# SOUTHERN ARC MINERALS INC.

## CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE YEARS ENDED**
**JUNE 30, 2011 and 2010**

*(Expressed in Canadian dollars)*

**CHARTERED ACCOUNTANTS**
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**Independent Auditor's Report**

**To the Shareholders of**
**Southern Arc Minerals Inc.**

We have audited the accompanying consolidated financial statements of Southern Arc Minerals Inc. and its subsidiaries, which comprise the consolidated balance sheets as at June 30, 2011 and June 30, 2010, and the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Southern Arc Minerals Inc. and its subsidiaries as at June 30, 2011 and June 30, 2010, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

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

***"MacKay LLP"***

**Chartered Accountants**
**Vancouver, British Columbia**
**October 28, 2011**

**SOUTHERN ARC MINERALS INC.**
CONSOLIDATED BALANCE SHEETS
AS AT JUNE 30
(Expressed in Canadian dollars)

| | 2011 | 2010 |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash | $ 38,632,091 | $ 1,604,476 |
| Receivables | 155,528 | 29,668 |
| Prepaid expense and deposit | 94,816 | 7,534 |
| Investment (Note 6) | - | 835,799 |
| | 38,882,435 | 2,477,477 |
| **Equity investment** (Note 3) | 357,871 | - |
| **Property, plant and equipment** (Note 4) | 234,965 | 11,074 |
| **Resource properties** (Note 5) | 23,401,805 | 22,410,416 |
| **Loans receivable** (Note 5) | 433,935 | - |
| **Total Assets** | **$ 63,311,011** | **$ 24,898,967** |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | $ 1,529,554 | $ 383,246 |
| Loans payable (Note 7) | - | 1,614,600 |
| | 1,529,554 | 1,997,846 |
| **Shareholders' equity** | | |
| Capital stock (Note 8) | 74,151,488 | 30,474,172 |
| Treasury stock (Note 8) | (1,170,000) | - |
| Contributed surplus (Note 8) | 10,461,028 | 5,926,928 |
| Reserve | - | 221,008 |
| Deficit | (22,066,164) | (15,692,612) |
| Capital and reserve attributable to shareholders of Southern Arc Minerals Inc. | 61,376,352 | 20,929,496 |
| Non-controlling interest (Note 3 and 4) | 405,105 | 1,971,625 |
| Total equity | 61,781,457 | 22,901,121 |
| **Total Liabilities and Shareholders' Equity** | **$ 63,311,011** | **$ 24,898,967** |

Nature and continuance of operations (Note 1)
Subsequent events (Note 16)

Approved by the Board of Directors and authorized for issue on October 26, 2011:

*"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, AND COMPREHENSIVE LOSS
FOR THE YEARS ENDED JUNE 30
(Expressed in Canadian dollars)

| | 2011 | 2010 |
|---|---|---|
| **EXPENSES** | | |
| Amortization | $ 5,970 | $ 2,768 |
| Consulting fees | 227,067 | 42,557 |
| Foreign exchange loss | 50,406 | 18,843 |
| Investor relations | - | 67,893 |
| Management fees (Note 10) | 348,000 | 402,000 |
| Office and miscellaneous (Note 10) | 551,506 | 193,742 |
| Professional fees | 507,547 | 423,758 |
| Property investigation costs | - | 190,271 |
| Rent | 32,169 | 16,648 |
| Resource properties written-off (Note 5) | 87,693 | 15,616 |
| Stock-based compensation (Note 8) | 4,060,214 | 333,661 |
| Stock-based financing cost (Note 7iii) | - | 117,713 |
| Transfer agent and filing fees | 142,783 | 40,344 |
| Travel | 209,242 | 35,566 |
| **Loss before other items** | **(6,222,597)** | **(1,901,380)** |
| **OTHER ITEMS** | | |
| Interest income | 90,294 | 2,231 |
| Gain on settlement of lawsuit (Note 5) | - | 250,000 |
| Other income | 28,295 | - |
| Unrealized gain on investment | - | 36,063 |
| Loss on equity investment (Note 3) | (534,197) | - |
| Gain on sale of investment (Note 6) | 54,852 | - |
| | (360,756) | 288,294 |
| **Loss before income taxes** | **(6,583,353)** | **(1,613,086)** |
| **Future income tax recovery** (Note 11) | - | - |
| **Loss and comprehensive loss for the year** | **$ (6,583,353)** | **$ (1,613,086)** |
| **Loss and comprehensive loss attributable to:** | | |
| Shareholders of Southern Arc Minerals Inc. | $ (6,373,552) | $ (1,559,227) |
| Non-controlling interests | (209,801) | (53,859) |
| | $ (6,583,353) | $ (1,613,086) |
| **Basic and diluted loss per share** | **$ (0.08)** | **$ (0.02)** |
| **Weighted average number of shares outstanding** | 84,293,973 | 74,317,213 |

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

**SOUTHERN ARC MINERALS INC.**
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30
(Expressed in Canadian dollars)

| | 2011 | 2010 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Loss and comprehensive loss for the year | $ (6,583,353) | $ (1,613,086) |
| Items not affecting cash: | | |
| Stock-based compensation | 4,060,214 | 333,661 |
| Stock-based financing cost | - | 117,713 |
| Amortization | 5,970 | 2,768 |
| Unrealized gain on investment | - | (36,063) |
| Gain on sale of investments | (54,852) | - |
| Loss on equity investments | 534,197 | - |
| Resource properties written-off | 87,693 | 15,616 |
| Foreign exchange loss | 50,406 | 18,843 |
| Changes in non-cash working capital items: | | |
| Increase in receivables | (132,907) | (16,422) |
| Prepaid expense and deposit | (91,476) | 730,896 |
| Increase in accounts payable and accrued liabilities | 92,359 | 112,972 |
| Net cash used in operating activities | (2,031,749) | (333,102) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Additions to resource properties | (3,973,673) | (4,449,156) |
| Property, plant and equipment | (241,455) | - |
| Exploration advances received (Note 5) | 836,357 | - |
| Sale of investment | 890,277 | - |
| Repayment of investment | 374 | 16,967 |
| Net cash used in investing activities | (2,488,120) | (4,432,189) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Proceeds from issuance of shares, net of share issue costs | 44,151,202 | 1,365,349 |
| Treasury shares purchased | (1,170,000) | - |
| Reimbursement of income tax paid by Nickel Oil & Gas shareholders | - | (100,375) |
| Issue of equity securities by Nickel Oil & Gas to non-controlling interests | 189,042 | 1,077,624 |
| Proceeds from loans (Note 7) | 1,966,400 | 1,614,600 |
| Repayment of non-revolving bridge loan (Notes 6 & 7) | (550,000) | - |
| Repayment of loans (Note 7) | (2,961,000) | - |
| Net cash provided by financing activities | 41,625,644 | 3,957,198 |
| Effect of exchange rate changes on cash | (78,160) | (18,843) |
| **Change in cash during year** | 37,027,615 | (826,936) |
| Cash, beginning of year | 1,604,476 | 2,431,412 |
| **Cash, end of year** | **$ 38,632,091** | **$ 1,604,476** |
| **Cash paid for interest** | $ 5,200 | $ 9,150 |
| **Cash paid for income taxes** | $ - | $ - |

**Supplemental disclosure with respect to cash flows** (Note 9)

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

**SOUTHERN ARC MINERALS INC.**
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED JUNE 30
(Expressed in Canadian dollars)

| | Capital Stock | Treasury 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 share subscribers | - | - | - | - | - | - | (100,375) | (100,375) |
| Gain on diluted interest in subsidiary (Note 3) | - | - | - | 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 5) | 2,415,000 | - | - | - | - | 2,415,000 | - | 2,415,000 |
| | 3,909,105 | - | 322,618 | 221,008 | - | 4,452,731 | 656,320 | 5,109,051 |
| **Balance at June 30, 2010** | **30,474,172** | **-** | **5,926,928** | **221,008** | **(15,692,612)** | **20,929,496** | **1,971,625** | **22,901,121** |
| Comprehensive loss for the period | - | - | - | - | (6,373,552) | (6,373,552) | (209,801) | (6,583,353) |
| Private placement, net of transaction costs | - | - | - | - | - | - | 623,674 | 623,674 |
| Private placements, net of transaction costs | 43,488,202 | - | - | - | - | 43,488,202 | - | 43,488,202 |
| Repurchase of shares | - | (1,170,000) | - | - | - | (1,170,000) | - | (1,170,000) |
| Agent warrants (Stock-based financing costs) | (1,013,070) | - | 1,013,070 | - | - | - | - | - |
| Gain on diluted interest in subsidiary (Note 3) | - | - | - | 43,466 | - | 43,466 | (43,466) | - |
| Adjustment for elimination of subsidiary (Note 3) | - | - | - | (264,474) | - | (264,474) | (1,936,927) | (2,201,401) |
| Stock-based compensation | - | - | 4,060,214 | - | - | 4,060,214 | - | 4,060,214 |
| Exercise of options | 1,202,184 | - | (539,184) | - | - | 663,000 | - | 663,000 |
| | 43,677,316 | (1,170,000) | 4,534,100 | (221,008) | - | 46,820,408 | (1,356,719) | 45,463,689 |
| **Balance at June 30, 2011** | **$ 74,151,488** | **$ (1,170,000)** | **$ 10,461,028** | **$ -** | **$ (22,066,164)** | **$ 61,376,352** | **$ 405,105** | **$ 61,781,457** |

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

## 1. NATURE AND CONTINUANCE OF OPERATIONS

Southern Arc Minerals Inc. ("Southern Arc" or "the Company") was incorporated in British Columbia, Canada on August 19, 2004. The Company is a natural resource company engaged in the acquisition and exploration of resource properties 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, 12 months from the end of the reporting period. Based on its current plans, budgeted capital expenditures and cash requirements, the Company has sufficient cash to finance its current plans for at least 12 months from the date of approval of the financial statements. However, the Company recognizes that exploration expenditures may change with ongoing results and, as a result, it may be required to obtain additional financing.

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.

## 2. SIGNIFICANT ACCOUNTING POLICIES

**Principles of consolidation**

These consolidated financial statements include:

i) the accounts of the Company; and
ii) its wholly-owned Canadian subsidiary West Indonesia Mining Holdings Inc.; and
iii) its wholly-owned Singapore subsidiaries: Indotan Lombok Pte. Ltd., Indotan Sumbawa Pte. Ltd., East Indonesia Mining Pte. Ltd. and Southern Sunda Mining Pte. Ltd.; and
iv) its wholly-owned Indonesian subsidiary PT. Selatan Arc Minerals; and
v) its 85%-owned Indonesian subsidiaries: PT. Indotan Lombok Barat Bangkit and PT. Indotan Sumbawa Barat.

Significant intercompany balances and transactions have been eliminated upon consolidation.

**Basis of presentation**

The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").

**The acquisition of Indotan Lombok Pte. Ltd. and Indotan Sumbawa Pte. Ltd.**

In December 2009, the Company acquired the right to the name Indotan Inc. as well as control over two companies (Indotan Lombok Pte. Ltd. and Indotan Sumbawa Pte. Ltd.) (each a "Singapore Company"). 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, which entitled 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, was assigned to a related party in relation to a loan agreement (see Note 7(iii)) and was exercised during the period ended December 31, 2010. The second option entitled the

(Expressed in Canadian dollars)

**2. SIGNIFICANT ACCOUNTING POLICIES** (cont'd…)

Company to acquire 1,500,000 of these shares at a price of $0.90 per common share during the year ended June 30, 2011. The Company assigned 200,000 of these $0.90 options to a Director of the Company as stock-based compensation. The Company exercised the remaining 1,300,000 $0.90 options and currently holds those shares.

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

**Property, plant and equipment**

Telephone equipment is recorded at cost and amortized using the declining balance method at 20% per year.

Vehicle, furniture, computer, field equipment and leasehold improvements are recorded at cost and amortized on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives are as follows:

| | Years |
|---|---|
| Vehicles | 4 |
| Furniture | 4 |
| Computers | 4 |
| Field equipment | 4 |
| Leasehold improvement | 10 |

Amortization of vehicles, computers (field) and field equipment were allocated to resources property deferred exploration costs.

**Resource properties**

(i) Resource properties

All costs related to the acquisition, exploration and development of resource properties are capitalized by geographical area. If economically recoverable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the unit of production method. When a property is abandoned, all related costs are written off to operations. If, after management review, it is determined that the carrying amount of a resource property is impaired, that property is written down to its estimated fair value. A resource property is reviewed for impairment annually and whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

The amounts shown for resource properties do not necessarily represent present or future values. Their recoverability is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete property development and future profitable production or proceeds from the disposition thereof.

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

(ii) Joint interest

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

**2. SIGNIFICANT ACCOUNTING POLICIES** (cont'd…)

(iii) Asset retirement obligations

Asset retirement obligations are recognized for legal obligations related to the retirement of long-lived tangible assets that arise from the acquisition, construction, development or normal operation of such assets. A liability for an asset retirement obligation must be recognized in the period in which it is incurred and when a reasonable estimate of the fair value of the liability can be made. Furthermore, a corresponding asset retirement cost should be recognized by increasing the carrying value of the related long-lived asset. The asset retirement cost is subsequently charged to operations in a rational and systematic manner over the underlying asset's useful life. The initial fair value of the asset retirement liability is accreted, by charges to operations, to its estimated future value. The Company has determined that there are no significant asset retirement obligations at June 30, 2011 and 2010.

(iv) Impairment of long-lived assets

The Company has adopted the recommendations of CICA Handbook Section 3063 "Impairment of Long-lived Assets" and abstract EIC 174, "Mining Exploration Costs" ("EIC 174") of the Emerging Issues Committee. Section 3063 requires that long-lived assets and intangibles to be held and used by the Company be reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If changes in circumstance indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, future cash flows expected to result from the use of the asset and its disposition must be estimated.

EIC 174 provides that an enterprise that is in the development stage with initially capitalized exploration costs but that has not established mineral reserves objectively and therefore does not have a basis for preparing a projection of the estimated future net cash flow from the property, is not obliged to conclude that the capitalized costs have been impaired. However, such an enterprise should consider whether a subsequent write-down of capitalized exploration costs related to mining properties is required.

**Oil and gas interests**

(i) Oil and gas properties

The Company follows the full cost method of accounting for oil and gas interests whereby all costs of exploration for and development of oil and gas reserves are capitalized by cost centre. These costs include lease acquisition costs, geological and geophysical expenses, drilling costs of successful as well as unsuccessful wells, and overhead charges related directly to exploration.

Depletion of exploration and development costs is provided using the unit of production method based on estimated proven oil and gas reserves as determined by the Company and substantiated by independent professional engineers. For the purposes of depletion calculations, proved oil and gas reserves are converted to a common unit of measure on the basis that six thousand cubic feet of natural gas is equivalent to one barrel of petroleum. The depletion cost base includes total capitalized costs, less costs of unproven properties, plus estimated future development costs associated with proven undeveloped reserves. If the interests are sold, the proceeds will be applied against capitalized costs unless such sale significantly impacts the rate of depletion by more than 20%, in which case a gain or loss is recorded. If the interests are abandoned, the costs will be written off to operations.

(ii) Impairment

All cost centres are in the exploration, appraisal or "pre-development" stage and as such, the costs in each centre are not subject to depletion. An impairment review is performed at every reporting date to determine whether the aggregate net costs in each pre-development stage cost centre are recoverable. Recoverability is determined by comparing capitalized costs for each cost centre with estimated future net revenues using estimated future prices and costs and internal estimates of recoverable reserves or resources. Sensitivity to key assumptions is also tested using a range of values. Costs which are unlikely to be recovered are written off. The recovery of the costs incurred to date is

**2. SIGNIFICANT ACCOUNTING POLICIES** (cont'd…)

ultimately dependent upon production of commercial quantities of hydrocarbons or the sale of the related asset. The likelihood of such production is not assured at this time.

(iii) Ceiling test

The net carrying value of the Company's oil and gas properties is limited to an ultimate recoverable amount. The Company tests impairment against undiscounted future net revenue from proved reserves using expected future prices and costs as well as the income tax legislation in effect at the period end. Impairment is recognized when the carrying value of the asses is greater than the undiscounted future net revenues, in which case the assets are written down to the fair value of proved plus probable reserves plus the cost of unproved properties, net of impairment allowances. Fair value is determined based on discounted future net cash flows calculated using expected future prices and costs as well as the income tax legislation in effect at the period end. The discount rate used is a risk free interest rate.

(iv) Title

Although the Company has taken steps to secure and verify title to its property interests, in accordance with industry norms, these procedures do not guarantee the Company's title. Properties may be subject to prior unregistered agreements, native land claims, transfers which have not been recorded or detected through title research or which have been asserted since the date research may have been completed, or inadvertent noncompliance with regulatory requirements.

Certain of the Company's property interests are held as conditional exploration licenses or permits. Conversion of these interests into ownership interests requires that the conditions attaching to the licenses or permits be fulfilled. The Company may or may not elect to fulfill such conditions.

**Estimates**

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Significant areas requiring the use of management estimates include assessment of carrying values of long-term investments, impairment of resource properties and valuation of stock-based compensation and financing costs. Actual results could differ from these estimates.

**Foreign currency translation**

Transactions denominated in foreign currencies are translated into Canadian dollars at exchange rates in effect at the related transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date; non-monetary assets and liabilities denominated in foreign currencies are translated at the historical rate. Exchange gains and losses arising on translation are included in the results of operations.

**Future income taxes**

Future income taxes are recorded using the asset and liability method. Under the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or enactment occurs. To the extent that the Company does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

## 2. SIGNIFICANT ACCOUNTING POLICIES (cont'd…)

### Stock-based compensation

The Company accounts for its stock-based compensation programs using the fair value method. The fair value of option grants is generally established at the date of grant using the Black-Sholes option pricing model and the expense is recognized over the vesting period, with offsetting amounts recorded as contributed surplus. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is complete, the date the performance commitment is reached or the date on which the equity instruments are granted if they are fully vested and non-forfeitable. The Company has not incorporated an estimated forfeiture rate for stock options; rather, the Company accounts for actual forfeitures as they occur. If and when the stock options are exercised, the applicable amounts of contributed surplus are transferred to share capital.

### Loss per share

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method, the dilutive effect on loss per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be

used to purchase common shares at the average market price during the period. For the periods presented, this calculation proved to be anti-dilutive. Basic loss per share is calculated using the weighted average number of common shares outstanding during the period.

### Share capital

The Company has adopted the residual value method with respect to the valuation of warrants issued as part of a private placement unit. The residual value method allocates the net proceeds to the common shares up to their fair value, as determined by the current quoted trading price on the announcement date, and the balance, if any, to the attached warrants. The fair value attributed to the warrants, if any, is recorded in contributed surplus.

Share capital issued as non-monetary consideration is recorded at the fair market value of the shares issued, and is generally based on the trading price of the shares at the time an agreement to issue shares has been reached, which is determined by the Board of Directors of the Company.

Share issue costs incurred on the issue of the Company's shares are charged directly to share capital.

### Comparative figures

Certain of the comparative figures have been reclassified to conform with the consolidated financial statement presentation adopted in the current year.

### Flow-through shares

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Under the liability method of accounting for income taxes, the future income taxes related to the temporary difference arising at the renunciation date are recorded at that time together with a corresponding reduction to the carrying value of the shares issued. In instances where the Company has sufficient deductible temporary differences available to offset the future income tax liability created from renouncing qualifying expenditures, the realization of the deductible temporary differences will be shown as a recovery in operations in the period of renunciation.

(Expressed in Canadian dollars)

## 2. SIGNIFICANT ACCOUNTING POLICIES (cont'd…)

**Investment**

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

**Financial instruments**

In accordance with CICA Handbook Section 3855, the Company classifies all financial instruments as either held-maturity, available-for-sale, held-for-trading, loans and receivables, or other financial liabilities. All financial instruments are measured in the balance sheet at fair value initially with the exception of certain related party transactions. Subsequent measurement and changes in fair value will depend on their value will depend on their initial classification. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading, are measured at amortized cost. Available-for-sale assets are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Instruments classified as held-for-trading are measured at fair value with unrealized gains and losses recognized on the statement of operations.

Section 3862 provides guidance on disclosures in the financial statements to enable users of the financial statements to evaluate the significance of financial instruments to the Company's financial position and performance, and about risks associated with both recognized and unrecognized financial instruments and how these risks are managed. Section 3863 establishes standards for presentation of financial instruments. See Note 12 for relevant disclosure.

The Company does not use derivative instruments or hedges to manage risks. Transaction costs related to all financial instruments will be expensed in the period incurred. The Company has elected to use settlement date accounting on any regular way contracts.

Cash has been designated as held-for-trading. Accounts receivable, and deposits are designated as loans and receivables. Investments in asset-backed commercial paper and bank loan are discussed in Note 6. Accounts payable and accrued liabilities are designated as other financial liabilities.

| | |
|---|---|
| Held for trading assets - | measured at fair value with the change in the fair value recognized in net income during the period. |
| Available-for-sale assets - | measured at fair value with the change in fair value recorded in other comprehensive income. |
| Held-to-maturity assets - | measured at amortized cost using the effective interest rate method. |
| Loans and receivables - | measured at amortized cost using the effective interest rate method. |
| Other liabilities - | measured at amortized cost using the effective interest rate method. |

**Recent accounting pronouncements**

The new primary sources of GAAP 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 Canadian 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.

(Expressed in Canadian dollars)

## 3. INVESTMENT IN NICKEL OIL & GAS CORP.

On July 7, 2008, the Company acquired 15,300,000 common shares of Nickel Oil & Gas Corp. (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.

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

| | |
|---|---|
| Cash | $ 5,669,935 |
| Resource property | 1,966,801 |
| Receivables, payables and accrued liabilities | (752) |
| Non-controlling interest | (2,280,984) |
| | $ 5,355,000 |

During the year ended June 30, 2010 and 2009, Nickel Oil & Gas issued additional common shares to third parties, which diluted the Company's ownership of Nickel Oil & Gas to 38.54% (2009 – 43.56%). During the year ended June 30, 2011, Nickel Oil & Gas issued additional common shares to a director, which diluted the Company's ownership percentage of Nickel Oil & Gas to 37.59%, resulting in a gain on diluted interest in subsidiary of $43,466 (2010: $221,008).

Effective April 1, 2011, due to the changes in voting relationships, ownership and the Board of Directors, the Company determined that it no longer controlled Nickel Oil & Gas. The Company's March 31, 2011 non-controlling interest and reserve balance were restored to their $nil balances on the same date on a non-consolidated basis by upward adjustments of $1,936,927 and $264,474, respectively.

As at June 30, 2011, the Company held 15,300,000 Nickel Oil & Gas shares (37.59%) with a carrying value of $357,871. Under the equity method of accounting, the Company recorded a loss of $534,197, which represented its equity ownership proportion of Nickel Oil & Gas's loss for the period from April 1, 2011 to June 30, 2011.

## 4. PROPERTY, PLANT AND EQUIPMENT

| | June 30, 2011 | | | June 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value | Cost | Accumulated Amortization | Net Book Value |
| Telephone equipment | $ 26,278 | $ 17,420 | $ 8,858 | $ 26,278 | $ 15,204 | $ 11,074 |
| Vehicles | 8,677 | 720 | 7,957 | - | - | - |
| Furniture | 16,504 | 784 | 15,720 | - | - | - |
| Computers | 95,216 | 7,825 | 87,391 | - | - | - |
| Field equipment | 86,342 | 5,730 | 80,612 | - | - | - |
| Leasehold improvements | 34,716 | 289 | 34,427 | - | - | - |
| Total | $ 267,733 | $ 32,768 | $ 234,965 | $ 26,278 | $ 15,204 | $ 11,074 |

(Expressed in Canadian dollars)

## 5. RESOURCE PROPERTIES

| June 30, 2011 | Lombok Property, Indonesia | Sumbawa Properties, Indonesia | Oil& Gas Properties, Canada | Total |
|---|---|---|---|---|
| **Acquisition costs** | | | | |
| Incurred during the year: | | | | |
| Adjustment to eliminate subsidiary (Note 3) | $ - | $ - | $ (1,691) | $ (1,691) |
| Balance, beginning of the year | 2,427,299 | 1,736,682 | 1,691 | 4,165,672 |
| Balance, end of the year | 2,427,299 | 1,736,682 | - | 4,163,981 |
| **Deferred exploration costs** | | | | |
| Incurred during the year: | | | | |
| Assaying, surveying and analysis | 30,052 | 169,637 | - | 199,689 |
| Camp construction and other | 1,343,056 | 490,888 | - | 1,833,944 |
| Drilling | 781,624 | - | - | 781,624 |
| Geological and other consulting (Note 10) | 586,631 | 445,591 | - | 1,032,222 |
| Labour | 314,508 | 171,902 | - | 486,410 |
| Write-off during the year | - | (87,693) | - | (87,693) |
| Adjustment to eliminate subsidiary (Note 3) | - | - | (3,253,116) | (3,253,116) |
| Total deferred exploration costs | 3,055,871 | 1,190,325 | (3,253,116) | 993,080 |
| Balance, beginning of the year | 10,773,410 | 4,218,218 | 3,253,116 | 18,244,744 |
| Balance, end of the year | 13,829,281 | 5,408,543 | - | 19,237,824 |
| **Total resource property costs** | **$16,256,580** | **$ 7,145,225** | **$ -** | **$ 23,401,805** |

(Expressed in Canadian dollars)

## 5. **RESOURCE PROPERTIES** (cont'd…)

| June 30, 2010 | Lombok Property, Indonesia | Sumbawa Properties, Indonesia | Oil& Gas Properties, Canada | Total |
|---|---|---|---|---|
| **Acquisition costs** | | | | |
| Balance, beginning of year | $ 1,051,254 | $ 450,537 | $ - | $ 1,501,791 |
| Cash | 168,545 | 94,261 | 1,691 | 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 | 2,427,299 | 1,736,682 | 1,691 | 4,165,672 |
| **Deferred exploration costs** | | | | |
| Incurred during the year: | | | | |
| Assaying, surveying & analysis | 34,721 | 167 | - | 34,888 |
| Camp construction and other | 293,734 | 121,576 | - | 415,310 |
| Completion | - | - | 968,367 | 968,367 |
| Drilling | 11,167 | - | 2,216,933 | 2,228,100 |
| Geological and other consulting (Note 10) | 416,299 | 132,519 | 67,816 | 616,634 |
| Total deferred exploration costs | 755,921 | 254,262 | 3,253,116 | 4,263,299 |
| Balance, beginning of year | 10,017,489 | 3,963,956 | - | 13,981,445 |
| Balance, end of year | 10,773,410 | 4,218,218 | 3,253,116 | 18,244,744 |
| **Total resource property costs** | **$ 13,200,709** | **$ 5,954,900** | **$ 3,254,807** | **$ 22,410,416** |

### Lombok and Taliwang (Sumbawa) Properties, Indonesia

During 2005, the Company acquired its original interests in the Lombok and Taliwang properties by paying $81,572 and issuing 11,500,000 common shares (valued at $862,500) to Sunda Mining Corporation ("Sunda") and by paying $180,000 and issuing 1,000,000 common shares (valued at $125,000) to Indotan Inc. ("Indotan"). The Company also granted a 0.5% net smelter return ("NSR") to individuals related to Sunda and a 2% NSR to Indotan on the Taliwang property, and a 0.5% NSR to individuals related to Sunda and a 1% NSR to Indotan on approximately 8% of the current Lombok property, which excludes Block 1 described below.

In August, 2005, the Company entered into an agreement with PT Newmont Nusa Tenggara ("Newmont") regarding a property ("Block 1") which now forms the western portion of the Company's Lombok property (including the Selodong, Mencanggah and Pelangan prospects) and is included in the mining business license ("IUP"). The acquisition was completed through a relinquishment by Newmont of the Block 1 area. The terms of the agreement include granting Newmont a 2% NSR on any mineral production from the Block 1 area and 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. The Company has the right to repurchase this 2% NSR for US$1 million at any time.

In December 2009, the Company acquired the right to the name Indotan Inc. as well as control over two Singapore companies by issuing 3,500,000 common shares with a value of $2,415,000. The acquisition of the Singapore companies has been accounted for using the purchase method and the purchase price of $2,415,000 has been allocated to resource properties. Refer also to note 2.

**5. RESOURCE PROPERTIES** (cont'd…)

During the year ended June 30, 2011, the Company established new 85%-owned Indonesian subsidiaries (PT. Indotan Lombok Barat Bangkit and PT. Indotan Sumbawa Barat) to hold its Lombok and Taliwang properties, respectively. A 5% carried interest in these companies is owned by the Company's Indonesian joint venture partner, PT Puri Permata Mega ("PTPM") and a 10% carried interest is owned by the respective local governments.

The Company has advanced loans receivable of $433,935 (US$450,000) on an unsecured basis and without interest to the Indonesian subsidiary companies as capital contributions on behalf of the Indonesian shareholders, and these funds are to be repaid to the Company from future revenues of the subsidiaries.

During the year ended June 30, 2011, 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 ("Minimum Spend Obligation") on the Taliwang property 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;
c) Following its acquisition of the shares in the Singapore Company, Newcrest may retain its interest in the Taliwang property 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 property, leaving Southern Arc with an effective 21.25% interest. The remaining interest is held by the West Sumbawa Regency government (10%) and PTPM (5%).

**East Elang and Sabalong (Sumbawa) Properties**

The Company acquired the East Elang and Sabalong properties by way of mining licenses ("KPs") which were granted to the Company by the Sumbawa Regency in 2006 and 2007, respectively. Both KPs were subsequently transitioned into IUPs in December 2009.

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

a) Phase 1 – Vale will fund US$1,000,000 (Sabalong) and US$1,200,000 (East Elang) of exploration expenditures within one year from the date the Company receives an exploration activities permit from the Ministry of Forestry for that property. Vale can then elect to proceed to;
b) Phase 2 minimum program – Vale could fund at least US$2,000,000 (Sabalong) and/or US$2,500,000 (East Elang) of additional exploration expenditures within 2 years of commencing Phase 2;
c) Phase 2 full program – Vale may proceed to completion of a pre-feasibility study or fund further exploration expenditures of at least US$10,000,000 (on either property) within 4 years of commencing Phase 2;
d) Upon completing the Phase 2 full program, Vale may elect to solely fund the completion of a bankable Feasibility Study within 7 years of commencing Phase 2.

If Vale completes a bankable feasibility study on either of the East Elang or Sabalong properties within the permitted timeframes, Vale will be entitled to receive a 75% interest in the Company's subsidiary PT. Selatan Arc Minerals ("PT SAM") which holds the IUPs for East Elang and Sabalong.

**5. RESOURCE PROPERTIES** (cont'd…)

The East Elang and Sabalong properties are held by the Company's wholly-owned Indonesian subsidiary, PT SAM. Funds advanced to PT SAM by Vale are recorded as cash and as accounts payable and accrued liabilities in the Company's accounts until such time as the funds are expended on approved exploration activities. During the year ended June 30, 2011, Vale advanced $836,357 to PT SAM and PT SAM held $204,426 of these funds as cash at June 30, 2011.

**Oil and gas properties, Canada** (Nickel Oil & Gas)

*Brewster Area, Alberta, Canada*

During the year ended June 30, 2010, Nickel Oil & Gas, entered into a joint venture agreement (the "Joint Venture"). According to the Joint Venture, 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 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. Nickel Oil & Gas's joint venture partner solely funded the completion, equipping and tie-in costs of the well and will receive 100% of all revenue from the well until it recoups 125% of the payout costs incurred.

*Pine Creek Area, Alberta, Canada*

During the year ended June 30, 2010, Nickel Oil & Gas, entered into a farmout and option agreement granting Nickel Oil & Gas the option to earn certain oil and gas rights with respect to property in the Pine Creek area, Alberta. During the period ended December 31, 2010, Nickel Oil & Gas entered into an Amending Agreement with its joint venture partner on the 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 by Nickel Oil & Gas and Nickel Oil & Gas'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.

**Other rights, Ontario, Canada**

*Gain on settlement of lawsuits*

During the year ended June 30, 2009, the Company through its (then) subsidiary Nickel Oil & Gas, entered into an option agreement with Diamondex Resources Ltd. ("Diamondex") to earn up to a 51% interest in the James Bay Nickel Project. The Company did not continue the option agreement and recognized an impairment loss of $8,066,801 during fiscal 2009. Nickel Oil & Gas commenced a legal action against Diamondex in connection with its option agreement and, upon settlement of the legal action, the Company recognized a gain on settlement of lawsuit of $250,000 in fiscal 2010.

Nickel Oil & Gas holds a royalty equal to a 1.5% NSR in the Nickel Bay Project, Ontario. Nickel Oil & Gas has granted an exclusive option to purchase up to two-thirds of this 1.5% NSR 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.

(Expressed in Canadian dollars)

## 6. INVESTMENTS

| | 2011 | 2010 |
|---|---|---|
| MAVII notes | $ - | $ 835,799 |

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

During the year ended June 30, 2011, the Company:

i) received repayments of investment of $374 (2010: $16,967); and

ii) disposed all of its holdings in MAVII notes for proceeds of $890,277. Concurrently, the Company repaid the demand non-revolving bridge loan of $550,000 (Note 7(i)) to its bank and recognized a gain on sale of investment of $54,852 (2010: $nil).

## 7. LOANS PAYABLE

| | 2011 | 2010 |
|---|---|---|
| Non-revolving bridge loan | $ - | $ 550,000 |
| Non-interest-bearing loans from a director | - | 1,064,600 |
| | $ - | $ 1,614,600 |

The Company's loans payable consist of:

i) a demand non-revolving bridge loan from its bank of $nil (June 30, 2010: $550,000);

ii) a non-interest-bearing loan of $nil (June 30, 2010: $1,064,600).

During the year ended June 30, 2011, the Company:

iii) repaid a non-interest-bearing loan of US$1,000,000 (CDN$1,064,600) from a director of the Company. In consideration for granting the loan, the Company assigned its option to acquire 500,000 of the Company's shares at $0.50 per share from Indotan Inc. A fair value of $117,713 was allocated to stock-based financing costs and recorded to contributed surplus in fiscal year 2010 in connection with the assignment. The director has exercised the option and acquired the mentioned shares.

iv) received and repaid a non-interest-bearing loan of US$1,000,000 (CDN$994,600) from a director of the Company to the Company's 100% owned subsidiary, Indotan Lombok Pte. Ltd.

v) received and repaid a non-interest-bearing loan of US$1,000,000 (CDN$971,800) from a director of the Company to the Company's 100% owned subsidiary, Southern Sunda Mining Pte. Ltd.

(Expressed in Canadian dollars)

## 8. CAPITAL STOCK AND CONTRIBUTED SURPLUS

| | Number of Common Shares | Capital Stock | Number of Treasury Shares | Treasury 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 7(iii)) | - | - | - | - | 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 | 3,500,000 | 2,415,000 | - | - | - |
| Balance as at June 30, 2010 | 77,329,990 | 30,474,172 | - | - | 5,926,928 |
| Private placements | 28,409,520 | 46,522,309 | - | - | - |
| Share issue costs | - | (3,034,107) | - | - | - |
| Agent warrants issued | - | (1,013,070) | - | - | 1,013,070 |
| Stock-based compensation | - | - | - | - | 4,060,214 |
| Repurchase of shares | - | - | 1,300,000 | (1,170,000) | - |
| Exercise of options | 1,225,000 | 1,202,184 | - | - | (539,184) |
| Balance as at June 30, 2011 | 106,964,510 | $ 74,151,488 | 1,300,000 | $(1,170,000) | $ 10,461,028 |

During the year ended June 30, 2011, the Company issued 1,225,000 common shares at $0.30 to $0.80 per share for total proceeds of $663,000 pursuant to the exercise of stock options previously granted.

On February 24, 2011, the Company completed a private placement offering of 17,738,750 common shares at $1.60 per share for total proceeds of $28,382,000. In connection with the offering, the underwriters received a cash commission of 6% of the gross proceeds and 1,064,325 non-transferable common share purchase warrants exercisable for 18 months at $1.60 per share.

On June 21, 2011, the Company completed a private placement offering of 10,670,770 common shares at $1.70 per share for total proceeds of $18,140,309. In connection with the offering, the underwriters received a cash commission of 6% of the gross proceeds and 640,246 non-transferable common share purchase warrants exercisable for 12 months at $1.70 per share.

During the year ended June 30, 2011, the Company purchased 1,300,000 shares of the Company for $0.90 per share from Indotan Inc. (Note 5).

**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.

(Expressed in Canadian dollars)

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

| | Number of Options | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at 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 at June 30, 2010 | 4,075,000 | 0.41 |
| Granted | 4,650,000 | 1.03 |
| Exercised | (1,225,000) | (0.54) |
| Outstanding at June 30, 2011 | 7,500,000 | $ 0.77 |
| Number of options currently exercisable | 7,500,000 | $ 0.77 |

During the year ended June 30, 2011, the Company recorded stock-based compensation of $4,060,214 (2010: $333,661) using the Black-Scholes Option Pricing model, as a result of the granting of 4,650,000 (2010: 3,500,000) options. These amounts were recorded as contributed surplus on the balance sheet. The weighted average fair value of the options granted was $0.84 (2010: $0.27) 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 year:

| | 2011 | 2010 |
|---|---|---|
| Risk-free interest rate | 2.36% | 2.62% |
| Expected life of options | 4.80 years | 5 years |
| Annualized volatility | 117.74% | 121.25% |
| Dividend rate | 0.00% | 0.00% |

At June 30, 2011, the Company had share purchase options outstanding enabling holders to acquire common shares as follows:

| | Number of Shares | Exercise Price | Expiry Date |
|---|---|---|---|
| **Options** | 3,150,000 | $ 0.40 | September 16, 2014 |
| | 3,350,000 | $ 0.80 | July 19, 2015 |
| | 400,000 | $ 2.00 | January 18, 2016 |
| | 300,000 | $ 1.85 | February 11, 2016 |
| | 300,000 | $ 1.70 | June 22, 2016 |
| | 7,500,000 | | |

(Expressed in Canadian dollars)

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

**Warrants**

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

| | Number of Warrants | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at June 30, 2009 | 4,716,418 | $ 1.75 |
| Re-priced | (4,630,168) | (1.75) |
| Re-priced | 4,630,168 | 0.70 |
| Exercised | (1,679,084) | (0.70) |
| Expired | (3,037,334) | (0.70) |
| Outstanding at June 30, 2010 | - | $ - |
| Issued | 1,704,571 | 1.64 |
| Outstanding at June 30, 2011 | 1,704,571 | $ 1.64 |

During the year ended June 30, 2011, the Company recorded share issue cost of $1,013,070 (2010: $nil) using the Black-Scholes Option Pricing model, as a result of the issuance of 1,704,571 (2010: nil) warrants to its agents in connection with private placement offerings. These amounts were recorded as contributed surplus on the balance sheet. The weighted average fair value of the warrant granted was $0.59 (2010: $nil) per warrant.

Fair value 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 warrants granted during the year:

| | 2011 | 2010 |
|---|---|---|
| Risk-free interest rate | 1.56% | Nil |
| Expected life of options | 1 year | Nil |
| Annualized volatility | 67.93% | Nil |
| Dividend rate | 0.00% | Nil |

At June 30, 2011, the Company had share purchase warrants outstanding enabling holders to acquire common shares as follows:

| | Number of Shares | Exercise Price | Expiry Date |
|---|---|---|---|
| **Warrants** | 1,064,325 | $ 1.60 | August 24, 2012 |
| | 640,246 | $ 1.70 | June 21, 2012 |
| | 1,704,571 | | |

## 9. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

The Company had the following significant non-cash transactions:

During the year ended June 30, 2011, the Company allocated $539,184 (2010: $128,756) to capital stock from contributed surplus for stock options exercised during the period.

During the year ended June 30, 2011, the Company recorded $1,013,070 (2010: $117,713) to contributed surplus for stock-based financing cost.

At June 30, 2011, the Company had included in accounts payable $498,400 (2010: $101,312) of resource property costs.

During the year June 30, 2010, the Company issued 3,500,000 common shares at $0.69 per share for a value of $2,415,000 for acquisition of resource property.

## 10. RELATED PARTY TRANSACTIONS

During the period ended June 30, 2011, the Company entered into transactions with related parties as follows:

i) paid $348,000 (2010: $402,000) for management fees and $112,500 (2010: $80,400) for administration, (recorded in office and miscellaneous expense) to a private company controlled by the Chief Executive Officer and director of the Company;

ii) paid $261,518 (2010: $209,476) for geological consulting services included in resource properties to an officer of the Company and a company controlled by an officer of the Company;

iii) paid $235,018 (2010: $nil) for geological consulting services included in resource properties to an officer of the Company; and

iv) paid $1,999 (2010: $nil) for directors fees to an officer of a subsidiary;

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. The Company also:

v) entered into a contract with a company controlled by a director and officer of the Company for drilling services at the Company's West Lombok property. This contract was awarded under a competitive bidding process and all charges under the contract are considered to be at market rates. During the year ended June 30, 2011, the Company paid a total of $781,624 (US$807,880) for drilling services pursuant to the contract. A balance of $297,387 (US$308,391) is included in accounts payable for drilling services incurred during the year ended June 30, 2011 under this contract.

(Expressed in Canadian dollars)

## 11. INCOME TAXES

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

| | 2011 | 2010 |
|---|---|---|
| Loss for the year, before income taxes | $ (6,583,353) | $ (1,613,086) |
| Expected income tax recovery | $ (1,843,339) | $ (471,828) |
| Items not deductible for income tax purposes | 1,327,493 | 127,985 |
| Effect of change in tax rate | 44,125 | 49,961 |
| Effect of tax rates in other jurisdictions | 18,577 | - |
| Unrecognised tax benefits | (1,270,868) | - |
| Adjustment to opening tax pool | 1,997,548 | - |
| Change in valuation allowance | (273,536) | 293,882 |
| Total income taxes | $ - | $ - |

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

| | 2011 | 2010 |
|---|---|---|
| Future income tax assets: | | |
| Non-capital loss carry forwards | $ 2,018,999 | $ 1,143,620 |
| Capital loss carry forwards | 35,868 | - |
| Share issuance costs | 647,988 | 87,192 |
| Financing costs | - | 35,223 |
| Cumulative exploration expenses | (1,033,187) | 1,243,479 |
| Equipment | 7,819 | 3,801 |
| Long-term investment | 624,641 | 62,350 |
| | 2,302,128 | 2,575,665 |
| Valuation allowance | (2,302,128) | (2,575,665) |
| Net future income tax liability | $ - | $ - |

The Company has available for deduction against future years' taxable income non-capital losses of approximately $7,824,909. Non-capital losses expire as follows:

| | |
|---|---|
| 2015 | $ 403,890 |
| 2016 | 604,856 |
| 2027 | 486,895 |
| 2028 | 511,735 |
| 2029 | 886,865 |
| 2030 | 2,938,228 |
| 2031 | 1,992,440 |
| | $ 7,824,909 |

The Company has $15,022,863 (2010: $15,022,863) of unclaimed resource expenses for Canadian income tax purposes that can be carried forward indefinitely and used to reduce taxable income in Canada.

Future tax benefits, which may arise as a result of these losses and resource expenditures, have not been recognized in these financial statements and have been offset by a valuation allowance.

(Expressed in Canadian dollars)

## 12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

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

The Company 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 June 30, 2011 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 7) is considered to approximate fair value since it bears interest at current rates for similar types of borrowing arrangements.

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

| | 2011 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| Assets | | | |
| Cash | $ 38,632,091 | $ - | $ - |

| | 2010 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| Assets | | | |
| Cash | $ 1,604,476 | $ - | $ - |
| Investment | $ - | $ - | $ 835,799 |

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

**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:

*Credit risk*

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash and cash equivalents. Management believes that the credit risk concentration with respect to cash and cash equivalents is remote as it maintains accounts with highly-rated financial institutions.

## 12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd…)

*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 June 30, 2011, the Company had a cash balance of $38,632,091 (June 30, 2010: $1,604,476) to settle current liabilities of $1,529,554 (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 a 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 risks associated with legal and political issues in a developing-country environment. The Company minimizes cash and monetary assets or liabilities in Indonesia.

At June 30, 2011, the Company had US$2,528,618 (approximately CAD$2,437,856) and Indonesian Rupiah ("Rph") 2,657,051,280 (approximately CAD$298,098) in cash and US$1,379,281 (approximately CAD$1,330,040) and Rph 62,050,266 (approximately CAD$6,949) in account payable and accrued liabilities. As at June 30, 2011, US$ amounts were converted at a rate of US$1.0370 to CAD$1 and Rph amounts were converted at a rate of Rph 8,929 to CAD$1.

(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, if any.

## 13. COMMITMENT

The Company has committed to rent office space through August 31, 2012 totalling $5,529 per month.

(Expressed in Canadian dollars)

## 14. SEGMENTED INFORMATION

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

| | 2011 | 2010 |
|---|---|---|
| Oil and gas properties – Canada | $ - | $ 3,254,807 |
| Resource properties – Indonesia | 23,401,805 | 19,155,609 |
| Equipment – Indonesia | 226,107 | - |
| Equipment – Canada | 8,858 | 11,074 |
| | $ 23,636,770 | $ 22,421,490 |
| Resource property write-down – Indonesia | $ 87,693 | $ 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 components of equity (i.e., share capital, contributed surplus and deficit).

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 year ended June 30, 2011.

## 16. SUBSEQUENT EVENTS

Subsequent to June 30, 2011:

i) On August 8, 2011, the Company experienced a disruption of exploration activities at its West Lombok property due to local demonstrations that destroyed a contractor's drilling equipment and disrupted drilling activity for approximately two months. The Company suffered no significant financial loss, but as a result has increased security at its West Lombok property.

ii) On September 22, 2011, the Company held a Special Meeting where its shareholders elected Mr. Mohammed Al-Shahwani as a Director of the Company and ratified Southern Arc's Bonus and Compensation Plan, which permits the Company to distribute or option up to 1.3 million common shares of the Company from time to time to eligible persons, including directors, officers, employees or consultants of the Company.

iii) The Company issued 200,000 options to an officer exercisable at $1.71 for a period of five years from the grant date and 200,000 options to a consultant exercisable at $1.11 for a period of five years from the grant date.