

SOUTHERN ARC MINERALS INC.
FORM 51-102F1
MANAGEMENT DISCUSSION AND ANALYSIS
SIX MONTH PERIOD ENDED DECEMBER 31, 2005

The following discussion, prepared as of February 26, 2006, is management's assessment and analysis of the results and financial condition of Southern Arc Minerals Inc. (the "Company") and should be read in conjunction with the accompanying unaudited financial statements for the six month period ended December 31, 2005 and related notes attached thereto. The preparation of financial data is in accordance with Canadian generally accepted accounting principles and all figures are reported in Canadian dollars unless otherwise indicated.

The reader should also refer to the annual audited financial statements for the period ended June 30, 2005 and the Management Discussions and Analysis for that period.

Additional information relating to the Company is available on SEDAR at www.sedar.com.

Description of Business

The Company was incorporated in British Columbia on August 19, 2004. The Company completed an IPO on June 2, 2005 and its common shares commenced trading on the TSX Venture Exchange on June 30, 2005.

The Company's business activities include the acquisition, exploration and development of resource properties in Indonesia. To date, the company has not generated significant revenues from operations and is considered to be in the development stage.

Forward Looking Statements

Certain information included in this discussion may constitute forward-looking statements. Forward looking statements are based on current expectations and entail various risks and uncertainties. These risks and uncertainties could cause or contribute to actual results that are materially different from those expressed or implied.

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 commercially mineable deposits. The geological focus of the Company is on areas in which the geological setting is well understood by management.

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Trends

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

Risks and Uncertainties

The Company is subject to a number of risk factors due to the nature of the mining business in which it is engaged, not least adverse movements in commodity prices, which are impossible to forecast. The Company seeks to counter this risk as far as possible by selecting exploration areas on the basis of their recognized geological potential to host economic deposits.

Gold and Metal Prices

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

Resource Properties

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

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Resource Properties (cont'd...)

Lombok and Sumbawa Properties, Indonesia

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

Pursuant to the Option Agreement, the Company has the option, directly with Indotan, to acquire all of its rights to the Properties in consideration for which the Company issued 1,000,000 common shares, valued at \$125,000, and paid \$180,000. The Company now has an option, until February, 2010 to acquire 50% of Indotan’s 1% net smelter returns royalty (“NSR”) on the Properties in consideration for the payment of \$500,000. Concurrently with the signing of the Option Agreement, the Company received an option to acquire 50% of the remaining 1% NSR on the Properties in consideration for \$60,000 (paid) and \$500,000, which can be paid prior to the expiry of the option in February, 2010. All of the holders of the NSR agreed that the NSR only applies to the Properties as at July 21, 2004 and not to any additional property interests which the Company acquires after that date. In accordance with the terms of the Option Agreement, the Company also filed a listing application with the TSX-V and filed a prospectus for a public offering which has been completed.

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

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Resource Properties (cont'd...)

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

Lombok and Sumbawa are currently comprised of two separate applications to the Indonesian Government for a COW to conduct mining activities and earn mineral rights to certain mineral tenements. Upon the approval in principle of the COW, preliminary general survey licenses (“SIPPs”) were granted for the properties. The SIPP permits the Company to conduct preliminary general survey work over the COW application areas. The Sumbawa SIPP was granted on January 2, 2004 for an initial 12 month period. On April 19, 2005, an extension and expansion of the Sumbawa Property SIPP was granted until April 19, 2006. The Lombok SIPP was granted on December 4, 2002. A 12 month extension was granted on February 16, 2004. On July 15, 2005, an extension and expansion of the Lombok SIPP was granted until February 16, 2006. The granting of a SIPP is not a guarantee that a COW will be entered into.

The Company has received assay results from the first three diamond drill holes of Phase Two drilling at its Lemonga Prospect located on Sumbawa Island, Indonesia. The holes LDG-17 to LDG-19 were drilled to test down-dip and along lateral extensions of high-grade gold-silver shoots intersect in the southern Amy vein in an earlier scout drilling program.

The Lemonga Prospect is focused on a low-sulphidation epithermal quartz vein system over which surface mapping by Southern Arc and previous operators has confirmed hydrothermal argillic alteration within an area approximately 1 km East-West by 1.5 km North-South. Five quartz vein targets, named Amy, Betty, Cici, Dessy and Evi, have been identified within the alteration zone. The best exposed vein, the Amy Vein, has a mapped strike extent of at least 950 meters. In 2005 the company completed eight drill holes along the strike of the Amy Vein, with high grade shoots intersected in the southern portion over a 300+ m strike extent.

In all three drill holes significant widths of quartz veining were intersected and confirm the near vertical dip and pinch and swell nature of veining. Higher grades tend to be associated with a finer grained, base-metal sulfide rich quartz phase, one of at least four veining phases.

Highlights of drill hole intercepts (Figure 1) in the vicinity of LDG-01 returned:

Drill hole LDG-18 13.30 m @ 4.64 g/t Au & 21 g/t Ag from 63.15 m
(including 2.15 m @ 19.44 g/t Au & 18 g/t Ag)

Drill hole LDG-17 20.80 m @ 2.02 g/t Au & 15 g/t Ag from 107.6 m
(including 3.10 m @ 5.76 g/t Au & 11 g/t Ag
3.15 m @ 5.62 g/t Au & 59 g/t Ag)

Drill hole LDG-19 21.90 m @ 1.02 g/t Au & 10 g/t Ag from 130.65 m
(including 3.10 m @ 4.70 g/t Au & 19 g/t Ag)

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Resource Properties (cont'd...)

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

Interpretation of data from the recently completed CSAMT ("resistivity") ground area indicate initial findings of moderate to strongly resistive linear targets more or less correspond to the position and strike of the known veins and breccia zones, along with possible significant lateral extensions at depth. Additional blind targets that masked by talus scree have also been interpreted in the Northwest section of the prospect area.

On January 31, 2006, the Company reported on the first three drill holes of the phase two drill program. Drill hole's LDG-20 and LDG-21, representing the 4th and 5th drill holes of phase two, were targeted to test lateral extensions of intercepts from drill hole LDG-03 at 33 meter and 66 meter positions south along strike. Drill hole LDG-22, the 6th drill hole of phase two, was drilled 117 metres north of LDG-03 and below an earlier Aneka Tambang hole BOS-2 as part of the infill program between LDG-03 and LDG-04. All holes were drilled at right angles to the strike of the vein and at -45° inclinations.

In all three drill holes significant widths of quartz veining were intersected and again confirm the near vertical dip and pinch and swell nature of the veining. An extensive section of variably mineralized wall rock (in the foot wall) immediately west of quartz veining intersected in LDG-21, returned surprisingly elevated gold results of 10.35 m @ 1.32 g/t Au and 29.70 m @ 4.24 g/t Au. These assay results have subsequently been checked by reassaying (see below). The anomalous gold tenure of wall rocks has been confirmed, and will require infill drilling in this vicinity to better understand the nature of this mineralization. LDG-22 has confirmed the presence of high grade gold-silver shoots within the Amy vein, north of this point, and justifies the need for the on-going northwards infill program.

Highlights of drill hole intercepts (Figure 1) returned:

Drill hole LDG-20 2.00 m @ 1.44 g/t Au & 4 g/t Ag from 3.00 m
 3.30 m @ 0.21 g/t Au & 516 g/t Ag from 11.00 m
 12.60 m @ 3.99 g/t Au & 37 g/t Ag from 48.40 m
 (including 2.00 m @ 13.65 g/t Au & 73 g/t Ag)
 1.30 m @ 6.26 g/t Au & 22 g/t Ag)

Drill hole LDG-21 10.35 m @ 1.32 [0.75] g/t Au & 2 [2] g/t Ag from 31.15 m (foot wall)
 29.70 m @ 4.24 [2.23] g/t Au & 4 [3] g/t Ag from 48.60 m (foot wall)
 19.55 m @ 1.67 g/t Au & 19 g/t Ag from 82.10 m
 (including 3.15 m @ 4.66 g/t Au & 28 g/t Ag)
 3.85 m @ 2.33 g/t Au & 21 g/t Ag)

Resource Properties (cont'd...)

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

The extensive section of gold anomalous, variably mineralized wall rock immediately west of the quartz vein intercept (intercepts: 10.35 m @ 1.32 [0.75] g/t Au & 2 [2] g/t Ag from 31.15 m and 29.70 m @ 4.24 [2.23] g/t Au & 4 [3] g/t Ag from 48.60 m) was checked by re-assaying selected pulp and re-splits of the bulk samples stored at the Intertek Testing Services (ITS) laboratory in Jakarta. This included quartering residual drill core over two broad intervals, then re-sampling on a tighter geological basis and comparing those results with the originals. The laboratory re-assays displayed negligible differences from the original samples assayed, while the quartered core results [shown in brackets] did return significant differences as compared to the original half-core samples. We believe that the significant difference is attributable to the nugget effect and the much smaller sample size.

Drill hole LDG-22 2.00 m @ 1.24 g/t Au & 5 g/t Ag from 5.60 m
 2.00 m @ 11.75 g/t Au & 694 g/t Ag from 13.60 m
 0.70 m @ 11.20 g/t Au & 10 g/t Ag from 46.20 m
 3.00 m @ 7.94 g/t Au & 56 g/t Ag from 68.30 m
 2.00 m @ 1.20 g/t Au & 3 g/t Ag from 75.70 m

The Lemonga Prospect is a low-sulphidation epithermal quartz vein system over which surface mapping by Southern Arc has confirmed hydrothermal argillic alteration within an area approximately 1 km East-West by 1.5km North-South. Five quartz vein targets, named Amy, Betty, Cici, Dessy and Evi, have been identified within the alteration zone. The best exposed vein, the Amy Vein, has a mapped strike extent of at least 950 meters.

All assaying of samples were undertaken by the ITS laboratory in Jakarta. ITS is one of the world's largest product and commodity testing, inspection and certification organizations. The Jakarta laboratory is ISO 17025 accredited and employs a Laboratory Information Management System (LIMS) for sample tracking, quality control and reporting.

Flores Property, Indonesia

The Company has been granted four exploration licenses over part of West Flores Island through its locally controlled Indonesian entity. The areas have been previously explored under fourth and seventh generation COW. The licenses were granted for twelve months and can be extended for a further twelve months.

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Resource Properties (cont'd...)

Other Property, Indonesia

On September 7, 2005, the Company entered into an arms-length letter agreement pursuant to which it can acquire a 75% interest in an Indonesian mineral property (the "Property") by paying US\$25,000 and:

Upon execution of a formal agreement:

- ?? Paying US\$100,000
- ?? Issuing 100,000 common shares; and
- ?? Paying US\$6,000 per month, increasing after one year to US\$10,000 per month.

Upon completion of the first 3,000 metres of drilling on the Property:

- ?? Paying US\$200,000;
- ?? Issuing 200,000 common shares; and

Upon commencement of commercial production:

- ?? Paying US\$3,000,000 less previous advances.

| December 31, 2005 | Lombok Property | Sumbawa Property | Flores Property | Other Property | Total |
|---|--------------------|---------------------|--------------------|-------------------|------------------|
| Acquisition costs | | | | | |
| Balance, beginning of period | \$ 1,025,852 | \$ 439,651 | \$ - | \$ - | \$ 1,465,503 |
| Additions | <u>25,402</u> | <u>10,886</u> | <u>17,941</u> | <u>23,797</u> | <u>78,026</u> |
| Balance, end of period | <u>1,051,254</u> | <u>450,537</u> | <u>17,941</u> | <u>23,797</u> | <u>1,543,529</u> |
| Deferred exploration costs | | | | | |
| Incurred during the period: | | | | | |
| Assaying, testing, surveying and analysis | 29,432 | 62,899 | - | - | 92,331 |
| Camp construction, supplies and accommodation | 114,394 | 166,682 | - | - | 281,076 |
| Geological and other consulting | 187,591 | 208,553 | - | - | 396,144 |
| Drilling | - | 108,022 | - | - | 108,022 |
| Travel | <u>4,291</u> | <u>7,621</u> | <u>-</u> | <u>-</u> | <u>11,912</u> |
| Total deferred exploration costs | 335,708 | 553,777 | - | - | 889,485 |
| Balance, beginning of period | <u>670,425</u> | <u>547,948</u> | <u>-</u> | <u>-</u> | <u>1,218,373</u> |
| Balance, end of period | <u>1,006,133</u> | <u>1,101,725</u> | <u>-</u> | <u>-</u> | <u>2,107,858</u> |

| | | | | | |
|--------------------------------------|--------------|--------------|-----------|-----------|--------------|
| Total resource property costs | \$ 2,057,387 | \$ 1,552,262 | \$ 17,941 | \$ 23,797 | \$ 3,651,387 |
|--------------------------------------|--------------|--------------|-----------|-----------|--------------|

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Resource Properties (cont'd...)

Other Property, Indonesia (cont'd..)

| June 30, 2005 | Lombok Property | Sumbawa Property | Total |
|---|---------------------|---------------------|---------------------|
| Acquisition costs | | | |
| Balance, beginning of period | \$ 22,798 | \$ 9,770 | \$ 32,568 |
| Additions | <u>1,003,054</u> | <u>429,881</u> | <u>1,432,935</u> |
| Balance, end of period | <u>1,025,852</u> | <u>439,651</u> | <u>1,465,503</u> |
| Deferred exploration costs | | | |
| Incurred during the period: | | | |
| Assaying, testing and analysis | 72,327 | 27,598 | 99,925 |
| Camp construction, supplies and accommodation | 162,005 | 142,055 | 304,060 |
| Geological and other consulting | 137,470 | 133,005 | 270,475 |
| Drilling | <u>58,216</u> | <u>88,879</u> | <u>147,095</u> |
| Total deferred exploration costs | 430,018 | 391,537 | 821,555 |
| Balance, beginning of period | <u>240,407</u> | <u>156,411</u> | <u>396,818</u> |
| Balance, end of period | <u>670,425</u> | <u>547,948</u> | <u>1,218,373</u> |
| Total resource property costs | <u>\$ 1,696,277</u> | <u>\$ 987,599</u> | <u>\$ 2,683,876</u> |

Financing

During the six month period ended December 31, 2005, the Company issued 4,000,000 units at \$0.35 per unit for proceeds of \$1,400,000. Each unit consists of one common share and one common share purchase warrant entitling the holder to acquire one additional common share at \$0.50 per share for a period of two years. Also during the six month period ended December 31, 2005, the Company issued 173,275 common shares at \$0.25 per share for total proceeds of \$43,318 pursuant to the exercise of warrants previously granted.

The Company has not paid any dividends on its common shares. The Company has no present intention of paying dividends on its common shares, as it anticipates that all available funds will be invested to finance the growth of its business.

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Results of Operations

During the six month period ended December 31, 2005, the Company incurred a loss of \$285,076, compared to a loss of \$101,527 for the period from incorporation on August 19, 2004 to December 31, 2004, as a result of incurring various general and administrative expenses. The general and administrative expenses primarily consisted of consulting fees of \$102,418 (December 31, 2004 - \$46,200) and professional fees of \$71,818 (December 31, 2004 - \$23,416) for corporate oversight, administration and stewardship. Included in consulting fees was \$48,000 (December 31, 2004 - \$40,000) paid or accrued to a company controlled by a director of the Company. Included in professional fees was \$37,900 (December 31, 2004 - \$6,000) paid or accrued to a firm in which an officer is a partner. The remaining consulting and professional fees were incurred for a variety of administrative and accounting services and for general corporate counsel. The Company also recognized stock-based compensation of \$20,541 (December 31, 2004 - \$Nil) in the statement of operations as a result of issuing incentive stock options.

Summary of Results

| | December 31, 2005 | September 30, 2005 | June 30, 2005 | December 31, 2004 |
|---|----------------------|-----------------------|------------------|----------------------|
| Total assets | \$ 4,860,083 | \$ 3,572,684 | \$ 3,726,995 | \$ 659,394 |
| Resource properties and deferred costs | 3,651,387 | 3,154,781 | 2,683,876 | 429,386 |
| Working capital | 1,006,688 | 249,272 | 817,479 | 57,787 |
| Accumulated deficit | (866,394) | (722,132) | (581,318) | (101,527) |
| Net Loss | (144,262) | (140,814) | (479,791) | (101,527) |
| Basic and diluted loss per share | (0.01) | (0.00) | (0.01) | (0.01) |

Liquidity

The Company has financed its operations to date primarily through the issuance of common shares.

The audited financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to commence profitable operations in the future.

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Liquidity (cont'd...)

Net cash used in operating activities for the six month period ended December 31, 2005 was \$934,858 compared to net cash used of \$22,568 during the period ended December 31, 2004. The cash used in operating activities for the periods consists primarily of the operating loss from the general and administrative expenditures and a change in non-cash working capital items.

Net cash used in the investing activity for the six month period ended December 31, 2005 was \$933,176 compared to cash used of \$429,386 during the period ended December 31, 2004. The cash used in the investing activity for the periods consists entirely of the acquisition and exploration of resource properties.

Net cash provided by financing activities for the six month period ended December 31, 2005 was \$1,421,255 compared to \$588,700 during the period ended December 31, 2004. The cash provided by financing activities consists of the issuance of common shares net of share issuance costs.

Investor Relations

The Company held its annual general meeting on November 25, 2005. The Company has recently engaged two investor relations consultants in order to raise its profile with the investment community.

Related Party Transactions

During the six month period ended December 31, 2005, the Company entered into transactions with related parties as follows:

- a) Paid or accrued \$48,000 (December 31, 2004 - \$40,000) for consulting fees to a company controlled by a director of the Company.
- b) Paid or accrued \$37,900 (December 31, 2004 - \$6,000) for professional fees to a firm in which an officer of the Company is a partner.
- c) Paid or accrued \$68,696 (December 31, 2004 - \$Nil) in geological consulting fees included in resource properties to an officer of the Company and a company controlled by an officer of the Company.
- d) Accounts payable include \$23,262 (December 31, 2004 - \$6,000) fees owing to a firm in which a director is a partner.

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.

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Financial Instruments

The carrying value of cash, receivables and accounts payable and accrued liabilities approximate fair value because of the short maturity of those instruments. It is management’s opinion that the Company is not exposed to significant interest or credit risk arising from these financial instruments.

Currency risk

The Company’s largest non-monetary assets are its resource interests in Indonesia. The Company could accordingly be at risk for foreign currency fluctuations and developing legal and political environments.

The Company does not maintain significant cash or monetary assets or liabilities in Indonesia.

Commitment

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

| | |
|------|-----------|
| 2006 | \$ 28,000 |
| 2007 | 20,170 |

Off-balance Sheet Arrangements

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

Stock-based compensation

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

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Current Share Data

As at February 26, 2006, the Company has 41,249,038 common shares issued and outstanding and has the following stock options and warrants outstanding:

| | Number of Shares | Exercise Price | Expiry Date |
|-----------------|---------------------|-------------------|-------------------|
| Options | | | |
| | 1,650,000 | \$ 0.25 | June 30, 2010 |
| | 75,000 | 0.35 | October 12, 2010 |
| | 2,275,000 | 0.56 | January 13, 2011 |
| Warrants | | | |
| | 700,963 | \$ 0.25 | June 30, 2006 |
| | 1,280,000 | 0.125 | April 15, 2007 |
| | 1,957,156 | 0.50 | December 28, 2007 |

Outlook

The Company continues to expand its portfolio of exploration properties across the Lombok, Sumbawa and Flores Islands in Indonesia. These acquisitions form part of the Company's strategy, which is to be an active junior resource exploration company through the entire Sunda Banda Magmatic Arc of south-central Indonesia.

Subsequent events

- a) The Company entered into an agreement with PT Newmont Nusa Tenggara ("NNT") regarding a 8,860 ha property ("*Block 1*") which is contiguous with the western boundary of the Company's current Lombok Island SiPP license. The acquisition was completed through a relinquishment by NNT of *Block 1* area. The terms of the agreement include granting NNT a 2% net smelter return ("NSR") on any mineral production from the area covered by *Block 1* together with a right of first refusal should the Company wish to introduce a new partner into any development within the area originally covered by *Block 1*.
- b) The Company issued 725,762 common shares at \$0.25 pursuant to the exercise of warrants previously granted.

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Subsequent events (cont'd...)

- c) The Company granted stock options to officers, directors and consultants of the company to acquire 2,275,000 common shares exercisable at \$0.56 per share exercisable for a period of five years; 250,000 of the options will be subject to vesting provisions, with one quarter of the total number vesting every three months.
- d) The Company issued 1,750,000 common shares at \$0.25 pursuant to the exercise of options previously granted to related parties.
- e) The Company re-priced 228,500 units included in the private placement pursuant to TSX-V terms. These units, originally issued at \$0.35, were adjusted to 142,812 units at \$0.56. Each re-priced unit consists of one common share and one-half of one common share purchase warrant, where one whole warrant entitles the holder to acquire one additional common share at \$0.66 for a period of two years. The total proceeds from the private placement were unchanged by the adjustment.