluted loss per share	(0.01)	(0.08)	(0.30)	(0.10)

**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED DECEMBER 31, 2015**

During the three-month period ended December 31, 2015, the Company had a net loss of \$1,504,397 compared to a loss of \$645,314 for the three-month period ended December 31, 2014. Significant fluctuations occurred in the following categories:

- a) During the quarter, the Company recorded a loss of \$104,675 relating to the sale of its investment in Oban shares. The Company also recorded a loss on fair value of Oban warrants of \$745,614 from mark-to-market adjustments to the fair value of Oban warrants as at December 31, 2015.
- b) During the quarter, the Company recorded an impairment of \$102,068 relating to the costs previously capitalized to the East Elang project. This was due to Vale terminating its option agreement to participate in the East Elang joint venture.
- c) Share-based compensation of \$116,652 (December 31, 2014: \$6,777) increased during the three-month period ended December 31, 2015 as the Company issued and granted stock options to directors, officers, employees and consultants. Share-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 share-based compensation, the fair value of the Company's stock and the risk-free interest rate.
- d) Management fees in the three-month period ended December 31, 2015 were \$105,000 compared to \$227,700 in the same period in the previous quarter. This decrease of \$122,700 was due to decreased activities and lower fees paid to officers and consultants.
- e) Consulting fees in the three-month period ended December 31, 2015 were \$75,154 compared to \$96,480 in the same period in the previous quarter. This decrease is due to fewer consulting activities during the current quarter as the Company had submitted its application of exploration licenses in Japan in the previous quarter.
- f) Professional fees of \$30,531 (December 31, 2014: \$79,416) decreased compared to the same period in the previous year due to decreased activities.
- g) Interest income of \$3 (December 31, 2014: \$2,309) decreased during the period as a result of lower cash balances.
- h) The Company spent \$28,667 (December 31, 2014: \$164,136) on exploration properties and \$Nil on property, plant and equipment (2014: \$Nil) during the period. These exploration costs (such as geological, camp and labour) were not capitalized and were written-off.

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**RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED DECEMBER 31, 2015**

During the six-month period ended December 31, 2015, the Company had a net loss of \$259,105 compared to a loss of \$1,524,796 for the six-month period ended December 31, 2014. Significant fluctuations occurred in the following categories:

- a) During the quarter, the Company received, in exchange for its common shares of Eagle Hill, a total of 3,129,319 common shares of Oban and also Oban warrants. As such, the Company recorded a gain of \$5,341,797 on investment from its receipt of Oban Shares and warrants for previously held Eagle Hill shares. The Company had recorded its share of Eagle Hill's equity loss of \$111,711 (2014: \$124,889) prior to the close of the exchange of Eagle Hill shares.
- b) During the quarter, the Company recorded an impairment of \$102,068 relating to the costs previously capitalized to the East Elang project. This was due to Vale terminating its option agreement to participate in the East Elang joint venture.
- c) During the quarter, the Company recorded a loss of \$158,637 relating to the sale on its investment in Oban shares. The Company also recorded a loss on fair value of Oban warrants of \$4,228,702 from mark-to-market adjustments to the fair value of Oban warrants as at December 31, 2015.
- d) Share-based compensation of \$119,097 (December 31, 2014: \$17,154) increased during the six-month period ended December 31, 2015 as the Company issued and granted stock options to directors, officers, employees and consultants. Share-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 share-based compensation, the fair value of the Company's stock and the risk-free interest rate.
- e) Management fees in the six-month period ended December 31, 2015 were \$210,000 compared to \$455,400 in the same period in the previous quarter. This decrease of \$245,400 was due to decreased activities and lower fees paid to officers and consultants.
- f) Consulting fees in the six-month period ended December 31, 2015 were \$193,112 compared to \$148,862 in the same period in the previous quarter. This overall increase is due to increased consulting activities relating to the application of exploration licenses in Japan.
- g) Professional fees of \$51,600 (December 31, 2014: \$92,841) decreased compared to the same period in the previous year due to decreased activities.
- h) Interest income of \$13 (December 31, 2014: \$5,576) decreased during the period as a result of lower cash balances.
- i) The Company spent \$94,000 (December 31, 2014: \$423,324) on exploration properties and \$Nil on property, plant and equipment (2014: \$Nil). These exploration costs (such as geological, camp and labour) were not capitalized and were written-off.

**LIQUIDITY AND CAPITAL RESOURCES**

The Company's cash position at December 31, 2015 was \$141,311, an increase of \$87,697 from June 30, 2015. The increase in cash is primarily due to loans received from an officer and director of the Company as well as the sale of Oban shares. As at December 31, 2015, the Company's working capital was \$4,540,039 compared to a working capital deficiency of \$386,509 at June 30, 2015.

As at the date of this MD&A, the Company's working capital balance is approximately \$3,453,000.

Net cash used in operating activities for the period ended December 31, 2015 was \$759,985 compared to net cash used of \$981,447 during the period ended December 31, 2014. The cash used in operating activities reflects the level of exploration and corporate activity and an increase in accounts payable balance during the period.

Net cash used in investing activities during the period ended December 31, 2015 was \$Nil compared to net cash used of \$78,513 during the period ended December 31, 2014.

Financing activities during the period ended December 31, 2015 related to a US\$110,371 (\$146,242) loan from a related party (December 31, 2014: \$Nil). Also, the Company received \$705,610 (December 31, 2014: \$Nil) in net proceeds from the sale of a portion of its investment in Oban shares.

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The accompanying condensed consolidated interim financial statements have been prepared on the basis of accounting principles applicable to a "going concern", which assumes that the Company will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company does not currently generate any revenues or have operations which generate cash flows. Accordingly, the Company relies on financing received from the issuances of common shares or loans and borrowings to finance its exploration activities and general and administrative costs. Based on current plans, budgeted expenditures, and cash requirements, the Company does not have sufficient cash to finance its planned activities for the twelve months from the date of this MD&A. As a result, the Company will require cash injections by way of selling its investments or obtaining additional financing in order to fund planned exploration activities and required general and administrative expenses. While the Company has been successful at securing financing in the past, there can be no assurance that it will be able to do so in the future. These material uncertainties cast significant doubt upon the Company's ability to continue as a going concern. The consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue business.

**RELATED PARTY TRANSACTIONS**

**Key management and personnel compensation**

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

	<b>Three months ended December 31, 2015</b>	Three months ended December 31 2014	<b>Six months ended December 31, 2015</b>	Six months ended December 31, 2014
Management fees	\$ 69,000	\$ 227,700	\$ 138,000	\$ 455,400
Consulting services (exploration)	-	74,297	-	129,664
Finance expense	-	-	12,233	-
Share-based compensation	93,707	481	94,711	7,884

During the period ended December 31, 2015, the Company paid \$138,000 (December 31, 2014: \$455,400) in management fees to a private company controlled by the Chief Executive Officer and Chairman of the Company. This fee is inclusive of administrative, finance, accounting, investor relations and management consulting fees, as well as certain office expenses.

On May 21, 2015, a US\$150,000 (\$207,600) promissory note was advanced to the Company by a director and officer of the Company. This promissory note is repayable on demand and bears no interest. There is a one-time finance expense of US\$12,000 (\$14,641) or 8% of the principal sum that the Company recorded and accrued within accounts payable. During the period ended December 31, 2015, an additional US\$112,371 (\$155,522) promissory note was advanced to the Company by a director and officer of the Company. This promissory note is repayable on demand and bears no interest. There is a one-time finance expense of US\$9,406 (\$12,233) or 8% of the principal sum that the Company recorded and accrued within accounts payable.

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

**CURRENT SHARE DATA**

As at the date of this MD&A, the Company had 15,088,116 common shares issued, of which 14,958,116 are outstanding and 130,000 are treasury shares.

On November 27, 2015, the Company granted 959,000 stock options to directors, officers, employees and consultants with an exercise price of \$0.32 with an expiry period of five years. These options vested 25% immediately, with the remainder to vest 25% every six months thereafter. During the period ended December 31, 2015, the Company recorded share-based compensation of \$119,097 (December 31, 2014: \$17,154) as a result of the vesting of options granted.

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During the period ended December 31, 2015, the Company cancelled 439,500 share options previously issued to directors, officers and consultants.

As at February 26, 2016, the Company had share options outstanding as follows:

	<b>Number of Options</b>	<b>Exercise Price</b>	<b>Expiry Date</b>
<b>Options</b>	959,000	\$ 0.32	November 26, 2020
	959,000		

As at the date of this MD&A, the Company had no share purchase warrants outstanding.

### **SUBSEQUENT EVENTS**

On January 26, 2016, the Company closed a private placement whereby it issued 4,166,667 units (the "Units") at a price of \$0.24 per Unit for gross proceeds of \$1,000,000. Each Unit consists of one common share and one non-transferrable share purchase warrant (the "Warrants"). Each Warrant entitles the holder to purchase one common share of the Company for a period of five years at an exercise price of \$0.32. No finder fees were paid in connection with the private placement.

In February 2016, the Company received a letter from Vale International S.A. notifying the Company that Vale will not be proceeding with a potential joint venture at the East Elang property. As a result, the Company wrote off the remaining \$102,068 in costs previously capitalized to the project.

### **RISKS AND UNCERTAINTIES**

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

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

#### **Credit risk**

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

#### **Liquidity risk**

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

#### **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. The Company is exposed to interest rate risk to the extent that the cash maintained at the financial institutions is subject to a floating rate of interest. The interest rate risk on the Company's cash is minimal. Also, the value of the shares in Eagle Hill changes based on the quoted market price of those shares which could impact the Company's

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impairment charge related to its investment. A 1% change (plus or minus) in the price of Oban's shares would change the fair value of the shares by approximately \$29,900.

**Foreign exchange risk**

The Company operates in Indonesia and is considering operating in Japan. The Company could accordingly be at risk for foreign currency fluctuations. The Company minimizes cash and monetary assets or liabilities in Indonesia and Japan.

At December 31, 2015, the Company had US\$24,256 (approximately CDN\$33,570), Japanese Yen ("Yen") 363,913 (approximately CDN\$4,185) and Indonesian Rupiah ("Rph") 17,882,478 (approximately CDN\$1,681) in cash, and US\$34,172 (approximately CDN\$47,294) and Yen 2,407,252 (approximately CDN\$27,683) in accounts payable and accrued liabilities. As at December 31, 2015, US\$ amounts were converted at a rate of US\$0.7225 to CDN\$1, Yen 86.9565 to CDN\$1, and Rph amounts were converted at a rate of Rph 10,638 to CDN\$1.

At June 30, 2015, the Company had US\$30,184 (approximately CDN\$37,296), Japanese Yen ("Yen") 569,898 (approximately CDN\$5,756) and Indonesian Rupiah ("Rph") 7,257,872 (approximately CDN\$682) in cash, and US\$160,536 (approximately CDN\$198,359), Yen 70,000 (approximately CDN\$707) and Rph 240,851,565 (approximately CDN\$22,640) in accounts payable and accrued liabilities. As at June 30, 2015, US\$ amounts were converted at a rate of US\$0.8093 to CDN\$1, Yen 99.0099 to CDN\$1, and Rph amounts were converted at a rate of Rph 10,638 to CDN\$1.

**Geopolitical risk**

To date, all of the Company's properties and operations have been located in Indonesia. In addition, the Company has applied for prospecting rights licenses in Northern Japan. As such, the Company is subject to political, economic and other uncertainties, including, but not limited to, changes in policies and regulations or the personnel administering them, changes with regard to foreign ownership of property rights, exchange controls and royalty and tax increases, and other risks arising out of foreign governmental sovereignty over the areas in which the Company's operations are to be conducted, as well as risks of loss due to civil strife, acts of war and insurrections. If a dispute arises regarding the Company's property interests, the Company cannot rely on western legal standards in defending or advancing its interests.

**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 focus of the Company is on areas in which the geological setting is well understood by management.

**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 US\$ 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.

**TRENDS**

Continued strength in the US dollar, decreasing oil prices and the stable gold price increases demand, especially from Asia, and perception of increased risk in major financial markets has supported a discernible need for the development of commodity exploration projects. Junior companies, like Southern Arc, are key participants in identifying properties of merit to explore and develop.

**SHAREHOLDER RIGHTS PLAN AND BONUS AND COMPENSATION PLAN**

The Company's Shareholder Rights Plan dated effective December 5, 2014 (the "Plan") is designed to ensure the fair treatment of shareholders in connection with any takeover bid for outstanding common shares of the Company. The Plan seeks to provide

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shareholders with adequate time to properly assess a takeover bid without undue pressure. It also provides the Board of Directors with adequate time to fully assess an unsolicited takeover bid, to allow competing bids to emerge, and, if applicable, to explore other alternatives to the takeover bid to maximize shareholder value.

The Plan is not intended to prevent or deter takeover bids that treat shareholders fairly. Under the Plan, those bids that meet certain requirements intended to protect the interests of all shareholders are deemed to be "Permitted Bids". Permitted Bids must be made by way of a takeover bid circular prepared in compliance with applicable securities laws and, among other conditions, must remain open for 60 days. In the event a takeover bid does not meet the Permitted Bid Requirements of the Plan, the rights will entitle shareholders, other than any shareholder or shareholders making the takeover bid, to purchase additional common shares of the Company at a substantial discount to the market price of the common share at that time. The Plan has an initial term of three years. The Plan is similar to plans adopted by other Canadian companies and ratified by their shareholders.

The Company's Bonus and Compensation Plan permits the Company to distribute or option up to 1.3 million common shares of the Company to eligible persons, including directors, officers, employees or consultants of Southern Arc.

### **CRITICAL ACCOUNTING POLICIES**

Reference should be made to the Company's significant accounting policies contained in Note 2 of the Company's audited consolidated financial statements as at June 30, 2015 and 2014. These accounting policies can have a significant impact on the financial performance and financial position of the Company.

#### **Significant accounting judgement and estimates**

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

#### *Critical accounting estimates*

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

- i) The estimated fair value of the Company's financial assets and liabilities, including the Company's equity accounted for investment in associates, are by their nature, subject to measurement uncertainty.
- ii) The calculation of share-based compensation requires estimates of volatility, forfeiture rates and market prices related to the issuance of share options. These estimates impact share-based compensation expense and share-based payment reserve.
- iii) The valuation of assets held for sale and loans receivable requires estimates with respect to expected future cash flows to be received and discount rates as applicable. Changes in estimated collectability impact bad debt expense.
- iv) The application of the Company's accounting policy for exploration expenditure requires estimates in determining whether it is likely that future economic benefits will flow to the Company, which may be based on assumptions about future events or circumstances. Estimates and assumptions made may change if new information becomes available. If, after an expenditure is capitalized, information becomes available suggesting that the recovery of the expenditure is unlikely, the amount capitalized is written off in profit or loss in the year the new information becomes available.
- v) The determination of fair value of investments in warrants, which are derivative instruments, requires assumptions with respect to volatility, expected life and discount rates. Changes in these assumptions impact mark to market gains and losses recognized in profit or loss.

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*Critical accounting judgements*

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

- i) The Company's assessment of its ability to continue as a going concern requires judgements about whether sufficient financing will be obtained in the near term. See "Liquidity and Capital Resources".
- ii) The determination of a subsidiary's functional currency often requires significant judgement where the primary economic environment in which they operate may not be clear. This can have a significant impact on the consolidated results of the Company based on the foreign currency translation method.

**Financial instruments**

On initial recognition, all financial assets and financial liabilities, including derivatives, are recorded at fair value. All transactions related to financial instruments are recorded on a trade date basis. The directly attributable transaction costs of financial assets and liabilities are included in the carrying value of financial assets and liabilities except transaction costs related to financial assets and liabilities classified as fair value through profit or loss which are expensed in the period they are incurred. Subsequently, derivatives are measured at fair value and changes in fair value are recognized in profit or loss. For other financial assets and liabilities, subsequent measurement is as follows:

*Subsequent measurement*

Financial assets

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

*Fair value through profit or loss* - This category comprises derivatives, or assets acquired or incurred principally for the purpose of selling or repurchasing it in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in profit or loss. Other than the warrants of Oban, the Company does not have any assets classified as fair value through profit or loss.

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

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

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

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

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Financial liabilities

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

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

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

**Fair value**

International Financial Reporting Standards ("IFRS") require disclosure about fair market value measurements for financial instruments and liquidity risk using a three-level hierarchy that reflects the significance of the inputs used in making the fair value measurements. The three-level hierarchy is as follows:

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

The Oban warrants are considered derivatives and are recognized at fair value using level 2 inputs. The Company does not have any other financial instruments that are measured at fair value on an ongoing basis.

The carrying value of cash, accounts receivable, accounts payable and accrued liabilities and amounts due to related parties approximate their fair value due to their short-term nature. The fair value of the Company's investment in Oban used to determine impairment is based on the quoted market price of those shares, which represents a level 1 input.

**New accounting standards and pronouncements**

- The final version of IFRS 9, Financial Instruments, was issued by the IASB in July 2014 and will replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 introduces a model for classification and measurement, a single, forward-looking 'expected loss' impairment model and a substantially reformed approach to hedge accounting. The new single principle based approach for determining the classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. The new model also results in a single impairment model being applied to all financial instruments, which will require more timely recognition of expected credit losses. It also includes changes in respect of the Company's credit risk in measuring liabilities elected to be measured at fair value, so that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. IFRS 9 is effective for the Company for annual periods beginning on July 1, 2018, and is available for early adoption. In addition, the own credit changes can be early applied in isolation without otherwise changing the accounting for financial instruments. The Company is in the process of assessing the impact of IFRS 9 and has not yet determined when it will adopt the new standard.
- On September 11, 2014, the IASB issued Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28). The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture ("JV"). Specifically, under the existing consolidation standard the parent recognises the full gain on the loss of control, whereas under the existing guidance on associates and JVs the parent recognises the gain only to the extent of unrelated investors' interests in the associate or JV. The main consequence of the amendments is that a full gain/loss is recognised when the assets transferred meet the definition of a 'business' under IFRS 3 Business Combinations. A partial gain/loss is recognised when the assets transferred do not meet the definition of a business, even if these assets are housed in a subsidiary. The amendments apply prospectively for the Company for annual periods beginning on or after July 1, 2016. Early adoption is permitted. The Company is in the process of assessing the impact the amendments and has not yet determined when it will adopt these amendments.

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**QUALIFIED PERSON AND QUALITY CONTROL AND ASSURANCE**

*The technical information in this document has been reviewed by Dr. Michael Andrews, Southern Arc's President & Chief Operating Officer, PhD, FAusIMM, who has sufficient experience relevant to the style of mineralization under consideration and qualifies as a Qualified Person as defined by National Instrument 43-101.*

**CAUTIONARY NOTE REGARDING 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. Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as "anticipates", "plans", "budget", "scheduled", "continue", "estimates", "forecasts", "expect", "is expected", "project", "propose", "potential", "targeting", "intends", "believes" or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might", or "will be taken", "occur" or "be achieved" or the negative connotation thereof. 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 readers, 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 and its joint venture partners on its properties and work plans to be conducted.*

*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, exploration and other permits in Indonesia;*
- uncertainties relating to receiving mining, exploration and other permits in Japan;*
- the impact of increasing competition;*
- unpredictable changes to the market prices for gold, copper and other commodities;*
- exploration and developments costs for properties in Indonesia and Japan;*
- 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 or at all.*

*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: 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. Although the Company has attempted to identify important factors that could cause results to differ materially from those contained in forward-looking statements, there may be other factors that cause results not to be as anticipated, estimated or intended. There can be no assurance that such statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. Readers are cautioned that the foregoing lists of factors are not exhaustive. Forward looking statements are made as of the date hereof and accordingly are subject to change after such date. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement. The Company does not undertake to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except in accordance with applicable securities laws.*