

Consolidated financial statements of

New Gold Inc.

December 31, 2008

New Gold Inc.

December 31, 2008

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Auditors' report

To the Shareholders of
New Gold Inc.

We have audited the consolidated balance sheets of New Gold Inc. as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for the year ended December 31, 2008 and the thirteen month period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the year ended December 31, 2008 and the thirteen month period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.

(Signed) Deloitte & Touche LLP

Chartered Accountants
March 12, 2009

New Gold Inc.

Consolidated statements of operations

(Expressed in thousands of U.S. dollars, except share and per share amounts)

| | Year ended December 31, 2008 | Thirteen months ended December 31, 2007 |
|---|------------------------------------|--|
| | \$ | \$ |
| Revenues | 218,135 | 131,084 |
| Operating expenses | (169,694) | (80,723) |
| Depreciation and depletion | (32,961) | (18,973) |
| Earnings from mine operations | 15,480 | 31,388 |
| Corporation administration ⁽¹⁾ | (23,029) | (13,295) |
| Exploration | (8,489) | (3,983) |
| Write-down of mining interests (Note 7 (b)) | (165,252) | - |
| (Loss) earnings from operations | (181,290) | 14,110 |
| Other income (expense) | | |
| Interest and other income | 5,368 | 4,113 |
| Interest and finance fees | (3,002) | (459) |
| Gain (loss) on foreign exchange | 69,222 | (2,864) |
| (Loss) earnings from operations before taxes | (109,702) | 14,900 |
| Income and mining taxes | 7,023 | (287) |
| Net (loss) earnings | (102,679) | 14,613 |
| (Loss) earnings per share | | |
| Basic | (0.69) | 0.27 |
| Diluted | (0.69) | 0.21 |
| Weighted average number of shares outstanding (in thousands) | | |
| Basic | 148,126 | 53,428 |
| Diluted | 148,126 | 68,226 |
| ⁽¹⁾ Stock option expense (a non-cash item included in corporation administration) | (7,039) | (6,156) |

New Gold Inc.

Consolidated statements of comprehensive income (loss)

(Expressed in thousands of U.S. dollars)

| | Year ended December 31, 2008 | Thirteen months ended December 31, 2007 |
|---|------------------------------------|--|
| | \$ | \$ |
| Net (loss) earnings | (102,679) | 14,613 |
| Other comprehensive income | | |
| Gain on available-for-sale securities (net of tax of \$Nil) | 1,160 | - |
| Comprehensive income (loss) | (101,519) | 14,613 |

New Gold Inc.

Consolidated balance sheets as at December 31

(Expressed in thousands of U.S. dollars)

| | 2008 | 2007 |
|---|------------------|-----------------|
| | \$ | \$ |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 185,668 | 149,924 |
| Short-term investments | - | 32,440 |
| Accounts receivable | 11,232 | 18,123 |
| Inventories and stockpiled ore (Note 5) | 39,402 | 39,792 |
| Future income and mining taxes | 2,690 | - |
| Prepaid expenses and other | 3,945 | 1,624 |
| | 242,937 | 241,903 |
| Investments (Note 6) | 77,016 | - |
| Mining interests (Note 7) | 1,618,761 | 315,831 |
| Intangible royalty asset | 14,087 | 14,664 |
| Reclamation deposits and other | 4,900 | - |
| | 1,957,701 | 572,398 |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 41,382 | 22,835 |
| Short-term borrowings | 7,193 | - |
| Income and mining taxes payable | 5,126 | 4,960 |
| | 53,701 | 27,795 |
| Reclamation and closure cost obligations (Note 11) | 21,949 | 18,036 |
| Future income and mining taxes (Note 10) | 224,068 | 25,943 |
| Long-term debt (Note 8) | 212,387 | - |
| Employee benefits and other | 3,808 | 3,253 |
| | 515,913 | 75,027 |
| Shareholders' equity | | |
| Common shares | 1,321,110 | 339,796 |
| Special warrants (Note 9 (b)) | - | 104,166 |
| Contributed surplus | 65,409 | 6,166 |
| Share purchase warrants (Note 9 (f)) | 145,614 | 57,673 |
| Equity component of convertible debentures (Note 8 (c)) | 21,604 | - |
| Accumulated other comprehensive loss | (406) | (1,566) |
| Deficit | (111,543) | (8,864) |
| | (111,949) | (10,430) |
| | 1,441,788 | 497,371 |
| | 1,957,701 | 572,398 |

Commitments and contingencies (Note 15)

Approved by the Board

(Signed) Robert Gallagher

Robert Gallagher, Director

(Signed) Craig Nelsen

Craig Nelsen, Director

New Gold Inc.

Consolidated statements of shareholders' equity

(Expressed in thousands of U.S. dollars, except share amounts)

| | Common shares | | Special warrants | Contributed surplus | Share purchase warrants | Equity component of convertible debentures | Accumulated other comprehensive loss | (Deficit) retained earnings | Total shareholders' equity |
|--|--------------------|------------------|------------------|---------------------|-------------------------|--|--------------------------------------|-----------------------------|----------------------------|
| | Shares | Amount | | | | | | | |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Balance, November 30, 2006 | 11,505,140 | 25,313 | 104,166 | 59 | - | - | (1,566) | (23,477) | 104,495 |
| Issued for cash in private placement (net of issue costs of \$14,248) | 43,500,000 | 209,689 | - | - | 57,673 | - | - | - | 267,362 |
| Issued for acquisition | 16,000,000 | 103,253 | - | - | - | - | - | - | 103,253 |
| Exercise of options | 129,000 | 175 | - | (49) | - | - | - | - | 126 |
| Exercise of warrants | 1,495,000 | 1,366 | - | - | - | - | - | - | 1,366 |
| Stock-based compensation | - | - | - | 6,156 | - | - | - | - | 6,156 |
| Net loss | - | - | - | - | - | - | - | 14,613 | 14,613 |
| Balance, December 31, 2007 | 72,629,140 | 339,796 | 104,166 | 6,166 | 57,673 | - | (1,566) | (8,864) | 497,371 |
| Exercise of special warrants | 14,772,333 | 80,448 | (104,166) | - | 23,718 | - | - | - | - |
| Exercise of options | 424,090 | 3,022 | - | (1,664) | - | - | - | - | 1,358 |
| Exercise of warrants | 561,645 | 3,167 | - | - | (1,533) | - | - | - | 1,634 |
| Acquisition of Metallica (Note 4 (a)(i)) | 87,447,821 | 605,139 | - | 7,294 | 46,674 | - | - | - | 659,107 |
| Acquisition of NGI (Note 4 (a)(ii)) | 37,005,717 | 289,538 | - | 8,241 | 57,415 | 21,604 | - | - | 376,798 |
| Expiry of warrants | - | - | - | 38,333 | (38,333) | - | - | - | - |
| Stock-based compensation | - | - | - | 7,039 | - | - | - | - | 7,039 |
| Other comprehensive income | - | - | - | - | - | - | 1,160 | - | 1,160 |
| Net loss | - | - | - | - | - | - | - | (102,679) | (102,679) |
| Balance, December 31, 2008 | 212,840,746 | 1,321,110 | - | 65,409 | 145,614 | 21,604 | (406) | (111,543) | 1,441,788 |

New Gold Inc.

Consolidated statements of cash flows

(Expressed in thousands of U.S. dollars)

| | Year ended December 31, 2008 | Thirteen months ended December 31, 2007 |
|--|------------------------------------|--|
| | \$ | \$ |
| Operating activities | | |
| Net (loss) earnings | (102,679) | 14,613 |
| Items not involving cash | | |
| Depreciation and depletion | 32,961 | 18,973 |
| Write-down of mining interests | 165,252 | - |
| Unrealized foreign exchange (gain) loss | (68,008) | 5,062 |
| Stock option expense | 7,039 | 6,156 |
| Future income and mining taxes | (13,496) | (6,537) |
| Other | 1,569 | 224 |
| Change in non-cash working capital (Note 12) | 2,047 | (11,871) |
| | 24,685 | 26,620 |
| Investing activities | | |
| Mining interests | (133,868) | (27,052) |
| Reclamation deposits | (1,225) | - |
| Cash acquired in business combination and asset acquisition (Note 4 (a)) | 137,718 | - |
| Acquisition, net of cash acquired (Note 4 (b)) | - | (190,552) |
| Purchase of short-term investments | - | (32,440) |
| Proceeds from short-term investments | 32,440 | - |
| | 35,065 | (250,044) |
| Financing activities | | |
| Common shares issued on exercise of warrants/ options | 2,991 | 1,492 |
| Proceeds from short-term borrowing | 8,500 | - |
| Repayment of short-term borrowing | (11,500) | - |
| Common shares issued in private placement, net | - | 267,362 |
| Special warrants issued in private placement, net | - | 104,166 |
| | (9) | 373,020 |
| Effect of exchange rate changes on cash and cash equivalents | (23,997) | - |
| Increase in cash and cash equivalents | 35,744 | 149,596 |
| Cash and cash equivalents, beginning of period | 149,924 | 328 |
| Cash and cash equivalents, end of period | 185,668 | 149,924 |
| Cash and cash equivalents are comprised of | | |
| Cash | 21,398 | 10,312 |
| Short-term money market instruments | 164,270 | 139,612 |
| | 185,668 | 149,924 |

Supplemental cash flow information (Note 12)

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

1. Description of business and nature of operations

On June 30, 2008 New Gold Inc. ("NGI"), Metallica Resources Inc. ("Metallica") and Peak Gold Ltd. ("Peak Gold" or the "Company") completed a business combination and the acquisition of assets (the "Transaction" see Note 4). In accordance with the provisions of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1581, *Business Combinations*, Peak Gold has been identified as the acquirer for accounting purposes. As such, these consolidated financial statements are a continuation of the consolidated financial statements of Peak Gold, with the comparative information being that of Peak Gold. Following completion of the Transaction, Peak Gold is now known as New Gold Inc. ("New Gold"). References to NGI in these consolidated financial statements refer to transactions involving the pre-transaction public company New Gold Inc.

In connection with the Transaction shareholders of Peak Gold exchanged one common share of Peak Gold for 0.1 of a New Gold common share and nominal cash consideration. All information related to common shares for the current and prior period has been restated to give effect to this share exchange.

The Company is a gold producer engaged in gold mining and related activities including acquisition, exploration, extraction, processing and reclamation. The Company's assets are comprised of the Amapari mine in Brazil, the Cerro San Pedro mine in Mexico, and the Peak mine in Australia. Significant development projects include the New Afton copper-gold project in Canada and a 30% interest in an advanced stage copper-gold project in Chile.

2. Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") using the following significant accounting policies:

(a) *Basis of presentation and principles of consolidation*

These consolidated financial statements include the accounts of the Company and all of its subsidiaries.

The principal subsidiaries of the Company as of December 31, 2008 are as follows:

| <u>Subsidiary</u> | <u>Interest</u> |
|--|-----------------|
| Metallica Resources Inc. ⁽¹⁾ | 100% |
| Metallica Resources Alaska Inc. ⁽¹⁾ | 100% |
| Minera Metallica Resources Chile Limitada ⁽¹⁾ | 100% |
| Minera San Xavier, S.A. de C.V. ⁽¹⁾ | 100% |
| Mineração Pedra Branca do Amapari Ltda ("Amapari") | 100% |
| Peak Gold Mines Pty | 100% |
| Sociedad Contractual Minera El Morro ⁽¹⁾ | 100% |

⁽¹⁾ These subsidiaries are included in the Company's results from June 30, 2008, the date of acquisition, onward (Note 4 (a)).

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

2. Summary of significant accounting policies (continued)

(a) *Basis of presentation and principles of consolidation (continued)*

Variable interest entities ("VIE's") as defined by the Accounting Standards Board in Accounting Guideline ("AcG") 15, *Consolidation of Variable Interest Entities*, are entities in which equity investors do not have the characteristics of a "controlling financial interest" or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIE's are subject to consolidation by the primary beneficiary who will absorb the majority of the entities' expected losses and/or expected residual returns. The Company has determined that it does not have any investments that qualify as VIE's.

All intercompany transactions and balances are eliminated.

(b) *Use of estimates*

The preparation of consolidated financial statements in conformity with Canadian GAAP requires the Company's management to make estimates and assumptions about future events that affect the amounts reported in the consolidated financial statements and related notes to the financial statements. Actual results may differ from those estimates.

Significant estimates used in the preparation of these consolidated financial statements include, but are not limited to, the recoverability of accounts receivable and investments, measurement of revenue and accounts receivable, the quantities of material on leach pads and in circuit and the recoverable gold in this material used in determining the estimated net realizable value of inventories, the proven and probable ore reserves and resources and the related depletion and amortization, the estimated tonnes of waste material to be mined and the estimated recoverable tonnes of ore from each mine area, the assumptions used in the accounting for stock-based compensation, valuation of warrants, valuation of embedded derivatives, the provision for income and mining taxes and composition of future income and mining tax assets and liabilities, the expected economic lives of and the estimated future operating results and net cash flows from mining interests, the anticipated costs of reclamation and closure cost obligations, and the fair value of assets and liabilities acquired in business combinations.

(c) *Cash and cash equivalents*

Cash and cash equivalents include cash, and those short-term money market instruments that are readily convertible to cash with an original term of less than three months.

(d) *Inventories and stockpiled ore*

Finished goods, work-in-process, heap leach ore and stockpiled ore are valued at the lower of average production cost or net realizable value. Production costs include the cost of raw materials, direct labor, mine-site overhead expenses and depreciation and depletion of mining interests. Net realizable value is calculated as the estimated price at the time of sale based on prevailing and long-term metal prices less estimated future production costs to convert the inventories into saleable form.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

2. Summary of significant accounting policies (continued)

(d) *Inventories and stockpiled ore (continued)*

The recovery of gold and silver from certain oxide ores is achieved through the heap leaching process. Under this method, ore is placed on leach pads where it is treated with a chemical solution which dissolves the gold contained ore. The resulting "pregnant" solution is further processed in a plant where the gold is recovered. For accounting purposes, costs are added to ore on leach pads on current mining and leaching costs, including applicable depreciation, depletion and amortization relating to mining interests. Costs are removed from ore on leach pads as ounces of gold and silver are recovered based on the average cost per recoverable ounce on the leach pad.

Estimates of recoverable gold on the leach pads are calculated from the quantities of ore placed on the leach pads (measured tonnes added to the leach pads), the grade of ore placed on the leach pads (based on assay data), and a recovery percentage (based on ore type). Although the quantities of recoverable gold and silver placed on each leach pad are reconciled by comparing the grades of ore placed on the leach pad to the quantities actually recovered, the nature of the leaching process inherently limits the ability to precisely monitor inventory levels. The recovery of gold and silver from the leach pad is not known until the leaching process has concluded.

In-process inventory represents materials that are currently in the process of being converted into finished goods. The average production cost of finished goods represents the average cost of in-process inventories incurred prior to the refining process, plus applicable refining costs and associated royalties.

Supplies are valued at the lower of average cost and net realizable value.

(e) *Mining interests*

Mining interests represent capitalized expenditures related to the development of mining properties, related plant and equipment and expenditures related to exploration arising from property acquisitions. Capitalized costs are depreciated and depleted using either a unit-of-production method over the estimated economic life of the mine to which they relate, or for plant and equipment, using the straight-line method over their estimated useful lives, if shorter than the mine life.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

2. Summary of significant accounting policies (continued)

(e) Mining interests (continued)

The costs associated with mining properties are separately allocated to reserves, resources and exploration potential, and include acquired interests in production, development and exploration stage properties representing the fair value at the time they were acquired. The value associated with resources and exploration potential is the value beyond proven and probable reserves assigned through acquisition. The value allocated to reserves is depreciated on a unit-of-production method over the estimated recoverable proven and probable reserves at the mine. The resource value represents the property interests that are believed to potentially contain economic mineralized material such as inferred material within pits; measured, indicated, and inferred resources with insufficient drill spacing to qualify as proven and probable reserves; and inferred resources in close proximity to proven and probable reserves. Exploration potential represents the estimated mineralized material contained within (i) areas adjacent to existing reserves and mineralization located within the immediate mine area; (ii) areas outside of immediate mine areas that are not part of measured, indicated, or inferred resources; and (iii) greenfields exploration potential that is not associated with any other production, development, or exploration stage property, as described above. At least annually or when otherwise appropriate, and subsequent to its review and evaluation for impairment, value from the non-depletable category is transferred to the depletable category as a result of an analysis of the conversion of resources or exploration potential into reserves.

Costs related to property acquisitions are capitalized until the viability of the mineral property is determined. When it is determined that a property is not economically recoverable the capitalized costs are written off.

Exploration costs incurred to the date of establishing that a property is economically recoverable are included in operations. Further development expenditures are capitalized to the property.

Drilling and related costs incurred on sites without an existing mine and on areas outside the boundary of a known mineral deposit which contains proven and probable reserves are exploration expenditures and are expensed as incurred to the date of establishing that property costs are economically recoverable. Further development expenditures, subsequent to the establishment of economic recoverability, are capitalized to the property.

Upon sale or abandonment the cost of the property and equipment, and related accumulated depreciation or depletion, are removed from the accounts and any gains or losses thereon are included in operations.

The Company reviews and evaluates its mining properties for impairment annually or when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Impairment is considered to exist if the total estimated future undiscounted cash flows are less than the carrying amount of the assets. An impairment loss is measured and recorded based on discounted estimated future cash flows. Future cash flows are estimated based on expected future production, commodity prices, operating costs and capital costs.

Interest expense allocable to the costs of developing mining properties and constructing new facilities are capitalized and included in the carrying amounts of related assets until mining properties reach commercial production and facilities are ready for their intended use.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

2. Summary of significant accounting policies (continued)

(f) *Reclamation and closure cost obligations*

The Company's mining and exploration activities are subject to various governmental laws and regulations relating to the protection of the environment. These environmental regulations are continually changing and are generally becoming more restrictive. The Company has made, and intends to make in the future, expenditures to comply with such laws and regulations. The Company has recorded a liability and corresponding asset for the estimated future cost of reclamation and closure, including site rehabilitation and long-term treatment and monitoring costs, discounted to net present value. Such estimates are, however, subject to change based on negotiations with regulatory authorities, or changes in laws and regulations.

(g) *Intangible royalty asset*

Intangible assets consist of a royalty agreement between Amapari and a third party, valued upon acquisition (Note 4 (b)). The agreement arose from the initial purchase of the Amapari mine leases. Under the agreement, the Company receives 1% of gross revenues from iron ore mined by the third party on adjacent properties. The asset is amortized on a units-of-production basis which is measured by a portion of the third party mine's economically recoverable and proven ore reserves recovered during the period. The carrying value of the intangible royalty asset was \$14.1 million.

The Company reviews and evaluates the intangible annually or when events or changes in circumstances indicate the carrying amount may not be recoverable.

(h) *Income and mining taxes*

The Company uses the liability method of accounting for income and mining taxes. Under the 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 and for tax losses and other deductions carried forward. Upon business acquisitions, the liability method results in a gross-up of mining interests to reflect the recognition of the future tax liabilities for the tax effect of such differences.

Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply when the asset is realized or the liability settled. A reduction in respect of the benefit of a future tax asset (a valuation allowance) is recorded against any future tax asset if it is not more likely than not to be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted.

(i) *Employee benefits*

A liability is recognized for benefits accruing to employees in respect of wages and salaries, annual leave and long service leave when it is probable that settlement will be required and they are capable of being measured reliably. Liabilities recognized in respect of employee benefits expected to be settled within 12 months are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Liabilities recognized in respect of employee benefits which are not expected to be settled within one year are measured at the present value of the estimated future cash outflows to be made by the Company in respect of services provided by employees up to reporting date.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

2. Summary of significant accounting policies (continued)

(j) *Foreign currency translation*

The Company's functional currency and that of its subsidiaries is the U.S. dollar. Transaction amounts denominated in foreign currencies (currencies other than U.S. dollars) are translated into U.S. dollars at exchange rates prevailing at the transaction dates. Carrying values of foreign currency monetary assets and liabilities are adjusted at each balance sheet date to reflect the U.S. exchange rate prevailing at that date. Gains and losses arising from translation of foreign currency monetary assets and liabilities at each period end are included in earnings. In addition, unrealized gains and losses due to movement in exchange rates on cash balances held in foreign currencies are shown separately on the consolidated statements of cash flows.

The accounts of subsidiaries, which are considered to be integrated operations, are translated into U.S. dollars using the temporal method. Under this method, monetary assets and liabilities of foreign subsidiaries are translated at exchange rates in effect at the end of each period and non-monetary assets and liabilities are translated using historical exchange rates. Revenues and expenses are translated at the average exchange rate for the period. Foreign currency transaction gains and losses are included in the determination of net income or loss.

(k) *Earnings (loss) per share*

Earnings (loss) per share calculations are based on the weighted average number of common shares and common shares equivalents issued and outstanding during the year. Diluted earnings per share are calculated using the treasury method and if converted method, as applicable, which requires the calculation of diluted earnings per share by assuming that outstanding stock options, warrants and convertible debentures with an average market price that exceeds the average exercise prices of the options and warrants for the period, are exercised and the assumed proceeds are used to repurchase shares of the Company at the average market price of the common share for the period.

(l) *Revenue recognition*

Revenue from the sale of metals is recognized in the accounts when persuasive evidence of an arrangement exists, title and risk passes to buyer, collection is reasonably assured and the price is reasonably determinable. Revenue from the sale of metals in concentrate may be subject to adjustment upon final settlement of estimated metal prices, weights and assays. Adjustments to revenue for metal prices are recorded monthly and other adjustments are recorded on final settlement. Refining and treatment charges are netted against revenue for sales of metal concentrate.

(m) *Stock-based compensation*

The Company applies the fair value method of accounting for all stock option awards. Under this method the Company recognizes a compensation expense for all stock options awarded to employees, based on the fair value of the options on the date of grant which is determined by using the Black-Scholes option pricing model. The fair value of the options is expensed over the vesting period of the options.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

2. Summary of significant accounting policies (continued)

(n) *Financial instruments - recognition and measurement*

The Company classifies all financial instruments as either held-to-maturity, available-for-sale, held for trading, loans and receivables, or other financial liabilities. 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 instruments 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.

The fair value of financial instruments traded in active markets (such as available-for-sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Company is the current bid price.

The carrying value less impairment provision, if necessary, of trade receivables and payables are assumed to approximate their fair values.

The Company has designated its cash and cash equivalents and short-term investments as held-for-trading. The Company has designated its asset backed commercial paper ("ABCP") as available-for-sale. Receivables are classified as loans and receivables. Accounts payable and accrued liabilities, short-term borrowings and long-term debt are classified as other financial liabilities.

Transaction costs related to financial instruments classified as held for trading are recognized immediately into income. For financial instruments classified as other than as held for trading, transaction costs are added to the financial instrument in accordance with the provision of CICA Handbook Section 3855.

Long-term debt are financial instruments which have been recorded at fair value at the date of acquisition and will be measured at amortized cost going forward.

(o) *Comprehensive income*

Comprehensive income is the change in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources. In accordance with this standard, the Company reports a statement of comprehensive income and a new category, accumulated other comprehensive income, in the shareholders' equity section of the consolidated balance sheet. The components of this new category may include unrealized gains and losses on financial assets classified as available-for-sale, exchange gains and losses arising from the translation of financial statements of a self-sustaining foreign operation and the effective portion of the changes in fair value of cash flow hedging instruments.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

3. Changes in accounting policies

(a) *Accounting policies implemented effective January 1, 2008*

(i) Capital disclosures and financial instruments - disclosures and presentation

The Company adopted three new presentation and disclosure standards that were issued by the CICA: Handbook Section 1535, *Capital Disclosures* ("Section 1535"), Handbook Section 3862, *Financial Instruments - Disclosures* ("Section 3862") and Handbook Section 3863, *Financial Instruments - Presentation* ("Section 3863").

Section 1535 requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital. Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, *Financial Instruments - Disclosure and Presentation*, revising and enhancing its disclosure requirements and carrying forward unchanged its presentation requirements for financial instruments. Sections 3862 and 3863 place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

(ii) Inventories

On January 1, 2008, the Company adopted Section 3031, *Inventories*, which replaces the existing Section 3030, and establishes standards for the measurement and disclosure of inventories. The new standard provides more extensive guidance on the determination of cost, including allocation of overhead, requires impairment testing and expands the disclosure requirements. The adoption of Section 3031 did not have a material impact on the Company's consolidated financial position and results of operations for the year ended December 31, 2008.

(b) *Accounting policies to be implemented effective January 1, 2009*

Effective January 1, 2009, the Company will adopt Section 3064, *Goodwill and Intangible Assets*, which replaces Section 3062, and establishes revised standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. Concurrent with the introduction of this standard, the CICA restricted the application of EIC 27, *Revenues and Expenditures in the Pre-operating Period* ("EIC 27"). The Company is evaluating the impact of the adoption of this new Section on its consolidated financial statements.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

3. Changes in accounting policies (continued)

(c) *Accounting policies to be implemented effective January 1, 2011*

In January 2009, the CICA issued Handbook Sections 1582, *Business Combinations*, ("Section 1582"), 1601, *Consolidated Financial Statements*, ("Section 1601") and 1602, *Non-controlling Interests*, ("Section 1602") which replaces CICA Handbook Sections 1581, *Business Combinations*, and 1600, *Consolidated Financial Statements*. Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under International Financial Reporting Standards ("IFRS"). Section 1582 is applicable for the Company's business combinations with acquisition dates on or after January 1, 2011. Early adoption of this Section is permitted. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company's interim and annual consolidated financial statements for its fiscal year beginning January 1, 2011. Early adoption of this Section is permitted. If the Company chooses to early adopt any one of these Sections, the other two sections must also be adopted at the same time. The Company is evaluating the impact of the adoption of these new Sections on its consolidated financial statements.

(d) *International Financial Reporting Standards*

In February 2008, the CICA announced that Canadian generally accepted accounting principles ("GAAP") for publicly accountable enterprises will be replaced by IFRS for fiscal years beginning on or after January 1, 2011. The conversion from Canadian GAAP to IFRS will be applicable to the Company's reporting for the first quarter of 2011 for which the current and comparative information will be prepared under IFRS. The Company expects the transition to IFRS to impact accounting policies, financial reporting, IT systems and processes as well as certain business activities. The Company is currently in the process of finalizing an IFRS changeover plan. This process involves assessing the impact of the transition to IFRS and planning to ensure that the appropriate resources are available for a timely conversion.

4. Business combination and asset acquisition

(a) *Acquisition of Metallica and NGI*

On May 9, 2008, the Company entered into an agreement to complete a business combination (the "Transaction") with Metallica and NGI.

(i) Metallica

The acquisition of Metallica has been accounted for as a purchase transaction. Shareholders of Metallica received 0.9 of a New Gold common share and nominal cash consideration for each one common share of Metallica.

87,447,821 common shares issued to Metallica shareholders were valued at \$6.92 per share. The value per share was determined with reference to the share price of New Gold common shares for the two days prior to, the day of, and the two days subsequent to the date of the announcement on March 31, 2008. Holders of options, warrants or other convertible instruments of Metallica ("Metallica equity instruments") exchanged such equity instrument for similar securities of New Gold at an exchange ratio of 0.9 and at a price equivalent to the original price divided by 0.9.

New Gold Inc.

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(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

4. Business combination and asset acquisition (continued)

(a) Acquisition of Metallica and NGI (continued)

(i) Metallica (continued)

The final allocation of the purchase price based on the consideration paid and Metallica's net assets acquired is as follows:

| | \$ |
|---|----------------|
| Issuance of New Gold shares (87,447,821 common shares) | 605,139 |
| Fair value of options issued | 7,294 |
| Fair value of warrants issued | 46,674 |
| Transaction costs | 3,651 |
| Purchase consideration | 662,758 |
| <hr/> | |
| Net assets acquired | |
| Net working capital acquired (including cash of \$34,154) | 35,340 |
| Mineral property, plant and equipment | 814,352 |
| Other long-term assets | 2,214 |
| Long-term liabilities | (3,684) |
| Future income tax liability | (185,464) |
| Net assets acquired | 662,758 |

(ii) NGI

This element of the Transaction has been accounted for as a purchase of assets and assumption of liabilities of NGI by Peak Gold.

In accordance with the determination that Peak Gold is the accounting acquirer in this Transaction, the deemed consideration is the market value of the 37,005,717 NGI common shares and the fair value of options, warrants and convertible or exchangeable securities of NGI currently outstanding. As at June 30, 2008, there were options, warrants, convertible or exchangeable securities and other rights to acquire an aggregate of 30,678,500 common shares of NGI. The common shares of NGI have been valued at \$7.82 per share, the share price of NGI as of June 30, 2008, the closing date of the Transaction.

New Gold Inc.

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December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

4. Business combination and asset acquisition (continued)

(a) *Acquisition of Metallica and NGI (continued)*

(ii) NGI (continued)

The final allocation of the purchase price based on the consideration paid and NGI's net assets acquired is as follows:

| | \$ |
|--|----------------|
| Issuance of New Gold shares (37,005,717 common shares) | 289,538 |
| Fair value of options issued | 8,241 |
| Fair value of warrants issued | 57,415 |
| Transaction costs | 4,011 |
| Purchase consideration | 359,205 |
| | |
| Net working capital (including cash of \$103,564) | 85,687 |
| Mineral property, plant and equipment | 537,720 |
| Other assets | 94,631 |
| Long-term liabilities | (252,892) |
| Future income tax liability | (84,337) |
| Convertible debentures | (21,604) |
| | 359,205 |

For the purposes of these consolidated financial statements, the purchase consideration has been allocated to the fair value of assets acquired and liabilities assumed, including allocation of mining interests to depletable and non-depletable properties, based on management's best estimates and all available information at the time of the Transaction.

(b) *Acquisition of Amapari and Peak Mines*

On February 15, 2007, the Company entered into an agreement with Goldcorp Inc. ("Goldcorp"), a company related by a director in common, to acquire Goldcorp's Amapari mine in Brazil and Peak mine in Australia (the "Acquisition"). The Company completed the acquisition of the Amapari mine and the Peak mine on April 3, 2007 and April 27, 2007, respectively. In consideration for the acquisition of the Amapari and Peak Mines, the Company issued to Goldcorp 155 million common shares with a value of \$100 million and paid \$200 million in cash, respectively.

Upon completion of the Acquisition, Goldcorp held approximately 22% ownership in Peak Gold and a position on the Board of Directors of the Company.

The business combination has been accounted for as a purchase transaction, with the Company as the acquirer and the Amapari and Peak Mines as the acquiree. The results of the operations of the acquired assets are included in the consolidated financial statements of the Company from the dates of the Acquisition.

New Gold Inc.

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December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

4. Business combination and asset acquisition (continued)

(b) Acquisition of Amapari and Peak Mines (continued)

The final allocation of the assets and liabilities acquired is as follows:

| | \$ |
|--|----------------|
| Purchase price | |
| Cash | 200,000 |
| Common shares | 100,000 |
| Acquisition costs | 5,032 |
| | <u>305,032</u> |
| Net assets acquired | |
| Cash and cash equivalents | 11,212 |
| Accounts receivable | 4,391 |
| Inventories and stockpiled ore | 40,286 |
| Mining interests | 299,535 |
| Intangible asset | 14,664 |
| Other | 5,091 |
| Current liabilities | (23,618) |
| Reclamation and closure cost obligations | (16,662) |
| Future income tax liabilities, net | (29,867) |
| | <u>305,032</u> |

5. Inventories and stockpiled ore

| | 2008 | 2007 |
|---------------------|---------------|---------------|
| | \$ | \$ |
| Supplies | 12,179 | 15,092 |
| Work-in-process (a) | 5,008 | 7,505 |
| Heap leach ore (b) | 19,141 | 12,254 |
| Stockpiled ore (c) | 112 | 1,106 |
| Finished goods | 2,962 | 3,835 |
| | <u>39,402</u> | <u>39,792</u> |

(a) Work-in-process

Work-in-process is the stage between the product (gold, silver and copper) as it sits as a raw material (mined or stockpiled) and when it has been converted into the finished product (doré or concentrate).

(b) Heap leach ore

The recovery of gold from certain oxide ores is achieved through the heap leaching process used at the Amapari and Cerro San Pedro mines. Under this method, ore is placed on leach pads where it is treated with a chemical solution which dissolves the gold contained in the ore.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

5. Inventories and stockpiled ore (continued)

(c) Stockpiled ore

The low-grade stockpiled ore is located at Amapari and Peak Mines and is forecasted to be drawn down throughout the remainder of the life of the mines.

The amount of inventories recognized in operating expenses for the year is \$116 million, which includes a \$1.3 million write-down related to inventories at Amapari. There were no reversals of write-downs during the year.

6. Investments

As at December 31, 2008, the Company had \$139 million (Cdn\$169 million) invested in ABCP which was rated R1-high by Dominion Bond Rating Service when it was initially acquired by NGI. In mid-August 2007, a number of non-bank sponsors of ABCP, including those with which NGI had invested, announced that they could not place ABCP due to unfavourable conditions in the Canadian capital markets. As a result, there is presently no active market for the ABCP held by the Company.

As at December 31, 2008, the non-bank ABCP market remained the subject of a restructuring process with the expressed intention of replacing the ABCP with a number of long-term floating rate notes ("New Notes"). The restructuring plan, which was completed on January 21, 2009, pooled all of the underlying assets from all the ABCP trusts with the exception of those assets designated as ineligible for pooling ("Ineligible Assets") and those series of assets backed exclusively by traditional financial assets ("Traditional Series"). Upon completion of the restructuring, income which had been accumulating from the underlying assets was distributed to investors.

ABCP relating to the pooled assets was replaced with four classes of asset backed notes named A1, A2, B and C in declining order of seniority. ABCP relating to Ineligible Assets and Traditional Series was replaced with new tracking notes whose characteristics are designed to track the performance of the particular assets of the series to which they correspond.

The Company has designated these new notes as held-for-trading.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

6. Investments (continued)

- (a) The Company has estimated the fair value of ABCP at December 31, 2008 using the methodology and assumptions outlined below. The fair value estimate of the New Notes to be received under the restructuring has been calculated based on information provided by the Pan Canadian Investor Committee as well as Ernst & Young, the Monitor of the restructuring. The table below summarizes the Company's valuation.

| Restructuring categories | Face value | Base case fair value estimate* | Expected maturity date |
|----------------------------------|--------------|--------------------------------|--|
| | millions \$ | millions \$ | |
| MAV 2 notes | | | |
| A1 (rated A) | 81.2 | 46.6 | December 31, 2016 |
| A2 (rated A) | 27.9 | 14.9 | December 31, 2016 |
| B | 5.0 | 0.9 | December 31, 2016 |
| C | 3.5 | 0.3 | December 31, 2016 |
| Traditional asset tracking notes | | | |
| MAV3 - Class 9 | 7.8 | 7.6 | September 12, 2015 |
| Ineligible asset tracking notes | | | |
| MAV2 - Class 3/13/15 | 13.0 | 2.0 | December 20, 2012 to October 24, 2016 |
| Accrued interest income | - | 4.7 | January 2, 2009 |
| Total original investment | 138.4 | 77.0 | |

* the range of fair values estimated by the Company varied between \$76 million and \$99 million

- (b) The A1, A2 and traditional asset tracking notes comprise the major categories of the notes contemplated to be received totalling 79% of the face value of the original investments made and 85% of the fair value estimate of the Company's holdings excluding accrued income. In the case of the A1 and A2 notes, it is estimated that they will pay interest at a rate 0.5% less than the bankers' acceptance ("BA") rate and it is estimated that prospective buyers of these notes will require premium yields between 7% and 8% over the BA rate.
- (c) The traditional asset notes are estimated to generate interest income of 0.5% above the BA rate and a prospective buyer of those notes is estimated to require a premium of 5% over the BA rate.

The Company has applied its best estimate of prospective buyers' required yield and calculated the present value of the New Notes using required yield as the discount factor. Using a range of potential discount factors allows the Company to estimate a range of recoverable values.

The Class B notes are not expected to pay any current interest until the Class A1 and A2 notes are paid in full, which is not anticipated until December 31, 2016. These notes, which will be subordinate to the Class A1 and A2 notes, will not receive a credit rating.

The Class C notes also will not pay any current interest and are subordinate to the Class B notes. In light of this subordination, the Class C notes are viewed as highly speculative with regard to ultimate payment of principal at maturity in 2016.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

6. Investments (continued)

The Company will also receive three classes of ineligible tracking notes, two of which have direct exposure to the U.S. sub-prime mortgage market and one of which is backed by a leveraged super senior ("LSS") credit default swap. The fair value of the sub-prime backed notes is less than 10% of par value while the LSS backed note has a fair value of less than 20% of par value.

Restructuring costs are excluded from this valuation as it has been stated that the costs will be deducted from the accrued interest that the Company will receive shortly after the completion of the restructuring.

Based upon a sensitivity analysis of the assumptions used, the expected yield required by a potential investor remains the most significant assumption included in the fair value estimate. There can be no assurance that this estimate will be realized. Subsequent adjustments, which could be material, may be required in future reporting periods.

7. Mining interests

| | 2008 | | |
|---------------------|------------------|--|-------------------|
| | Cost | Accumulated depreciation, depletion and write-downs | Net book value |
| | \$ | \$ | \$ |
| Mining properties | 1,540,195 | 98,518 | 1,441,677 |
| Plant and equipment | 280,720 | 103,636 | 177,084 |
| | 1,820,915 | 202,154 | 1,618,761 |

The Company capitalized \$10.6 million of interest in 2008 (2007 -\$Nil) related to the New Afton Project.

| | 2007 | | |
|---------------------|----------------|--|-------------------|
| | Cost | Accumulated depreciation and depletion | Net book value |
| | \$ | \$ | \$ |
| Mining properties | 190,163 | 2,687 | 187,476 |
| Plant and equipment | 144,641 | 16,286 | 128,355 |
| | 334,804 | 18,973 | 315,831 |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

7. Mining interests (continued)

A summary of net book value by property is as follows:

| | Mining properties | | | Plant and equipment | Total 2008 | Total 2007 |
|--------------------|-------------------|--------------------|------------------|------------------------|------------------|----------------|
| | Depletable | Non- depletable | Total | | | |
| | \$ | \$ | \$ | \$ | \$ | \$ |
| Amapari (b) | - | 5,000 | 5,000 | 4,537 | 9,537 | 174,744 |
| Cerro San Pedro | 260,305 | 84,822 | 345,127 | 54,503 | 399,630 | - |
| El Morro project | - | 377,430 | 377,430 | - | 377,430 | - |
| New Afton project | - | 567,358 | 567,358 | 64,727 | 632,085 | - |
| Peak Mines | 3,036 | 116,980 | 120,016 | 52,694 | 172,710 | 140,497 |
| Other projects (a) | - | 26,746 | 26,746 | - | 26,746 | - |
| Corporate | - | - | - | 623 | 623 | 590 |
| | 263,341 | 1,178,336 | 1,441,677 | 177,084 | 1,618,761 | 315,831 |

(a) (i) Chile - El Morro Project

The El Morro copper-gold project consists of the La Fortuna and El Morro areas. Xstrata has a 70% interest in the El Morro project.

The Company has other projects in Chile that consist of copper-gold exploration concessions that are contiguous to the El Morro project.

(ii) Other projects include

(1) Chile - Rio Figueroa Project

The Company has an option agreement with Sociedad Contractual Minera Los Potrillos ("Potrillos") to acquire a 100% interest in a copper-gold exploration project referred to as the Rio Figueroa project.

(2) USA - Liberty Bell

The Company entered into an exploration agreement with the right to acquire the Liberty Bell gold project in central Alaska.

(3) Canada - Ajax

The Company owns a 100% interest in the Ajax-Python Claim Group.

- (b) During the third quarter of 2008, the Company recorded an impairment charge of \$165.3 million before tax recoveries of \$8.4 million on its investment in the Amapari Mine. On January 2, 2009, the Company placed the mine on temporary care and maintenance. Mining at Amapari has been suspended and leaching of stacked material is expected to continue until it is no longer economical to do so. The Company is currently preparing a preliminary economic assessment to exploit the underlying sulphide resource with a conventional crush/grind/carbon in leaching mill. Commitments related to placing Amapari Mine on temporary care and maintenance total approximately \$2.2 million.

New Gold Inc.

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8. Long-term debt

Long-term debt consists of the following:

| | \$ |
|---|----------------------|
| Senior secured notes (a) | 182,553 |
| Embedded early redemption feature at fair value (b) | - |
| Subordinated convertible debentures (c) | 29,834 |
| | <hr/> <u>212,387</u> |

(a) *Senior secured notes*

The face value of the Notes at December 31, 2008 was Cdn\$237 million.

The Notes, originally issued by NGI pursuant to a note indenture dated June 28, 2007, mature and become due and payable on June 28, 2017 and bear interest at the rate of 10% per annum. Under the terms of the Notes, the Company has agreed to certain additional restrictions on its business as it relates to the New Afton assets. In particular, the Company has agreed:

- to grant to the Trustee under the note indenture, for the benefit of the noteholders, a first-ranking security interest on the New Afton project assets;
- that it will not sell or otherwise transfer any of the New Afton project assets except for transfers made in the ordinary course of business for fair market value or transfers of production from the New Afton project pursuant to any risk management or offtake agreement;
- that it will not incur additional indebtedness except for certain permitted indebtedness and it will not create any security interest of any kind securing indebtedness on any New Afton project assets except for certain permitted encumbrances; and
- to certain limitations on its ability to make advances to its subsidiary companies for cash flow produced from the New Afton project assets.

Interest is payable in arrears in equal semi-annual instalments on January 1 and July 1 in each year.

Subsequent to year end, the Company acquired Cdn\$50 million face value of its senior secured notes for consideration of Cdn\$30 million from the noteholders. This results in a reduction of approximately \$5 million per year in interest payments.

(b) *Embedded early redemption feature at fair value*

The Company has the right to redeem the Notes in whole or in part at any time and from time to time prior to June 27, 2017 at a price ranging from 120% to 100% (decreasing based on the length of time the Notes are outstanding) of the principal amount of the Notes to be redeemed.

The early redemption feature in the Notes qualifies as an embedded derivative that must be bifurcated for reporting purposes. As of December 31, 2008, the fair value of the derivative asset is determined to be \$Nil.

New Gold Inc.

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(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

8. Long-term debt (continued)

(c) *Subordinated convertible debentures*

In 2007, NGI issued 55,000 convertible subordinated debentures ("Debentures") for an aggregate principal amount of Cdn\$55 million. The Debentures, which were issued pursuant to a Debenture Indenture dated June 28, 2007 (the "Debenture Indenture"), each have a principal amount of \$1,000, bear interest at a rate of 5% per annum and are convertible by the holders into common shares of the Company at any time up to June 28, 2014 at a conversion price of Cdn\$9.35 per share. The Debentures do not allow forced conversion by the Company prior to January 1, 2012 but after that date the Company may redeem the Debentures if the market price of the Company's shares is at least 125% of the conversion price. The Debentures are classified as compound financial instruments for accounting purposes because of the holder conversion option.

Interest is payable in arrears in equal semi-annual instalments on January 1 and July 1 in each year.

The Debenture Indenture provides that in the event of a change of control of the Company, as defined therein, where 10% or more of the aggregate purchase consideration is cash, the Company must offer to either (i) redeem the outstanding Debentures at a redemption price equal to 100% of the principal amount, plus accrued and unpaid interest up to but excluding the date of redemption, or (ii) convert the outstanding Debentures into common shares at conversion prices ranging from Cdn\$7.48 at inception to Cdn\$9.35, based on a time formula specified in the Debenture Indenture.

The Debentures are subordinate to the Notes and any secured indebtedness incurred subsequent to the issue of the Debentures.

At the time of acquisition by the Company, the Company allocated \$34.5 million of the \$56.2 million fair value as a liability based on the fair value of a similar debt instrument without an associated conversion option. The similar debt instrument was assumed to have an interest at 8% at the time of acquisition. The equity component was valued using the Black-Scholes model with the following assumptions: no dividends paid, volatility of 60%, risk free interest rate of 3.45% and expected life of six years. The debt component of the Debentures will be accreted over the expected term to maturity using the effective interest method.

The Debenture Indenture requires the Company to comply with certain reporting and other covenants.

New Gold Inc.

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(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

9. Share capital

(a) *Authorized*

Unlimited number of voting common shares without par value

(b) *Special warrants*

On November 28, 2007, the Company completed a private placement financing of 14,772,333 Special Warrants at a price of Cdn\$7.50 per Special Warrant for total gross proceeds of Cdn\$110.8 million (US\$111.8 million) and net proceeds after issue costs of Cdn\$103.2 million (US\$104.2 million). Each Special Warrant entitled the holder thereof to receive one unit of the Company, at no additional cost. Each unit comprised one common share of the Company and one-half of one common share purchase warrant. Each whole common share purchase warrant entitled the holder to acquire one additional common share, at a price of Cdn\$9.00 until November 28, 2012.

On February 28, 2008, the 14,772,333 Special Warrants outstanding at December 31, 2007 were converted into 14,772,333 common shares of the Company and 7,386,168 common share purchase warrants. The warrants were valued at \$23.7 million using the Black-Scholes pricing model and that amount is included in share purchase warrants. A fair value of approximately \$3.20 for each warrant was calculated using the following assumptions: no dividends are paid, volatility of 60%, risk free interest rate of 3.4%, and expected life of five years. Every 10 warrants are exercisable into 1 New Gold common share.

(c) *Stock options*

The Company has established a "rolling" stock option plan (the "Plan") in compliance with the TSX Exchange's policy for granting stock options. Under the Plan, the maximum number of shares reserved for issuance may not exceed 10% of the total number of issued and outstanding common shares. The exercise price of each option shall not be less than the market price of the Company's stock at the date of grant. Options generally vest over three years, and have a maximum term of seven years from date of grant.

| | Number of options | Weighted average exercise price Cdn\$ |
|---|----------------------|---|
| Balance, November 30, 2006 | 160,000 | 1.00 |
| Exercised | (129,000) | 1.00 |
| Cancelled | (40,900) | 9.30 |
| Granted | 2,159,500 | 9.30 |
| Balance, December 31, 2007 | 2,149,600 | 9.10 |
| Granted | 3,084,700 | 6.92 |
| Options assumed on acquisition of Metallica | 1,930,095 | 4.07 |
| Options assumed on acquisition of NGI | 2,828,500 | 7.03 |
| Exercised | (424,090) | 3.39 |
| Forfeited | (578,917) | 8.44 |
| Balance, December 31, 2008 | 8,989,888 | 6.94 |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

9. Share capital (continued)

(c) Stock options (continued)

The following table summarizes information about the stock options outstanding at December 31, 2008:

| Options outstanding | | | Options exercisable | |
|-------------------------------------|---------------------------------|---|-------------------------------|---------------------------------|
| Number of stock options outstanding | Weighted average exercise price | Weighted average remaining contractual life | Number of options exercisable | Weighted average exercise price |
| | Cdn\$ | | | Cdn\$ |
| 75,000 | 1.29 | 6.9 years | - | 1.29 |
| 184,500 | 1.70 | 0.9 years | 184,500 | 1.70 |
| 103,500 | 2.74 | 0.8 years | 103,500 | 2.74 |
| 520,187 | 3.44 | 1.3 years | 520,187 | 3.44 |
| 600,000 | 4.60 | 0.8 years | 600,000 | 4.60 |
| 1,167,768 | 5.52 | 3.3 years | 901,102 | 5.55 |
| 1,849,400 | 6.42 | 3.2 years | 1,062,467 | 6.55 |
| 2,262,700 | 7.66 | 4.1 years | 839,233 | 7.37 |
| 1,749,333 | 9.29 | 3.2 years | 633,111 | 9.27 |
| 477,500 | 11.00 | 1.3 years | 477,500 | 11.00 |
| 8,989,888 | 6.94 | 3.0 years | 5,321,600 | 6.47 |

On February 17, 2009, the Company granted 2,306,000 stock options to employees. These options have an exercise price of Cdn\$2.71. The options vest over a three year period and have a contractual life of seven years from date of grant.

(d) Stock-based compensation

For the year ended December 31, 2008, the Company recorded \$7.0 million as stock-based compensation expense (2007 - \$6.2 million). The Company recorded this amount in contributed surplus. The value was determined using the Black-Scholes pricing model. A weighted average grant-date fair value of Cdn\$7.38 (2007 - \$0.37) was calculated using the following assumptions: no dividends are to be paid, volatility of 50% (2007 - 60%), risk free interest rate of 3.35% (2007 - 4.00%), and expected life of 4.62 years (2007 - 3.50 years).

New Gold Inc.

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(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

9. Share capital (continued)

(e) Share purchase warrants

A summary of the changes in share purchase warrants is presented below:

| | Number of warrants | Weighted average exercise price Cdn\$ |
|---|-----------------------|---|
| Balance, November 30, 2006 | 1,495,000 | 1.00 |
| Exercised | (1,495,000) | 1.00 |
| Issued | 21,750,000 | 15.00 |
| Balance, December 31, 2007 | 21,750,000 | 15.00 |
| Issued | 7,386,167 | 9.00 |
| Metallica share purchase warrants exercisable into New Gold shares | 17,196,115 | 3.93 |
| NGI share purchase warrants | 27,825,352 | 15.00 |
| Expired | (14,046,115) | 3.44 |
| Balance, December 31, 2008 | 60,111,519 | 13.80 |

The following table summarizes information about outstanding share purchase warrants at December 31, 2008:

| Number of warrants | Exercise prices Cdn\$ | Expiry date |
|-----------------------|-----------------------------|-------------------|
| 3,150,000 | 6.11 | December 20, 2009 |
| 21,750,000 | 15.00 | April 3, 2012 |
| 7,386,167 | 9.00 | November 28, 2012 |
| 4,150,000 | 15.00 | June 28, 2017 |
| 23,675,352 | 15.00 | June 28, 2017 |
| 60,111,519 | | |

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(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

9. Share capital (continued)

(f) *Diluted (loss) earnings per share*

The following table sets forth the computation of diluted earnings per share:

| | 2008 | 2007 |
|---|--------------------|----------|
| (Loss) earnings available to common shareholders | \$(102,679) | \$14,613 |
| <i>(in thousands)</i> | | |
| Basic weighted average number of shares outstanding | 148,126 | 53,428 |
| Effect of dilutive securities | | |
| Special warrants | - | 14,772 |
| Stock options | - | 26 |
| Diluted weighted average number of shares outstanding | 148,126 | 68,226 |
| (Loss) earnings per share | | |
| Basic | (0.69) | 0.27 |
| Diluted | (0.69) | 0.21 |

The following lists the equity securities excluded from the computation of diluted earnings per share because the exercise prices exceeded the average market value of the common shares of Cdn\$5.48 (2007 - Cdn\$0.63) for the year. The warrants related to Special Warrants (Note (9 b)) were issued subsequent to the year end.

| | 2008 | 2007 |
|-------------------------|---------------|--------|
| <i>(in thousands)</i> | | |
| Stock options | 7,271 | 2,119 |
| Share purchase warrants | 60,136 | 21,750 |
| Convertible debentures | 55,000 | - |

(g) *Share capital of NGI*

| | Number of shares | Amount Cdn\$ |
|------------------------------------|---------------------|-----------------|
| Balance, December 31, 2007 | 36,945,727 | 213,278 |
| Exercise of stock options | 56,000 | 469 |
| Tax effect for flow-through shares | - | (5,209) |
| Balance, June 30, 2008 | 37,001,727 | 208,538 |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

10. Income and mining taxes

| | 2008 | 2007 |
|---------------------------------------|-----------------|----------------|
| | \$ | \$ |
| Current income and mining tax expense | 6,473 | 6,824 |
| Future income and mining tax recovery | (13,496) | (6,537) |
| | (7,023) | 287 |

Income tax expense differs from the amount that would result from applying the Canadian federal and provincial income tax rates to earnings before taxes. These differences result from the following items:

| | 2008 | 2007 |
|---|------------------|----------------|
| | \$ | \$ |
| (Loss) earnings before income taxes | (109,702) | 14,900 |
| Canadian federal and provincial income tax rates | 31.00% | 34.12% |
| Income tax (recovery) expense based on above rates | (34,008) | 5,084 |
| Increase (decrease) due to | | |
| Non-taxable income | (27,786) | - |
| Non-deductible expenditures | 8,192 | 2,486 |
| Lower statutory tax rates on earnings of foreign subsidiaries | (992) | (1,183) |
| Adjustment of prior year provision to statutory tax returns | (872) | - |
| Benefit of losses not recognized in period | 4,589 | 2,137 |
| Change in valuation allowance and other | 43,854 | (8,237) |
| | (7,023) | 287 |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

10. Income and mining taxes (continued)

The components of future income taxes are as follows:

| | 2008 | 2007 |
|---|-----------|----------|
| | \$ | \$ |
| Future income and mining tax assets | | |
| Tax loss carryforwards | 18,904 | 11,308 |
| Deductible temporary differences and other | 43,840 | 13,601 |
| Deferred financing costs and other | 14,620 | - |
| Value of future income tax and mining assets | 77,364 | 24,909 |
| Valuation allowance | (49,381) | (8,399) |
| Future income and mining tax assets | 27,983 | 16,510 |
| Future income and mining tax liabilities | | |
| Accumulated cost base differences on assets | (249,361) | (42,453) |
| Future income and mining tax liabilities, net | (221,378) | (25,943) |
| Presented on the consolidated balance sheets as | | |
| Future income and mining tax assets | 2,690 | - |
| Future income and mining tax liabilities | (224,068) | (25,943) |
| Future income and mining tax liabilities, net | (221,378) | (25,943) |

Deductible temporary differences are comprised primarily of book to tax differences relating to the Company's reclamation liabilities. Taxable temporary differences are comprised primarily of book to tax differences relating to the value of the Company's mining interests acquired from corporate acquisitions.

Tax loss carryforwards

At December 31, 2008, the Company has:

- (i) Canadian income tax losses of approximately \$34,100,000 that expire from 2009 through 2028;
- (ii) U.S. loss carryforwards of approximately \$10,400,000 that expire from 2021 through 2028;
- (iii) Mexican loss carryforwards of approximately \$18,700,000 that expire from 2009 through 2017;
- (iv) Brazilian loss carryforwards of approximately \$9,730,000 that may be available for tax purposes. These losses carry forward indefinitely; and
- (v) Chilean loss carryforwards of approximately \$1,100,000 that may be available for tax purposes. These losses carry forward indefinitely.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

11. Reclamation and closure cost obligations

The Company's asset retirement obligations consist of reclamation and closure costs for Amapari Mine, Cerro San Pedro Mine, New Afton development project and Peak Mines. Significant reclamation and closure activities include land rehabilitation, demolition of buildings and mine facilities, ongoing care and maintenance and other costs.

The liability for reclamation and closure cost obligations at December 31, 2008 is \$22.0 (2007 - \$18.0 million). The undiscounted value of this liability is \$35.5 million (2007 - \$28.8 million). An inflation rate assumption ranging from 1.6% to 5.0% has been used. An accretion expense component of \$1.0 million (2007 - \$2.0 million) has been charged to operations in 2008 to reflect an increase in the carrying amount of the asset retirement obligation which has been determined using a discount rate ranging from 8.0% to 10.0%. Changes to the reclamation and closure cost balance during the year are as follows:

| | 2008 | 2007 |
|---|----------------|--------|
| | \$ | \$ |
| Reclamation and closure cost obligations, opening balance | 18,036 | - |
| Arising on acquisition of Amapari (Note 4) | - | 10,312 |
| Arising on acquisition of Peak Mines (Note 4) | - | 6,349 |
| Arising on acquisition of Metallica (Note 4) | 3,228 | - |
| Reclamation expenditures | (98) | - |
| Accretion expense, included in depreciation and depletion | 1,077 | 2,025 |
| Revisions in estimates and liabilities incurred | 3,400 | (650) |
| Foreign exchange | (3,694) | - |
| Reclamation and closure cost obligations, closing balance | 21,949 | 18,036 |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

12. Supplemental cash flow information

| | Year ended December 31, 2008 | Thirteen months ended December 31, 2007 |
|---|------------------------------------|--|
| | \$ | \$ |
| Change in non-cash working capital | | |
| Accounts receivable | 8,664 | (17,554) |
| Inventories and stockpiled ore | 24,684 | 2,279 |
| Accounts payable and accrued liabilities | (28,016) | 5,400 |
| Other | (3,285) | (1,996) |
| | 2,047 | (11,871) |
| Non-cash financing and investing activities | | |
| Shares/options/warrants issued on acquisition (Note 4 (a) and 4 (b)) | 894,677 | 103,253 |
| Operating activities included the following payments | | |
| Interest paid | 3,075 | - |
| Income taxes paid | 12,223 | 3,092 |

13. Segmented information

The Company manages its operations by geographical location. These reportable operating segments are summarized in the table below:

| | Year ended December 31, 2008 | | | | |
|-----------------------|------------------------------|----------------------------------|--|------------------|--|
| | Revenues | Depletion and depreciation | (Loss) earnings from operations | Total assets | Expenditures for mining interest |
| | \$ | \$ | \$ | \$ | \$ |
| Brazil | 75,052 | 14,408 | (177,053) | 44,857 | 7,077 |
| Chile ⁽²⁾ | - | - | - | 377,430 | - |
| Canada ⁽²⁾ | - | 9 | (4,901) | 640,133 | 87,466 |
| Mexico ⁽²⁾ | 47,285 | 8,788 | (12,549) | 444,555 | 9,812 |
| Australia | 95,798 | 9,665 | 28,595 | 198,477 | 29,389 |
| Other ⁽¹⁾ | - | 91 | (15,382) | 252,249 | 124 |
| | 218,135 | 32,961 | (181,290) | 1,957,701 | 133,868 |

⁽¹⁾ Other includes corporate balances and intercompany eliminations and exploration properties

⁽²⁾ Segments acquired on June 30, 2008 (Note 1)

New Gold Inc.

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December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

13. Segmented information (continued)

| Thirteen months ended December 31, 2007 | | | | | |
|--|----------------------------------|--|-----------------|--|---------------|
| Revenues | Depletion and depreciation | (Loss) earnings from operations | Total assets | Expenditures for mining interest | |
| \$ | \$ | \$ | \$ | \$ | \$ |
| Brazil | 48,369 | 9,129 | (321) | 215,971 | 6,108 |
| Australia | 82,715 | 9,805 | 25,786 | 184,056 | 20,315 |
| Other ⁽¹⁾ | - | 39 | (11,355) | 172,371 | 629 |
| | 131,084 | 18,973 | 14,110 | 572,398 | 27,052 |

⁽¹⁾ Other includes corporate balances and intercompany eliminations

The Company sells all of its concentrate production to one customer under an off-take contract. The loss of this customer or unexpected termination of the off-take contract could have a material adverse effect on the Company's results of operations, financial condition and cash flows. The Company is in the process of renegotiating the terms of the existing agreement for the period commencing January 1, 2009. The Company is currently evaluating its alternatives for a new contract which will commence when the existing contract terminates. The Company has not experienced any bad debts with this customer.

The Company is not economically dependent on a limited number of customers for the sale of its gold because gold can be sold through numerous commodity market traders worldwide.

The Company has four customers that account for 100% of the concentrate and doré sales revenue.

Metal sales

| Customer | Year ended December 31, 2008 | Thirteen months ended December 31, 2007 |
|-------------------------------|---|--|
| | \$ | \$ |
| 1 | 75,052 | 48,369 |
| 2 | 56,649 | 47,090 |
| 3 | 47,285 | - |
| 4 | 39,149 | 35,625 |
| Total | 218,135 | 131,084 |
| % of total metal sales | 100% | 100% |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

14. Financial instruments

The Company thoroughly examines the various financial instrument risks to which it is exposed and assesses the impact and likelihood of those risks. These risks may include credit risk, liquidity risk, market risk and other price risks. Where material, these risks are reviewed and monitored by the Board of Directors.

(a) *Capital risk management*

The Company manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance.

In the management of capital, the Company includes the components of shareholders' equity, short-term borrowings and long-term debt, as well as the cash and cash equivalents, short-term and long-term investments.

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. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets or sell its investments.

In order to facilitate the management of its capital requirements, the Company prepares annual budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

Prior to June 30, 2008, the Company's investment policy was to invest its cash in highly liquid, lower risk short-term interest-bearing investments with maturities of 120 days or less at the original date of acquisition, selected with regards to the expected timing of expenditures from continuing operations.

Upon completion of the Transaction, the Company adopted a new investment policy. Going forward, the Company must invest its funds in investments with a minimum credit rating at the time of purchase of R-1 (high) from the Dominion Bond Rating Service ("DBRS") or an equivalent rating from Standard & Poor, and Moody's. At all times, more than 50% of the aggregate amount of permitted investments must be invested in treasury bills, bonds, notes and other indebtedness of Canada or the Provinces of British Columbia, Alberta and Ontario. All investments must have a maximum term to maturity of six months and the average term will generally range from seven days to 90 days. Under the new policy, the Company is no longer permitted to invest in asset backed commercial paper ("ABCP") (Note 6) or auction rate securities ("ARS").

The Company has long-term note indentures (Note 8) that contain a general covenant that the Company shall work diligently toward obtaining and, once obtained, maintaining in good standing, all permits required for the operation of its properties.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

14. Financial instruments (continued)

(b) Credit risk

Credit risk is the risk of an unexpected loss if a party to its financial instrument fails to meet its contractual obligations.

The Company's financial assets are primarily composed of cash and cash equivalents, investments and accounts receivable. Credit risk is primarily associated with trade receivables and investments; however it also arises on cash and cash equivalents.

To mitigate exposure to credit risk, the Company has established policies to limit the concentration of credit risk, to ensure counterparties demonstrate minimum acceptable worthiness, and to ensure liquidity of available funds.

The Company closely monitors its financial assets and does not have any significant concentration of credit risk. The Company sells its gold exclusively to large international organizations with strong credit ratings. The Company's revenue is comprised of gold sales to four customers.

The historical level of customer defaults is minimal and, as a result, the credit risk associated with gold and copper concentrate trade receivables at December 31, 2008 is not considered to be high.

The Company's maximum exposure to credit risk at December 31, is as follows:

| | 2008 | 2007 |
|---------------------------|----------------|----------------|
| | \$ | \$ |
| Cash and cash equivalents | 185,668 | 149,924 |
| Short-term investments | - | 32,440 |
| Accounts receivable | 11,232 | 18,123 |
| | 196,900 | 200,487 |

The aging of accounts receivable at the reporting date was as follows:

| | 0-30 days | 31-60 days | 61-90 days | 91-120 days | Over 120 days | 2008 Total | 2007 Total |
|-----------------|--------------|---------------|---------------|----------------|------------------|---------------|---------------|
| | \$ | \$ | \$ | \$ | \$ | \$ | |
| Corporate | 305 | 42 | 50 | 25 | 391 | 813 | 723 |
| Amapari | - | - | - | - | - | - | - |
| Peak Mines | 3,440 | - | 2 | - | 13 | 3,455 | 17,400 |
| New Afton | 2,148 | - | - | - | - | 2,148 | - |
| Cerro San Pedro | 2,024 | 583 | 1,669 | 280 | 260 | 4,816 | - |
| | 7,917 | 625 | 1,721 | 305 | 664 | 11,232 | 18,123 |

A significant portion of the Company's cash and cash equivalents are held in large Canadian financial institutions. Short term investments (including those presented as part of cash and cash equivalents) are composed of financial instruments issued by Canadian banks and government with high investment-grade ratings.

The Company employs a restrictive investment policy as detailed in the capital risk management section (Note 14 (a)).

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

14. Financial instruments (continued)

(c) *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure and financial leverage as outlined in Note 14 (a).

The following are the contractual maturities of debt commitments. The amounts presented represent the future undiscounted principal and interest cash flows and therefore do not equate to the carrying amounts on the consolidated balance sheet.

| | Less than 1 year | 1-3 years | 4-5 years | After 5 years | 2008 Total | 2007 Total |
|---|---------------------|---------------|---------------|------------------|----------------|---------------|
| | \$ | \$ | \$ | \$ | \$ | |
| Accounts payable and accrued liabilities | 41,382 | - | - | - | 41,382 | 22,835 |
| Short-term borrowings | 7,193 | - | - | - | 7,193 | - |
| Long-term debt | - | - | - | 238,447 | 238,447 | - |
| Interest payable on long-term debt | 21,599 | 43,198 | 43,198 | 79,659 | 187,654 | - |
| | 70,174 | 43,198 | 43,198 | 318,106 | 474,676 | 22,835 |

In the opinion of management, the working capital of \$189 million at December 31, 2008, together with cash flows from operations, are sufficient to support the Company's normal operating requirements through its current reporting period. However, taking into consideration the Company's current cash position, volatile equity markets, global uncertainty in the capital markets and increasing cost pressures, the Company is continuing to review expenditures in order to ensure adequate liquidity and flexibility to support its growth strategy while maintaining production levels at its current operations.

The Company believes that external financing (which may include bank borrowings and future debt and equity offerings) will be required to complete its major development projects; however, these development projects are not likely to commence full construction until the second half of 2010 at the earliest. Continuing low copper prices may necessitate the deferral of capital expenditures which may impact production from mining operations. In addition, the Company may need external financing to repay its long-term debt in 2017.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

14. Financial instruments (continued)

(d) Currency risk

The Company operates in Australia, Brazil, Canada, Chile, Mexico and the United States. As a result, the Company has foreign currency exposure with respect to items denominated in foreign currencies. The three main types of foreign exchange risk of the Company can be categorized as follows:

(i) Transaction exposure

The Company's operations sell and incur costs in different currencies. This creates exposure at the operational level, which may affect the Company's profitability as exchange rates fluctuate. The Company has not hedged its exposure to currency fluctuations.

(ii) Translation exposure

The Company's functional and reporting currency is U.S. dollars. The Company's operations translate their operating results from its host currency to U.S. dollars. Therefore, exchange rate movements in the U.S. dollar, Brazilian real, Mexican peso, Australian dollar and Canadian dollar can have a significant impact on the Company's consolidated operating results. Some of the Company's earnings translation exposure is offset by interest on foreign currency denominated loans and debt.

A 10% strengthening (weakening) of the U.S. dollar against the following currencies would have decreased (increased) the Company's net loss from these financial instruments by the amounts shown below.

| | December 31, 2008 | December 31, 2007 |
|-------------------|------------------------------|----------------------|
| | \$ | \$ |
| Canadian dollar | 14,226 | 66 |
| Australian dollar | 1,673 | 2,736 |
| Mexican peso | 7,580 | - |
| Brazilian real | 2,929 | 1,877 |
| Chilean peso | 6,594 | - |
| | 33,002 | 4,679 |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

14. Financial instruments (continued)

(d) *Currency risk (continued)*

(iv) Exposure to currency risk

The Company is exposed to currency risk through the following assets and liabilities denominated in currencies other than the U.S. dollar: cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and short-term and long-term debt. The currencies of the Company's financial instruments and other foreign currency denominated liabilities, based on notional amounts, were as follows:

| | 2008 | | | | |
|-------------------------------|--------------------|----------------------|-----------------|-------------------|-----------------|
| | Canadian dollar | Australian dollar | Mexican peso | Brazilian real | Chilean peso |
| Cash and cash equivalents | 88,977 | 15,213 | 531 | 3,655 | - |
| ABCP | 77,017 | - | - | - | - |
| Accounts receivable | 2,667 | - | 5,228 | - | - |
| Accounts payable and accruals | (14,414) | (7,980) | (3,028) | (12,756) | - |
| Future income tax liabilities | (72,375) | (18,518) | (75,020) | - | (65,939) |
| ARO | (182) | (5,449) | (3,270) | (13,000) | - |
| Short-term and long-term debt | (223,951) | - | (238) | (7,193) | - |
| Gross balance sheet exposure | (142,261) | (16,734) | (75,797) | (29,294) | (65,939) |
| | | | | | |
| | 2007 | | | | |
| | Canadian dollar | Australian dollar | Mexican peso | Brazilian real | Chilean peso |
| Cash and cash equivalents | 2,804 | 8,988 | - | 2,120 | - |
| Accounts receivable | 149 | - | - | 10,806 | - |
| Accounts payable and accruals | (2,291) | (8,139) | - | (10,894) | - |
| Future income tax liabilities | - | (21,683) | - | (7,135) | - |
| ARO | - | (6,530) | - | (13,670) | - |
| Short-term and long-term debt | - | - | - | - | - |
| Gross balance sheet exposure | 662 | (27,364) | - | (18,773) | - |

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

14. Financial instruments (continued)

(e) Interest rate risk

Interest rate risk is the risk that the fair value of the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company is exposed to interest rate risk on its outstanding borrowings and short-term investments. In particular, the Company is exposed to interest rate changes on those ABCP investments that are expected to pay interest. Interest is proposed to be based on the Canadian bankers' acceptance rate which may fluctuate. A 100 basis points change in the bankers' acceptance rate would result in an annual difference of approximately \$0.4 million in the interest income to the Company. The Company has not entered into any derivative contracts to manage this risk.

The Company follows the policy of issuing fixed interest rate debt to avoid future fluctuations in its debt service costs.

(f) Commodity price risk

The Company's earnings and cash flows are subject to price risk due to fluctuations in the market price of gold, silver and copper. World gold prices have historically fluctuated widely. World gold prices are affected by numerous factors beyond our control, including:

- the strength of the U.S. economy and the economies of other industrialized and developing nations;
- global or regional political or economic crises;
- the relative strength of the U.S. dollar and other currencies;
- expectations with respect to the rate of inflation;
- interest rates;
- purchases and sales of gold by central banks and other holders;
- demand for jewelry containing gold; and
- investment activity, including speculation, in gold as a commodity.

In 2008, the Company's revenues and cash flows were negatively impacted by the declining copper prices. There is a time lag between the time of shipment for copper and final pricing and changes in copper pricing can significantly impact the Company's revenue and working capital position. As of December 31, 2008, working capital includes copper concentrate receivables totalling 8.1 million pounds. A \$0.10 change in copper price would have an impact of \$0.8 million on the Company's working capital position.

The Company is also subject to price risk for fluctuations in the cost of energy, principally electricity and purchased petroleum products. The Company's production costs are also affected by the prices of commodities it consumes or uses in its operations, such as lime, reagents and explosives. The prices of such commodities are influenced by supply and demand trends affecting the mining industry in general and other factors outside the Company's control. The Company has not entered into any hedging activities to mitigate these price risks.

New Gold Inc.

Notes to the consolidated financial statements

December 31, 2008

(Tabular amounts expressed in thousands of U.S. dollars, except share and per share amounts)

14. Financial instruments (continued)

(f) *Commodity price risk (continued)*

A 10% change in commodity prices would impact the Company's net earnings as follows:

| | Year ended December 31, 2008 | Thirteen months ended December 31, 2007 |
|--------------|------------------------------------|--|
| | \$ | \$ |
| Gold price | 16,322 | 11,203 |
| Copper price | 969 | 2,604 |

15. Commitments and contingencies

- (a) The Company has entered into a number of contractual commitments related to equipment orders to purchase long lead items or critical pieces of mining equipment related to the New Afton project. At December 31, 2008, these commitments totalled \$9.4 million and are expected to fall due over the next 12 months.
- (b) The Company has entered into a number of contractual commitments related to equipment orders to purchase long lead items or critical pieces of mining equipment at its mines. At December 31, 2008, these commitments totalled \$12.5 million and are expected to fall due over the next 12 months.
- (c) The Company has received notice that legal claims in the amount of approximately \$46 million have been filed in Brazilian courts against the Company's subsidiary, Mineração Pedra Branca do Amapari Ltda ("MPBA"). The claims allege that MPBA has adversely impacted the quality of William Creek causing economic loss and health concerns. The Company believes that these claims are unfounded and intends to vigorously defend against them. Accordingly, the Company has not made an accrual for this claim.
- (d) The Company is, from time to time, involved in various claims, legal proceedings and complaints arising in the ordinary course of business. The Company cannot reasonably predict the likelihood or outcome of these actions. The Company does not believe that adverse decisions in any other pending or threatened proceedings related to any matter, or any amount which may be required to be paid by reason there of, will have a material effect on the financial condition or future results of operations.

16. Subsequent event

On March 4, 2009, the Company announced that it had entered into a definitive agreement to acquire all of the outstanding common shares of Western Goldfields Inc. ("Western Goldfields"). Under the agreement, the Company will exchange one common share and Cdn\$0.0001 in cash for each common share of Western Goldfields (the "Transaction"). Upon completion of the Transaction, existing New Gold and Western Goldfields shareholders will own approximately 58% and 42% of the combined company, respectively, subject to approval of both companies and regulatory approval.