

newgold

THERE'S MORE



First Quarter Report  
For the Quarter Ended March 31, 2011





## **Management's Discussion and Analysis**

**For the quarter ended  
March 31, 2011**

## Table of Contents

FIRST QUARTER 2011 FINANCIAL AND OPERATIONAL HIGHLIGHTS .....	4
BACKGROUND .....	5
CORPORATE RESPONSIBILITY .....	5
CORPORATE DEVELOPMENTS .....	6
A. RICHFIELD ACQUISITION .....	6
B. EL MORRO TRANSACTION.....	6
C. AMAPARI MINE SALE AGREEMENT.....	6
D. REVOLVING CREDIT FACILITY .....	7
E. UPDATE ON CERRO SAN PEDRO MINE.....	7
ECONOMIC TRENDS.....	7
SELECTED QUARTERLY FINANCIAL INFORMATION.....	9
OVERVIEW OF 2011 FIRST QUARTER FINANCIAL RESULTS .....	9
OPERATIONS REVIEW .....	11
A. MESQUITE MINE, CALIFORNIA, USA .....	11
B. CERRO SAN PEDRO MINE, MEXICO.....	12
C. PEAK MINES, NEW SOUTH WALES, AUSTRALIA .....	14
PROJECT DEVELOPMENT REVIEW .....	16
A. MESQUITE MINE, CALIFORNIA, USA .....	16
B. CERRO SAN PEDRO MINE, SAN LUIS POTOSÍ, MEXICO .....	16
C. PEAK MINES, NEW SOUTH WALES, AUSTRALIA .....	17
D. NEW AFTON PROJECT, BRITISH COLUMBIA, CANADA.....	17
E. EL MORRO PROJECT, ATACAMA REGION, CHILE.....	18
REVIEW OF FINANCIAL RESULTS.....	19
FIRST QUARTER 2011 COMPARED TO FIRST QUARTER 2010.....	19
QUARTERLY INFORMATION.....	22
BALANCE SHEET REVIEW .....	22
A. ASSETS.....	22
B. ASSET BACKED NOTES.....	22
C. GOLD HEDGE CONTRACTS .....	23
D. LONG-TERM DEBT .....	23
E. DEFERRED INCOME AND MINING TAXES.....	25
F. ASSET RETIREMENT OBLIGATION .....	26

NON IFRS MEASURE- ADJUSTED NET EARNINGS (ADJUSTED NET EARNINGS PER SHARE) .....	26
NON-IFRS MEASURE – TOTAL CASH COST <sup>(1)</sup> PER GOLD OUNCE CALCULATION .....	27
LIQUIDITY AND CAPITAL RESOURCES OUTLOOK .....	29
OUTLOOK .....	29
COMMITMENTS .....	31
CONTINGENCIES .....	31
A. EL MORRO TRANSACTION .....	31
B. CERRO SAN PEDRO MINE .....	31
C. MESQUITE MINE .....	32
OFF-BALANCE SHEET ARRANGEMENTS .....	32
RELATED PARTY TRANSACTIONS .....	32
RISK FACTORS .....	33
FINANCIAL RISK MANAGEMENT .....	33
A. CREDIT RISK .....	33
B. LIQUIDITY RISK .....	35
C. CURRENCY RISK .....	35
D. INTEREST RATE RISK .....	37
E. COMMODITY PRICE RISK .....	37
F. ENVIRONMENTAL RISK .....	39
CONTRACTUAL OBLIGATIONS .....	39
OUTSTANDING SHARES .....	40
CRITICAL ACCOUNTING POLICIES AND ESTIMATES .....	40
A. INVENTORIES .....	40
B. MINING INTERESTS .....	41
C. RECLAMATION AND CLOSURE COST OBLIGATIONS .....	42
D. INCOME TAXES .....	42
E. REVENUE RECOGNITION .....	43
F. LONG TERM INCENTIVE PLANS .....	43
POLICIES USED IN ANNUAL FINANCIAL STATEMENTS .....	43
FUTURE CHANGES IN ACCOUNTING POLICIES .....	43
INTERNATIONAL FINANCIAL REPORTING STANDARDS .....	44
A. MINING INTERESTS .....	44
B. FINANCIAL INSTRUMENTS .....	45

C. FOREIGN CURRENCY TRANSLATION.....	45
D. DECOMMISSIONING LIABILITIES (RECLAMATION AND CLOSURE COST OBLIGATIONS) .....	46
E. PROPERTY, PLANT AND EQUIPMENT .....	46
F. REVERSAL OF IMPAIRMENT LOSS .....	46
G. DEFERRED TAXES.....	47
CONTROLS AND PROCEDURES .....	48
ENDNOTES .....	50
CAUTIONARY NOTE TO U.S. READERS CONCERNING ESTIMATES OF MEASURED, INDICATED AND INFERRED MINERAL RESOURCES.....	50
CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS .....	51

## **NEW GOLD INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE QUARTER ENDED MARCH 31, 2011**

*(IN UNITED STATES DOLLARS, EXCEPT WHERE NOTED)*

*The following Management's Discussion and Analysis ("MD&A") provides information that management believes is relevant to an assessment and understanding of the consolidated financial condition and results of operations of New Gold Inc. ("New Gold" or the "Company") and its subsidiaries and including its predecessor entities. This MD&A should be read in conjunction with New Gold's unaudited consolidated financial statements for the quarter ended March 31, 2011 and 2010, and related notes thereto which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This Management's Discussion and Analysis contains "forward-looking statements" that are subject to risk factors set out in a cautionary note contained herein. The reader is cautioned not to place undue reliance on forward-looking statements. All figures are in United States dollars and tabular amounts are in thousands, unless otherwise noted. This MD&A has been prepared as of May 4, 2011. Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).*

#### **FIRST QUARTER 2011 FINANCIAL AND OPERATIONAL HIGHLIGHTS**

- First quarter gold production increased by 39% to 107,622 ounces from 77,215 ounces in the same period in 2010.
- First quarter gold sales of 104,211 ounces, up 30% from 80,020 ounces in the same period in 2010.
- Cash flow from operations increased by 120% to \$50.5 million from \$23.0 million in the same period in 2010.
- First quarter total cash cost<sup>(1)</sup> per ounce sold, net of by-product sales, decreased by \$115 per ounce to \$352 per ounce from \$467 per ounce in the same period in 2010, representing the lowest cost quarter in the Company's history.
- Adjusted net earnings from continuing operations during the first quarter of \$47.9 million or \$0.12 per basic share compared to \$17.9 million or \$0.5 per basic share in the same period in 2010.
- Net earnings from continuing operations during the first quarter of \$24.7 million or \$0.06 per basic share compared to \$13.0 million or \$0.03 per basic share in the same period in 2010.
- Quarterly Earnings from mine operations of \$80.5 million, up from \$36.8 million in the same period in 2010.
- Subsequent to the quarter end, on April 4, 2011, New Gold announced the friendly acquisition of Richfield Ventures Corp. ("Richfield"), and its flagship Blackwater Project in British Columbia.
- In the first quarter, underground development at New Afton advanced a total of 1,580 metres compared to an advance of 742 metres in the first quarter of 2010.
- Cash and cash equivalents totaled \$520.2 million at March 31, 2011, up 6% from \$490.8 million at December 31, 2010.

## **BACKGROUND**

New Gold Inc. is an intermediate gold producer with a portfolio of global assets in the United States, Mexico, Australia, Canada and Chile. The Company's operating assets consist of the Mesquite gold mine ("Mesquite Mine") in the United States, the Cerro San Pedro gold-silver mine ("Cerro San Pedro Mine") in Mexico, and the Peak gold-copper mines ("Peak Mines") in Australia. Significant development projects include the New Afton copper-gold project ("New Afton") in Canada and a 30% interest in the El Morro copper-gold project ("El Morro") in Chile. New Gold has an objective of continuing to grow, both organically and through acquisitions, to become the leading intermediate gold producer. New Gold plans on achieving this vision through:

- Delivering on operational targets (safety, cost, production, environmental and social responsibility);
- Maintaining a strong financial position;
- Internal growth through project development and the continuous improvement of existing operations; and
- External growth through additional value enhancing merger and acquisition opportunities.

New Gold is working towards maximizing shareholder value through diversified production, maintaining a reduced risk profile and enhancing growth potential.

## **CORPORATE RESPONSIBILITY**

The Company's commitment to disciplined growth is founded on the concept of growing responsibly. This underlies management's belief that economic achievement, environmental stewardship and social contribution are key components in the success of the Company. The Company has adopted a Health, Safety, Environment and Sustainability Policy that establishes the principles we apply to meet this commitment.

The Company actively engages in meaningful dialogue with local community residents and stakeholders to identify economic, educational, social and infrastructure priorities, and contributes to the realization of these objectives in the communities surrounding its operations.

New Gold's corporate responsibility objectives are to prevent pollution, minimize the impact the operations may cause to the environment and practice the progressive rehabilitation of areas impacted by its activities. The Company has a history of operating in a socially responsible and sustainable manner, and of meeting international standards in the three countries where it currently operates mines. The Company is a member of the globally recognized Canadian Business for Social Responsibility and is a business participant of the United Nations Global Compact.

## **CORPORATE DEVELOPMENTS**

### **A. RICHFIELD ACQUISITION**

On April 4, 2011, New Gold and Richfield Ventures Corporation (“Richfield”) jointly announced a definitive agreement whereby New Gold would acquire, through a plan of arrangement (the “Arrangement”) all of the outstanding common shares of Richfield. Under the terms of the Arrangement, each Richfield shareholder will receive 0.9217 of a New Gold share for each Richfield share held. The transaction, net of cash and proceeds from all in-the-money dilutive instruments, is approximately \$513.0 million. Richfield’s flagship asset is the Blackwater Project, located in central British Columbia.

### **B. EL MORRO TRANSACTION**

On October 12, 2009, Barrick Gold Corporation (“Barrick”) announced that it had entered into an agreement with Xstrata Copper Chile S.A. (“Xstrata”), a wholly owned subsidiary of Xstrata Plc, to acquire Xstrata’s 70% interest in the El Morro copper-gold project in Chile. New Gold, through its 100% owned subsidiary Datawave Sciences Inc. (“Datawave”), held a right of first refusal over Xstrata’s 70% interest which came into effect when the agreement with Barrick was announced.

On January 7, 2010, Datawave provided notice to Xstrata of the exercise of its right of first refusal to acquire Xstrata’s 70% interest in the El Morro project for \$463.0 million. The Company completed this transaction on February 16, 2010. A subsidiary of Goldcorp Inc. (“Goldcorp”) loaned \$463.0 million to a Datawave subsidiary to fund the exercise of the right of first refusal. After acquisition of Xstrata’s 70% interest by a Datawave subsidiary, Datawave sold that subsidiary to a subsidiary of Goldcorp.

Concurrent with the sale of the Datawave subsidiary to a subsidiary of Goldcorp, Datawave received a \$50.0 million payment and the parties amended the terms of the existing El Morro Shareholders Agreement. Under the revised Shareholders Agreement, Goldcorp (through its subsidiary) has agreed to fund 100% of Datawave’s share of the development and construction capital for the project, which was estimated in the El Morro feasibility study at approximately \$2.5 billion.

In January 2010, New Gold received a Statement of Claim filed by Barrick in the Ontario Superior Court of Justice, against New Gold, Goldcorp and affiliated subsidiaries. A Fresh Amended Statement of Claim was received in August 2010 which included Xstrata and its affiliated subsidiaries as defendants. The claim relates to Datawave’s exercise of its right of first refusal with respect to the El Morro copper-gold project. New Gold believes the claim is without merit and intends to defend this action using all available legal avenues.

### **C. AMAPARI MINE SALE AGREEMENT**

On January 27, 2010, the Company announced the signing of an agreement to sell its Brazilian subsidiary Mineracao Pedra Branca do Amapari Ltda. (“MPBA”), which holds the Amapari Mine and other related assets, to Beadell Resources Ltd (“Beadell”). The transaction closed on April 13, 2010 and New Gold received gross proceeds of \$37.0 million in cash and 115 million Beadell shares valued on the closing date of the transaction at \$18.6 million. On December 1, 2010, New Gold announced the sale of its 115 million Beadell

shares, with Beadell's consent to release the shares from a 12 month escrow, at A\$0.53 per share for total net proceeds for \$58.4 million. Total proceeds inclusive of the sale of Beadell shares were \$95.4 million.

#### **D. REVOLVING CREDIT FACILITY**

On December 16, 2010, New Gold entered into an agreement with a syndicate of banks to establish a \$150.0 million revolving credit facility ("Facility") further enhancing the Company's financial flexibility. As a term of the facility, the company has granted the lenders a first ranking lien on the present and future property of Mesquite Mine, Cerro San Pedro Mine and Peak Mines, subject to permitted encumbrances. The Facility has an initial term of three years, with annual extensions permitted, and provides New Gold with additional liquidity supplementing the Company's already strong cash position.

#### **E. UPDATE ON CERRO SAN PEDRO MINE**

New Gold owns 100% of the Cerro San Pedro Mine through the Mexican Company, Minera San Xavier S.A. de C.V. ("MSX").

The Cerro San Pedro Mine has a history on on-going legal challenges. The Mine is in full operation and legal challenges relate primarily to a land use dispute; New Gold is in compliance with all environmental permits at Cerro San Pedro Mine.

On November 18, 2009 PROFEPA, the Mexican environmental enforcement agency, issued an order that MSX was to suspend mining operations at the Cerro San Pedro Mine. PROFEPA's order followed a ruling by the Federal Court of Fiscal and Administrative Justice ("FCFAJ") in September 2009 that SEMARNAT, the Mexican government's environmental protection agency, nullify the Mine's Environmental Impact Statement ("EIS") which was issued in 2006. The First Federal District Court in San Luis Potosi has issued injunctions to ensure that operations at the Cerro San Pedro Mine continue during the appeals process. The latest injunction was received on October 4, 2010.

MSX appealed the September 2009 ruling of the FCFAJ. A hearing was held in the Third Federal District Court in Mexico City in April 2010 and a negative decision was issued by the court in July 2010. MSX appealed the negative decision and in November 2010, a Collegiate Appeals Court in Mexico City ruled unanimously in favour of MSX's position in its appeal against the September 2009 nullification of the EIS. That ruling effectively reestablishes the validity of the mine's 2006 EIS.

MSX continues to work with all levels of government and other external stakeholders to maintain uninterrupted operation at the Cerro San Pedro Mine.

### **ECONOMIC TRENDS**

2010 was characterized by extreme volatility in the majority of asset classes, as financial markets attempted to digest a variety of often conflicting economic signals. Precious metals including gold and silver rose rapidly through the year as investors sought safe havens in the face of a tentative economic recovery, widespread volatility and concerns around future inflation. Commodity prices performed strongly, with copper climbing

on renewed demand from China and other emerging markets in particular coupled with the limited ability of miners to quickly bring on further supply.

The first quarter of 2011 has offered little relief from either the volatility in financial markets or the uncertainty surrounding what now appears to be a far more unpredictable route to global economic recovery than had initially been hoped. Major questions surround the deficits and public debt levels of numerous countries, with developed areas such as the United States and the Eurozone proving to be an increasing source of concern.

In this environment, precious metals have continued to outperform, with gold closing the first quarter of 2011 at \$1,439 per ounce. Gold has continued to rise to a new high of over \$1,500 per ounce early into the second quarter. It seems clear that global economic decision makers will continue to be faced with an extremely challenging set of circumstances, including an uncertain inflation outlook, stuttering growth in developed markets, and severe fiscal and political challenges for policy makers wrestling with sovereign debt crises. This unpredictable environment is likely to continue to generate volatility, and offers the potential for continued strength in precious metal prices.

The price of gold is the largest single factor affecting New Gold's profitability and operating cash flows, in addition to operating costs. As such, the current and future performance of the Company will be closely correlated with the prevailing price of gold. However, copper will become more important as New Afton achieves commercial production in 2012 based on current development plans. During the first quarter of 2011, New Gold had an average realized gold price<sup>(2)</sup> of \$1,317 per ounce (including monthly deliveries of 5,500 ounces of gold hedged at the Mesquite Mine at \$801 per ounce) which was 5% below an average market gold price of \$1,384 per ounce.

## SELECTED QUARTERLY FINANCIAL INFORMATION

*(U.S. dollars in thousands, except ounces, per ounce and per pound amounts)*

	Three months ended March 31,	
	2011	2010
<b>Operating Data <sup>(1)</sup></b>		
Tonnes of ore mined (000's)	6,158	3,664
Tonnes of waste mined (000's)	15,188	11,001
Ratio of waste to ore	2.47	3.00
Gold (ounces):		
Produced	107,622	77,215
Sold	104,211	80,020
Silver (ounces):		
Produced	635,320	206,700
Sold	585,796	193,506
Copper (000's of pounds):		
Produced	3,492	3,959
Sold	3,905	4,055
Realized prices <sup>(2)</sup> :		
Gold (\$/ounce)	1,317	1,079
Silver (\$/ounce)	32.69	17.08
Copper (\$/lb)	4.19	3.39
Total cash cost per gold ounce sold <sup>(3)(4)</sup>	352	467
<b>Financial Data</b>		
Revenues	171,213	101,620
Earnings from mine operations	80,470	36,771
Net earnings (loss) from continuing operations	24,719	13,042
Earnings (loss) per share – basic and diluted:		
From continuing operations	0.06	0.03
From discontinued operations	0.00	0.00
Total	0.06	0.03
Operating cash flows from continuing operations	50,543	22,980

(1) The 2010 tables include results for the Amapari Mine which is presented as a discontinued operation for financial reporting purposes. The 2010 table presented is for comparative purposes only.

(2) Realized price is a non-IFRS financial performance measure with no standard meaning under IFRS. See Endnote 2 at the end of this MD&A.

(3) The calculation of total cash cost per ounce of gold is net of by-product silver and copper revenues. If silver and copper revenues were treated as a co-product, average total cash cost for the three months ended March 31, 2011 would be \$542 per ounce of gold (2010 - \$555), \$14.08 per ounce of silver (2010 - \$10.36); and \$1.76 per pound of copper (2010 - \$1.80).

(4) Total cash cost is a non-IFRS financial performance measure with no standard meaning under IFRS. See Endnote 1 at the end of this MD&A. The 2010 comparative has been adjusted to be consistent with the 2011 calculation methodology which capitalizes significant property, plant and equipment components as defined by IFRS. The calculation of total cash cost per ounce of gold sold for the Peak Mines is net of by-product copper sales revenue. The calculation of total cash cost per ounce of gold for the Cerro San Pedro Mine is net of by-product silver sales revenue.

## OVERVIEW OF 2011 FIRST QUARTER FINANCIAL RESULTS

In the first quarter of 2011, adjusted net earnings from continuing operations was \$47.9 million, which increased from \$17.9 million in the prior year period. The increase in adjusted net earnings from operations is attributed to higher realized commodity prices, increased production and related sales and lower cash cost per ounce. Net earnings has been adjusted and tax affected for the group of costs in “Other gains and losses” on the condensed consolidated income statement. Key entries in this grouping are the fair value changes for share purchase warrants, convertible debt, asset backed commercial paper and the embedded

derivative in the senior secured notes. Additionally, foreign exchange gain or loss and other non-recurring items are adjusted. Of particular note, the fair value change of non-hedged derivatives (share purchase warrants and convertible debt) in the first quarter of 2011 was a loss of \$24.4 million, relative to a loss of \$10.1 million in the same prior year period. Adjusting for all of these items provides an improved measure to internally evaluate the underlying operating performance of the company as a whole for the reporting periods presented. The adjusted entries are also impacted for tax to the extent that the underlying entries are impacted for tax in the unadjusted net earnings from continuing operations. As the loss on the fair value change of non-hedged derivatives is only minimally tax affected in unadjusted net earnings from continuing operations, the reversal of tax on an adjusted basis is also minimal. This also serves to normalize the adjusted effective tax rate which is approximately 31%, relative to reported effective tax rate of the 45%.

In the first quarter of 2011, net earnings from continuing operations was \$24.7 million, which increased from \$13.0 million in the prior year period. The increase in net earnings from operations is attributed to higher realized commodity prices, increased production and related sales and lower cash cost per ounce. Offsetting these benefits is the fair value change of share purchase warrants and convertible debt generating a loss of \$24.4 million relative to \$10.1 million in the same prior year period. This adjustment is a requirement under International Financial Reporting Standards to account for share purchase warrants and convertible debt as a liability, which are then fair valued quarterly. As the traded value of the New Gold share purchase warrants increases or decreases, a respective loss or gain is reflected on the financial statements. This is also the case for the convertible debt which is fair valued using the black-scholes methodology. Additionally, an unrealized loss on revaluing the prepayment option related to the senior secured notes of \$2.5 million relative to a gain of \$1.9 million in the same prior year period.

The Company sold 104,211 ounces of gold during the first quarter of 2010, compared to 80,020 ounces in the same prior year period. In addition to increased ounces sold, the increase in average realized price<sup>(2)</sup> of gold has increased from \$1,079 to \$1,317 per ounce which contributed to a 68% increase in revenues to \$171.2 million. Coupled with the revenue increase, the reduction in cash cost<sup>(1)</sup> per ounce of gold sold to \$352 per ounce from \$467 in the same prior year period caused earnings from mine operations to increase from \$36.8 million in the first quarter of 2010 to \$80.5 million in the first quarter of 2011.

Cash flow from continuing operations for the first quarter of 2011 was \$50.5 million compared to \$23.0 million for the same period in 2010. The significant increase in quarterly cash flow is a direct result of the Company's strong operating performance during the quarter and higher realized commodity prices. A negative impact to cash flow from continuing operations was the increase in trade and other receivables. A shipment of copper concentrate from our Peak Mines was in transit over quarter-end and a \$15.0 million receivable was outstanding. That cash has subsequently been received and will positively impact the second quarter cash flow from operations.

## OPERATIONS REVIEW

*(tabular data in thousands of U.S. dollars unless otherwise stated)*

### A. MESQUITE MINE, CALIFORNIA, USA

The Company's Mesquite Mine is located in Imperial County, California, approximately 70 kilometres northwest of Yuma, Arizona and 230 kilometres east of San Diego, California. The Mesquite Mining District lies beneath alluvial pediment deposits at the base of the Chocolate Mountains. The mine was operated between 1985 – 2001 by Goldfields Mining Corporation, subsequently Santa Fe Minerals Corporation, and finally Newmont Mining Corporation with Western Goldfields Inc. acquiring the mine in 2003. New Gold acquired the Mesquite Mine as part of the acquisition of Western Goldfields Inc. on May 27, 2009. The mine resumed production in 2008. In its history, the Mesquite Mine has been subject to significant exploration with over 6,000 reverse circulation drill holes having been completed during its life. Recent exploration has been focused on the areas surrounding the three existing pits: Rainbow, Big Chief and Vista.

The Mesquite operations are included in New Gold's operating results for the full year of 2010.

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Operating Data</b>		
Tonnes of ore mined (000's)	2,276	2,373
Tonnes of waste removed (000's)	10,591	9,119
Ratio of waste to ore	4.65	3.84
Tonnes of ore to leach pad (000's)	2,276	2,373
Average gold grade (grams/tonne)	0.77	0.53
Gold (ounces):		
Produced <sup>(1)</sup>	48,855	44,034
Sold	50,418	49,502
Realized prices: <sup>(2)</sup>		
Gold (\$/ ounce) <sup>(3)</sup>	1,239	1,047
Total cash cost per gold ounce sold <sup>(4)</sup>	543	543
<b>Financial Data</b>		
Revenues	62,448	51,835
Earnings from mine operations	28,733	17,383

(1) Tonnes of ore processed each quarter does not necessarily correspond to ounces produced during the quarter, as there is a time delay between placing tonnes on the leach pad and pouring ounces of gold.

(2) Realized price is a non-IFRS financial performance measure with no standard meaning under IFRS. See Endnote 2 at the end of this MD&A.

(3) Includes realized gains and losses from gold hedge settlements.

(4) Total cash cost is a non-IFRS financial performance measure with no standard meaning under IFRS. See Endnote 1 at the end of this MD&A. The 2010 comparative has been adjusted to be consistent with the 2011 calculation methodology which capitalizes significant property, plant and equipment components as defined by IFRS.

### FIRST QUARTER OF 2011 COMPARED TO FIRST QUARTER OF 2010

Gold production for the quarter ended March 31, 2011 was 48,855 ounces compared to 44,034 ounces produced in the same period in 2010. Mesquite had higher total tonnes mined period over period while total ore tonnes were consistent with ore tonnes placed in the first quarter of 2010, reflecting a higher strip ratio based on mine sequencing. Gold production was higher in the first quarter of 2011 compared to first quarter

of 2010 due to a higher head grade. Period over period, the average head grade increased to 0.77 g/t from 0.53 g/t.

Revenue for the quarter ended March 31, 2011 was \$62.4 million compared to \$51.8 million in the same period last year. The change was due largely to an increase in gold prices and an increase in ounces sold. Gold ounces sold were 50,418 ounces in 2011 compared to 49,502 ounces in 2010, an increase of 2% due to higher production. The average realized gold price<sup>(2)</sup> during the first quarter of 2011 and 2010 was \$1,239 per ounce, including hedged gold ounce settlements at \$801 per ounce, compared to \$1,047 per ounce in the same prior year period. This is lower than the average London Metals Exchange PM gold fix price of \$1,384 and per ounce as a result of the impact of the hedged ounces.

Total cash cost<sup>(1)</sup> per ounce of gold sold for the quarter ended March 31, 2011 was \$543 per ounce compared to \$543 per ounce in the same prior year period. The consistency in total cash cost<sup>(1)</sup> is primarily attributable to higher gold production and gold sales in the first quarter of 2011 when compared to the same period in 2010, partially offset by higher input costs of diesel and explosives during the first quarter when compared to the same period in 2010.

Mesquite generated \$28.7 million in earnings from mine operations in the first quarter of 2011 compared to \$17.4 million in the same period of the prior year due higher average gold realized price<sup>(2)</sup>, higher gold ounces sold and lower cash cost<sup>(1)</sup> per ounce sold.

Cash flow relating to capital expenditures totaled \$2.6 million and \$3.3 million for the three month periods ended March 31, 2011 and 2010, respectively.

## **B. CERRO SAN PEDRO MINE, MEXICO**

The Cerro San Pedro Mine is located in the state of San Luis Potosí in central Mexico, approximately 20 kilometres east of the city of San Luis Potosí. The project property consists of 36 mining and exploration concessions (this number reflects previously held larger number of concessions which have been consolidated for administrative purposes) totaling 78 square kilometres in the historic Cerro San Pedro mining district. The current focus of exploration is on the southern half of a two-plus kilometre San Pedro trend of gold-silver-zinc-lead mineralization that extends south from beneath the current open pit mine operation.

The Cerro San Pedro Mine achieved ISO 14001 certification of its environmental management system and has a record of compliance with Mexican and international environmental standards. Despite MSX's enviable record with Mexican and international environmental standards, there has been a history of legal challenges to the Cerro San Pedro Mine. Current legal challenges relate primarily to a land use dispute.

On November 18, 2009 PROFEPA, the Mexican environmental enforcement agency, issued an order that MSX was to suspend mining operations at the Cerro San Pedro Mine. PROFEPA's order followed a ruling by the Federal Court of Fiscal and Administrative Justice ("FCFAJ") in September 21, 2009 that SEMARNAT, the Mexican government's environmental protection agency, nullify the Mine's Environmental Impact Statement

("EIS") which was issued in 2006. The First Federal District Court in San Luis Potosi has issued injunctions to ensure that operations at the Cerro San Pedro Mine continue during the appeals process.

MSX appealed the September 2009 ruling of the FCFAJ. A hearing was held in the Third Federal District Court in Mexico City in April 2010 and a negative decision was issued by the court in July 2010. MSX appealed the negative decision and in November 2010, a Collegiate Appeals Court in Mexico City ruled unanimously in favour of MSX's position in its appeal against the September 21, 2009 nullification of the EIS. That ruling effectively reestablishes the validity of the mine's 2006 EIS. The Collegiate Appeals Court in Mexico City requested to the FCFAJ and SEMARNAT to comply with the resolution. The resolution by FCFAJ is pending.

MSX continues to work with all levels of government and other external stakeholders to maintain uninterrupted operation at the Cerro San Pedro Mine.

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Operating Data</b>		
Tonnes of ore mined (000's)	3,705	1,102
Tonnes of waste mined (000's)	4,597	1,882
Ratio of waste to ore	1.24	1.71
Tonnes of ore processed (000's)	3,705	1,102
Average gold grade (grams/tonne)	0.56	0.50
Average silver grade (grams/tonne)	27.61	26.15
Gold (ounces):		
Produced <sup>(1)</sup>	35,601	12,938
Sold	31,717	13,124
Silver (ounces):		
Produced <sup>(1)</sup>	635,320	206,700
Sold	585,796	193,506
Realized prices <sup>(3)</sup> :		
Gold (\$/ounce)	1,391	1,118
Silver (\$/ounce)	32.62	17.08
Total cash cost per gold ounce sold <sup>(2)(4)</sup>	7	622
<b>Financial Data</b>		
Revenues	63,236	17,977
Earnings from mine operations	34,365	3,256

- (1) Tonnes of ore processed each quarter do not necessarily correspond to ounces produced during the quarter, as there is a time delay between placing tonnes on the leach pad and pouring ounces of gold and silver.
- (2) The calculation of total cash cost per ounce of gold is net of by-product silver revenue. If the silver revenues were treated as a co-product, average total cash cost at Cerro San Pedro Mine for the three months ended March 31, 2011, would be \$425 per ounce of gold (2010 - \$713 ) and \$9.97 per ounce of silver (2010 - \$10.90 ).
- (3) Realized price is a non-IFRS financial performance measure with no standard meaning under IFRS. See Endnote 2 at the end of this MD&A.
- (4) Total cash cost is a non-IFRS financial performance measure with no standard meaning under IFRS. See Endnote 1 at the end of this MD&A.

## **FIRST QUARTER OF 2011 COMPARED TO FIRST QUARTER OF 2010**

Gold production for the first quarter of 2011 increased by 175% to 35,601 ounces, compared to 12,938 ounces produced in the same prior year period. The increased gold production was a result of mining of higher grade ore per the mine plan sequencing and leach pad recoveries returning to more steady-state

levels during the first quarter of 2011. Additionally, full operations were only resumed on March 17, 2010 following a delay in receiving the mines' explosives permit, whereas 2011 represents full operations for the entire quarter. Silver production increased to 635,320 ounces compared to 206,700 ounces in the same prior year period. The increased production resulted from favourable ore grades, improved silver recoveries from the leach pad and full operation for the first quarter of 2011.

Revenue for the first quarter of 2011 was \$63.2 million, which was a 252% or \$45.3 million increase over the same prior year period. The main driver for this was an increase in gold sales of 18,593 ounces and an increase in the average realized price. The average realized gold price per ounce during the first quarter 2011 and 2010 was \$1,391 and \$1,118 respectively, which corresponds well to the average London Metals Exchange PM gold fix price of \$1,384 and \$1,109 per ounce, respectively. The average realized silver price per ounce during the first quarter 2011 and 2010 was \$32.62 and \$17.08 respectively, which also correlates to the average London Metals Exchange silver fix price of \$31.66 and \$16.92 per ounce, respectively.

Total cash cost<sup>(1)</sup> per ounce of gold sold in the first quarter of 2010 was \$7 per ounce compared to \$622 per ounce in the same prior year period, representing a decrease of 99%. The decrease in total cash cost<sup>(1)</sup> is primarily a result of higher by-product revenues resulting from higher silver volumes and higher realized silver price during the first quarter of 2011 when compared to the same prior year period. These benefits were partially offset by higher total tonnes moved, higher diesel prices and the appreciation of the Mexican Peso during the first quarter of 2011 when compared to the same period in 2010.

The increased gold sales, coupled with a significant reduction in total cash cost<sup>(1)</sup> per ounce of gold sold, net of by-product sales, resulted in Cerro San Pedro generating \$34.4 million in earnings from mine operations in the first quarter of 2011 compared to \$3.3 million in the same period of the prior year.

Cash flow relating to capital expenditures totaled \$1.2 million and \$3.8 million for the three month period ended March 31, 2011 and 2010, respectively. Capital expenditures in 2011 were primarily associated with a leach pad expansion.

#### **IMPACT OF FOREIGN EXCHANGE ON OPERATIONS**

The Cerro San Pedro Mine was impacted by changes in the value of the Mexican peso against the U.S. dollar in the first quarter of 2011 relative to the first quarter of 2010. The value of the Mexican peso increased from an average of 12.76 to the U.S. dollar in the first quarter of 2010 to 12.06 to the U.S. dollar in the first quarter of 2011. This had a negative impact of approximately \$33 per ounce of gold sold.

#### **C. PEAK MINES, NEW SOUTH WALES, AUSTRALIA**

The Company's 100% owned Peak Mines gold-copper mining operation is located in the Cobar Mineral Field near Cobar, New South Wales, Australia. Peak Mines consists of mining and exploration licenses totaling 845 square kilometres of prospective ground covering the mining operation and mineralized extensions.

	Three Months Ended March 31,	
	2011	2010
<b>Operating Data</b>		
Tonnes of ore processed (000's)	188	173
Average gold grade (grams/tonne)	4.27	3.94
Average copper grade (%)	0.98	1.14
Gold (ounces):		
Produced	23,166	20,243
Sold	22,076	17,393
Copper (thousands of pounds):		
Produced	3,492	3,959
Sold	3,905	4,055
Realized prices <sup>(1)</sup> :		
Gold (\$/ ounce)	1,389	1,138
Copper (\$/ pound)	4.19	3.39
Total cash cost per gold ounce sold <sup>(2)</sup>	413	136
<b>Financial Data</b>		
Revenues	45,529	31,808
Earnings from mine operations	17,436	16,132

(1) Realized price is a non-IFRS financial performance measure with no standard meaning under U.S. IFRS. See Endnote 2 at the end of this MD&A.

(2) Total cash cost is a non-IFRS financial performance measure with no standard meaning under IFRS. See Endnote 1 at the end of this MD&A. The calculation of total cash cost per ounce of gold is net of by-product copper revenue. If the copper revenue was treated as a co-product, average total cash cost at Peak Mines for the three month period ended March 31, 2011 would be \$695 per ounce of gold and \$2.27 per pound of copper, as compared to \$473 per ounce of gold and \$1.63 per pound of copper for the period ended March 31, 2010.

## FIRST QUARTER OF 2011 COMPARED TO FIRST QUARTER OF 2010

Peak Mines produced 23,166 ounces of gold and 3.5 million pounds of copper during the first quarter of 2011 compared to 20,243 ounces of gold and 4.0 million pounds of copper in the same prior year period. Gold production increased due to higher mill throughput and to mine sequencing leading to higher head grades. Mill throughput was 188,442 tonnes in the first quarter 2011 compared to 172,877 tonnes in 2010. Mill feed grade was 8% higher in gold grade and 14% lower in copper grade. During the first quarter of 2011, higher gold grades were produced from the Perseverance and New Occidental ore bodies.

Revenue for the first quarter of 2011 was 43% higher than in the same quarter 2010 mainly due to higher realized gold prices<sup>(2)</sup> of \$1,389 per ounce compared to \$1,138 per ounce and the higher realized copper prices of \$4.19 per pound compared to \$3.39 per pound in the same prior year period. This compares to the average London Metals Exchange PM gold fix price of \$1,384 and \$1,109 per ounce for the first quarter of 2011 and 2010, respectively. The average London Metals Exchange copper fix price was \$4.38 for the first quarter of 2011 and \$3.02 for the first quarter of 2010. Quarter-end copper concentrate stocks, containing 12,131 ounces of gold and 3.0 million pounds of copper, are relatively high compared to the end of the same quarter last year, containing 6,546 ounces of gold and 2.4 million pounds of copper. It is anticipated these stocks will reduce in the second quarter as additional trains are arranged.

Total cash cost<sup>(1)</sup> per ounce of gold sold, net of by-product sales, for the first quarter was \$413 compared to \$136 in the first quarter of 2010. Total cash cost<sup>(1)</sup> increased due to the appreciation of the Australian dollar, higher mining costs in current working areas and the benefit of the copper by-product being applied against

higher gold sales in the first quarter of 2011 compared to the same period in the prior year. Additionally, in the first quarter of 2010, a change in inventory valuation method to value copper in the concentrate also decreased operating costs.

The higher average realized price, offset by increased total cash cost<sup>(1)</sup> per ounce of gold sold, net of by-product sales and reduced sales volume resulted in Peak Mines generating \$17.4 million in earnings from operations during the first quarter of 2011 compared to \$16.1 million in the same period of the prior year.

Capital expenditures totaled \$8.6 million and \$3.2 million for the three month period ended March 31, 2011 and 2010, respectively. Significant capital expenditure during the first quarter of 2011 included building of conventional copper flotation cells, Perseverance Zone D fresh air vent project and routine underground development.

#### **IMPACT OF FOREIGN EXCHANGE ON OPERATIONS**

Peak Mines' operations continue to be impacted by fluctuations in the valuation of the Australian dollar against the U.S. dollar. The value of Australian dollar in the first quarter of 2011 averaged 1.01 compared to 1.11 in the first quarter of 2010 resulting in a negative impact on cash costs<sup>(1)</sup> of approximately \$113 per gold ounce sold.

#### **PROJECT DEVELOPMENT REVIEW**

##### **A. MESQUITE MINE, CALIFORNIA, USA**

During the first quarter of 2011, the Company concluded its investigation of the economic viability of the sulphide mineral resource at the Mesquite gold mine. Results of a program involving approximately 12,000 metres of exploration drilling completed in Q4 2010 indicated that the potential to expand the sulphide resource is insufficient to warrant further exploration. Metallurgical testing of the sulphide mineralization to provide further confirmation of estimated gold recoveries for the sulphide resource is continuing in 2011. In 2010, an additional 1.1 million ounces of oxide mineral resource was added to Mesquite's mineral resource base.

##### **B. CERRO SAN PEDRO MINE, SAN LUIS POTOSÍ, MEXICO**

During the first quarter of 2011, the Cerro San Pedro Sulphide exploration project progressed with the continuation of core drilling to explore a zone of high grade manto-style sulphide mineralization as it extends from an area of historic underground mining south of the current open pit. At the end of Q4 2010 the company reported an updated inferred mineral resource estimate of 6.1 million tonnes averaging 1.89 g/t gold, 105 g/t silver, 4.7% zinc and 1.4% lead contained within the manto zone. Additionally, the deep penetrating geophysical survey completed during 2010 has provided further evidence that the San Pedro manto system remains open for another several hundred metres south of the currently defined inferred mineral resource.

### **C. PEAK MINES, NEW SOUTH WALES, AUSTRALIA**

During the first quarter of 2011, the Company's ongoing mineral resource development program at Peak Mines' operations resulted in the completion of 11,337 metres of exploration and delineation diamond drilling to replace mine depletion. This total includes 9,836 metres of underground drilling to delineate and explore for additional reserves in the Perseverance deposit, 267 metres of underground drilling to delineate reserves in the New Cobar deposit, and 1,234 metres of surface drilling to explore the Norma Vale project south of the Company's mining operations. The Company's regional exploration initiative at Peak Mines likewise continues with geophysical surveys and geochemical sampling of targets identified within the Cobar mineral field. The Company has many surface and underground targets and the mine geology and exploration goal is to replace reserves consumed by mining activities in 2011, and generate additional resources in the areas surrounding the mine.

### **D. NEW AFTON PROJECT, BRITISH COLUMBIA, CANADA**

The Company's New Afton copper-gold development project is located in Kamloops, British Columbia, Canada. The New Afton project's property package consists of the nine square kilometre Afton mining lease which centres on the New Afton copper-gold mine currently under development as well as 111 square kilometres of exploration licenses covering multiple mineral prospects within the historic Iron Mask mining district.

Project spending for the first quarter of 2011 was \$44.6 million compared to \$11.6 million for the first quarter of 2010.

In the quarter, underground development advanced a total of 1,580 metres compared to an advance of 742 metres during the first quarter of 2010. Shotcrete support work during the period included the spraying of 3,427 cubic metres in the development headings compared to 1,516 cubic metres in the first quarter of 2010.

Excavation and ground support of the Conveyor Transfer Chambers CTC 3 and CTC 4, the third and the fourth large bulk mining excavation at New Afton were completed during the first quarter. The Development Crusher excavation and ground support continued during the quarter. The mining of Conveyor Leg 4 continued to be driven from the top and bottom and break through occurred on January 9, 2011. Excavation continues on the extraction, undercut and apex drifts in the ore-body at the mining level horizon. The first three draw-points were mined during the quarter as well. Ore continues to be stockpiled on surface close to the mill for future concentration. Contract raise boring started on VR7, the fourth main ventilation raise from the surface and on VR3A the second main raise of four internal to the underground mine. The contractor's raise bore drill string was freed from VR5 during the period and the raise relocated to a site with more favourable geology for raise drilling. Approximately one half of the new mining equipment slated for use in developing the extraction area was received during the quarter including two drill jumbos, one rock bolter, a scooptram and a transmixer.

Construction activities continued on the surface during the first quarter, 2011, albeit suffering in terms of progress due to inclement weather. Work placing concrete operating floor slabs in the concentrator went better than expected. The use of the permanent natural gas system to supply temporary fuel to the

concentrator was very beneficial. The interior structural steel and placing of the two feeders in the reclaim Chamber went well in spite of the cold. Subsequent to this the final concrete pour for the Reclaim Chamber was accomplished at the end of the quarter after a cold weather related hold-up of three weeks. The First Nations contract doing base preparation in the concentrator was successfully completed. A second First Nations contractor installed the permanent high bay lighting in the concentrator. Some earthworks were done on the Tailings Line Corridor as weather allowed.

Underground construction saw the completion of all concrete in the Conveyor Transfer Chamber (CTC 1) as well as 80% completion of structural steel and mechanical erection. The remedial activities centered around CTC 1, Conveyor Legs 1 and 2 were completed. Concrete and remedial work in CTC 2 were well advanced by the end of the quarter. Piping installation was completed in Leg 1 and was also well advanced in Leg 2.

The electrical crews continued reticulation of the underground 13.8 kV power including installation of a temporary 13.8 kV distribution line down the leg 4 decline and the commissioning of two substations, UG8 and UG9. Crews also continued to provide power sources, communications and controls to a number of new development headings in the production areas as well as addressing the requirements of contract mining and raise bore drilling crews. Design and permitting for the 138 kV power supply to the Main Substation continued with commissioning of the Main Substation anticipated in April. Plans for alternative routing of the 13.8 kV power to the lower reaches of the mine (down a ventilation raise) were developed.

Maintenance planning and supervision staff made significant advancements with inventory management, primarily focusing on cataloguing existing parts inventories and identification and correction of deficiencies within the inventory, as well as expansion of stocks of critical and long-lead time items. Mechanical crews continued to address a number of mobile equipment reliability issues, notably scoop and haul truck drivetrains. Additional work was undertaken during the quarter to upgrade to automated fire suppression devices on several production units.

#### **E. EL MORRO PROJECT, ATACAMA REGION, CHILE**

The Company's 30% interest in the El Morro copper-gold project (held through its subsidiary) is located in the Atacama Region, Chile, approximately 80 kilometres east of the city of Vallenar. El Morro was acquired by the Company as part of the business combination with Metallica Resources Inc. on September 30, 2008. The project is a development stage asset initially managed under a shareholder agreement with Xstrata, the previous project operator and owner of a 70% interest.

On October 12, 2009, Barrick announced that it had entered into an agreement with Xstrata to acquire Xstrata's 70% interest in the El Morro copper-gold project. New Gold, through its 100% owned subsidiary Datawave held a right of first refusal over Xstrata's 70% interest which came into effect when the agreement with Barrick was announced. On January 7, 2010, Datawave provided notice to Xstrata of the exercise of its right of first refusal to acquire Xstrata's 70% interest in the El Morro project for \$463.0 million. The Company completed this transaction on February 16, 2010. A subsidiary of Goldcorp loaned \$463.0 million to a Datawave subsidiary to fund the exercise of the right of first refusal. After acquisition of Xstrata's 70% interest by a Datawave subsidiary, Datawave sold that subsidiary to a subsidiary of Goldcorp.

Concurrent with the sale of the Datawave subsidiary to a subsidiary of Goldcorp, Datawave received a \$50.0 million payment and the parties amended the terms of the existing El Morro Shareholders' Agreement. Under the revised Shareholders Agreement, Goldcorp (through its subsidiary) has agreed to fund 100% of Datawave's share of the development and construction capital for the project, which was estimated in the El Morro feasibility study at approximately \$2.5 billion.

On January 13, 2010, New Gold received a Statement of Claim filed by Barrick in the Ontario Superior Court of Justice, against New Gold, Goldcorp, and affiliated subsidiaries. A Fresh Amended Statement of Claim was received in August 2010 which included Xstrata and its affiliated subsidiaries as defendants. The claim relates to Datawave's exercise of its right of first refusal with respect to the El Morro copper-gold project. New Gold believes that the claim is without merit and intends to defend this action using all available legal avenues.

The Environmental Impact Assessment ("EIA") necessary for the project permitting to proceed was received on March 16, 2011. The granting of the EIA facilitates commencement of construction activities by Goldcorp, and specific permits will be obtained during the course of project development. Goldcorp has commenced condemnation drilling, and subsequent exploration drilling will concentrate on in-fill drilling and sampling for metallurgical and geo-technical data.

The scientific and technical information in the above sections has been prepared under the supervision of Mark Petersen, a Qualified Person under National Instrument 43-101 and an employee of the Company.

## **REVIEW OF FINANCIAL RESULTS**

### **FIRST QUARTER 2011 COMPARED TO FIRST QUARTER 2010**

Revenues increased by 68% or \$69.6 million to \$171.2 million when comparing the first quarter of 2011 to 2010. The increase was attributed to an increase in average realized prices<sup>(2)</sup> for gold, silver and copper to \$1,317 per ounce, \$32.69 per ounce, and \$4.19 per pound in the first quarter of 2011, respectively; compared to \$1,079 per ounce, \$17.08 per ounce and \$3.39 per pound in the first quarter of 2010, respectively. Additionally, sales of gold ounces increased to 104,211 ounces compared to 80,020 ounces in the same prior year period and sales of silver ounces increased to 585,796 from 193,506 in the same prior year period.

Operating expenses increased from \$51.9 million in 2010 to \$70.7 million in the first quarter of 2011. The increase is attributed to an increase in mining rate and related production levels, an adverse impact of foreign exchange as the U.S. dollar has weakened to the Australian dollar and Mexican peso, and higher consumable prices. 2010 operating expenses have been adjusted to reflect IFRS policy to capitalize significant components.

Depreciation and depletion was \$20.0 million for the first quarter of 2011 compared to \$13.0 million for the first quarter of 2010 reflecting an increase in production and related depreciation expense on a unit of production basis, particularly at Cerro San Pedro.

For the three months ended March 31, 2011, New Gold had earnings from mine operations of \$80.5 million compared with \$36.8 million in the same prior year period.

Corporate administration costs were \$6.2 million in the first quarter of 2011 compared to \$5.6 million incurred in the same prior year period.

Share-based compensation costs were \$2.9 million and \$1.9 million in first quarters of 2011 and 2010, respectively.

Exploration expense is \$2.1 for the first quarter of 2011 relative to \$1.8 in the same prior year period. The increase is primarily related to \$1.1 million of exploration expense related to the Cerro San Pedro Sulphide project, offset by lower expensed exploration at Peak Mines relative to the same prior year period.

On July 1, 2010, the Company met the criteria for hedge accounting under International Financial Reporting Standards IAS 39 – *Financial Instruments: Recognition and Measurement* (“IAS 39”) for its gold hedge and fuel contracts. Application of the accounting standards allows the Company to record realized gains and losses on gold hedge settlements within revenue. For settlements on the fuel hedges, the realized gains and losses are classified within operating expenses. Changes resulting from the mark-to-market of the gold hedge and fuel contracts are now recognized within Other Comprehensive Income. On December 16, 2010, a portion of the gold hedge was moved from one counterparty to another where the underlying terms of the agreement were not materially changed. This resulted in a de-designation and subsequent immediate re-designation of the hedge position. On re-designation, the Company continued to meet the criteria for hedge accounting under the under IAS 39 in accounting for its gold hedge and fuel contracts.

For the three month period ended March 31, 2011, the Company’s Mesquite Mine realized losses of \$7.6 million within revenues for settlement of three months of gold hedge contracts totaling 16,500 ounces. As a result of the increase in the spot price of gold from \$1,406 per ounce to \$1,439 per ounce between December 31, 2010 and March 31, 2011, the Mesquite Mine recognized \$3.8 million of pre-tax unrealized losses in the mark-to-market of remaining contracts within Other Comprehensive Income.

For the three month period ended March 31, 2011, the company recorded a fair value change of share purchase warrants and convertible debt generating a loss of \$24.4 million relative to \$10.1 million in the same prior year period. This adjustment is a requirement under International Financial Reporting Standards to account for share purchase warrants and a portion of the convertible debt as a liability, which are then fair valued quarterly. As the traded value of the New Gold share purchase warrants increases or decreases, a respective loss or gain is reflected on the financial statements. This is also the case for the convertible debt which is fair valued using the black-scholes methodology.

During the first quarter of 2011, the Company had realized and unrealized gains on investments related to the mark to market of remaining Asset Backed Notes of \$1.3 million as the credit quality of these notes continued to improve. This compares to a gain of \$3.9 million for the same prior year period. In the first quarter of 2011, all remaining Asset Backed Notes were disposed for \$8.9 million.

As the Company’s creditworthiness improves, there is a deemed benefit to exercising the prepay option on the senior secured notes and refinancing at lower rates. The prepay option on the senior secured notes which was fair valued at \$5.3 million at March 31, 2011 generating an unrealized loss of \$2.5 million for the quarter. The decrease in the fair value resulted from the gradual increase in interest rates over the quarter.

This compares to a fair value gain of \$1.9 million recognized in the same prior year period. This is an accounting transaction and has no cash impact.

The Company recognized a foreign exchange gain of \$3.1 million in the first quarter of 2011 compared to a gain of \$1.4 million in the same prior year period. During the first quarter of 2011, the U.S. dollar weakened against the foreign currencies that the Company operates in. The Canadian and Australian dollars strengthened 4% and 5% respectively against the U.S. dollar since December 31, 2010. The foreign exchange gain arose due to the revaluation of monetary assets and liabilities and future income tax liabilities recorded on the business combination between New Gold, Metallica, and Peak Gold. Under International Financial Reporting Standards, the foreign exchange gain or loss related to US dollar functional currency entities is accounted for in the consolidated statement of operations. This includes the revaluation of all Canadian and Australian dollar denominated cash. The strengthening of these currencies generated a foreign exchange gain on this cash. For entities that are not US dollar functional currency, any resulting foreign exchange gain or loss is accounted for in the cumulative translation account. This is the case for the Canadian dollar denominated debt which is recoded at New Afton, a Canadian dollar functional currency entity.

Income and mining tax expense in the first quarter of 2011 was \$20.1 million compared to \$9.4 million in the same prior year period, reflecting an effective tax rate of 45% for the first quarter of 2011 relative to 42% in the same prior year period. In the first quarter of 2011, the Company recorded an unrealized loss of \$24.4 million related to the mark to market for share purchase warrants and convertible debentures. For tax purposes, this is considered a capital loss; however, a deferred tax benefit has not been recognized as the Company does not project to have any future capital gains against which the capital loss can be recorded. This reduces earnings before tax without any offsetting tax benefit, resulting in 45% effective tax rate. Ignoring the impact of this unrealized loss will result in an effective tax rate of 33% which is considered reasonable for the jurisdictions in which we are currently taxable. Additionally, under IFRS, a deferred tax liability has been recorded relating to the foreign exchange temporary difference of translating non-monetary assets and liabilities at current exchange rates relative to historic rates. The related deferred tax expense again causes the effective tax rate under IFRS to be higher than under Canadian GAAP as Canadian GAAP does not require a deferred tax asset or liability for such temporary differences. The two noted reasons also cause the 2010 restated IFRS effective tax rate to be 42%, whereas it was 34% under Canadian GAAP.

For the three months ended March 31, 2011, New Gold had net earnings from continuing operations of \$24.7 million, or \$0.06 per basic share. This compares with net earnings from continuing operations of \$13.0 million, or \$0.03 per basic share in the same prior year period. In the first quarter of 2011, net earnings, including earnings from discontinued operations, was \$24.7 million, or \$0.06 per basic share. This compares with net earnings of \$13.3 million, or \$0.03 per basic share in 2010.

For the three months ended March 31, 2011, adjusted net earnings from continuing operations was \$47.9 million or \$0.12 per basic share, which increased from \$17.9 million or \$0.05 per basic share in the prior year period. Net earnings has been adjusted inclusive the associated tax impact for the group of costs in "Other gains and losses" on the condensed consolidated income statement. Key entries in this grouping are the fair value changes for share purchase warrants, convertible debt, asset backed commercial paper and the

embedded derivative in the senior secured notes. Additionally, foreign exchange gain or loss and other non-recurring items are adjusted. Of particular note, the fair value change of non-hedged derivatives (share purchase warrants and convertible debt) in the first quarter of 2011 was a loss of \$24.4 million, relative to a loss of \$10.1 million in the same prior year period. Adjusting for of these items provides an improved measure to internally evaluate the underlying operating performance of the company as a whole for the reporting periods presented. The adjusted entries are also adjusted for tax in the same manner as the underlying entries are unadjusted net earnings from continuing operations. The tax impact on the fair value change of non-hedged derivatives is minimal in unadjusted net earnings from continuing operations, as is the reversal of tax on an adjusted basis. This, in conjunction with other adjustments, also serves to normalize the adjusted effective tax rate which is approximately 31%, relative to reported effective tax rate of the 45%.

### QUARTERLY INFORMATION

*(tabular data in thousands of U.S. dollars, except per share amounts)*

	IFRS					CGAAP		
	2011 Q1	2010 Q4	2010 Q3	2010 Q2	2010 Q1	2009 Q4	2009 Q3	2009 Q2
Gold sales (ounces)	104,211	116,964	89,692	82,401	80,020	106,475	77,645	52,890
Revenues	171,213	189,355	127,116	112,359	101,620	131,765	88,491	59,199
Net earnings (loss) from continuing operations	24,719	25,557	44,754	(26,006)	13,042	(2,295)	6,096	(199,304)
Earnings (loss) per share from continuing operations								
Basic	0.06	0.15	0.11	(0.07)	0.03	(0.01)	0.02	(0.77)
Diluted	0.06	0.15	0.11	(0.07)	0.03	(0.01)	0.02	(0.77)
Net earnings (loss)	24,719	25,557	44,754	(36,197)	13,347	(7,650)	4,101	(202,846)
Earnings (loss) per share								
Basic	0.06	0.12	0.11	(0.09)	0.03	(0.02)	0.01	(0.79)
Diluted	0.06	0.12	0.11	(0.09)	0.03	(0.02)	0.01	(0.79)

### BALANCE SHEET REVIEW

#### A. ASSETS

At March 31, 2011, New Gold held cash and cash equivalents of \$520.2 million. This compares to \$490.8 million held at December 31, 2010. As at March 31, 2011, \$330.1 million of the cash is held in Canadian dollars. Of the Company's holdings, \$159.4 million is held in Canadian federal and provincial treasury bills and \$256.3 million in cash. The remainder is held in the following liquid forms: banker's acceptances, term deposits, and guaranteed investment certificates.

#### B. ASSET BACKED NOTES

All remaining AB Notes were disposed of in February for proceeds of \$8.9 million (C\$8.8 million) resulting in a gain on sale of \$1.3 million.

### **C. GOLD HEDGE CONTRACTS**

Under the terms of the term loan facility entered into by WMMI, as a condition precedent to drawdown of the loan, WMMI entered into a gold hedging program required by the banking syndicate. As such, at the time of the agreement, the Company had executed gold forward sales contracts for 429,000 ounces of gold at a price of \$801 per ounce. New Gold assumed the liability upon acquisition of Western Goldfields Inc. on May 27, 2009. As at March 31, 2011, the remaining gold contracts represent a commitment of 5,500 ounces per month for 45 months with the last commitment deliverable in December 2014 for a total of 247,500 ounces.

The Company's gold hedge contracts did not initially meet the criterion in IAS 39 and therefore were not designated as cash flow hedges. Accordingly, the period-end mark to market adjustments related to these contracts were immediately reflected on the statement of operations of the Company as unrealized gains or losses on gold forward sales contracts and the cumulative effect was reflected as an asset or liability on the balance sheet.

On July 1, 2009, the Company's gold hedging contracts met the requirements for cash flow hedges under IAS 39. Prospective hedge effectiveness is assessed on these hedges using the hypothetical derivative method. The hypothetical derivative assessment involves comparing the effect of theoretical shifts in forward gold prices on the fair value of both the actual hedging derivative and a hypothetical derivative. The retrospective assessment involves comparing the effect of historic changes in gold prices each period on the fair value of both the actual and hypothetical derivative. The effective portion of the gold contracts is recorded in Other Comprehensive Income until the forecasted gold sale impacts earnings. Where applicable, the fair value of the derivative has been evaluated to account for the Company's credit risk.

On December 16, 2010, a portion of the gold hedges with two counterparties who had previously been lenders in the Mesquite project financing was moved to one of the new banks included in the Company's revolving credit facility. This resulted in a de-designation and subsequent immediate re-designation of the hedge position. On re-designation, the Company continued to meet the criteria for hedge accounting under IAS 39 in accounting for its gold hedge and fuel contracts. As such, the Company continues to account for the hedges in the same manner as it did prior to the change.

The remaining contracts were marked to market as at March 31, 2011 using the March 31, 2011 spot price of \$1,439 per ounce, resulting in a cumulative unrealized pre-tax loss of \$147.5 million that has been disclosed as a liability and a pre-tax adjustment of \$5.7 million to Other Comprehensive Income for the quarter ending March 31, 2011.

### **D. LONG-TERM DEBT**

The majority of the Company's contractual obligations consist of long-term debt and interest payable. At March 31, 2011, the Company had \$239.6 million in long-term debt compared to \$229.9 million at December 31, 2010.

Long-term debt obligations are comprised primarily of senior secured notes and subordinated convertible debentures. The senior secured notes ("Notes"), which were originally issued by New Gold pursuant to a

note indenture dated June 28, 2007, mature and become payable on June 28, 2017 and bear interest at a rate of 10% per annum. At March 31, 2011 the face value of the Notes totalled \$192.4 million (Cdn\$187.0 million). Interest is payable in arrears in equal semi-annual installments on January 1 and July 1 each year. Once the New Afton project is in commercial production, the Company will be obligated to offer to repay a face value amount equal to 50% of excess cash flow each year, at the option of the note holders. The Company also has the option to prepay the Notes at a price ranging from 120% to 100% (decreasing rates based on the length of time the Notes are outstanding). At March 31, 2011 the redemption price was 110%, which is scheduled to decrease to 105% on June 28, 2011. These Notes are secured by the New Afton Project assets. Capitalized interest relating to the Notes was \$5.0 million in the first quarter of 2011 compared to \$4.5 million during the first quarter of 2010.

The Company has 55,000 subordinated convertible debentures (“Debentures”) that 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. At March 31, 2011, the aggregate principal of the Debentures was \$56.6 million (Cdn\$55.0 million). The Debentures are accounted for as compound financial instruments comprised of a liability and a derivative liability for the conversion option. At March 31, 2011, the carrying amount of the liability of \$42.6 million will be accreted to the face value of the Debentures over their term to maturity. Interest is payable in arrears in equal semi-annual installments on January 1 and July 1 each year. Capitalized interest relating to the Debentures was \$1.0 million in the first quarter of 2011 compared to \$0.9 million during the first quarter of 2010.

On December 16, 2010, the Company entered into an agreement for a \$150 million revolving credit facility with a syndicate of banks. The amount of the Facility will be reduced by \$50 million if the Cerro San Pedro Mine is not operational for 45 consecutive days due to any injunction, order, judgment or other determination of an official body in Mexico as a result of any disputes now or hereafter before an official body in Mexico with jurisdiction to settle such a dispute. However, the full \$50 million of credit will be reinstated if operations at the Cerro San Pedro Mine resume in accordance with the mine plan for 45 consecutive days and no similar disruption event occurs during this period. The purpose of the Facility is for general corporate purposes, including acquisitions. The Facility, which is secured on the Company’s material assets (excluding the New Afton and El Morro project assets) and a pledge of certain subsidiary shares, has a term of three years with annual extensions permitted. The Facility contains various covenants customary for a loan facility of this nature, including limits on indebtedness, asset sales and liens. The credit agreement makes allowances to ensure that there shall not be a breach of any financial covenants solely from the change in the opening balance sheet balances as restated from GAAP to IFRS. Significant financial covenants are as follows:

Minimum tangible net worth	\$1.38 billion + 25% of positive quarterly net income
Minimum interest coverage ratio (EBITDA to interest)	>4.0:1.0

Maximum leverage ratio (debt to EBITDA) <3.0:1.0

The Company is in compliance with these covenants at March 31, 2011.

The interest margin on drawings under the Facility ranges from 2.00% to 4.25% over LIBOR, the Prime Rate or the Base Rate. For the first two quarters following the execution of the credit agreement fixed interest margins are applicable and depend on the currency and type of credit selected by the Company. Thereafter, the interest margins will be based on the Company's debt to EBITDA ratio (the Debentures are not considered debt for covenant purposes). Based on Prime Rate, the interest rate at March 31, 2011 would be 5.5% if any funds had been drawn. The standby fee on undrawn amounts under the Facility is 0.875% through the first two full quarters following execution of the credit agreement, after which time it will range between 0.75% and 1.06% depending on the Company's debt to EBITDA ratio. If based on the Company's current debt to EBITDA ratio, the standby fee would be 0.75%.

To the date of this MD&A, the Company has not drawn any funds under the Facility; however the Facility has been used to issue an A\$10.2 million letter of credit related to Peak Mines' reclamation obligation to the New South Wales government in Australia, an C\$8.0 million letter of credit related to the New Afton reclamation obligation to the British Columbia government in Canada (resulting in the release to the Company by the British Columbia government of C\$8.0 million in cash on deposit with a major Canadian bank), and the previously issued C\$9.5 million letter of credit provided to B.C. Hydro for support of power and transmission construction work has been brought under the Facility. At March 31, 2011, \$121.4 million of the Facility remains unused.

New Gold's wholly-owned subsidiary Western Goldfields Inc. had a \$105.0 million term loan facility with a syndicate of banks under which \$86.3 million was borrowed in connection with the development of the Mesquite Mine. The remaining loan balance of \$27.2 million was fully repaid on February 26, 2010 which allowed the Company the flexibility to monetize the remaining hedges outstanding at its discretion. The gold hedge extends to the end of 2014 and the related security and covenants were released by the syndicate of banks on December 14, 2010 when New Gold entered in to the new revolving credit facility. The gold hedge is now secured under the credit facility and shares in security, on a pari passu basis, with the new lenders. One of the banks under the Facility replaced two of the original banking institutions as the hedge counterparty for a portion of the overall hedge under the same terms. The hedge will remain in place until the hedge is monetized or delivered over this period at 5,500 ounces per month at \$801 per ounce.

#### **E. DEFERRED INCOME AND MINING TAXES**

The net deferred income tax liability decreased slightly from \$163.2 million on December 31, 2010 to \$161.9 million on March 31, 2011 (March 31, 2010 - \$306.0 million).

The current income tax liability increased from \$31.4 million on December 31, 2010 to \$38.2 million on March 31, 2011. The change in the current income tax liability is a primarily a function of profitability, tax installment payments, and the impact of foreign exchange.

## **F. ASSET RETIREMENT OBLIGATION**

Reclamation and closure cost obligations are asset retirement obligations that arise from the acquisition, development, construction and normal operation of mining property, plant and equipment, due to government controls and regulations that protect the environment on the closure and reclamation of mining properties. The Company has future obligations to retire its mining assets including dismantling, remediation and ongoing treatment and monitoring of sites. The exact nature of environmental issues and costs, if any, which the Company may encounter in the future are subject to change, primarily because of the changing character of environmental requirements that may be enacted by governmental agencies.

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

The long-term portion of the liability at March 31, 2011 is \$35.6 million compared to \$34.2 million at December 31, 2010. The increase relates to accretion and a negative foreign exchange impact.

### **NON IFRS MEASURE- ADJUSTED NET EARNINGS (ADJUSTED NET EARNINGS PER SHARE)**

Adjusted net earnings is a non- GAAP financial measure which excludes the following from net earnings:

- Fair value changes of embedded derivative in Senior secured notes
- Gains (loss) on Fair Value Through Profit and Loss financial assets
- Ineffectiveness of hedging instruments
- Fair value changes of non-hedged derivatives
- Gains (losses) on foreign exchange
- Other non- recurring items

Management uses this measure to internally evaluate the underlying operating performance of the company as a whole for the reporting periods presented, and to assist with the planning and forecasting of future operating results of the underlying business of the Company. While the adjustments to net earnings in this measure include items that are recurring, management believes that adjusted net earnings is a useful measure of the Company's performance because the changes in fair value on embedded derivatives and non-hedged derivatives, gains/losses on FVTPL financial assets and foreign exchange and other non-recurring items do not reflect the underlying operating performance of our core mining business and are not necessarily indicative of future operating results.

As noted, the Company uses this measure for its own internal purposes. Management's internal budgets and forecasts and public guidance do not reflect fair value changes on senior notes and non-hedged derivatives, foreign currency translation and FVTPL financial asset gains/losses. Consequently, the presentation of adjusted net earnings enables investors and analysts to better understand the underlying operating performance of our core mining business through the eyes of Management. Management periodically

evaluates the components of adjusted net earnings based on an internal assessment of performance measures that are useful for evaluating the operating performance of our business and a review of the non-GAAP measures used by the mining industry analysts and other mining companies.

Adjusted net earnings are intended to provide additional information only and do not have any standardized definition under IFRS and should not be considered in isolation or as substitutes for measures of performance prepared in accordance with IFRS. The measures are not necessarily indicative of operating profit or cash flow from operations as determined under IFRS. Other companies may calculate these measures differently. The following table reconciles these non-GAAP measures to the most directly comparable IFRS measure.

#### RECONCILIATION OF NET EARNINGS TO ADJUSTED NET EARNINGS

	Three Months Ended March 31,	
	2011	2010
<b>Net earnings before taxes</b>	<b>44,818</b>	22,478
Fair Value of embedded derivative in Senior Notes	<b>2,454</b>	(1,907)
Gains (loss) on FVTPL financial assets	<b>(1,349)</b>	(3,944)
Ineffectiveness on hedging instruments	<b>1,827</b>	-
Fair Value change of non-hedged derivatives	<b>24,355</b>	10,109
Gain (loss) on foreign exchanges	<b>(3,115)</b>	(1,368)
Other	<b>226</b>	1,722
<b>Adjusted Net earnings before Tax</b>	<b>69,216</b>	27,090
Unadjusted Tax	<b>(20,099)</b>	(9,436)
Add tax related to Other Gains and Losses	<b>(1,220)</b>	236
<b>Adjusted Tax</b>	<b>(21,319)</b>	(9,200)
<b>Adjusted Net earnings</b>	<b>47,897</b>	17,890
<b>Adjusted EPS</b>	<b>0.12</b>	0.05

#### NON-IFRS MEASURE – TOTAL CASH COST<sup>(1)</sup> PER GOLD OUNCE CALCULATION

New Gold reports total cash cost<sup>(1)</sup> on a sales basis. In the gold mining industry, this is a common performance measure but does not have any standardized meaning under IFRS. The Company believes that, in addition to conventional measures prepared in accordance with IFRS, certain investors use this information to evaluate the Company's performance and ability to generate cash flow. Accordingly, it is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS. The following table provides a reconciliation of total cash cost<sup>(1)</sup> per ounce of gold sold to the financial statements:

	Three months ended March 31,	
	2011	2010
<b>Operating expenses from continuing operations</b>	70,716	51,886
Operating expenses from discontinued operations	-	-
Treatment and refining charges on concentrate sales	2,352	2,324
By-product copper and silver sales	(36,321)	(17,637)
Non-cash adjustments	(41)	836
Total cash cost	<u>36,706</u>	<u>37,409</u>
Ounces of gold sold	104,211	80,020
<b>Total cash cost<sup>(1)</sup> per ounce of gold sold</b>	<b>352</b>	<b>467</b>

## LIQUIDITY AND CAPITAL RESOURCES

As at March 31, 2011, the Company had cash and cash equivalents held by continuing operations of \$520.2 million compared \$490.8 million at December 31, 2010. These balances exclude \$9.0 million at December 31, 2010 and March 31, 2011, the reclamation deposit for the Mesquite Mine, which is included in Reclamation Deposits and Other on the balance sheet. The change in cash in the three month period to the end of 2011 was attributed to the following key items:

- Strong cash flows from gold sales at the Company's Mesquite, Peak Mines and Cerro San Pedro operating mines which benefited from prevailing average market gold and silver prices of \$1,384 and \$31.66 per ounce during the quarter;
- Project spending at the New Afton project for the quarter ended March 31, 2011 of \$44.6 million;
- Value from the strengthening of the Canadian dollar compared to the U.S. dollar, which has increased the U.S. dollar value of the Company's cash and cash equivalents held in Canadian dollars (approximately \$330 million) to fund New Afton construction.

The Company's cash and cash equivalents are either held in cash or invested in highly liquid, low risk, interest-bearing investments with maturities of 90 days or less from the original date of investment. The surplus corporate funds are only invested with approved government or bank counterparties.

As at March 31, 2011, the Company had working capital of \$507.2 million. In the opinion of management, the working capital at March 31, 2011, together with cash flows from operations, are sufficient to support the Company's normal operating requirements on an ongoing basis. However, taking into consideration volatile equity markets, global uncertainty in the capital markets and cost pressures, the Company is continually reviewing expenditures in order to ensure adequate liquidity and flexibility to support its growth strategy while maintaining or increasing production levels at its current operations. Based on our current cash balance it is expected that the Company's existing cash will be sufficient to fully fund the construction of the New Afton, El Morro and Richfield projects. However, this could change if any further acquisitions or external growth opportunities are realized.

During the quarter ended March 31, 2011, the Company had positive operating cash flows from continuing operations of \$50.5 million and invested a total of \$57.2 million in mining interests, including \$2.6 million at the Mesquite Mine, \$1.2 million at the Cerro San Pedro Mine, \$8.6 million at the Peak Mines, \$44.6 million at the New Afton project and \$0.2 million at other projects.

### **LIQUIDITY AND CAPITAL RESOURCES OUTLOOK**

The Company's future profits and cash position are highly dependent on metal prices, including gold, silver and copper. Copper will become increasingly important when the New Afton and El Morro projects are completed, which is expected in 2012 for New Afton and at a later date for El Morro. In addition to these internal growth opportunities, the Company has other prospective properties which include, but are not limited to, Cerro San Pedro Mine Sulphides, and Rio Figueroa in Chile. Internal growth will focus on the New Afton and El Morro projects, as well as Richfield upon completion; however there are other potential development properties that may become high priorities as further exploration and assessment is completed. In order to supplement this internal growth, the Company considers expansion opportunities through mergers and acquisitions.

Capital expenditures for 2011 are expected to be approximately \$416.0 million with approximately \$9.0 million allocated to the Mesquite Mine, \$12.0 million to the Cerro San Pedro Mine, \$45.0 million to the Peak Mines, \$292.0 million (including capitalized interest) to the continued development of New Afton, \$57 million for El Morro and \$1.0 million for corporate expenditures.

At the end of the first quarter the Company has significant cash and cash equivalents balance of \$520.2 million with almost 64% of the funds in Canadian dollars in order to fund the significant spending on New Afton during the period from 2011 to mid-2012. There is a general expectation from economists and market observers that the Canadian dollar will continue to remain strong compared to the U.S. dollar over the mid-term and during the construction phase at New Afton. As a result, we believe holding significant Canadian dollar cash and cash equivalents balance is a prudent position in order to protect against any increase in the Canadian dollar during this period of significant spending at New Afton. Management believes the Company will not need external financing to complete its major development projects and will continue to seek opportunities to effectively utilize its cash funds. Based on our current cash balance it is expected that the Company's existing cash will be sufficient to fully fund the construction of the New Afton, El Morro and Richfield projects.

The Company expects it will not need external financing to repay its remaining debt in 2014 and 2017 and the El Morro carried funding loan with Goldcorp will be repaid directly out of the Company's share of cash flows from El Morro. These statements are based on the current financial position of the Company and are subject to change if any acquisitions or external growth opportunities are realized.

### **OUTLOOK**

The prevailing volatility in financial markets and increasing concern towards sovereign deficits and debt levels have proved beneficial for precious metals, while copper has remained relatively strong, supported by demand from China and other emerging markets and restricted mine supply. Gold increased to \$1,439 per

ounce at the end of the first quarter of 2011 from \$1,116 at March 31, 2010 and \$1,406 at December 31, 2010. Silver increased to \$37.87 at the end of the first quarter of 2011, compared to \$17.48 and \$30.63 per ounce at March 31, 2010 and December 31, 2010 respectively. The average gold and silver prices for the first quarter of 2011 were \$1,384 and \$31.66 per ounce, compared to the quarter ended March 31, 2010 when prices averaged \$1,109 and \$16.92 per ounce respectively. Copper prices declined slightly from \$4.34 per pound at December 31, 2010 to \$4.26 per pound at March 31, 2011. Copper averaged \$4.38 per pound during the quarter compared to \$3.28 per pound in the first quarter of 2010. Key factors influencing the price of gold include currency rate fluctuations and the relative strength of the U.S. dollar, the supply of, and demand for, gold and macroeconomic factors such as the level of interest rates and inflation expectations. Management anticipates that the long term economic environment is likely to remain positive with respect to precious metals and for gold in particular, and believes the prospects for the business are favorable. The Company has not hedged foreign exchange rates and metal prices with the exception of the gold hedge mandated by the Mesquite project financing. New Gold's growth plan is focused on organic and acquisition-led growth, and the Company plans to remain flexible in the current environment to be able to respond to opportunities as they arise, such as acquisitions, debt buybacks, gold hedge monetization and other transactions. Based on the Company's current cash balance it is expected that existing cash will be sufficient to fully fund the construction of the New Afton project. In addition, New Gold is not required to fund any of the development capital for the El Morro project, as under the agreement with Goldcorp the Company's 30% share is fully funded and both principal and interest will be repaid solely from future cash generated from New Gold's share of the El Morro project's distributable cash flows. As at March 31, 2011 the interest rate on New Gold's share of the capital funded by Goldcorp has been locked in at 4.58%, based on the 7 year U.S. treasury bond yield plus 1.87%, as per the Company's funding agreement with Goldcorp.

The New Afton project remains on schedule to start commercial production in mid-2012. The Company looks forward to production commencing as New Afton is expected to contribute significantly to New Gold's current portfolio of assets. As a low-cost operation, New Afton should meaningfully expand the Company's operating margin and cash flow generation.

New Gold's 2011 guidance for gold production remains 380,000 to 400,000 ounces while total cash cost<sup>(1)</sup> reduces to \$390 to \$410 per ounce of gold sold, net of by-product sales, compared to \$430 to \$450 per ounce at the beginning of the year.

Mine	Forecast 2011 Gold Production (ounces)	Forecast 2011 Total Cash Cost <sup>(2)</sup>
<b>Mesquite Mine</b>	145,000 – 155,000	\$660 - \$680
<b>Cerro San Pedro Mine</b>	135,000 – 145,000	\$90 - \$110
<b>Peak Mines</b>	90,000 – 100,000	\$410 - \$430
<b>Total</b>	380,000 – 400,000	\$390 - \$410

The decrease in total cash cost<sup>(1)</sup> is driven by the continued strength of the silver price and significant impact it is having on total cash cost<sup>(1)</sup> at Cerro san Pedro where New Gold is expected to produce between 1.9 and 2.1 million ounces of silver in 2011.

Assumptions used in the 2011 forecast include silver and copper prices of \$33.00 per ounce and \$4.00 per pound, respectively, and Canadian dollar, Australian dollar and Mexican peso exchange rates of 1.00, 1.00 and 11.50 to the U.S. dollar, respectively. The oil price is assumed to be \$105 per barrel.

## **COMMITMENTS**

The Company has entered into a number of contractual commitments related to purchases of equipment with long lead times or critical pieces of mining equipment related to the New Afton project. At March 31, 2011, these commitments totaled \$91.3 million and are expected to be paid over the next 12 months.

In addition to the above, 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 operating mines. At March 31, 2011, these commitments totaled \$17.3 million and are expected to be paid over the next 12 months.

## **CONTINGENCIES**

In assessing the loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company and its legal counsel evaluate the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought. If the assessment of a contingency suggests that a loss is probable, and the amount can easily be estimated, then a loss is recorded. When a contingent loss is not probable but if reasonably possible, or is probable but the amount of the loss cannot be reliably estimated, then details of the contingent loss are disclosed. Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the Company discloses the nature of the guarantees. Legal fees incurred in connection with pending legal proceedings are expensed as incurred.

### **A. EL MORRO TRANSACTION**

On January 13, 2010, New Gold received a Statement of Claim filed by Barrick in the Ontario Superior Court of Justice, against New Gold, Goldcorp and affiliated subsidiaries. A Fresh Amended Statement of Claim was received in August 2010 which included Xstrata and its affiliated subsidiaries as defendants. The claim relates to Datawave's exercise of its right of first refusal with respect to the El Morro copper-gold project. New Gold believes the claim is without merit and intends to defend this action using all available legal avenues. No amounts have been accrued for any potential loss under this claim.

### **B. CERRO SAN PEDRO MINE**

New Gold owns 100% of the Cerro Sand Pedro Mine through the Mexican Company, MSX.

On November 18, 2009 PROFEPA, the Mexican environmental enforcement agency, issued an order that MSX was to suspend mining operations at the Cerro San Pedro Mine. PROFEPA's order followed a ruling by the Federal Court of Fiscal and Administrative Justice ("FCFAJ") in September 2009 that SEMARNAT, the Mexican government's environmental protection agency, nullify the Mine's Environmental Impact Statement ("EIS") which was issued in 2006. The First Federal District Court in San Luis Potosi has issued injunctions to ensure that operations at the Cerro San Pedro Mine continue during the appeals process. The latest injunction was received on October 4, 2010.

MSX appealed the September 2009 ruling of the FCFAJ. A hearing was held in the Third Federal District Court in Mexico City in April 2010 and a negative decision was issued by the court in July 2010. MSX appealed the negative decision and in November 2010, a Collegiate Appeals Court in Mexico City ruled unanimously in favour of MSX's position in its appeal against the September 2009 nullification of the EIS. That ruling effectively reestablishes the validity of the mine's 2006 EIS.

MSX continues to work with all levels of government and other external stakeholders to maintain uninterrupted operation the Cerro San Pedro Mine.

### **C. MESQUITE MINE**

New Gold and its subsidiary Western Mesquite Mines, Inc. ("WMMI") have been named as defendants under the California Labor Code, Private Attorneys General Act 2004 alleging breaches of employment regulations at the Mesquite Mine. The primary claims relate to allegations of unpaid overtime wages, non-compliant first and second meal periods, non-compliant rest breaks and penalties for willful failure to pay all wages due upon termination of employment. The complainants are seeking certification of the matter as a class action.

New Gold is working to analyze and respond to the claims in a timely and appropriate manner. New Gold cannot accurately predict the scope of the claims or their likely outcome at this time but does not believe the claims will have a material effect on the financial conditions or future operations at the Mesquite Mine.

### **OFF-BALANCE SHEET ARRANGEMENTS**

The Company has no off-balance sheet arrangements.

### **RELATED PARTY TRANSACTIONS**

Certain directors and officers of New Gold are also directors of a company to which the Company pays royalties in the normal course of business. Royalty payments were \$3.0 million for the quarter ended March 31, 2011 (2010- \$1.4 million). At March 31, 2011, the Company had \$1.7 million included as accrued liabilities related to this company (December 31, 2010 - \$2.1 million). These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related party.

A director of New Gold is also a director of the company that purchased from New Gold an interest in the El Morro project.

## RISK FACTORS

Readers of this Management's Discussion and Analysis should give careful consideration to the information included in this document and the Company's audited consolidated financial statements and related notes. Significant risk factors for the Company are metal prices, government regulations, foreign operations, environmental compliance, asset backed commercial paper, the ability to obtain additional financing, risk relating to recent acquisitions, dependence on management, title to the Company's mineral properties, and litigation. For details of risk factors, please refer to our audited consolidated financial statements, and Annual Information Form filed from time to time on SEDAR at [www.sedar.com](http://www.sedar.com).

### FINANCIAL RISK MANAGEMENT

#### A. 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 comprised 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 credit 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 primarily five 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 March 31, 2011 is not considered to be high. The Company's maximum exposure to credit risk at March 31, 2011, is as follows:

<i>(U.S. dollars in thousands)</i>	<b>March 31, 2011</b>	December 31, 2010
	\$	\$
Cash and cash equivalents	<b>520,169</b>	490,754
Trade receivables	<b>29,542</b>	11,929
Investments	-	7,533
Reclamation deposits and other	<b>24,553</b>	31,295
	<b>574,264</b>	541,511

The aging of accounts receivable at March 31, 2011 was as follows:

(U.S. dollars in thousands)

	0-30	31-60	61-90	91-120	Over 120	March 31, 2011	December 31, 2010
	days	days	days	days	days	Total	Total
	\$	\$	\$	\$	\$	\$	\$
Mesquite mine	160	1	1	4	253	419	442
Cerro San Pedro	2,641	460	82	749	300	4,232	3,798
Peak Mines	19,064	-	-	1	16	19,081	3,176
New Afton	4,542	-	-	4	-	4,546	3,581
Corporate	1,264	-	-	-	-	1,264	932
	27,671	461	83	758	569	29,542	11,929

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 with high investment-grade ratings and the governments of Canada and the U.S.

The Company has a bonding and insurance program, primarily with Chartis, formerly American International Specialty Lines Insurance Company ("AIG Insurance") in respect of the operations and closure liabilities of the Mesquite Mine. At March 31, 2011, the Company had \$9.0 million in the account. In September 2008, AIG Insurance's parent company, American International Group, Inc. ("AIG"), suffered a liquidity crisis following the downgrade of its credit rating. The United States Federal Reserve loaned money to AIG in order for the company to meet its obligations to post additional collateral to trading partners. As a result of federal and state laws governing the operation of AIG Insurance and segregation of funds, it is not believed that the Company's funds are at risk. During 2009, AIG has been working through its restructuring under the supervision of the Federal Reserve Bank of New York and the U.S. Department of the Treasury. The U.S. Department of the Treasury has a majority stake in the equity of AIG, which owns Chartis. Chartis is advancing towards the goal of becoming an independent property-casualty and general insurance company and in December 2010 announced that they had signed a definitive recapitalization agreement with the government in the U.S.

The Company sells all of its copper concentrate production to a 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, however, there are alternative customers in the market.

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 five customers (2010, five customers) that account for approximately 95% (2010, 94%) of the concentrate and doré sales revenue.

<i>Metal sales</i>		<b>Three Months ended March 31,</b>	
Customer	2011	2010	
	\$	\$	
1	95,026	40,060	
2	27,288	21,690	
3	18,480	17,977	
4	15,888	9,981	
5	5,821	5,704	
<b>Total</b>	<b>162,503</b>	<b>95,412</b>	
<b>% of total metal sales</b>	<b>95%</b>	<b>94%</b>	

## B. 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.

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 statement of financial position.

	<i>(U.S. dollars in thousands)</i>				<b>March 31,</b>	December 31,
	Less than 1 year	1-3 years	4-5 years	After 5 years	<b>2011 Total</b>	2010 Total
	\$	\$	\$	\$	\$	\$
Trade and other payables	76,975	-	-	-	<b>76,975</b>	<b>72,006</b>
Long-term debt	-	-	56,595	192,423	<b>249,018</b>	<b>243,307</b>
Interest payable on long-term debt	22,072	44,144	39,872	28,864	<b>134,952</b>	<b>131,857</b>
Gold contracts	40,718	77,976	28,760	-	<b>147,454</b>	<b>153,375</b>
	<b>139,765</b>	<b>122,120</b>	<b>125,227</b>	<b>221,287</b>	<b>608,399</b>	<b>600,545</b>

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. A period of continuous low gold and copper prices may necessitate the deferral of capital expenditures which may impact production from mining operations. These statements are based on the current financial position of the Company and are subject to change if any acquisitions or external growth opportunities are realized.

## C. CURRENCY RISK

The Company operates in Canada, Australia, Mexico, Chile and the United States. As a result, the Company has foreign currency exposure with respect to items not denominated in U.S. dollars. The three main types of foreign exchange risk for the Company can be categorized as follows:

i. Transaction exposure

The Company's operations sell commodities 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. 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, investments, accounts receivable, reclamation deposits, accounts payable and accruals, reclamation and closure cost obligations 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:

<i>(in thousands)</i>	March 31, 2011			
	Canadian dollar	Australian dollar	Mexican peso	Chilean peso
Cash and cash equivalents	328,145	18,857	2,847	-
Trade and other Receivable	5,858	19,081	4,194	-
Prepayment option	5,225	-	-	-
Trade and other Payables	(30,795)	(23,091)	(35,707)	-
Reclamation and closure cost obligations	(3,630)	(13,904)	(9,644)	-
Share purchase warrants	(145,857)	-	-	-
Conversion option on convertible debt	(37,510)	-	-	-
Share award units	(6,338)	-	-	-
Long-term debt	(227,766)	-	-	-
Gross balance sheet exposure	(112,668)	943	(38,310)	154
	December 31, 2010			
	Canadian dollar	Australian dollar	Mexican peso	Chilean peso
Cash and cash equivalents	331,948	41,254	5,224	11
Investments	7,533	-	-	-
Accounts receivable	4,556	3,176	3,063	39
Reclamation deposit	8,043	-	-	-
Prepayment option	7,679	-	-	-
Accounts payable and accruals	(24,458)	(24,415)	(34,003)	-
Reclamation and closure cost obligations	(3,655)	(13,618)	(8,421)	-
Share purchase warrants	(125,936)	-	-	-
Conversion option on convertible debt	(29,429)	-	-	-
Share award units	(3,294)	-	-	-
Long-term debt	(221,832)	-	-	-
Gross balance sheet exposure	(48,845)	6,397	(34,137)	50

iii. Translation exposure

The Company's functional and reporting currency is U.S. dollars. The Company's operations translate their operating results from the host currency to U.S. dollars. Therefore, exchange rate movements in the Canadian dollar, Australian dollar, Mexican peso and Chilean peso can have a significant impact on the Company's consolidated operating results. Some of the Company's earnings translation exposure to financial instruments 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 earnings (loss) from the financial instruments presented by the amounts shown below.

<i>(in thousands)</i>	<b>March 31, 2011</b>	December 31, 2010
	\$	\$
Canadian dollar	<b>(11,267)</b>	<b>(4,885)</b>
Australian dollar	<b>94</b>	<b>640</b>
Mexican peso	<b>(3,831)</b>	<b>(3,414)</b>
Chilean peso	<b>15</b>	<b>5</b>
	<b>(14,989)</b>	<b>(7,654)</b>

#### **D. INTEREST RATE RISK**

Interest rate risk is the risk that the fair value or the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. All of the Company's debt obligations are fixed and therefore there is no exposure to changes in market interest rates. The revolving credit facility interest is variable, however the facility is undrawn at March 31, 2011.

The Company is exposed to interest rate risk on its short-term investments which are included in cash and cash equivalents. The short term investment interest earned is based on prevailing one to 90 days money market interest rates which may fluctuate. A 1.0% change in the interest rate would result in an annual difference of approximately \$3.0 million in interest earned by the Company. The Company has not entered into any derivative contracts to manage this risk.

Where possible and depending on market conditions, the Company follows the policy of issuing fixed interest rate debt to avoid future fluctuations in its debt service costs.

#### **E. 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 and are affected by numerous factors beyond the Company's 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.

The Company has acquired gold contracts which mitigate the effects of price changes and designated these contracts as an accounting cash flow hedge effective July 1, 2009. At March 31, 2011, the Company had remaining gold forward sales contracts for 247,500 ounces of gold at a price of \$801 per ounce at a remaining commitment of 5,500 ounces per month for 45 months.

In the first quarter of 2011, the Company's revenues and cash flows were impacted by the variation in copper prices in the range of \$4.13 and \$4.62 per pound. 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 March 31, 2011, working capital includes copper concentrate receivables totaling 2.4 million pounds. A \$0.10 change in the copper price would have an impact of \$1.0 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 no fuel hedge contracts at this time.

The Company is also subject to price risk for changes in the Company's common stock price per share. The Company has implemented, as part of its long-term incentive plan, a share award unit plan that the Company is required to satisfy in cash upon vesting. The amount of cash the Company will be required to expend is dependent upon the price per common share at the time of vesting. The Company considers this plan a financial liability and is required to fair value the outstanding liability with the resulting changes included in compensation expense each period.

An increase in Gold, Copper and Silver prices would increase the Company's net earnings whereas an increase in fuel or share award unit prices would decrease the Company's net earnings. A 10% change in prices would impact the Company's net earnings before taxes from continuing operations and Other Comprehensive Income before taxes as follows:

	<b>Net Earnings</b>	<b>Comprehensive Income</b>	Net Earnings	Comprehensive Income
	\$	\$	\$	\$
Gold price	<b>13,725</b>	<b>31,536</b>	8,248	29,796
Copper price	<b>1,636</b>	-	1,375	-
Silver price	<b>1,911</b>	-	331	-
Fuel price	<b>1,201</b>	-	729	565
Share purchase warrants	<b>14,586</b>	-	3,925	-
Conversion option on convertible debt	<b>5,607</b>	-	1,572	-
Share Award Unit	<b>634</b>	-	107	-

## F. ENVIRONMENTAL RISK

The Company is and will be subject to environmental regulation in Australia, Mexico and the United States where it operates, as well in Canada and Chile where it has development properties. In addition the Company will be subject to environmental regulation in any other jurisdictions in which the Company may operate or have development properties. These regulations mandate, among other things, the maintenance of air and water quality standards, land use standards and land reclamation. They also set out limitations on the generation, transportation, storage and disposal of solid, liquid and hazardous waste.

Environmental legislation is evolving in a manner which will require, in certain jurisdictions, stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. No certainty exists that future changes in environmental regulation, if any, will not adversely affect the Company's operations or development properties. Environmental hazards may exist on the Company's properties which are unknown to management at present and which have been caused by previous owners or operators of the properties.

Failure by the Company to comply with applicable laws, regulations and permitting requirements may result in enforcement actions, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. The Company may be required to compensate those suffering loss or damage by reason of its mining operations or its exploration or development of mineral properties and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

### CONTRACTUAL OBLIGATIONS

<i>(U.S. dollars in thousands)</i>	Payments due by period				
	Total	Less than 1 year	2 - 3 years	4 - 5 years	After 5 years
Contractual obligations					
Long-term debt	249,018	-	56,595	-	192,423
Interest payable on long-term debt	134,951	22,072	44,144	39,872	28,863
Operating Leases and Other Commitments	192,940	134,390	43,963	14,587	-
Asset retirement obligations	55,701	1,342	1,823	1,424	51,112
Total contractual obligations	632,610	157,804	146,526	55,882	272,398

The majority of the Company's contractual obligations consist of long-term debt and interest payable. Long-term debt obligations are comprised of senior secured notes and subordinated convertible debentures. The Notes, which were originally issued by New Gold pursuant to a note indenture dated June 28, 2007, mature and become payable on June 28, 2017 and bear interest at a rate of 10% per annum. At March 31, 2011, the face value of the Notes totaled \$192.4 million (Cdn\$187.0 million) with remaining interest payable totaling \$125.1 million (Cdn\$121.6 million). Interest is payable in arrears in equal semi-annual installments on January 1 and July 1 each year. Once the New Afton project is in commercial production, the Company is obligated to offer to repay a face value amount equal to 50% of excess cash flow each year, at the option of

the noteholders. The Company also has the option to prepay the Notes at a premium ranging from 110% to 101% (decreasing rates based on the length of time the Notes are outstanding). These Notes are secured on the New Afton project assets and do not have recourse to other assets of New Gold.

The Company has 55,000 subordinated convertible debentures that 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 March 31, 2011, the aggregate principal of the subordinated convertible debentures was \$56.6 million (Cdn\$55.0 million) with remaining interest payable totaling \$9.9 million (Cdn\$9.6 million). Interest is payable in arrears in equal semi-annual installments on January 1 and July 1 each year.

### **OUTSTANDING SHARES**

As at May 3, 2011, there were 400,962,643 common shares of the Company outstanding. The Company had 11,749,382 stock options outstanding under its share option plan, exercisable for 11,749,382 common shares. In addition, the Company had 56,986,032 common share purchase warrants outstanding exercisable for 56,986,032 common shares.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in conformity with International Financial Reporting Standards requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Based on historical experience, current market conditions and expert advice, management makes assumptions that are believed to be reasonable under the circumstances. These estimates and assumptions form the basis for judgments about the carrying value of assets and liabilities and reported amounts for revenues and expenses. The following have been identified as critical accounting policies and estimates and a change in these policies or estimates could materially impact the consolidated financial statements. The Company's complete accounting policies are described in Note 2 to the consolidated annual financial statements for the year ended March 31, 2011

#### **A. INVENTORIES**

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 labour, 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.

The recovery of gold and silver from certain 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 for 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 and silver 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.

## **B. 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.

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.

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 expensed. Further development expenditures 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 income from operations.

The Company reviews and evaluates its mining interests for indicators of impairment at the end of each reporting period. Impairment assessments are conducted at the level of cash-generating units ("CGUs"), with each operating mine and development project representing a separate CGU. If an indication of impairment exists, the recoverable amount of the CGU is estimated. An impairment loss is recognized when the carrying amount of the CGU is in excess of its recoverable amount. The recoverable amount is the greater of the CGU's fair value less costs to sell and its value in use.

The Company assesses at the end of each reporting period whether there is any indication that an impairment loss recognized in prior periods for a long-lived asset may no longer exist or may have decreased. If any such indication exists, the Company estimates the recoverable amount of that CGU. A reversal of an impairment loss is recognized up to the lesser of the recoverable amount or the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the CGU in prior years.

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset that necessarily takes a substantial period of time to get ready for its intended use are capitalized until such time as the assets are substantially ready for their intended use. Other borrowing costs are recognized as an expense in the period in which they are incurred.

### **C. 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, changes in laws and regulations or changes to market inputs to the decommissioning model.

### **D. INCOME TAXES**

The Company uses the liability method of accounting for income taxes. Under the liability method, deferred 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 deferred tax liabilities for the tax effect of such differences.

Current tax for each taxable entity is based on the local taxable income at the local statutory rate enacted or substantively enacted at the statement of financial position date and includes adjustments to tax payable or recoverable in respect of previous periods.

Deferred 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 deferred tax asset (a valuation allowance) is recorded against any deferred tax asset if it is not more likely than not to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted.

Mining taxes and royalties are treated and disclosed as current and deferred taxes if they have the characteristics of an income tax.

## **E. 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. These types of adjustments can have a material impact on revenues.

## **F. LONG TERM INCENTIVE PLANS**

As part of its long-term incentive plans, the Company has established an employee stock option plan. Compensation expense is determined using the Black-Scholes option pricing model based on estimated fair values of all stock-based awards at the date of grant and is expensed to operations over each award's vesting period. The Black-Scholes option pricing model utilizes subjective assumptions such as expected price volatility and expected life of the option. Changes in these input assumptions can significantly affect the fair value estimate.

The Company has also established a share unit award plan that results in future cash payments to the holder of share unit awards as a long-term incentive plan. As the Company is required to settle this award in cash based on the market price of the Company's common shares, the Company recognizes a provision based on the vesting of the awards. The provision is recorded at fair value and changes in the fair value of the award are included in compensation expense.

## **POLICIES USED IN ANNUAL FINANCIAL STATEMENTS**

As described below, the Company's current interim financial statements are its first financial statements prepared using IFRS. These interim financial statements were prepared using the accounting policies the Company expects to adopt in its December 31, 2011 annual financial statements. In preparing the Company's first annual financial statements the Company is required to use the standards in effect as at December 31, 2011, which may differ from the policies the Company currently expects to adopt and use in the current interim financial statements. Differences may arise as a result of new standards being issued, with an effective date of December 31, 2011 or prior, before the preparation of the Company's December 31, 2011 annual financial statements. Accordingly, to the extent that new standards are issued with an effective date of December 31, 2011 or prior the accounting policies used in the Company's current interim financial statements would differ from those used in the company's annual December 31, 2011 financial statements. A change in the accounting policies used may result in material changes to the Company's reported financial position, results of operations and cash flows.

## **FUTURE CHANGES IN ACCOUNTING POLICIES**

IFRS 9 Financial instruments ("IFRS 9") was issued by the IASB on November 12, 2009 and will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 is effective for annual periods

beginning on or after January 1, 2013. The Company has not early adopted IFRS 9 and is currently evaluating the impact on its financial statements.

### **INTERNATIONAL FINANCIAL REPORTING STANDARDS**

In February 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed January 1, 2011, as the date International Financial Reporting Standards (“IFRS”) would replace Canadian generally accepted accounting principles (“GAAP”) for publicly accountable enterprises. As a result, the Company has prepared its current interim consolidated financial statements using IFRS accounting policies, with restatement for comparative purposes of amounts reported under Canadian GAAP. The Company’s financial statements for the year ending December 31, 2011 will be its first annual financial statements that comply with IFRS.

The transition to IFRS had a significant impact on the Company’s consolidated balance sheets and statements of comprehensive income. The impact on the January 1, 2010 opening balance sheet under IFRS compared to the December 31, 2009 balance sheet under Canadian GAAP was a \$255.9million decrease in the equity balance. Please refer to Note 25 of the consolidated interim financial statements for the reconciliations between IFRS and Canadian GAAP for the balance sheets at January 1, March 31, and December 31, 2010, and for the statements of comprehensive income for the three months ended March 31, 2010 and for the year ended December 31, 2010. Reconciliations between IFRS and Canadian GAAP for the statements of cash flows for the three months ended March 31, 2010 and the year ended December 31, 2010 are provided in Note 25; however, the actual cash flows of the Company were not affected by the transition to IFRS.

The following discussion highlights the impact of significant differences between Canadian GAAP and IFRS on the Company’s consolidated financial statements:

#### **A. MINING INTERESTS**

IFRS 1 First-time Adoption of International Financial Reporting Standards (“IFRS 1”) allows an entity to initially measure an item of property, plant and equipment on transition to IFRS at fair value on the transition date and use that fair value as its deemed cost. Please refer below for further details on the IFRS 1 exemptions elected by the Company.

Under IFRS 1, the Company elected to measure the New Afton project at fair value on transition to IFRS. The Company calculated the fair value of the project using a discounted cash flow methodology. Under Canadian GAAP, the estimates of future cash flows used to test the recoverability were on an undiscounted basis.

The write-down of the project to its fair value on the date of transition resulted in a \$327.6 million decrease in mining interests, a decrease in deferred tax liabilities of \$81.2 million, with an offsetting adjustment of \$246.4 million to the deficit balance in the January 1, 2010 balance sheet. The use of the fair value as deemed cost election resulted in setting a new historical cost base of the property from which potential future impairment losses and reversals will be measured.

## **B. FINANCIAL INSTRUMENTS**

The transition to IFRS resulted in presentation and measurement differences for the Company's share purchase warrants and convertible debentures. Under IFRS, share purchase warrants with an exercise price denominated in a currency other than the Company's functional currency are required to be classified and accounted for as financial liabilities at their fair values, with changes in fair values being included in the income statement. Under Canadian GAAP, all the Company's outstanding share purchase warrants were classified and accounted for as equity. The January 1, 2010 balance sheet adjustment was an increase in derivative liabilities of \$29.8 million, a reduction in share purchase warrants included in equity of \$138.8 million, an increase in deferred tax liabilities of \$11.9 million, a reduction in common shares of \$0.8 million, with a net adjustment of \$97.9 million to the deficit balance. The impact of this difference on the Company's income statement for the year ended December 31, 2010, was an unrealized loss on derivative liabilities of \$92.6 million and a \$3.5 million foreign exchange loss.

Under IFRS, the conversion option of the Company's convertible debentures does not meet the criteria for equity classification and accordingly, is treated as a derivative liability that is measured at fair value on initial recognition. Under Canadian GAAP, the conversion option was classified as equity in the Company's balance sheet. Under IFRS, the conversion option derivative is re-measured at fair value at each balance sheet date, while under Canadian GAAP the equity component was not re-measured. The impact of this difference on the Company's January 1, 2010 balance sheet was an increase in derivative liabilities of \$7.7 million, a decrease in equity component of convertible debentures of \$21.6 million, an increase in deferred tax liabilities of \$2.6million, with an offsetting adjustment to the deficit balance of \$ 11.3million. The impact of this difference on the Company's income statement for the year ended December 31, 2010, was an unrealized loss on derivative liabilities of \$20.8 million.

Due to the Company's election of the IFRS 1 exemption for business combinations (see below), the initial recognition and subsequent measurement of the debt portion of the convertible debentures was unchanged on transition to IFRS.

## **C. FOREIGN CURRENCY TRANSLATION**

IFRS does not have the concept of group functional currency and requires a separate functional currency assessment for each entity within the consolidated group. Under Canadian GAAP, all the Company's entities had U.S. dollar functional currencies.

Under IFRS, the Company is continuing with U.S. dollar functional currencies for all entities, with the exception of the New Afton project. The Canadian dollar was determined to be the functional currency for New Afton under IFRS. .

This difference resulted in an \$8.7 million increase in mining interests, an increase in deferred tax liabilities of \$2.2 million, with an offsetting adjustment to the deficit balance of \$6.5 million in the Company's January 1, 2010 balance sheet.

The impact of this difference was a \$13.9 million decrease in unrealized foreign exchange loss in the Company's income statement for the year ended December 31, 2010.

#### **D. DECOMMISSIONING LIABILITIES (RECLAMATION AND CLOSURE COST OBLIGATIONS)**

IFRS requires provisions to be updated at each statement of financial position (balance sheet) date using a current pre-tax discount rate (which reflects current market assessment of the time value of money and the risk specific to the liability). Canadian GAAP required the use of a current credit-adjusted, risk-free rate for upward adjustments, and the original credit-adjusted, risk-free rate for downward revisions.

This difference resulted in different discount rates being applicable for IFRS purposes than the discount rates used for Canadian GAAP. Accordingly, the Company was required to recalculate its reclamation and closure cost obligations and related asset amounts on transition. In performing the calculations, the IFRS 1 elective exemption for decommissioning liabilities was applied (see IFRS 1 below).

The impact on the January 1, 2010 balance sheet was an increase in reclamation and closure cost obligations of \$4.9 million, an increase in mining interests of \$4.3 million, with an offset to the deficit balance of \$0.6 million. The impact on the December 31, 2010 balance sheet was an increase in reclamation and closure cost obligations of \$8.5 million.

#### **E. PROPERTY, PLANT AND EQUIPMENT**

IFRS requires identifying and measuring the cost of significant individual components of assets which have different useful lives than the core asset. Significant components are then separately depreciated based on their individual useful lives.

The impact on the January 1, 2010 balance sheet was a decrease in mining interests of \$2.5 million, a decrease in deferred tax liabilities of \$0.7 million, with an offset to the deficit balance of \$1.8 million.

The impact on the Company's income statement for the year ended December 31, 2010 was a reduction in operating expenses of \$3.5 million and an increase in depreciation and depletion of \$2.5 million.

#### **F. REVERSAL OF IMPAIRMENT LOSS**

Under IFRS, previous impairment losses recognized must be reversed where circumstances have changed such that the impairments have reduced (other than for impairments of goodwill, which are not reversed). Reversals of impairment losses were not permitted under Canadian GAAP.

The Company increased the carrying value by \$51.9 million for the Amapari property to reverse an impairment charge that was recognized in 2008. The increase resulted in an impairment reversal to the fair value of the property, less estimated costs to sell, at January 1, 2010. When the property was sold in the second quarter of 2010, the \$51.9 million was reversed, and offset against the gain on sale recognized for Canadian GAAP purposes.

## **G. DEFERRED TAXES**

IFRS requires a deferred tax asset or liability to be recognized for exchange gains and losses related to non-monetary assets and liabilities that are re-measured into the functional currency using the historical exchange rates. Under Canadian GAAP, a deferred tax asset or liability was not recognized for a temporary difference arising from the difference between the historical exchange rate and the current exchange rate translations of the cost of non-monetary assets and liabilities of integrated foreign operations. As a result of this difference, an adjustment was required to increase deferred tax liabilities by \$23.2 million, with an offset to the deficit balance at January 1, 2010.

Under Canadian GAAP, a deferred tax asset was not recognized on the disposition of the AB Notes, as it was assumed there was no future source of capital gains. Under IFRS, due to the deferred tax liability recognized on the warrants (refer to the financial instruments discussion in section B above), a deferred tax asset was required to be recognized on disposition of the notes. The impact on the January 1, 2010 balance sheet was a decrease in deferred tax liabilities of \$9.5 million, with an offsetting adjustment to the deficit balance.

### ***IFRS 1 Exemptions***

IFRS 1 provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions to the general requirement for full retrospective application of IFRS. A summary of the exemptions elected by Company is as follows:

i) Business combinations

IFRS 1 provides an option to not restate business combinations that occurred prior to the transition date or to only restate business combinations that occurred after a designated date prior to the transition date. The Company elected to apply this exemption to all business combinations that occurred prior to January 1, 2010. As a result, all prior business combinations were accounted for as they were under Canadian GAAP, and there was no impact on the Company's opening balance sheet as a result of this election.

ii) Fair value as deemed cost

IFRS 1 allows an entity to initially measure an item of property, plant and equipment upon transition to IFRS at fair value on the transition date or at an event-driven fair value (e.g. a fair value determined through a business combination or initial public offering). This elective exemption can be applied on an individual asset basis.

The Company elected to measure the New Afton project at January 1, 2010 at fair value and use that fair value as its deemed cost. Please refer to section A above for further details on the impact of this election on the Company's opening balance sheet.

iii) Cumulative translation account ("CTA")

IFRS 1 allows cumulative translation differences for all foreign operations to be deemed zero at the date of transition to IFRS, with future gains or losses on subsequent disposal of any foreign operations to exclude

translation differences arising from prior to the date of transition to IFRS. The Company elected to apply this exemption, and accordingly reset the CTA to zero on transition to IFRS. Please refer to section C above for further details on the impact on the Company's opening balance sheet.

iv) Decommissioning liabilities

Under IFRS 1, an entity can elect to not apply the provisions of IFRIC 1 - Changes in Existing Decommission, Restoration and Similar Liabilities, as they relate to changes in such liabilities before the date of transition to IFRS.

When applying this exemption, an entity determines its decommissioning liabilities at the transition date, discounts the liabilities back to the dates when they first arose using management's best estimate of the historical risk-adjusted discount rates, and depreciates these amounts forward to the transition date to determine the amount to be included in the depreciated cost of the assets. The Company elected to apply this exemption on transition to IFRS. Please refer to section D above for further details on the impact on the Company's opening balance sheet.

v) Share-based payment

IFRS 1 encourages, but does not require a first time adopter to apply IFRS 2 – Share-based Payment ("IFRS 2") to equity instruments that were granted on or before November 7, 2002, or were granted after November 7, 2002 but vested before the Company's IFRS transition date. Accordingly, an entity may elect not to retrospectively apply IFRS 2 to these equity instruments.

The Company elected this exemption and as a result, applied IFRS 2 retrospectively for only share-based payments that were granted after November 7, 2002 and had not vested at the date of transition. There was no impact on the Company's opening balance sheet as a result of this election.

vi) Borrowing costs

IFRS 1 permits an entity to apply the transitional provisions of IAS 23 - Borrowing Costs ("IAS 23") as an alternative to full retrospective application. Under these provisions, an entity may elect to only apply IAS 23 to qualifying assets for which the commencement date for capitalization is on or after the date of transition (or an elected earlier date).

The Company elected to apply this exemption from its transition date of January 1, 2010, and as a result, will apply IAS 23 to qualifying properties for which the commencement date for capitalization is January 1, 2010 or later. There was no impact on the Company's opening balance sheet as a result of this election.

## **CONTROLS AND PROCEDURES**

### **A. DISCLOSURE CONTROLS AND PROCEDURES**

The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the

end of the period covered by this report, the Company's disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by the Company in reports it files is recorded, processed, summarized and reported, within the appropriate time periods.

## **B. MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Company's management, including the Chief Executive Officer and the Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting ("IFCR") is a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detections of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

The Company's management, including its President and Chief Executive Officer and Executive Vice President and Chief Financial Officer, believe that any internal controls and procedures for financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Furthermore, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented and or detected. These inherent limitations include the realities that judgments in decision-making can be faulty and breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010. In making this assessment, it used the criteria set forth in the Internal

Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our assessment, management has concluded that, as of December 31, 2010, the Company's internal control over financial reporting is effective based on those criteria.

The Company's internal control over financial reporting as of December 31, 2010 has been audited by Deloitte & Touche LLP, Independent Registered Chartered Accountants who also audited the Company's Consolidated Financial Statements for the year ended December 31, 2010. Deloitte & Touche LLP as stated in their report, that immediately precedes the Company's audited consolidated financial statements for the year ended December 31, 2010, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

### **C. CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There has been no change in the Company's design of internal controls and procedures over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting during the period covered by this Management's Discussion and Analysis.

### **ENDNOTES**

1. "Total cash cost" figures are calculated in accordance with a standard developed by The Gold Institute, which was a worldwide association of suppliers of gold and gold products and included leading North American gold producers. The Gold Institute ceased operations in 2002, but the standard is the accepted standard of reporting cash cost of production in North America. Adoption of the standard is voluntary and the cost measures presented may not be comparable to other similarly titled measures of other companies. The Company reports total cash cost on a sales basis. Total cash cost includes mine site operating costs such as mining, processing, administration, royalties and production taxes, realized gains and losses on fuel contracts, but is exclusive of amortization, reclamation, capital and exploration costs and net of by-product sales. Total cash cost is then divided by gold ounces sold to arrive at the total cash cost per ounce sold. The measure, along with sales, is considered to be a key indicator of a company's ability to generate operating earnings and cash flow from its mining operations. This data is furnished to provide additional information and is a non-IFRS measure. It should not be considered in isolation as a substitute for measures of performance prepared in accordance with IFRS and is not necessarily indicative of operating costs presented under IFRS.
2. Average realized price per ounce of gold sold is a non-IFRS financial measure which:
  - excludes from revenues unrealized gains and losses on non-hedge derivative contracts; and,
  - includes revenues from the Amapari Mine which has been presented as a discontinued operation.

### **CAUTIONARY NOTE TO U.S. READERS CONCERNING ESTIMATES OF MEASURED, INDICATED AND INFERRED MINERAL RESOURCES**

Information concerning the properties and operations of New Gold has been prepared in accordance with Canadian disclosure standards under applicable Canadian securities laws, and may not be comparable to similar information for United States companies. The terms "Mineral Resource", "Measured Mineral Resource", "Indicated Mineral Resource" and "Inferred Mineral Resource" used in this MD&A are Canadian mining terms as defined in accordance with NI 43-101 under guidelines set out in the Canadian Institute of Mining, Metallurgy and Petroleum ("CIM") Standards on Mineral Resources and Mineral Reserves adopted by the CIM Council on December 11, 2005. While the terms "Mineral Resource", "Measured Mineral Resource", "Indicated Mineral Resource" and "Inferred Mineral Resource" are recognized and required by Canadian regulations, they are not defined terms under standards of the United States Securities and Exchange Commission. Under United States standards, mineralization may not be classified as a "reserve" unless the determination has been made that the mineralization could be economically and legally produced or extracted at the time the reserve calculation is made. As such, certain information contained in this MD&A concerning descriptions of mineralization and resources under Canadian standards is not comparable to similar information made public by United States companies subject to the reporting and disclosure requirements of the United States Securities and Exchange Commission. An "Inferred Mineral Resource" has a great amount of uncertainty as to its existence and as to its economic and legal feasibility. It cannot be assumed that all or any part of an "Inferred Mineral Resource" will ever be upgraded to a higher category. Under Canadian rules, estimates of Inferred Mineral Resources may not form the basis of feasibility or other economic studies. Readers are cautioned not to assume that all or any part of Measured or Indicated Resources will ever be converted into Mineral Reserves. Readers are also cautioned not to assume that all or any part of an "Inferred Mineral Resource" exists, or is economically or legally mineable. In addition, the definitions of "Proven Mineral Reserves" and "Probable Mineral Reserves" under CIM standards differ in certain respects from the standards of the United States Securities and Exchange Commission.

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain information contained in this document, including any information relating to New Gold's future financial or operating performance may be deemed "forward looking". All statements in this document, other than statements of historical fact, that address events or developments that New Gold expects to occur, are "forward-looking statements". Forward-looking statements are statements that are not historical facts and are generally, but not always, identified by the words "expects", "does not expect", "plans", "anticipates", "does not anticipate", "believes", "intends", "estimates", "projects", "potential", "scheduled", "forecast", "budget" and similar expressions or their negative connotations, or that events or conditions "will", "would", "may", "could", "should" or "might" occur. All such forward-looking statements are based on the opinions and estimates of management as of the date such statements are made and are subject to important risk factors and uncertainties, many of which are beyond New Gold's ability to control or predict. Forward-looking statements are necessarily based on estimates and assumptions that are inherently subject to known and unknown risks, uncertainties and other factors that may cause New Gold's actual results, level of activity, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. Such factors include, without limitation: price levels and volatility in the spot and forward markets for commodities; the uncertainties inherent to current and future legal challenges New Gold is or may become a party to, including the third party claim related to the El Morro transaction with respect to New Gold's exercise of its right of first refusal on the El Morro copper-gold project in Chile and its partnership with Goldcorp Inc., which transaction and third party claim were announced by New Gold in January 2010; controls, regulations and political or economic developments in the countries in which New Gold does or may carry on business; changes in national and local government legislation in Canada, the United States, Australia, Mexico and Chile or any other country in which New Gold currently does or may in the future carry on business; the lack of certainty with respect to foreign legal systems, which may not be immune from the influence of political pressure, corruption or other factors that are inconsistent with the rule of law; the speculative nature of mineral exploration and development, including the risks of obtaining and maintaining the validity and enforceability of the necessary licenses and permits and complying with the permitting requirements of each jurisdiction that New Gold operates, including, but not limited to, Mexico, where New Gold is involved with ongoing challenges relating to its environmental impact statement for the Cerro San Pedro Mine; discrepancies between actual and estimated production, between actual and estimated costs, between actual and estimated reserves and resources and between actual and estimated metallurgical recoveries; actual results of current exploration or reclamation activities; fluctuations in the international currency markets and in the rates of exchange of the currencies of Canada, the United States, Australia, Mexico and Chile; significant capital requirements; impact of any hedging activities; taxation; additional funding requirements; loss of key employees; diminishing quantities or grades of reserves; changes in project parameters as plans continue to be refined; accidents; labour disputes; defective title to mineral claims or property or contests over claims to mineral properties; and competition. In addition, there are risks and hazards associated with the business of mineral exploration, development and mining, including environmental hazards, industrial accidents, unusual or unexpected formations, pressures, cave-ins, flooding and gold bullion losses (and the risk of inadequate insurance or inability to obtain insurance to cover these risks) as well as other risks discussed under the heading "Risks Factors" included in New Gold's latest Annual Information Form filed on [www.sedar.com](http://www.sedar.com) and this MD&A for the quarter ended March 31, 2011, both available at [www.sedar.com](http://www.sedar.com). Forward-looking statements are not guarantees of future performance, and actual results and future events could materially differ from those anticipated in such statements. All of the forward-looking statements contained in this document are qualified by these cautionary statements. New Gold expressly disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, events or otherwise, except in accordance with applicable securities laws.

Condensed consolidated interim financial statements of

**New Gold Inc.**

At and for the three months ended March 31, 2011  
(unaudited)

## Table of contents

Condensed consolidated income statements .....	1
Condensed consolidated statements of comprehensive income .....	2
Condensed consolidated statements of financial position .....	3
Condensed consolidated statements of changes in equity .....	4
Condensed consolidated statements of cash flows .....	5
Notes to the condensed consolidated interim financial statements .....	6-65

# New Gold Inc.

## Condensed consolidated income statements Three month periods ended March 31

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

(Unaudited)

	2011	2010
	\$	\$
		Note 25
Revenues	171,213	101,620
Operating expenses	(70,716)	(51,886)
Depreciation and depletion	(20,027)	(12,963)
Earnings from mine operations	80,470	36,771
Corporate administration expenses	(6,181)	(5,645)
Share-based payment expenses	(2,856)	(1,940)
Exploration expenses	(2,126)	(1,794)
Income from operations	69,307	27,392
Finance income (Note 4)	1,046	256
Finance costs (Note 4)	(1,137)	(558)
Other gains and losses (Note 4)	(24,398)	(4,612)
Earnings before taxes	44,818	22,478
Income tax expense (Note 13)	(20,099)	(9,436)
Net earnings from continuing operations	24,719	13,042
Earnings from discontinued operations (Note 8)	-	305
<b>Net earnings</b>	<b>24,719</b>	<b>13,347</b>
Earnings per share from continuing operations		
Basic	0.06	0.03
Diluted	0.06	0.03
Earnings per share from discontinued operations		
Basic	-	-
Diluted	-	-
Earnings per share from continuing and discontinued operations		
Basic	0.06	0.03
Diluted	0.06	0.03
Weighted average number of shares outstanding (in thousands)		
Basic	399,336	388,956
Diluted	405,523	398,190

See accompanying notes to the condensed consolidated financial statements.

# New Gold Inc.

## Condensed consolidated statements of comprehensive income Three month periods ended March 31

(Expressed in thousands of U.S. dollars)

(Unaudited)

	2011	2010
	\$	\$
		Note 25
<b>Net earnings</b>	<b>24,719</b>	13,347
Other comprehensive income (loss)		
Unrealized losses on mark-to-market of gold contracts (Note 11)	(1,866)	(6,029)
Realized losses on mark-to-market of gold contracts (Note 11)	7,610	2,869
Unrealized gains on mark-to-market of fuel contracts (Note 11)	-	85
Cumulative translation adjustment	7,907	7,584
Deferred income tax related to components of other comprehensive income	(2,269)	1,824
Total other comprehensive income	11,382	6,333
Total comprehensive income	36,101	19,680

See accompanying notes to the condensed consolidated financial statements.

# New Gold Inc.

## Condensed consolidated statements of financial position

(Expressed in thousands of U.S. dollars)

(Unaudited)

	March 31 2011	December 31 2010	January 1 2010
	\$	\$	\$
<b>Assets</b>		Note 25	Note 25
<b>Current assets</b>			
Cash and cash equivalents (Note 2(c))	520,169	490,754	271,526
Trade and other receivables (Note 2(p))	29,542	11,929	10,345
Inventories (Note 6)	107,902	103,055	86,299
Current portion of derivative assets (Note 11)	-	-	706
Prepaid expenses and other	5,467	7,325	6,933
Current assets of operations held for sale (Note 8)	-	-	10,298
<b>Total current assets</b>	<b>663,080</b>	613,063	386,107
Investments (Note 7)	-	7,533	45,890
Mining interests (Note 9)	1,830,427	1,767,240	1,664,563
Deferred tax assets (Note 13)	10,211	10,058	11,098
Reclamation deposits and other (Note 14)	24,553	31,295	17,646
Assets of operations held for sale (Note 8)	-	-	78,989
<b>Total assets</b>	<b>2,528,271</b>	2,429,189	2,204,293
<b>Liabilities</b>			
<b>Current liabilities</b>			
Trade and other payables (Note 5)	76,975	69,245	37,999
Current portion of long-term debt (Note 10)	-	-	12,088
Current portion of derivative liabilities (Note 11)	40,718	40,072	19,206
Current tax liabilities	38,203	31,392	13,711
Current liabilities of operations held for sale (Note 8)	-	-	10,414
<b>Total current liabilities</b>	<b>155,896</b>	140,709	93,418
Reclamation and closure cost obligations (Note 14)	35,571	34,173	24,764
Provisions (Note 23)	12,569	9,227	4,541
Non-current portion of derivative liabilities (Note 11)	106,736	113,303	76,780
Non-hedged derivative liabilities (Note 11)	183,367	155,365	37,542
Deferred tax liabilities	178,034	179,180	245,969
Long-term debt (Note 10)	239,550	229,884	225,456
Deferred benefit (Note 9 (a))	46,276	46,276	-
Other	661	577	814
Liabilities of operations held for sale (Note 8)	-	-	19,890
<b>Total liabilities</b>	<b>958,660</b>	908,694	729,174
<b>Equity</b>			
Common shares (Note 12)	1,862,196	1,845,886	1,810,039
Contributed surplus	77,881	81,176	82,984
Share purchase warrants (Note 12)	-	-	11,850
Other reserves	(40,531)	(51,913)	(27,639)
Deficit	(329,935)	(354,654)	(402,115)
	(370,466)	(406,567)	(429,754)
<b>Total equity</b>	<b>1,569,611</b>	1,520,495	1,475,119
<b>Total liabilities and equity</b>	<b>2,528,271</b>	2,429,189	2,204,293

Commitments and contingencies (Note 22)

Subsequent events (Note 24)

Approved and authorized by the Board on May 4, 2011

**"Robert Gallagher"**

Robert Gallagher, Director

**"James Estey"**

James Estey, Director

See accompanying notes to the condensed consolidated financial statements.

# New Gold Inc.

## Condensed consolidated statements of changes in equity Three month periods ended March 31

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

(Unaudited)

	2011	2010
	\$	\$
		Note 25
<b>Common shares</b>		
Balance, beginning of period	1,845,886	1,810,039
Exercise of options	16,310	1,760
Balance, end of period	1,862,196	1,811,799
<b>Contributed surplus</b>		
Balance, beginning of period	81,176	82,984
Exercise of options	(5,070)	(995)
Share-based payments	1,775	1,898
Balance, end of period	77,881	83,887
<b>Share purchase warrants</b>		
Balance, beginning of period	-	11,850
Exercise of warrants	-	-
Balance, end of period	-	11,850
<b>Cumulative translation adjustment*</b>		
Balance, beginning of period	14,334	-
Currency translation differences	7,907	7,584
Balance, end of period	22,241	7,584
<b>Unrealized gains/losses on cash flow hedges*</b>		
Balance, beginning of period	(66,247)	(27,639)
Ineffective portion of changes in fair value of cash flow hedges, net of tax		
Net change in fair value of hedging instruments	3,475	(1,251)
Balance, end of period	(62,772)	(28,890)
<b>Deficit</b>		
Balance, beginning of period	(354,654)	(402,115)
Net earnings	24,719	13,347
Balance, end of period	(329,935)	(388,768)
<b>Total equity</b>	<b>1,569,611</b>	<b>1,497,462</b>

See accompanying notes to the condensed consolidated financial statements.

\* Other reserves

# New Gold Inc.

## Condensed consolidated statements of cash flows Three month periods ended March 31

(Expressed in thousands of U.S. dollars)

(Unaudited)

	2011	2010
	\$	\$
		Note 25
<b>Operating activities</b>		
Net earnings	24,719	13,347
Earnings from discontinued operations	-	(305)
Adjustments for:		
Unrealized gain on gold contracts	(2,002)	(2,076)
Unrealized loss on fuel contracts	-	65
Unrealized foreign exchange gain	(3,115)	(1,369)
Unrealized and realized gain on of investments	(1,349)	(3,944)
Unrealized loss on non-hedge derivatives	24,355	10,109
Loss on disposal of assets	108	398
Depreciation and depletion	19,637	13,070
Share-based payments	1,775	1,898
Unrealized loss (gain) on embedded derivative contract	2,454	(1,907)
Unrealized loss (gain) on hedging items entered into for cash flow hedges	1,827	-
Income tax expense	20,099	9,436
Income tax paid	(11,236)	(9,120)
Finance income	(1,046)	(256)
Interest received	1,046	232
Finance costs	1,137	558
Interest paid	(265)	(206)
Change in non-cash working capital (Note 15)	(27,601)	(6,950)
Cash provided by continuing operations	50,543	22,980
Cash used in discontinued operations	-	(1,696)
<b>Investing activities</b>		
Mining interests	(57,182)	(22,002)
Recovery (contribution) of reclamation deposits	8,147	(41)
Proceeds from disposal of assets	132	29
Cash received in El Morro transaction, net of transaction costs	-	46,276
Investment in El Morro	-	(463,000)
Proceeds from sale of investments	8,927	48,112
Cash used in continuing operations	(39,976)	(390,626)
Cash used in discontinued operations	-	(219)
<b>Financing activities</b>		
Exercise of options to purchase common stock	11,240	765
El Morro loan	-	463,000
Revolving credit facility costs	(431)	-
Repayment of long-term debt	-	(27,235)
Cash provided by continuing operations	10,809	436,530
Cash provided by (used in) discontinued operations	-	-
Effect of exchange rate changes on cash and cash equivalents	8,039	5,295
Increase in cash and cash equivalents	29,415	72,264
Cash and cash equivalents, beginning of period	490,754	272,352
<b>Cash and cash equivalents, end of period</b>	<b>520,169</b>	<b>344,616</b>
Comprised of		
Cash and cash equivalents of continuing operations	520,169	343,715
Cash and cash equivalents of discontinued operations	-	901
	520,169	344,616
Cash and cash equivalents are comprised of		
Cash	256,343	113,202
Short-term money market instruments	263,826	231,414
	520,169	344,616

Supplemental cash flow information (Note 15)

See accompanying notes to the condensed consolidated financial statements.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 1. Description of business and nature of operations

New Gold Inc. and its wholly owned subsidiaries are gold producers engaged in gold mining and related activities including acquisition, exploration, extraction, processing and reclamation. New Gold Inc.'s assets are comprised of the Mesquite Mine in the United States ("U.S."), the Cerro San Pedro Mine in Mexico, and the Peak Mines in Australia. Significant development projects include the New Afton copper-gold project in Canada and a 30% interest in the El Morro copper-gold project in Chile.

New Gold Inc. is a publicly listed company incorporated in Canada with limited liability under the legislation of the Province of British Columbia. The Company's shares are listed on the Toronto Stock Exchange, and the NYSE AMEX under the symbol NGD.

The Company's registered office is located at 3110 – 666 Burrard Street, Vancouver, British Columbia, V6C 2X8, Canada.

### 2. Summary of significant accounting policies

These unaudited condensed consolidated interim financial statements, including comparatives, have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB"), using the accounting policies the Company expects to adopt in its consolidated financial statements for the year ended December 31, 2011. The disclosures related to the transition from Canadian generally accepted accounting principles ("Canadian GAAP") to International Financial Reporting Standards ("IFRS") are included in Note 25.

The condensed consolidated interim financial statements have been prepared on the historical cost basis except for the revaluation of the certain financial instruments. The principal accounting policies are set out below.

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

These condensed consolidated interim financial statements include the accounts of the Company and all of its subsidiaries. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by the other members of the Group.

Subsidiaries are entities controlled by the Company. The financial statements of subsidiaries are included in the consolidated financial statements. Associates are those entities in which the Company has significant influence over the financial and operating policies. Significant influence is presumed to exist when the Company holds between 20 and 50 percent of the voting power of another entity. Investments in associates are accounted for using the equity method.

The principal subsidiaries and associates of the Company as of March 31, 2011 are as follows:

Name of subsidiary/associate	Principal Activity	Country of incorporation and operation	Interest March 31 2011	Interest December 31 2010	Interest January 1 2010
Metallica Resources Inc.	Holding company	Canada	100%	100%	100%
Minera Metallica Resources Chile Limitada	Mining	Chile	100%	100%	100%
Minera San Xavier, S.A. de C.V.	Mining	Mexico	100%	100%	100%
Peak Gold Mines Pty Ltd	Mining	Australia	100%	100%	100%
Inversiones El Morro Limitada	Holding company	Chile	100%	100%	100%
Sociedad Contractual Minera El Morro	Mining	Chile	30%	30%	30%
Western Goldfields Inc.	Holding company	Canada	100%	100%	100%
Western Goldfields (USA) Inc.	Holding company	USA	100%	100%	100%
Western Mesquite Mines, Inc.	Mining	USA	100%	100%	100%

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

#### (b) Use of estimates

The preparation of interim consolidated financial statements in conformity with International Financial Reporting Standards requires the Company's management to make judgments, estimates and assumptions about future events that affect the amounts reported in the condensed consolidated interim financial statements and related notes to the financial statements. Actual results may differ from those estimates.

Significant estimates used in the preparation of these condensed consolidated interim financial statements include, but are not limited to, the recoverability of trade receivables and investments, measurement of revenue and trade receivables, 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 share-based payments, valuation of warrants, valuation of embedded derivatives, valuation of derivative instruments, valuation of investments, the provision for income and mining taxes and composition of deferred 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 decommissioning cost obligations, and the fair value of assets and liabilities acquired in business combinations.

Significant critical judgments, estimates and assumptions include the following:

#### Estimated recoverable reserves and resources

The Company estimates its ore reserves and mineral resources based on information compiled by appropriately qualified persons. The estimation of recoverable reserves will be impacted by forecast commodity prices, exchange rates, production costs and recoveries amongst other factors. Changes in the reserve or resource estimates may impact the carrying value of assets and depreciation and impairment charges recorded in the income statement.

#### Reclamation and closure cost obligations

Reclamation and closure costs obligations are based on management's best estimates of the present value of the future costs using information available at the date of the statement of financial position. Changes in factors used in determining these estimates such as cost estimates, technological or regulatory changes, or changes in inflation or discount rates will result in the future actual expenditures differing from the amounts currently provided.

#### Impairment testing

Significant judgments and assumptions are required in performing impairment testing of non-current assets. Fair value for mineral assets is determined as the present value of estimated future cash flows arising from continued use of the asset. The Company estimates future cash flows based on expected future production, long-term commodity prices, operating costs and capital costs. Estimates also include costs of future expansion plans and eventual disposal. The discount rates used are management's best estimates of the real after-tax rates that would be used by market participants for properties or projects of a similar nature. Changes in these assumptions may alter the results of impairment testing, impairment losses in the income statement and the resulting carrying value of mining assets.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

(b) *Use of estimates (continued)*

Fair value hierarchy

Fair values are determined using valuation techniques. These techniques use assumptions based on market conditions existing at the date of the statement of financial position.

Where the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques including the discounted cash flow model. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect reported fair value of financial instruments.

(c) *Cash and cash equivalents*

The Company considers all highly liquid investments with original maturities of three months or less at the date of acquisition to be cash equivalents. These highly liquid investments only comprise short-term Canadian and U.S. government treasury bills and other evidences of indebtedness and treasury bills of the Canadian provinces with a minimum credit rating of R-1 mid from the Dominion Bond Rating Service ("DBRS") or an equivalent rating from Standard & Poors and Moody's. In addition, the Company is permitted to invest in bankers' acceptances and other evidences of indebtedness of certain financial institutions, including Canadian banks.

(d) *Inventories*

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 labour, 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.

The recovery of gold and silver from certain 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 for current mining and leaching costs, including applicable depreciation, depletion and amortization relating to mining interests. Costs are removed from ore on leachpads as ounces of gold and silver are recovered based on the average cost per recoverable ounce on the leach pad.

Estimates of recoverable gold and silver 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.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

#### (d) *Inventories (continued)*

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.

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 expensed. 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 income from operations.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

#### (e) Mining interests (continued)

Mining assets are depreciated using a unit-of-production method based on the estimated economically recoverable reserves to which they relate.

Plant and equipment is depreciated using the straight-line method over their estimated useful lives, or the remaining life of the mine if shorter.

	Average Life
Building	15 - 50
Plant and machinery	3 - 20
Vehicles	5 - 7
Office equipment	5 - 10
Computer equipment	3 - 5

The Company reviews and evaluates its mining interests for indicators of impairment at the end of each reporting period. Impairment assessments are conducted at the level of cash-generating units ("CGUs"), with each operating mine and development project representing a separate CGU. If an indication of impairment exists, the recoverable amount of the CGU is estimated. An impairment loss is recognized when the carrying amount of the CGU is in excess of its recoverable amount. The recoverable amount is the greater of the CGU's fair value less costs to sell and its value in use.

The Company assesses at the end of each reporting period whether there is any indication that an impairment loss recognized in prior periods for a long-lived asset may no longer exist or may have decreased. If any such indication exists, the Company estimates the recoverable amount of that CGU. A reversal of an impairment loss is recognized up to the lesser of the recoverable amount or the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the CGU in prior years.

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset that necessarily takes a substantial period of time to get ready for its intended use are capitalized until such time as the assets are substantially ready for their intended use. Other borrowing costs are recognized as an expense in the period in which they are incurred.

#### (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, changes in laws and regulations or changes to market inputs to the decommissioning model.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

#### (g) *Income taxes*

The Company uses the liability method of accounting for income taxes. Under the liability method, deferred 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 deferred tax liabilities for the tax effect of such differences.

Current tax for each taxable entity is based on the local taxable income at the local statutory rate enacted or substantively enacted at the statement of financial position date and includes adjustments to tax payable or recoverable in respect of previous periods.

Deferred 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 deferred tax asset (a valuation allowance) is recorded against any deferred tax asset if it is not probable to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted.

Mining taxes and royalties are treated and disclosed as current and deferred taxes if they have the characteristics of an income tax.

#### (h) *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 it is 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 the reporting date.

#### (i) *Foreign currency translation*

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which that entity operates (its functional currency). The functional currency of the parent entity and the presentation currency of the consolidated financial statements is the U.S. Dollar. The Company's Mexican, Australian, and U.S. operations also have the U.S. Dollar as their functional currency. The functional currency of the Canadian development project (New Afton) is the Canadian dollar.

In preparing the functional currency financial statements of the individual entities, transaction amounts denominated in foreign currencies (currencies other than the functional currency of the respective entity) are translated into the entity's functional currency using exchange rates prevailing at the transaction dates.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

(i) *Foreign currency translation (continued)*

The method of translation of an entity's financial statements to the Company's U.S. dollar presentation currency is dependent upon the functional currency of the entity being translated. For the operations with the U.S. Dollar as their functional currency, monetary assets and liabilities 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 exchange rates at the dates of the transactions or using a rate that approximates the exchange rates at the dates of the transactions. Foreign currency transaction gains and losses are included in the determination of profit or loss. In addition, unrealized gains and losses to movement in exchange rates on cash balances held in foreign currencies are shown separately on the consolidated statements of cash flows.

For the entity with Canadian dollar as its functional currency, carrying values of foreign currency assets and liabilities are translated at each statement of financial position date using the closing exchange rate on that date. Revenues and expenses are translated at exchange rates at the dates of the transactions or using a rate that approximates the exchange rates at the dates of the transactions. Gains and losses arising from translation of foreign currency assets and liabilities at each reporting period are included in the cumulative translation adjustment account in other comprehensive income.

(j) *Earnings per share*

Earnings 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.

(k) *Revenue recognition*

Revenue from the sale of metals and metals in concentrate is recognized when all the following conditions are satisfied:

- the Company has transferred to the buyer the significant risks and rewards of ownership;
- the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably

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.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

#### (l) *Long-term incentive plans*

As part of its long-term incentive plans, the Company has established an employee stock option plan. 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.

The Company has also established a share unit award plan that results in future cash payments to the holder of share unit awards as a long-term incentive plan. As the Company is required to settle this award in cash based on the market price of the Company's common shares, the Company recognizes a provision based on the vesting of the awards. The provision is recorded at fair value and changes in the fair value of the award are included in compensation expense.

#### (m) *Non-derivative financial assets*

The Company recognizes all financial assets initially at fair value and classifies them into one of the following four categories: held-to-maturity, available-for-sale ("AFS"), loans and receivables, or fair value through profit or loss ("FVTPL"). Financial assets held to maturity and loans and receivables 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 FVTPL are measured at fair value with unrealized gains and losses recognized on the income statement.

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

The Company has designated its short-term investments and its asset backed notes ("AB Notes") as FVTPL. Cash and cash equivalents, trade receivables and reclamation deposits are classified as loans and receivables.

Transaction costs related to financial assets classified as FVTPL are recognized immediately into income. For financial instruments assets classified as other than as FVTPL, transaction costs are included in the initial carrying value of the instrument.

#### (n) *Non-derivative financial liabilities*

Financial liabilities are classified as either financial liabilities at FVTPL or other financial liabilities. Financial liabilities classified as FVTPL are measured at fair value with unrealized gains and losses recognized on the income statement. Other financial liabilities including borrowings are initially measured at fair value net of transaction costs, and subsequently measured at amortized cost.

Trade and other payables, short-term borrowings and long-term debt are classified as other financial liabilities. Accrued liabilities related to the share unit award plan have been classified as FVTPL.

Compound financial instruments comprise convertible debentures that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 2. Summary of significant accounting policies (continued)

(n) *Non-derivative financial liabilities (continued)*

The Debentures are classified as compound financial instruments for accounting purposes because of the holder conversion option. The conversion option is treated as a derivative liability and measured at fair value on initial recognition, and subsequently re-measured at fair value through profit and loss at the end of each period. The debt component is measured at amortized cost and is accreted over the expected term to maturity using the effective interest method.

Transaction costs related to financial liabilities classified as FVTPL are recognized immediately into income. For financial liabilities classified as other than as FVTPL, transaction costs are included in the initial carrying value of the instrument.

(o) *Derivative instruments, including hedge accounting*

Financial and derivative instruments, including embedded derivatives, are recorded at fair values on initial recognition and at each subsequent reporting period. Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to profit or loss for the year.

The Company has entered into arrangements for the sale of gold. The Company has designated this derivative as a cash flow hedge. At the inception of a hedge relationship, the Company formally designates and documents the hedge relationship to which the Company wishes to apply hedge accounting and risk management objective and strategy for understanding the hedge. In addition, at the inception of the hedge and on an ongoing basis, the Company documents whether the hedging instrument is highly effective.

Gains and losses for the effective portion of the hedging instruments are included in other comprehensive income. Gains and losses for any ineffective portion of hedging instruments are included in profit or loss. Amounts previously recognized in other comprehensive income and accumulated in equity are reclassified to profit or loss in the period when the hedged items is recognized in profit or loss in the same line of the income statement.

The Company's share purchase warrants with Canadian dollar exercise prices are derivative liabilities and accordingly, they are recorded at fair value at each reporting period, with the gains or losses recorded in profit or loss for the period.

As described in Note 10 (a), the Company has Senior Secured Notes outstanding that contain an embedded derivative.

(p) *Trade and other receivables*

Trade and other receivables are carried at amortized cost less impairment. Trade and other receivables are written off as they are determined to be uncollectible. No receivables were written off during the three months ended March 31, 2011 or the year ended December 31, 2010.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 2. Summary of significant accounting policies (continued)

(q) *Reclamation deposits*

The Company maintains cash deposits that are restricted to the funding of reclamation costs. Cash deposits are required under a reclamation insurance policy that the Company has purchased for the Mesquite Mine. For the New Afton Development, a letter of credit related to the mines reclamation obligation to the British Columbia Government in Canada was issued in February 2011, releasing the \$8.0 million cash on deposit with a major Canadian bank to the Company. Reclamation deposits are designated as FVTPL, are recorded at fair value, and are classified as a non-current asset.

(r) *Leases*

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the leased asset to the lessee. All other leases are classified as operating leases.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

### 3. Future changes in accounting policies

IFRS 9 *Financial instruments* ("IFRS 9") was issued by the IASB on November 12, 2009 and will replace IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 is effective for annual periods beginning on or after January 1, 2013. The Company has not early adopted IFRS 9 and is currently evaluating the impact on its financial statements.

### 4. Expenses

(a) *Finance costs and income*

	Three months ended March 31	
	2011	2010
	\$	\$
<b>Finance costs:</b>		
Interest on convertible debentures	978	938
Interest on senior notes	5,005	4,527
Other interest	732	232
Unwinding of the discount on decommissioning obligations	405	326
Finance costs	7,120	6,023
Less: amounts included in cost of qualifying assets	(5,983)	(5,465)
<b>Finance costs</b>	<b>1,137</b>	<b>558</b>
<b>Finance income:</b>		
Interest income	1,046	256

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 4. Expenses (continued)

(b) *Other gains and losses*

	Three months ended March 31	
	2011	2010
	\$	\$
Fair value change of embedded derivative in senior notes	(2,454)	1,907
Gains (loss) on FVTPL financial assets	1,349	3,944
Ineffectiveness on hedging instruments	(1,827)	-
Fair value change of non-hedged derivatives	(24,355)	(10,109)
Gain (loss) on foreign exchange	3,115	1,368
Other	(226)	(1,722)
<b>Total other gains (losses)</b>	<b>(24,398)</b>	<b>(4,612)</b>

### 5. Trade and other payables

	March 31	December 31	January 1
	2011	2010	2010
	\$	\$	\$
Trade payables	20,754	31,963	13,452
Payables to related parties	1,718	2,119	1,300
Accruals	53,189	33,848	22,633
Current portion of decommissioning obligation	1,314	1,315	614
<b>Total trade payables and other</b>	<b>76,975</b>	<b>69,245</b>	<b>37,999</b>

### 6. Inventories

	March 31	December 31	January 1
	2011	2010	2010
	\$	\$	\$
Heap leach ore	61,977	61,738	58,169
Work-in-process	23,977	21,623	13,907
Finished goods	6,833	5,506	4,819
Stockpiled ore	79	79	55
Supplies	15,036	14,109	9,349
	<b>107,902</b>	<b>103,055</b>	<b>86,299</b>

The amount of inventories recognized in operating expenses for the three months ended March 31, 2011 is \$63.4 million (2010 - \$48.5 million). There were no write-downs or reversals of write-downs during the period. The inventory is expected to be used within one year.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 7. Investments

	<b>Asset Backed Notes</b>	<b>Available for Sale Securities</b>
		\$
Balance, January 1, 2010	45,890	-
Exchange differences	48	-
Additions	-	18,600
Disposals	(45,184)	(58,300)
Changes in fair value	6,779	39,700
Balance, December 31, 2010	7,533	-
<b>Exchange differences</b>	<b>45</b>	<b>-</b>
<b>Additions</b>	<b>-</b>	<b>-</b>
<b>Disposals</b>	<b>(8,927)</b>	<b>-</b>
<b>Changes in fair value</b>	<b>1,349</b>	<b>-</b>
<b>Balance, March 31, 2011</b>	<b>-</b>	<b>-</b>

#### (a) Asset Backed Notes

At December 31<sup>st</sup> 2010 the Company owned \$21 million (Cdn\$20.9 million) of face value long-term asset backed notes ("AB Notes"). These AB Notes were issued as replacement of asset backed commercial paper ("ABCP") formerly held by the Company. When the ABCP matured but was not redeemed in 2007, it became the subject of a restructuring process that replaced the ABCP with long-term asset backed securities. The restructuring was completed and the AB Notes were issued on January 21, 2009. The Company designated the investments as held-for-trading financial instruments.

In February 2011, the Company disposed of its remaining \$21 million face value AB Notes, which had a fair value of \$7.5 million at December 31, 2010, for proceeds of \$8.9 million. At March 31<sup>st</sup> 2011 the Company no longer has a position in AB Notes.

The table below summarizes the Company's valuations at March 31, 2011 and December 31, 2010 and January 1, 2010.

Restructuring categories	March 31 2011		December 31 2010		January 1 2010		Expected maturity date
	Face value	Fair value estimate	Face value	Fair value estimate	Face value	Fair value estimate	
	\$ (millions)	\$ (millions)	\$ (millions)	\$ (millions)	\$ (millions)	\$ (millions)	
MAV 2 Notes							
A1 (rated A)	-	-	-	-	66.7	39.3	
A2 (rated A)	-	-	-	-	12.7	5.9	
B	-	-	5.8	2.4	5.5	0.5	December 31, 2016
C	-	-	4.3	0.4	4.1	-	December 31, 2016
Traditional asset tracking notes							
MAV3 - Class 9	-	-	0.1	0.1	0.1	0.1	September 12, 2015
Ineligible asset tracking notes							
MAV2 - Class 3/13/15	-	-	10.8	4.6	10.3	0.1	December 20, 2012 to October 24, 2016
	-	-	21.0	7.5	99.4	45.9	

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

---

### 7. Investments (continued)

#### (b) Available for Sale Securities

The Company acquired 115 million shares of Beadell Resources Limited ("Beadell") as partial consideration for the sale of our interest in Amapari on April 13, 2010 (Note 8). Beadell is an Australian listed gold-focused company with exploration and development assets in Western Australia and Brazil. Beadell's shares are publicly traded on the Australian Stock Exchange. The Company held approximately 18.5% of Beadell's outstanding shares as a result of the Amapari disposition. As a condition of closing, the Company was restricted from trading the shares for a period of one year due to a voluntary escrow arrangement. The Company designated its investment in Beadell as an available-for-sale financial asset with the changes in the fair value being included in other comprehensive income.

The fair value of the Beadell shares received on the transaction date of April 13, 2010 was \$18.6 million. The shares were valued using the Beadell ask price on April 13, 2010, with subsequent revaluations based on the bid price. On December 1, 2010, the Company sold the 115 million shares, with Beadell's consent to release the shares from the escrow arrangement, for total net proceeds of \$58.4 million resulting in a gain on sale of \$39.7 million which was included in earnings for the year ended December 31, 2010.

### 8. Operations held for sale

On January 2, 2009, the Company placed the Amapari Mine on care and maintenance. Mining at the Amapari Mine was suspended and leaching of stacked material continued until April 2009 at which time leaching operations were suspended. On January 27, 2010, the Company announced the signing of an agreement to sell its Brazilian subsidiary Mineracao Pedra Branca do Amapari Ltda., which held the Amapari Mine and other related assets, to Beadell. The transaction closed on April 13, 2010. Proceeds to the Company were \$37.0 million in cash and 115 million Beadell shares valued at \$18.6 million. The Company subsequently sold the 115 million shares of Beadell, as described in Note 7.

Assets and liabilities pertaining to the Amapari Mine are as follows:

	March 31 2011	December 31 2010	January 1 2010
	\$	\$	\$
Current assets	-	-	10,298
Non-current assets	-	-	78,989
Current liabilities	-	-	(10,414)
Long-term liabilities	-	-	(19,890)
	-	-	58,983

The Amapari Mine was classified as an asset held for sale on the consolidated statements of financial position.

# New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

## 8. Operations held for sale (continued)

The consolidated income statement has separately presented the net earnings from discontinued operations for the three months ended March 31, 2011 and 2010. Revenues, earnings before taxes and net earnings are as follows:

	2011	2010
	\$	\$
Revenue	-	2,746
Earnings before taxes	-	305
Net earnings	-	305

# New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

## 9. Mining interests

	Mining Properties				Exploration and evaluation	Total
	Depletable	Non depletable	Plant and equipment	Construction in Progress		
	\$	\$	\$	\$		\$
<b>Cost</b>						
As at January 1, 2010	528,155	865,448	369,980	19	25,388	1,788,990
Additions	13,665	93,959	75,219	1,787	-	184,630
Disposals	-	-	(5,362)	-	-	(5,362)
Impairment	-	-	-	-	(15,728)	(15,728)
Transfers	16,250	(16,250)	-	-	-	-
Foreign exchange translation	-	20,965	4,622	-	-	25,587
<b>As at December 31, 2010</b>	<b>558,070</b>	<b>964,122</b>	<b>444,459</b>	<b>1,806</b>	<b>9,660</b>	<b>1,978,117</b>
Additions	4,510	34,682	28,569	4,051	-	71,812
Disposals	-	-	(490)	-	-	(490)
Foreign exchange translation	-	10,173	3,038	-	-	13,211
<b>As at March 31, 2011</b>	<b>562,580</b>	<b>1,008,977</b>	<b>475,576</b>	<b>5,857</b>	<b>9,660</b>	<b>2,062,650</b>
<b>Accumulated depreciation</b>						
As at January 1, 2010	54,744	-	69,683	-	-	124,427
Depreciation for the period	58,732	-	31,149	-	-	89,881
Disposals	-	-	(3,431)	-	-	(3,431)
Impairment	-	-	-	-	-	-
Foreign exchange translation	-	-	-	-	-	-
<b>As at December 31, 2010</b>	<b>113,476</b>	<b>-</b>	<b>97,401</b>	<b>-</b>	<b>-</b>	<b>210,877</b>
Depreciation for the period	15,401	-	5,932	-	-	21,333
Disposals	-	-	(382)	-	-	(382)
Foreign exchange translation	-	-	395	-	-	395
<b>As at March 31, 2011</b>	<b>128,877</b>	<b>-</b>	<b>103,346</b>	<b>-</b>	<b>-</b>	<b>232,223</b>
<b>Net book value</b>						
As at January 1, 2010	473,411	865,448	300,297	19	25,388	1,664,563
As at December 31, 2010	444,594	964,122	347,058	1,806	9,660	1,767,240
As at March 31, 2011	433,703	1,008,977	372,230	5,857	9,660	1,830,427

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 9. Mining interests (continued)

The Company capitalized \$6.0 million of interest for the three months ended March 31, 2011 (2010 - \$5.5 million) related to the New Afton project.

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

	Mining properties			Plant and equipment	March 31 2011
	Depletable	Non-depletable	Total		
	\$	\$	\$		
Mesquite Mine	164,031	49,783	213,814	100,086	313,900
Cerro San Pedro Mine	193,810	85,419	279,229	72,755	351,984
Peak Mine	75,862	46,671	122,533	70,033	192,566
New Afton Project	-	460,399	460,399	128,088	588,487
El Morro Project (a)	-	372,562	372,562	-	372,562
Other projects	-	9,660	9,660	-	9,660
Corporate	-	-	-	1,268	1,268
	433,703	1,024,494	1,458,197	372,230	1,830,427

	Mining properties			Plant and equipment	December 31 2010
	Depletable	Non-depletable	Total		
	\$	\$	\$		
Mesquite Mine	168,068	46,485	214,553	98,826	313,379
Cerro San Pedro Mine	204,144	82,927	287,071	73,203	360,274
Peak Mine	72,382	46,671	119,053	68,934	187,987
New Afton Project	-	420,912	420,912	104,934	525,846
El Morro Project (a)	-	368,933	368,933	-	368,933
Other projects	-	9,660	9,660	-	9,660
Corporate	-	-	-	1,161	1,161
	444,594	975,588	1,420,182	347,058	1,767,240

	Mining properties			Plant and equipment	January 1 2010
	Depletable	Non-depletable	Total		
	\$	\$	\$		
Mesquite Mine	182,231	44,566	226,797	97,235	324,032
Cerro San Pedro Mine	233,696	84,779	318,475	66,208	384,683
Peak Mine	57,484	61,506	118,990	57,251	176,241
New Afton Project	-	310,079	310,079	78,581	388,660
El Morro Project (a)	-	364,537	364,537	-	364,537
Other projects	-	25,388	25,388	-	25,388
Corporate	-	-	-	1,022	1,022
	473,411	890,855	1,364,266	300,297	1,664,563

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 9. Mining interests (continued)

(a) *Chile - El Morro project ("El Morro")*

The Company owns a 30% interest (held through its subsidiary) in the El Morro copper-gold project which is an advanced stage copper-gold project located in the Atacama region of north-central Chile.

On October 12, 2009, Barrick Gold Corporation ("Barrick") announced that it had entered into an agreement with Xstrata Copper Chile S.A. ("Xstrata"), a wholly owned subsidiary of Xstrata Plc, to acquire Xstrata's 70% interest in the El Morro project. The Company, through its 100% owned subsidiary Datawave Sciences Inc. ("Datawave"), held a right of first refusal over Xstrata's 70% interest which came into effect when the agreement with Barrick was announced.

On January 7, 2010, Datawave provided notice to Xstrata of the exercise of its right of first refusal to acquire Xstrata's 70% interest in the El Morro project for \$463.0 million. The Company completed this transaction on February 16, 2010. A subsidiary of Goldcorp Inc. ("Goldcorp") loaned \$463.0 million to a Datawave subsidiary to fund the exercise of the right of first refusal. After acquisition of Xstrata's 70% interest by a Datawave subsidiary, Datawave sold that subsidiary to a subsidiary of Goldcorp.

Concurrent with the sale of the Datawave subsidiary to a subsidiary of Goldcorp, Datawave received a \$50.0 million payment and the parties amended the terms of the existing El Morro Shareholders Agreement. The payment to Datawave was recorded, net of \$3.7 million of transaction costs, as a deferred benefit which will be amortized into income over a period of time equal to the life of the Shareholders Agreement. Under the revised Shareholders Agreement, Goldcorp (through its subsidiary) has agreed to fund 100% of Datawave's share of the development and construction capital for the project, which was estimated in the El Morro feasibility study at \$2.5 billion. The funding will be interest bearing at U.S. 7-year Treasury Rate plus 1.87% and is compounded monthly. As at December 31, 2010 the interest rate was locked in at 4.58% based on the 7 year U.S. treasury bond yield plus 1.87%. Datawave will be entitled to a penalty payment of \$1.5 million per month up to a maximum of \$36.0 million if the construction on the El Morro Project does not commence within 60 days of receipt of required permits and approvals.

(b) *Other projects include:*

(i) *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. The Company has entered into an agreement with Antofagasta Minerals Plc ("AMSA") in which AMSA can acquire a 30% interest in this project by making the required option payments between the Company and Potrillos. AMSA can earn a further 20% interest by incurring \$7.0 million in exploration expenditure by June 5, 2012. AMSA can earn a further 20% to bring its interest to 70% by completing a feasibility study by June 5, 2015 and pay the Company \$5.0 million.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 10. Long-term debt

Long-term debt consists of the following:

	March 31 2011	December 31 2010	January 1 2010
	\$	\$	\$
Senior secured notes (a)	183,623	179,197	169,044
Subordinated convertible debentures (b)	44,143	42,635	37,609
Term loan facility (c)	-	-	27,235
El Morro project funding loan (d)	11,784	8,052	3,656
Revolving credit facility	-	-	-
	239,550	229,884	237,544
Less: Current portion of term loan facility	-	-	(12,088)
	239,550	229,884	225,456

#### (a) Senior secured notes

The face value of the senior secured notes ("Notes") at March 31, 2011 was \$192.4 million (Cdn\$187.0 million) (2010 - \$184.1 million (Cdn\$187.0 million)). The Notes mature and become due and payable on June 28, 2017, and bear interest at the rate of 10% per annum. Interest is payable in arrears in equal semi-annual installments on January 1 and July 1 in each year.

The Notes are secured by a charge on the assets comprising and relating to the Company's New Afton gold-copper project. The senior secured note agreement requires the Company to comply with certain reporting and other non-financial covenants.

The Company has the right to redeem the Notes in whole or in part at any 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. At March 31, 2011, the redemption price was 110% and is scheduled to decrease to 105% on June 28, 2011. The early redemption feature in the Notes qualifies as an embedded derivative that must be bifurcated for reporting purposes. At March 31, 2011, the fair value of the derivative asset was determined to be \$5.2 million (December 2010 - \$7.7 million). The Company has recorded the fair value of the derivative asset in reclamation deposits and other. The change in the fair value has resulted in a loss of \$2.5 million recorded in earnings for the three months ended March 31, 2011 (2010 - \$1.9 million gain).

#### (b) Subordinated convertible debentures

The face value of the subordinated convertible debentures ("Debentures") at March 31, 2011 was \$56.6 million (Cdn\$55.0 million) (2010 - \$54.2 million (Cdn\$55.0 million)).

In 2007, the Company issued 55,000 Debentures for an aggregate principal amount of Cdn\$55.0 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.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 10. Long-term debt (continued)

#### (b) *Subordinated convertible debentures (continued)*

The Debentures are classified as compound financial instruments for accounting purposes because of the holder conversion option. The conversion option is treated as a derivative liability and was measured at fair value on initial recognition, and is subsequently re-measured at fair value through profit and loss at the end of each period and is recorded in non-hedged derivative liabilities. At March 31, 2011, the fair value of the derivative liability was \$37.5 million (December 31, 2010 - \$29.4 million). The change in the fair value has resulted in a loss of \$8.1 million recorded in earnings for the 3 months ended March 31, 2011 (2010 - \$1.8 million). The debt component is measured at amortized cost and is accreted over the expected term to maturity using the effective interest method.

Interest is payable in arrears in equal semi-annual installments 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.

The Debenture Indenture requires the Company to comply with certain reporting and other non-financial covenants. The debentures are unsecured and subordinate to the notes and any secured indebtedness incurred subsequent to the issue of the debentures.

#### (c) *Term loan facility*

As part of the business combination with Western Goldfields Inc. in 2009, the Company acquired a term loan facility with a syndicate of banks under which the Company could borrow up to \$105.0 million in connection with the development of the Mesquite Mine. The term of the facility was until December 31, 2014 and comprised a multiple-draw term loan of which \$86.3 million was drawn for the development of the Mesquite Mine. The facility was secured by all of the assets of the Company's wholly-owned subsidiary, Western Mesquite Mines Inc. ("WMMI"), and a pledge of the shares of WMMI owned by the Company. In addition, until reaching a defined completion point, the facility was guaranteed by Western Goldfields.

On February 26, 2010 the Company retired the term loan facility by paying the total outstanding principal of \$27.2 million. The gold hedge extends to the end of 2014 and the related security and covenants have been released by the term loan facility syndicate of banks on December 14, 2010 when New Gold entered into a new revolving credit facility (Note 10 (e)). The gold hedge is now secured under the new revolving credit facility and shares in security, on a pari passu basis, with the syndicate of banks providing the revolving credit facility. The hedge will remain in place until the hedge is monetized or delivered until the end of 2014 at 5,500 ounces per month at \$801 per ounce. The total commitment at March 31, 2011 is 247,500 ounces.

#### (d) *El Morro project funding loan*

Prior to completion of the Agreement with Goldcorp on February 16, 2010, Xstrata had agreed to fund 70% of the Company's program funding commitments on El Morro (Note 9 (a)) until commencement of commercial production. These amounts, plus interest, would be repaid out

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 10. Long-term debt (continued)

(d) *El Morro project funding loan (continued)*

of 80% of the Company's distributions once El Morro was in production. Interest was based on the lower of the Xstrata cost of financing plus 100 basis points and the Chilean prescribed government rate and was compounded monthly. As of December 31, 2009, Xstrata had funded \$3.7 million of the Company's funding commitments. Under the Agreement, Goldcorp has agreed to fund 100% of the Company's El Morro funding commitments until commencement of commercial production. These amounts, plus interest, will be repaid out of 80% of the Company's distributions once El Morro is in production.

As at December 31, 2010 the interest rate on the Company's share of the capital funded by Goldcorp was locked in at 4.58% (and is compounded monthly), based on the 7 year U.S. treasury bond yield plus 1.87%, as per the Agreement. Goldcorp assumed this loan at the new, lower interest rate from February 16, 2010. As at March 31, 2011, the outstanding loan balance was \$11.8 million including accrued interest. The loan is secured against all rights and interests of the Company's El Morro subsidiaries, including a pledge of the El Morro shares.

(e) *Revolving credit facility*

On December 14, 2010, the Company entered into an agreement for a \$150.0 million revolving credit facility ("Facility") with a syndicate of banks. The amount of the Facility will be reduced by \$50.0 million if the Cerro San Pedro Mine is not operational for 45 consecutive days due to any injunction, order, judgment or other determination of an official body in Mexico as a result of any disputes now or hereafter before an official body in Mexico with jurisdiction to settle such a dispute. However, the full \$50.0 million of credit will be reinstated if operations at the Cerro San Pedro Mine resume in accordance with the mine plan for 45 consecutive days and no similar disruption event occurs during this period. The purpose of the Facility is for general corporate purposes, including acquisitions. The Facility, which is secured on the Company's material assets (excluding the New Afton and El Morro project assets) and a pledge of certain subsidiary shares, has a term of three years with annual extensions permitted. The Facility contains various covenants customary for a loan facility of this nature, including limits on indebtedness, asset sales and liens. Significant financial covenants are as follows:

Minimum tangible net worth	\$1.38 billion + 25% of positive quarterly net income
----------------------------	---

Minimum interest coverage ratio (Earnings before interest, taxes, depreciation and amortization "EBITDA" to interest)	4.0:1.0
---	---------

Maximum leverage ratio (debt to EBITDA)	3.0:1.0
---	---------

The Company is in compliance with these covenants at March 31, 2011.

The interest margin on drawings under the Facility ranges from 2.00% to 4.25% over LIBOR, the Prime Rate or the Base Rate, based on the Company's debt to EBITDA ratio (the Debentures are not considered debt for covenant purposes) and the currency and type of credit selected by the Company. The standby fees on undrawn amounts under the Facility range between 0.75% and 1.06% depending on the Company's debt to EBITDA ratio.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 10. Long-term debt (continued)

#### (e) Revolving credit facility (continued)

To the date of these financial statements, the Company has not drawn any funds under the Facility, however the Facility has been used to issue letters of credit of A\$10.2 million for Peak Mines' reclamation bond for the state of New South Wales, Cdn\$9.5 million for New Afton's commitment to B.C. Hydro for power and transmission construction work (the B.C. Hydro letter of credit will be released over time as New Afton consumes and pays for power in the early period of operations) and Cdn\$8.0 million for New Afton's reclamation requirements. In exchange for the letter of credit, the B.C. Ministry of Energy, Mines and Petroleum released the Cdn\$8.0 million New Afton reclamation deposit back to the Company in February, 2011.

### 11. Derivative instruments

The following tables summarize derivative related assets and liabilities:

	Asset derivatives		
	March 31 2011	December 31 2010	January 1 2010
	\$	\$	\$
Derivatives designated as hedging instruments			
Fuel contracts	-	-	706
Total derivatives classified as hedging instruments	-	-	706
Less: Current portion	-	-	(706)
	Liability derivatives		
	March 31 2011	December 31 2010	January 1 2010
	\$	\$	\$
Derivatives designated as hedging instruments			
Gold contracts	147,454	153,375	95,986
Less: Current portion	(40,718)	(40,072)	(19,206)
	106,736	113,303	76,780

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 11. Derivative instruments (continued)

The following table summarizes realized derivative gains (losses) for the three months ended March 31, 2011 and 2010.

	2011	2010
	\$	\$
Derivatives designated as hedging instruments		
Gold hedging contracts	(7,610)	(2,869)
Fuel contracts	-	25
	<b>(7,610)</b>	<b>(2,844)</b>

Realized gains (losses) on derivatives not in a hedging relationship are classified in other income. Realized gains (losses) on derivatives in a qualifying hedge relationship are classified as revenue for gold hedging contracts and operating expenses for fuel hedging contracts.

The following table summarizes unrealized derivative gains for the three months ended March 31, 2011 and 2010.

	2011	2010
	\$	\$
Derivatives not classified as hedging instruments for accounting purposes		
Share purchase warrants	(16,965)	(8,501)
Conversion option on convertible debentures	(7,390)	(1,608)
Prepayment option embedded derivative	(2,454)	1,907
	<b>(26,809)</b>	<b>(8,202)</b>

For the three months ended March 31, 2011 and 2010 there were no unrealized derivative gains (losses) recorded in earnings for derivatives classified as hedging instruments for accounting purposes.

The following table summarizes derivative gains (losses) in other comprehensive income for the three months ended March 31, 2011 and 2010.

	\$	\$
Effective portion of change in fair value of hedging instruments		
Gold hedging contracts - unrealized	(3,693)	(6,029)
Gold hedging contracts - realized	7,610	2,869
Fuel contracts	-	85
Deferred income tax	(2,269)	1,824
	<b>1,648</b>	<b>(1,251)</b>

Ineffective portion of change in fair value of hedging instruments

Gold hedging contracts - unrealized	1,827	-
-------------------------------------	-------	---

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 11. Derivative instruments (continued)

The net amount of existing gains (losses) arising from the unrealized fair value of the Company's gold hedging contracts and fuel contracts, which are derivatives that are designated as cash flow hedges and are reported in other comprehensive income, would be reclassified to net earnings as contracts are settled on a monthly basis. The amount of such reclassification would be dependent upon fair values and amounts of the contracts settled. At March 31, 2011, the Company's estimate of the net amount of existing derivative losses arising from the unrealized fair value of derivatives designated as cash flow hedges, which are reported in other comprehensive income and are expected to be reclassified to net earnings in the next twelve months, excluding tax effects, is \$31.5 million for gold hedging contracts.

#### (a) Gold hedging contracts

Under the terms of the term loan facility (Note 10 (c)), Western Mesquite Mines Inc. was required, as a condition precedent to drawdown the loan, to enter into a gold hedging program acceptable to the banking syndicate. As such, the Company executed gold forward sales contracts for 429,000 ounces of gold at a price of \$801 per ounce. The hedging contracts represent a commitment of 5,500 ounces per month for 78 months that commenced July 2008 with the last commitment deliverable in December 2014. The Company settles these contracts, at the Company's option, by physical delivery of gold or on a net financial settlement basis. At March 31, 2011, the Company had remaining gold forward sales contracts for 247,500 ounces of gold at a price of \$801 per ounce at a remaining commitment of 5,500 ounces per month for 45 months.

On July 1, 2009, the Company's gold hedging contracts were designated as cash flow hedges. Prospective and retrospective hedge effectiveness is assessed on these hedges using a hypothetical derivative method. The hypothetical derivative assessment involves comparing the effect of theoretical shifts in forward gold prices on the fair value of both the actual hedging derivative and a hypothetical derivative. The retrospective assessment involves comparing the effect of historic changes in gold prices each period on the fair value of both the actual and hypothetical derivative. The effective portion of the gold contracts is recorded in other comprehensive income until the forecasted gold sale impacts earnings. Where applicable, the fair value of the derivative has been adjusted to account for the Company's credit risk.

#### (b) Share purchase warrants

The following table summarizes information about outstanding share purchase warrants at March 31, 2011 and December 31, 2010.

Series	Number of warrants (000's)	Common Shares Issuable (000's)	Exercise prices Cdn\$	Expiry date
Series B	217,500	21,750	15.00	April 3, 2012
Series C	73,862	7,386	9.00	November 28, 2012
Series A	27,850	27,850	15.00	June 28, 2017
	319,212	56,986		

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 12. Share capital

At March 31, 2011, the Company had unlimited authorized common shares and 400,841,000 common shares outstanding.

(a) *No par value common shares issued*

	Number of shares (000's)	\$
Balance, January 1, 2010	388,815	1,810,039
Exercise of options (i)	4,171	19,394
Exercise of warrants (ii)	6,056	16,453
Balance, December 31, 2010	399,042	1,845,886
<b>Exercise of options (iii)</b>	<b>1,799</b>	<b>16,310</b>
<b>Balance, March 31, 2011</b>	<b>400,841</b>	<b>1,862,196</b>

- (i) During the year ended December 31, 2010, 4,171,000 common shares were issued pursuant to the exercise of stock options. The Company received proceeds of \$11.0 million from these exercises and transferred \$8.4 million from contributed surplus.
- (ii) During the year ended December 31, 2010, 6,056,000 common shares were issued pursuant to the exercise of warrants. The Company received proceeds of \$4.6 million from these exercises and transferred \$11.9 million from share purchase warrants.
- (iii) During the three months ended March 31, 2011, 1,799,000 common shares were issued pursuant to the exercise of stock options. The Company received proceeds of \$11.2 million from these exercises and transferred \$5.1 million from contributed surplus.

(b) *Stock options*

The following table presents the changes in the stock options.

	Number of options (000's)	Weighted average exercise price Cdn\$
Balance, January 1, 2010	15,324	4.34
Granted	2,704	4.80
Exercised	(4,171)	2.74
Forfeited	(1,609)	8.00
Balance, December 31, 2010	12,248	4.50
<b>Granted</b>	<b>1,618</b>	<b>7.71</b>
<b>Exercised</b>	<b>(1,799)</b>	<b>6.05</b>
<b>Forfeited</b>	<b>(179)</b>	<b>4.82</b>
<b>Balance, March 31, 2011</b>	<b>11,888</b>	<b>4.70</b>

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 12. Share capital (continued)

#### (b) Stock options (continued)

The following table summarizes information about the stock options outstanding at March 31, 2011.

Exercise prices Cdn\$	Weighted average remaining contractual life (years)	Number of stock options outstanding (000's)	Weighted average exercise price Cdn\$	Number of options exercisable (000's)	Weighted average exercise price Cdn\$
0.34 - 0.99	2.53	765	0.71	765	0.71
1.00 - 1.99	2.70	334	1.77	334	1.77
2.00 - 2.99	4.42	1,434	2.56	905	2.48
3.00 - 3.99	4.71	3,499	3.26	1,248	3.34
4.00 - 4.99	5.72	1,723	4.39	438	4.40
5.00 - 5.99	3.88	430	5.72	134	5.44
6.00 - 6.99	1.79	429	6.38	429	6.38
7.00 - 7.99	5.15	2,450	7.73	711	7.82
8.00 - 8.99	6.61	150	8.84	-	-
9.00 - 9.99	1.00	466	9.31	466	9.31
10.00 - 10.99	6.93	25	10.46	-	-
11.00	0.16	183	11.00	183	11.00
0.34 - 11.00	4.39	11,888	4.70	5,613	4.43

The Company granted 1,593,000 stock options on January 26, 2011 and 25,000 on March 7, 2011 to employees, officers and directors. These options have an exercise price of Cdn\$7.67 and Cdn\$10.46 respectively. These options vest over a three year period and have a contractual life of seven years from date of grant. The stock options had a weighted average grant date fair value of Cdn\$4.23, which was determined by a Black-Scholes pricing model using the following assumptions: no dividends are to be paid, volatility of 70%, risk free interest rate of 1.81%, forfeiture rate of 3% and expected life of 4.56 years. Volatility is measured as the annualized standard deviation of stock price returns, based on historical movements of New Gold's stock and those of a number of peer companies. No other features of the option grant were incorporated into the measurement of fair value. The grant date fair value will be amortized as part of compensation expense over the vesting period.

On January 27, 2010, the Company granted 2,258,000 stock options to employees, officers and directors. These options have an exercise price of Cdn\$4.39. These options vest over a three year period and have a contractual life of seven years from date of grant. The stock options had a weighted average grant date fair value of Cdn\$2.36, which was determined by a Black-Scholes pricing model using the following assumptions: no dividends are to be paid; volatility of 70%, risk free interest rate of 2.81%, forfeiture rate of 3% and expected life of 4.53 years. The grant date fair value will be amortized as part of compensation expense over the vesting period.

At March 31, 2011, the intrinsic value of the stock options outstanding was \$82.2 million (December 31, 2010 - \$63.7 million) and the intrinsic value of the stock options that were exercisable was \$40.3 million (December 31, 2010 - \$28.5 million). For the three months ended March 31, 2011, the intrinsic value of the stock options exercised during the year was \$7.7 million (2010 - \$1.4 million).

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 12. Share capital (continued)

#### (b) Stock options (continued)

For the three months ended March 31, 2011, the Company recorded \$1.8 million (2010 - \$1.9 million) as stock-based compensation expense and recorded this amount in contributed surplus. At March 31, 2011, the total value of the non-vested stock options that remain to be expensed is \$9.3 million (March 31, 2010 - \$8.2 million). It is expected that this amount shall be included in the determination of net earnings over the next 1.7 years.

#### (c) Share award units

	<b>Number of units</b>
Balance, January 1, 2010	560,000
Units granted	723,500
Units settled in cash	(361,000)
Units cancelled	(165,000)
Balance, December 31, 2010	757,500
<b>Units granted</b>	<b>1,027,500</b>
<b>Units settled in cash</b>	<b>(12,000)</b>
<b>Units cancelled</b>	<b>(39,000)</b>
<b>Balance, March 31, 2011</b>	<b>1,734,000</b>

In 2009, the Company established a share award unit program as part of its long-term incentive program. Each share award unit allows the recipient, subject to certain plan restrictions, to receive cash on the entitlement date equal to the Company's share price on that date. One-third of the share awards units vest annually on the anniversary of the grant date. As the Company is required to settle this award in cash, it will record an accrued liability and record a corresponding compensation expense. The share award unit is a financial instrument that will be fair valued at each reporting date based on the five day weighted average price of the Company's common shares. The changes in fair value will be included in the compensation expense for that period.

The Company issued 1,027,500 share award units in 2011 and 723,500 share award units in 2010. At March 31, 2011, there were 1,734,000 non-vested share awards outstanding (December 2010 – 757,500). Including the fair value adjustment for the share award units previously issued, the Company recorded \$3.1 million as compensation expense for the three months ended March 31, 2011 (2010 - \$0.9 million). A portion of this expense has been capitalized for recipients working at the Company's development projects. The total value of the non-vested share award units that remains to be expensed is \$13.5 million (December 31, 2010 - \$3.8 million). It is expected that this amount will be included in the determination of net income over the next 2.5 years.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 12. Share capital (continued)

#### (d) Share purchase warrants

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

	Number of warrants (000's)	Common Shares Issuable (000's)	Weighted average exercise price Cdn\$
Balance, January 1, 2010	6,056	6,056	0.77
Issued (i)			
Exercised (ii)	(6,056)	(6,056)	0.77
<b>Balance, March 31, 2011 and December 31, 2010</b>	<b>-</b>	<b>-</b>	

\*The exercise price of these US\$0.76 warrants have been converted to Canadian dollars for presentation purposes.

On May 27, 2009, the Company issued 6,056,000 share purchase warrants. The holders of these warrants were entitled to purchase one common share for US\$0.76 per share for every share purchase warrant held. These share purchase warrants expired between June 9, 2011 and June 9, 2012.

During the year ended December 31, 2010, 6,056,000 share purchase warrants were exercised resulting in the issuance of 6,056,000 common shares.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 12. Share capital (continued)

#### (e) Earnings per share

The following table sets forth the computation of diluted earnings per share for the three months ended March 31, 2011 and 2010.

	2011	2010
Earnings from continuing operations	<b>\$24,719</b>	\$13,042
Earnings from discontinued operations, net of tax	-	305
<b>Net earnings</b>	<b>\$24,719</b>	<b>\$13,347</b>
<i>(in thousands)</i>		
Basic weighted average number of shares outstanding	<b>399,336</b>	388,956
Effective of diluted securities		
Stock options	<b>5,875</b>	4,237
Warrants	<b>296</b>	4,997
Debentures	<b>16</b>	-
<b>Diluted weighted average number of shares outstanding</b>	<b>405,523</b>	<b>398,190</b>
Earnings per share from continuing operations		
Basic	<b>\$0.06</b>	\$0.03
Diluted	<b>\$0.06</b>	\$0.03
Earnings per share from discontinued operations		
Basic	<b>\$0.00</b>	\$0.00
Diluted	<b>\$0.00</b>	\$0.00
Earnings per share from continuing and discontinued operations		
Basic	<b>\$0.06</b>	\$0.03
Diluted	<b>\$0.06</b>	\$0.03

The following lists the equity securities excluded from the computation of diluted earnings per share. For the three months ended March 31, 2011 and 2010 the equity securities were excluded as the exercise prices related to the particular security exceed the average market price of the common shares of the Company of Cdn\$9.38 (2010 – Cdn\$4.57) for the period.

	2011	2010
	(000's)	(000's)
Stock options	<b>359</b>	5,904
Share purchase warrants	<b>49,600</b>	56,986
Convertible debentures	-	5,900

# New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

## 13. Income and mining taxes

	Three months ended	
	March 31 2011	March 31 2010
	\$	\$
Current tax		
Canadian income tax	106	3,419
Foreign income tax and mining tax	21,903	7,084
Canadian mining tax	-	-
Adjustments in respect of the prior year	-	-
<b>Total current tax</b>	<b>22,009</b>	<b>10,503</b>
Deferred tax		
Canadian income tax	(2,367)	2,126
Foreign income tax and mining tax	457	(3,193)
Canadian mining tax	-	-
Change in tax rates	-	-
Adjustments in respect to the prior year	-	-
<b>Total deferred tax</b>	<b>(1,910)</b>	<b>(1,067)</b>

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:

	Three months ended	
	March 31 2011	March 31 2010
	\$	\$
<b>Earnings before income taxes</b>	<b>44,818</b>	<b>22,478</b>
<b>Canadian federal and provincial income tax rates</b>	<b>26.50%</b>	<b>28.50%</b>
Income tax recovery based on above rates	11,877	6,407
Increase (decrease) due to		
Non-taxable income	(6,312)	(4,679)
Non-deductible expenditures	4,250	1,350
Different statutory tax rates on earnings of foreign subsidiaries	5,706	7,189
Adjustment of prior year provision to statutory tax returns	-	4,623
Non-taxable gain	-	(7,124)
Benefit of losses not recognized in period	19	152
Deferred tax assets not recognized and other	4,559	1,518
	<b>20,099</b>	<b>9,436</b>

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 13. Income and mining taxes (continued)

The tax rate used for the 2011 and 2010 reconciliations above is the corporate tax rate of 28.5% payable by corporate entities in British Columbia, Canada, on taxable profits under the tax law in that jurisdiction.

### 14. Reclamation and closure cost obligations

Changes to the reclamation and closure cost obligations are as follows:

	Mesquite Mine	Cerro San Pedro Mine	Peak Mine	New Afton Project	Total
	\$	\$	\$	\$	\$
Balance, January 1, 2010	7,301	5,764	9,201	3,112	25,378
Reclamation expenditures	(23)	-	(19)	-	(42)
Unwinding of discount	246	308	571	121	1,246
Revisions to expected cash flows	964	2,597	3,189	238	6,988
Foreign exchange movement	-	242	1,492	184	1,918
Balance, December 31, 2010	8,488	8,911	14,434	3,655	35,488
<b>Reclamation expenditures</b>	<b>-</b>	<b>-</b>	<b>(136)</b>	<b>-</b>	<b>(136)</b>
<b>Unwinding of discount</b>	<b>73</b>	<b>76</b>	<b>205</b>	<b>34</b>	<b>388</b>
<b>Revisions to expected cash flows</b>	<b>(160)</b>	<b>1,147</b>	<b>-</b>	<b>(145)</b>	<b>842</b>
<b>Foreign exchange movement</b>	<b>-</b>	<b>-</b>	<b>217</b>	<b>86</b>	<b>303</b>
<b>Balance, March 31, 2011</b>	<b>8,401</b>	<b>10,134</b>	<b>14,720</b>	<b>3,630</b>	<b>36,885</b>
<b>Less: current portion</b>	<b>8</b>	<b>490</b>	<b>816</b>	<b>-</b>	<b>1,314</b>
	<b>8,393</b>	<b>9,644</b>	<b>13,904</b>	<b>3,630</b>	<b>35,571</b>

The current portion of the reclamation and closure cost obligations has been included in trade and other payables.

### 15. Supplemental cash flow information

	Three months ended March 31	
	2011	2010
	\$	\$
Change in non-cash working capital		
Accounts receivable	(16,860)	(4,837)
Inventories and stockpiled ore	(5,604)	109
Trade and other payables	(3,376)	(493)
Current income and resources taxes payable	(3,986)	(1,701)
Prepays and other	2,225	(28)
	<b>(27,601)</b>	<b>(6,950)</b>

The Company had \$9.2 million in restricted cash included in the cash and cash equivalents balance at January 1, 2010.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 15. Supplemental cash flow information (continued)

Non-cash investing activities includes \$3.6 million for the three months ended March 31, 2011 (2010 - \$1.1 million), and represents the Company's share of contributions to the El Morro project funded by the joint venture partner (Note 10 (d)). The completion of the Agreement with Goldcorp after Datawave had exercised its right of first refusal to acquire a 70% interest in the El Morro Project resulted in non-cash retirement of debt to Goldcorp of \$463.0 million and the non-cash disposal of the 70% interest in the El Morro project of \$463.0 million.

### 16. Segmented information

The Company manages its operations by geographical location. The results from operations for these reportable operating segments are summarized in the table below:

	Three months ended March 31, 2011				
	USA	Mexico	Australia	Other <sup>(1)</sup>	Total
	\$	\$	\$	\$	\$
Revenues	62,448	63,236	45,529	-	171,213
Operating expenses	(27,041)	(19,704)	(23,971)	-	(70,716)
Depreciation and depletion	(6,674)	(9,167)	(4,122)	(64)	(20,027)
Earnings from mine operations	28,733	34,365	17,436	(64)	80,470
Corporate administration expenses	-	-	-	(6,181)	(6,181)
Share-based payment expenses	-	-	-	(2,856)	(2,856)
Exploration expenses	104	(1,055)	(475)	(700)	(2,126)
Earnings (loss) from operations	28,837	33,310	16,961	(9,801)	69,307
Finance income	26	52	59	909	1,046
Finance costs	(92)	(101)	(451)	(493)	(1,137)
Other gains and losses	(2,293)	(650)	(1,208)	(20,247)	(24,398)
Earnings before taxes	26,478	32,611	15,361	(29,632)	44,818
Income tax (expense) recovery	(6,716)	(9,233)	(4,655)	505	(20,099)
Net earnings (loss) from continuing operations	19,762	23,378	10,706	(29,127)	24,719

<sup>(1)</sup> Other includes corporate balances and exploration properties. Results of operations for the Canadian and Chilean development properties have been included in Other as these properties are still in the development phase with no revenues or operating costs.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 16. Segmented information (continued)

	Three months ended March 31, 2010				
	USA	Mexico	Australia	Other <sup>(1)</sup>	Total
	\$	\$	\$	\$	\$
Revenues	51,835	17,977	31,808	-	101,620
Operating expenses	(27,109)	(11,488)	(13,289)	-	(51,886)
Depreciation and depletion	(7,343)	(3,233)	(2,387)	-	(12,963)
Earnings from mine operations	17,383	3,256	16,132	-	36,771
Corporate administration expenses	-	-	-	(5,645)	(5,645)
Share-based payment expenses	-	-	-	(1,940)	(1,940)
Exploration expenses	-	(48)	(1,345)	(401)	(1,794)
Loss from operations	17,383	3,208	14,787	(7,986)	27,392
Finance income	16	65	165	10	256
Finance costs	(288)	(93)	(138)	(39)	(558)
Other gains and losses	33	(2,085)	(2,400)	(160)	(4,612)
Earnings (loss) before taxes	17,144	1,095	12,414	(8,175)	22,478
Income tax (expense) recovery	(7,291)	(672)	(4,430)	2,957	(9,436)
Net earnings (loss) from continuing operations	9,853	423	7,984	(5,218)	13,042

<sup>(1)</sup> Other includes corporate balances and exploration properties. Results of operations for the Canadian and Chilean development properties have been included in Other as these properties are still in the development phase with no revenues or operating costs.

The following tables present the segmented assets:

	March 31 2011	December 31 2010	January 1 2010
	Total assets	Total assets	Total assets
	\$	\$	\$
USA	449,546	423,395	416,499
Mexico	483,857	456,864	443,238
Australia	252,968	255,658	226,458
Canada	605,718	566,836	421,604
Chile	382,222	378,592	374,166
Other <sup>(1)</sup>	353,960	347,844	233,041
Assets of operations held for sale	-	-	89,287
	<b>2,528,271</b>	<b>2,429,189</b>	<b>2,204,293</b>

<sup>(1)</sup> Other includes corporate balances and exploration properties.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 16. Segmented information (continued)

The following table presents the segmented liabilities:

	<b>March 31 2011</b>	December 31 2010	January 1 2010
	<b>Total liabilities</b>	Total liabilities	Total liabilities
	\$	\$	\$
USA	<b>216,296</b>	211,837	186,929
Mexico	<b>120,726</b>	119,897	119,488
Australia	<b>69,691</b>	68,021	56,976
Canada	<b>282,260</b>	262,940	221,740
Chile	<b>130,461</b>	125,575	70,892
Other <sup>(1)</sup>	<b>139,226</b>	120,424	42,845
Liabilities of operations held for sale	-	-	30,304
	<b>958,660</b>	908,694	729,174

<sup>(1)</sup> Other includes corporate balances and exploration properties.

### 17. 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 equity, short-term borrowings and long-term debt, as well as the cash and cash equivalents, and investments.

Capital, as defined above, at March 31, 2011 and December 31, 2010 is summarized in the following table.

	<b>March 31 2011</b>	December 31 2010	January 1 2010
	\$	\$	\$
Equity	<b>1,569,611</b>	1,520,495	1,475,119
Long-term debt	<b>239,550</b>	229,884	225,456
	<b>1,809,161</b>	1,750,379	1,700,575
Cash and cash equivalents	<b>(520,169)</b>	(490,754)	(271,526)
Investments	-	(7,533)	(45,890)
	<b>1,288,992</b>	1,252,092	1,383,159

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 budget and quarterly updated forecasts are approved by the Board of Directors. The Company's investment policy is to invest its surplus funds in

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 17. Capital risk management (continued)

permitted investments consisting of treasury bills, bonds, notes and other evidences of indebtedness of Canada, the U.S. or any of the Canadian Provinces with a minimum credit rating of R-1 mid from the

Dominion Bond Rating Service ("DBRS") or an equivalent rating from Standard & Poors and Moody's and with maturities of 90 days or less at the original date of acquisition. In addition, the Company is permitted to invest in bankers' acceptances and other evidences of indebtedness of certain financial institutions. At all times, more than 25% of the aggregate amount of permitted investments must be invested in treasury bills, bonds, notes and other indebtedness of Canada or Provinces with a minimum credit rating of R-1 mid from DBRS. 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 policy, the Company is not permitted to make new investments in ABCP or auction rate securities.

The Company has a long-term note indenture (Note 10) that contains 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 the New Afton project.

### 18. Financial risk management

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) 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 trade and other receivables. Credit risk is primarily associated with trade and other 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 credit 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 primarily five 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 March 31, 2011 is not considered to be high.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 18. Financial risk management (continued)

#### (a) Credit risk (continued)

The Company's maximum exposure to credit risk at March 31, 2011, is as follows:

	March 31 2011	December 31 2010
	\$	\$
Cash and cash equivalents	520,169	490,754
Trade receivables	29,542	11,929
Investments	-	7,533
Reclamation deposits and other	24,553	31,295
	<b>574,264</b>	<b>541,511</b>

The aging of trade receivables at March 31, 2011 was as follows:

	0-30 days	31-60 days	61-90 days	91-120 days	Over 120 days	March 31 2011 Total	December 31 2010 Total
	\$	\$	\$	\$	\$	\$	\$
Mesquite Mine	160	1	1	4	253	419	442
Cerro San Pedro Mine	2,641	460	82	749	300	4,232	3,798
Peak Mine	19,064	-	-	1	16	19,081	3,176
New Afton	4,542	-	-	4	-	4,546	3,581
Corporate	1,264	-	-	-	-	1,264	932
	27,671	461	83	758	569	29,542	11,929

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 with high investment-grade ratings and the governments of Canada and the U.S.

The Company employs a restrictive investment policy as detailed in the capital risk management section (Note 17).

The Company has a bonding and insurance program, primarily with Chartis, formerly American International Specialty Lines Insurance Company ("AIG Insurance"), in respect of the operations and closure liabilities of the Mesquite Mine. At March 31, 2011, the Company had \$9.0 million in the account. In September 2008, AIG Insurance's parent company, American International Group, Inc. ("AIG"), suffered a liquidity crisis following the downgrade of its credit rating. The United States Federal Reserve loaned money to AIG in order for the company to meet its obligations to post additional collateral to trading partners. As a result of Federal and State laws governing the operation of AIG Insurance and segregation of funds, it is not believed that the Company's funds are at risk. During 2009, AIG worked through its restructuring under the supervision of the Federal Reserve Bank of New York and the U.S. Department of the Treasury. The U.S. Department of the Treasury has a majority stake in the equity of AIG, which owns Chartis. Chartis is advancing towards the goal of becoming an independent property-casualty and general insurance company and in December 2010 announced that they had signed a definitive recapitalization agreement with the government in the U.S.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 18. Financial risk management (continued)

#### (a) Credit risk (continued)

The Company sells all of its copper concentrate production to a 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, however there are alternative customers in the market.

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 five customers (2010, five customers) that account for approximately 95% (2010, 94%) of the concentrate and doré sales revenue.

Metal sales Customer	Three months ended March 31	
	2011	2010
		\$
1	95,026	40,060
2	27,288	21,690
3	18,480	17,977
4	15,888	9,981
5	5,821	5,704
<b>Total</b>	<b>162,503</b>	<b>95,412</b>
<b>% of total metal sales</b>	<b>95%</b>	<b>94%</b>

#### (b) 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 17.

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 statement of financial position.

	Less than 1 year	1-3 years	4-5 years	After 5 years	March 31	December 31
					2011	2010
	\$	\$	\$	\$	Total	Total
Trade and other payables	76,975	-	-	-	76,975	69,245
Long-term debt	-	-	56,595	192,423	249,018	243,307
Interest payable on long-term debt	22,072	44,144	39,872	28,864	134,952	131,857
Gold contracts	40,718	77,976	28,760	-	147,454	153,375
	139,765	122,120	125,227	221,287	608,399	597,784

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. A period of continuous low gold and copper prices may necessitate the deferral of capital expenditures which may impact production from mining operations. These statements are based on the current

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 18. Financial risk management (continued)

#### (b) Liquidity risk (continued)

financial position of the Company and are subject to change if any acquisitions or external growth opportunities are realized.

#### (c) Currency risk

The Company operates in Canada, Australia, Mexico, Chile and the United States. As a result, the Company has foreign currency exposure with respect to items not denominated in U.S. dollars. The three main types of foreign exchange risk of the Company can be categorized as follows:

##### (i) Transaction exposure

The Company's operations sell commodities 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) 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, investments, trade and other receivables, reclamation deposits, trade and other payables, reclamation and closure cost obligations 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:

	March 31, 2011			
	Canadian dollar	Australian dollar	Mexican peso	Chilean peso
Cash and cash equivalents	328,145	18,857	2,847	154
Trade and other receivables	5,858	19,081	4,194	-
Prepayment option	5,225	-	-	-
Trade and other payables	(30,795)	(23,091)	(35,707)	-
Reclamation and closure cost obligations	(3,630)	(13,904)	(9,644)	-
Share purchase warrants	(145,857)	-	-	-
Conversion option on convertible debt	(37,510)	-	-	-
Share award units	(6,338)	-	-	-
Long-term debt	(227,766)	-	-	-
<b>Gross balance sheet exposure</b>	<b>(112,668)</b>	<b>943</b>	<b>(38,310)</b>	<b>154</b>

	December 31, 2010			
	Canadian dollar	Australian dollar	Mexican peso	Chilean peso
Cash and cash equivalents	331,948	41,254	5,224	11
Investments	7,533	-	-	-
Trade and other receivables	4,556	3,176	3,063	39
Reclamation deposit	8,043	-	-	-
Prepayment option	7,679	-	-	-
Trade and other payables	(24,458)	(24,415)	(34,003)	-
Reclamation and closure cost obligations	(3,655)	(13,618)	(8,421)	-
Share purchase warrants	(125,936)	-	-	-
Conversion option on convertible debt	(29,429)	-	-	-
Share award units	(3,294)	-	-	-
Long-term debt	(221,832)	-	-	-
<b>Gross balance sheet exposure</b>	<b>(48,845)</b>	<b>6,397</b>	<b>(34,137)</b>	<b>50</b>

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 18. Financial risk management (continued)

(c) *Currency risk (continued)*

(iii) Translation exposure

The Company's functional and reporting currency is U.S. dollars. The Company's operations translate their operating results from the host currency to U.S. dollars. Therefore, exchange rate movements in the Canadian dollar, Australian dollar, Mexican peso and Chilean peso can have a significant impact on the Company's consolidated operating results. As described in Note 18 (c) (ii), some of the Company's earnings translation exposure to financial instruments 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 earnings (loss) before taxes from continuing operations from the financial instruments presented in Note 18 (c) (ii) by the amounts shown below.

	<b>March 31</b>	December 31
	<b>2011</b>	2010
	\$	\$
Canadian dollar	<b>(11,267)</b>	(4,885)
Australian dollar	<b>94</b>	640
Mexican peso	<b>(3,831)</b>	(3,414)
Chilean peso	<b>15</b>	5
	<b>(14,989)</b>	(7,654)

(d) *Interest rate risk*

Interest rate risk is the risk that the fair value or the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. All of the Company's outstanding debt obligations are fixed; therefore, there is no exposure to changes in market interest rates. The revolving credit facility interest is variable, however the facility is undrawn at March 31, 2011.

The Company is exposed to interest rate risk on its short-term investments which are included in cash and cash equivalents. The short-term investment interest earned is based on prevailing one to 90 days money market interest rates which may fluctuate. A 1.0% change in the interest rate would result in an annual difference of approximately \$3.0 million in interest earned by the Company. The Company has not entered into any derivative contracts to manage this risk. Where possible and depending on market conditions, the Company follows the policy of issuing fixed interest rate debt to avoid future fluctuations in its debt service costs.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 18. Financial risk management (continued)

#### (e) 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 and are affected by numerous factors beyond the Company's 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.

The Company acquired gold contracts which mitigate the effects of price changes. The Company designated these contracts as an accounting cash flow hedge effective July 1, 2009 as described in Note 11 (a). At March 31, 2011 the Company had remaining gold forward sales contracts for 247,500 ounces of gold at a price of \$801 per ounce at a remaining commitment of 5,500 ounces per month for 45 months.

In the first quarter of 2011, the Company's revenues and cash flows were impacted by copper prices primarily in the range of \$4.13 and \$4.62 per pound. 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 March 31, 2011, working capital includes copper concentrate receivables totaling 2.4 million pounds. A \$0.10 change in copper price would have an impact of \$1.0 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 no fuel hedge contracts at this time.

The Company is also subject to price risk for changes in the Company's common stock price per share. The Company has implemented, as part of its long-term incentive plan, a share award unit plan that the Company is required to satisfy in cash upon vesting. The amount of cash the Company will be required to expend is dependent upon the price per common share at the time of vesting. The Company considers this plan a financial liability and is required to fair value the outstanding liability with the resulting changes included in compensation expense each period.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 18. Financial risk management (continued)

#### (e) Price risk (continued)

An increase in gold, copper and silver prices would increase the Company's net earnings whereas an increase in fuel or share unit award prices would decrease the Company's net earnings. A 10% change in prices would impact the Company's net earnings before taxes from continuing operations and other comprehensive income before taxes as follows:

	Three months ended March 31			
	2011	2011	2010	2010
	Net	Other	Net	Other
	Earnings	Comprehensive	Earnings	Comprehensive
	\$	\$	\$	\$
Gold price	13,725	31,536	8,248	29,796
Copper price	1,636	-	1,375	-
Silver price	1,911	-	331	-
Fuel price	1,201	-	729	565
Share purchase warrants	14,586	-	3,925	-
Conversion option on convertible debt	5,607	-	1,572	-
Share award unit	634	-	107	-

### 19. Fair value measurement

The Company defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In assessing the fair value of a particular contract, the market participant would consider the credit risk of the counterparty to the contract. Consequently, when it is appropriate to do so, the Company adjusts the valuation models to incorporate a measure of credit risk. Fair value represents management's estimates of the current market value at a given point in time.

At March 31, 2011 and December 31, 2010, the Company's financial assets and liabilities are categorized as follows:

	March 31, 2011			
	Loans and	Fair value	Financial	Total
	Receivables	through	Liabilities at	
	\$	profit/loss	Amortized	\$
	\$	\$	Cost	\$
<b>Financial Assets</b>				
Cash and cash equivalents	520,169	-	-	520,169
Trade and other receivables	29,542	-	-	29,542
Prepayment option	-	5,225	-	5,225
Reclamation deposits	10,019	-	-	10,019
<b>Financial Liabilities</b>				
Trade and other payables	-	-	76,975	76,975
Long-term debt	-	-	239,550	239,550
Gold contracts	-	147,454	-	147,454
Share purchase warrants	-	145,857	-	145,857
Conversion option on convertible debt	-	37,510	-	37,510
Share award units	-	6,338	-	6,338

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 19. Fair value measurement (continued)

	December 31, 2010			
	Loans and Receivables	Fair value through profit/loss	Financial Liabilities at Amortized Cost	Total
	\$	\$	\$	\$
<b>Financial Assets</b>				
Cash and cash equivalents	490,754	-	-	490,754
Trade and other receivables	11,929	-	-	11,929
Prepayment option	-	7,679	-	7,679
Investments	-	7,533	-	7,533
Reclamation deposits	17,955	-	-	17,955
<b>Financial Liabilities</b>				
Trade and other payables	-	-	69,245	69,245
Long-term debt	-	-	229,884	229,884
Gold contracts	-	153,375	-	153,375
Share purchase warrants	-	125,936	-	125,936
Conversion option on convertible debt	-	29,429	-	29,429
Share award units	-	3,294	-	3,294

At March 31, 2011 and December 31, 2010, the carrying values and the fair values of the Company's financial instruments are shown in the following table.

	March 31, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	\$	\$	\$	\$
<b>Financial Assets</b>				
Cash and cash equivalents	520,169	520,169	490,754	490,754
Trade and other receivables	29,542	29,542	11,929	11,929
Prepayment option	5,225	5,225	7,679	7,679
Investments	-	-	7,533	7,533
Reclamation deposits	10,019	10,019	17,955	17,955
<b>Financial Liabilities</b>				
Trade and other payables	76,975	76,975	69,245	69,245
Long-term debt	239,550	291,046	229,884	276,887
Gold contracts	147,454	147,454	153,375	153,375
Share purchase warrants	145,857	145,857	125,936	125,936
Conversion option on convertible debentures	37,510	37,510	29,429	29,429
Share award units	6,338	6,338	3,294	3,294

The Company has certain financial assets and liabilities that are held at fair value. The investments and the gold contracts are presented at fair value at each reporting date using appropriate valuation methodology. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, inputs other than quoted prices that are observable for the asset or liability (for example, interest rate and yield curves observable at commonly quoted intervals, forward pricing curves used to value currency and commodity contracts and volatility measurements used to value option contracts), or inputs that are derived principally from or corroborated by observable market data or other means. Level 3 inputs are unobservable (supported by little or no market activity). The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 19. Fair value measurement (continued)

The following table summarizes information relating to the fair value determination of the Company's financial instruments which are fair valued on a recurring basis.

	2011		
	Level 1	Level 2	Level 3
	\$	\$	\$
Cash and cash equivalents	520,169	-	-
Prepayment option	-	5,225	-
Gold contracts	-	147,454	-
Share purchase warrants	-	145,857	-
Conversion option on convertible debt	-	37,510	-
Share award units	-	6,338	-

The senior secured notes, share purchase warrants and the subordinated convertible debentures are traded on a public exchange. The fair value estimates for these notes have been estimated using the March 31, 2011 and December 31, 2010 closing prices. The term loan facility and the El Morro project funding are floating rate facilities whose carrying value approximates fair value.

### 20. Operating leases

Non-cancellable operating lease rentals are payable as follows:

	March 31 2011	December 31 2010	January 1 2010
Less than 1 year	11,815	15,415	3,730
Between 1 and 5 years	43,964	58,570	13,600
More than 5 years	14,587	-	-
	<b>70,366</b>	<b>73,985</b>	<b>17,330</b>

The Company leases a number of offices and the mobile equipment fleet at CSP. The leases typically run for a period of 1 to 5 years, with an option to review the lease after that date. Some leases provide for increases to rent payments that are based on changes in the local price index.

During the three months ended March 31, 2011, an amount of \$8.6 million was recognized as an expense in profit or loss in respect of operating leases (2010 - \$8.3 million). There was no contingent rent or sublease revenue recognized during the period ended March 31, 2011, or for the comparative period in 2010.

### 21. Related Parties

Certain directors and officers of the Company are also directors of a company to which the Company pays royalties in the normal course of business. Royalty payments were \$3.0 million for the three months ended March 31, 2011 (2010 - \$1.4 million). At March 31, 2011, the Company had \$1.7 million included as accrued liabilities related to this company (December 31, 2010 - \$2.1 million). These transactions were in the normal course of operations and were measured at fair value. A director of New Gold is also a director of the company that purchased from New Gold an interest in the El Morro Project as described in Note 9. That company is now the 70% owner manager of the El Morro Project.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 22. Commitments and contingencies

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company and its legal counsel evaluate the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought. If the assessment of a contingency suggests that a loss is probable, and the amount can be reliably estimated, then a loss is recorded. When a contingent loss is not probable but is reasonably possible, or is probable but the amount of loss cannot be reliably estimated then details of the contingent loss are disclosed. Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed. Legal fees incurred in connection with pending legal proceedings are expensed as incurred.

#### (a) Capital commitments

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 for its operations. At March 31, 2011, these commitments totaled \$122.6 million, of which all are expected to fall due over the next 12 months.

Capital expenditure contracted for at the statement of financial position date but not yet incurred is as follows:

(US\$ in millions)	2011 \$	2010 \$
Property, plant and equipment	108,683	69,244
Other assets	13,892	13,573

On January 13, 2010, New Gold Inc. received a Statement of Claim filed by Barrick in the Ontario Superior Court of Justice, against New Gold, Goldcorp and affiliates subsidiaries. A Fresh Amended Statement of Claim was received in August 2010 which included Xstrata and its affiliated subsidiaries as defendants. The claim relates Datawave's exercise of its right of first refusal with respect to the El Morro copper-gold project. New Gold believes the claim is without merit and intends to defend this action using all available legal avenues. No amounts have been accrued for any potential loss under this claim.

#### (b) New Gold owns 100% of the Cerro San Pedro Mine through the Mexican Company, Minera San Xavier S.A. de C.V. ("MSX").

The Cerro San Pedro Mine has a history of on-going legal challenges. The Mine is in full operation and legal challenges relate primarily to a land use dispute; New Gold is in compliance with all environmental permits at Cerro San Pedro Mine.

On November 18, 2009 PROFEPA, the Mexican environmental enforcement agency, issued an order that MSX was to suspend mining operations at the Cerro San Pedro Mine. PROFEPA's order followed a ruling by the Federal Court of Fiscal and Administrative Justice ("FCFAJ") in September 2009 that SEMARNAT, the Mexican government's environmental protection agency, nullify the Mine's Environmental Impact Statement ("EIS") which was issued in 2006. The First Federal District Court in San Luis Potosi has issued injunctions to ensure that operations at the Cerro San Pedro Mine continue during the appeals process. The latest injunction was received on October 4, 2010.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 22. Commitments and contingencies (continued)

MSX appealed the September 2009 ruling of the FCFAJ. A hearing was held in the Third Federal District Court in Mexico City in April 2010 and a negative decision was issued by the court in July 2010. MSX appealed the negative decision and in November 2010, a Collegiate Appeals Court in Mexico City ruled unanimously in favour of MSX's position in its appeal against the September 2009 nullification of the EIS. That ruling effectively reestablishes the validity of the mine's 2006 EIS.

MSX continues to work with all levels of government and other external stakeholders to maintain uninterrupted operation of the Cerro San Pedro Mine.

New Gold and its subsidiary Western Mesquite Mines, Inc. ("WMMI") have been named as defendants under the California Labor Code, Private Attorneys General Act 2004 alleging breaches of employment regulations at the Mesquite Mine. The primary claims relate to allegations of unpaid overtime wages, non-compliant first and second meal periods, non-compliant rest breaks and penalties for willful failure to pay all wages due upon termination of employment. The complainants are seeking certification of the matter as a class action.

New Gold is working to analyze and respond to the claims in a timely and appropriate manner. New Gold cannot accurately predict the scope of the claims or their likely outcome at this time but does not believe the claims will have a material effect on the financial conditions or future operations at the Mesquite Mine.

### 23. Provisions

The following table presents changes in provisions.

	Share unit awards	Employee Benefits	Total \$
Balance, January 1, 2010	99	4,541	4,640
Additional provisions recognized	6,097	3,807	9,904
Used during the year	(3,126)	(3,080)	(6,206)
Foreign exchange	225	664	889
Balance, December 31, 2010	3,295	5,932	9,227
<b>Additional provisions recognized</b>	<b>3,087</b>	<b>1,121</b>	<b>4,208</b>
<b>Used during the year</b>	<b>(108)</b>	<b>(906)</b>	<b>(1,014)</b>
<b>Foreign exchange</b>	<b>64</b>	<b>84</b>	<b>148</b>
<b>Balance, March 31, 2011</b>	<b>6,338</b>	<b>6,231</b>	<b>12,569</b>

### 24. Subsequent events

Subsequent to the quarter end, on April 4, 2011, New Gold announced the friendly acquisition of Richfield Ventures Corp., and its flagship Blackwater Project in British Columbia. New Gold and Richfield jointly announced a definitive agreement whereby New Gold will acquire, through a plan of arrangement, all of the outstanding common shares of Richfield. Under the terms of the Arrangement, each Richfield shareholder will receive 0.9217 of a New Gold share for each Richfield share held.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

---

### 25. First time adoption of IFRS

The Company adopted IFRS effective January 1, 2010 ("the transition date") and has prepared its opening statement of financial position in accordance with International Financial Reporting Standards. The date of the first annual financial statements in compliance with IFRS will be for the year ending December 31, 2011.

IFRS 1 'First-time adoption of International Financial Reporting Standards' ("IFRS 1"), which governs the first time adoption of IFRS requires that the same policies are applied for all periods presented and that these policies are based on IFRS effective at the end of the first IFRS reporting year, December 31, 2011. The Company will therefore prepare its opening statement of financial position by applying existing IFRS at December 31, 2011 or earlier. Accordingly, it is possible that the opening statement of financial position and consolidated financial statements for December 31, 2011 may differ from the information presented in these interim financial statements.

The IFRS accounting policies as presented in Note 2 have been applied in preparing the financial statements for the period ended March 31, 2011, the comparative information and the opening statement of financial position at the date of transition.

#### (a) Elected exemptions from full retrospective application

IFRS 1 requires accounting policies to be applied retrospectively to determine the opening statement of financial position at the Company's transition date of January 1, 2010, and allows certain exemptions on the transition to IFRS. The optional exemptions applied are as follows:

##### (i) Business combinations

Under IFRS 1, the Company can elect to not restate in accordance with IFRS 3R *Business Combinations*, all business combinations that occurred prior to the transition date or to only restate all business combinations that occurred after a designated date prior to the transition date. The Company has applied this exemption to all business combinations that occurred prior to January 1, 2010.

##### (ii) Deemed cost

IFRS 1 allows an entity to initially measure an item of property, plant and equipment upon transition to IFRS at fair value on the transition date or at an event-driven fair value (i.e. a fair value determined through a business combination or initial public offering) and use that fair value as its deemed cost. This elective exemption can be applied on an individual asset basis. The Company applied this exemption and used fair value as deemed cost in its opening statement of financial position to establish carrying values for \$375.4 million of New Afton mining interests at the transition date.

##### (iii) Share-based payment transactions

IFRS 1 encourages, but does not require a first time adopter to apply IFRS 2 *Share-based Payment* ("IFRS 2") to equity instruments that were granted on or before November 7, 2002, or were granted after November 7, 2002 but vested before the Company's IFRS transition date. Accordingly, an entity may elect not to retrospectively apply IFRS 2 to these equity instruments.

The Company has elected this exemption and as a result, has applied IFRS 2 retrospectively only for share-based payments that were granted after November 7, 2002, and had not vested at the date of transition.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

---

### 25. First time adoption of IFRS (continued)

#### (iv) Cumulative translation differences

IFRS 1 allows cumulative translation differences for all foreign operations to be reset to zero at the date of transition to IFRS, with future gains or losses on subsequent disposal of any foreign operations to exclude translation differences arising prior to the date of transition to IFRS. The Company has elected this exemption and accordingly, has reset all cumulative translation differences to zero on transition to IFRS.

#### (v) Decommissioning liabilities included in the cost of property, plant and equipment

Under IFRS 1, an entity can elect to not apply the provisions of IFRIC 1 - *Changes in Existing Decommission, Restoration and Similar Liabilities*, as they relate to changes in such liabilities before the date of transition to IFRS.

When applying this exemption, an entity would determine its decommissioning liabilities at the transition date, discount the liabilities back to the dates when they first arose using management's best estimate of the historical risk-adjusted discount rates, and depreciate these amounts forward to the transition date to determine the amount to be included in the depreciated cost of the assets. The Company has elected this exemption and in doing so, will be required to apply it to all its decommissioning liabilities.

#### (vi) Borrowing costs

IFRS 1 permits an entity to apply the transitional provisions of IAS 23 - *Borrowing Costs* as an alternative to full retrospective application. Under these provisions, the Company may elect to only apply IAS 23 to qualifying assets for which the commencement date for capitalization is on or after the date of transition (or an elected earlier date).

The Company has elected to apply this exemption from its transition date of January 1, 2010, and as a result, will apply IAS 23 from this date onwards for projects with a commencement date of January 1, 2010 or later.

#### (vii) Assets and liabilities of subsidiaries, associates and joint ventures

IFRS 1 requires that when a parent company becomes a first-time adopter later than its subsidiary the parent shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary at the same carrying amounts as in the financial statements of the subsidiary, after adjusting for consolidation adjustments and for the effects of the business combination in which the parent acquired the subsidiary.

The Company applied this exemption to its Australian subsidiaries that are already reporting under IFRS.

#### (b) Mandatory exceptions to retrospective application

IFRS 1 outlines specific guidelines that a first-time adopter must adhere to under certain circumstances. The Company has applied the following guidelines to its opening statement of financial position dated January 1, 2010:

##### (i) Hedge accounting

Only hedging relationships that satisfied the hedge accounting criteria as of the transition date are reflected as hedges in the Company's results under IFRS. Any derivatives not meeting the IAS 39 "Financial Instruments: Recognition and Measurement" ("IAS 39") criteria for hedge accounting were recorded as non-hedged derivative instruments.

# New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

## 25. First time adoption of IFRS (continued)

### (ii) *Estimates*

Hindsight was not used to create or revise estimates and accordingly, the estimates previously made by the Company under Canadian GAAP are consistent with their application under IFRS.

### (c) Reconciliations from Canadian generally accepted accounting principles ("GAAP") to IFRS

The Company's transition from Canadian GAAP to IFRS has resulted in a number of adjustments to its statement of income, statement of comprehensive income, statement of financial position and statement of cash flows for the quarter ended March 31, 2011, the year ended December 31, 2010 and to the statement of financial position for January 1, 2010. Further details of the adjustments are provided in the following reconciliations and the notes that accompany the reconciliations. The adoption of IFRS has not changed the Company's actual cash flows.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 25. First time adoption of IFRS (continued)

The January 1, 2010 Canadian GAAP ("CGAAP") statement of financial position has been reconciled to IFRS as follows:

	Notes	December 31 2009 CGAAP	Effect of IFRS Transition	January 1 2010 IFRS
<b>Assets</b>				
Current assets				
Cash and cash equivalents	p	262,325	9,201	271,526
Restricted cash	p	9,201	(9,201)	-
Trade and other receivables		10,345	-	10,345
Inventories		86,299	-	86,299
Deferred income and mining taxes	a	8,848	(8,848)	-
Current portion of derivative asset		706	-	706
Prepaid expenses and other		6,933	-	6,933
Current portion of operations held for sale		10,298	-	10,298
<b>Total current assets</b>		<b>394,955</b>	<b>(8,848)</b>	<b>386,107</b>
Investments		45,890	-	45,890
Mining interests	b	2,000,438	(327,606)	1,664,563
	d		8,743	
	e		4,311	
	f		(2,513)	
	q		(18,810)	
Deferred tax assets	a	2,250	8,848	11,098
Reclamation deposits and other		17,646	-	17,646
Assets of operations held for sale	g	27,080	51,909	78,989
<b>Total assets</b>		<b>2,488,259</b>	<b>(283,966)</b>	<b>2,204,293</b>
<b>Liabilities</b>				
Current liabilities				
Trade and other payables	h	36,033	1,966	37,999
Current portion of long-term debt		12,088	-	12,088
Current portion of derivative liability		19,206	-	19,206
Current tax liabilities	h	15,677	(1,966)	13,711
Assets of operations held for sale		10,414	-	10,414
<b>Total current liabilities</b>		<b>93,418</b>	<b>-</b>	<b>93,418</b>
Reclamation and closure cost obligations	e	19,889	4,875	24,764
Provisions	i	-	4,541	4,541
Non-current portion of derivative liabilities		76,780	-	76,780
Non-hedged derivative liabilities	c	-	7,701	37,542
	j	-	29,841	
Deferred tax liabilities	b	316,426	(81,245)	245,969
	c		2,600	
	d		2,186	
	f		(754)	
	j		11,913	
	k		(9,507)	
	l		23,160	
	q		(18,810)	
Long-term debt		225,456	-	225,456
Employee benefits and other	i	5,355	(4,541)	814
Liabilities of operations held for sale		19,890	-	19,890
<b>Total liabilities</b>		<b>757,214</b>	<b>(28,040)</b>	<b>729,174</b>

# New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

## 25. First time adoption of IFRS (continued)

		December 31 2009	Effect of IFRS	January 1 2010
	Notes	CGAAP	Transition	IFRS
<b>Equity</b>				
Common shares	j	1,810,865	(826)	1,810,039
Contributed surplus		82,984	-	82,984
Share purchase w warrants	j	150,656	(138,806)	11,850
Equity components of convertible debentures	c	21,604	(21,604)	-
Other reserves	m	(29,205)	1,566	(27,639)
Deficit	b	(305,859)	(246,361)	(402,115)
	c		11,303	
	d		6,557	
	e		(564)	
	f		(1,759)	
	g		51,909	
	j		97,878	
	k		9,507	
	l		(23,160)	
	m		(1,566)	
Total equity		1,731,045	(255,926)	1,475,119
Total liabilities and equity		2,488,259	(283,966)	2,204,293

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 25. First time adoption of IFRS (continued)

The CGAAP income statement and statement of comprehensive income for the three months ended March 31, 2010 have been reconciled to IFRS as follows:

<i>(US\$ in thousands)</i>	Notes	3 months ended March 31, 2010		
		CGAAP	Effect of IFRS transition	IFRS
Revenues		101,620	-	101,620
Operating expenses	f	(52,256)	370	(51,886)
Depreciation and depletion	e	(12,741)	326	(12,963)
	f		(548)	
Earnings from mine operations		36,623	148	36,771
Corporation administration	n	(7,989)	404	(7,585)
Exploration		(1,794)	-	(1,794)
Earnings from operations		26,840	552	27,392
Finance income		256	-	256
Finance costs	e	(232)	(326)	(558)
Realized and unrealized gain on investments		3,944	-	3,944
Unrealized gain on prepayment option		1,907	-	1,907
Other expense		(2,082)	-	(2,082)
Gain(loss) on foreign exchange	c	(4,453)	(235)	1,728
	d		7,324	
	j		(908)	
Unrealized loss on non-hedged derivatives	c		(1,608)	(10,109)
	j		(8,501)	
Earnings (loss) before taxes		26,180	(3,702)	22,478
Income tax expense	c	(8,992)	50	(9,436)
	j		1,051	
	k		(1,657)	
	l		112	
Net earnings (loss) from continuing operations		17,188	(4,146)	13,042
Earnings from discontinued operations, net of taxes		305	-	305
Net earnings		17,493	(4,146)	13,347

<i>(US\$ in thousands)</i>	Notes	3 months ended March 31, 2010		
		CGAAP	Effect of IFRS transition	IFRS
<b>Net earnings</b>		17,493	(4,146)	13,347
Other comprehensive income (loss)				
Unrealized losses on mark-to-market of gold contracts		(3,160)	-	(3,160)
Unrealized gains on mark-to-market of fuel contracts		85	-	85
Currency translation adjustment	d	-	7,584	7,584
Deferred income tax		1,824	-	1,824
Total other comprehensive income (loss)		(1,251)	7,584	6,333
Total comprehensive income		16,242	3,438	19,680

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 25. First time adoption of IFRS (continued)

The Canadian GAAP income statement and statement of comprehensive income for the year ended December 31, 2010 have been reconciled to IFRS as follows:

<i>(US\$ in thousands)</i>	Notes	Year ended December 31, 2010		
		CGAAP	Effect of IFRS transition	IFRS
Revenues		530,450	-	530,450
Operating expenses	e	(250,338)	(962)	(247,773)
	f		3,527	
Depreciation and depletion	e	(77,016)	(566)	(78,691)
	f		(2,475)	
	e		1,366	
Earnings from mine operations		203,096	890	203,986
Corporation administration	n	(32,622)	1,611	(31,011)
Exploration		(12,834)	-	(12,834)
Impairment charge of exploration assets		(15,728)	-	(15,728)
Earnings from operations		141,912	2,501	144,413
Finance income		3,258		3,258
Finance costs	e	(947)	259	(2,054)
	e		(1,366)	
Realized and unrealized gain on investments		9,128	-	9,128
Unrealized gain on prepayment option		7,679	-	7,679
Gain on sale of investment		39,710	-	39,710
Other expense	f	(2,883)	(884)	(3,767)
Loss on foreign exchange	c	(21,816)	(941)	(9,675)
	d		13,857	
	j		(3,544)	
	q		2,769	
Unrealized loss on non-hedged derivatives	c	-	(20,785)	(113,336)
	j		(92,551)	
Earnings (loss) before taxes		176,041	(100,685)	75,356
Income tax expense	c	(41,110)	2,600	(18,009)
	f		(306)	
	j		11,887	
	k		(8,762)	
	l		18,642	
	o		(960)	
Net earnings (loss) from continuing operations		134,931	(77,584)	57,347
Earnings (loss) from discontinued operations, net of taxes	g	42,023	(51,909)	(9,886)
Net earnings		176,954	(129,493)	47,461

<i>(US\$ in thousands)</i>	Notes	Year ended December 31, 2010		
		CGAAP	Effect of IFRS transition	IFRS
<b>Net earnings</b>		176,954	(129,493)	47,461
Other comprehensive income (loss)				
Unrealized losses on mark-to-market of gold contracts		(85,849)	-	(85,849)
Realized losses on mark-to-market of gold contracts		20,035	-	20,035
Unrealized gains on mark-to-market of fuel contracts		(366)	-	(366)
Currency translation adjustment	d	-	14,334	14,334
Deferred income tax		27,572	-	27,572
Total other comprehensive loss		(38,608)	14,334	(24,274)
Total comprehensive income		138,346	(115,159)	23,187

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 25. First time adoption of IFRS (continued)

The Canadian GAAP statement of financial position at March 31, 2010 has been reconciled to IFRS as follows:

	Notes	March 31, 2010		
		CGAAP	Effect of IFRS Transition	IFRS
<b>Assets</b>				
Current assets				
Cash and cash equivalents		343,715	-	343,715
Trade and other receivables		15,644	-	15,644
Inventories	f	88,743	(2,664)	86,079
Deferred income and mining taxes	a	6,934	(6,934)	-
Current portion of derivative asset		726	-	726
Prepaid expenses and other		6,539	-	6,539
Current portion of operations held for sale		10,585	-	10,585
<b>Total current assets</b>		<b>472,886</b>	<b>(9,598)</b>	<b>463,288</b>
Investments		2,149	-	2,149
Mining interests	b	2,012,749	(327,606)	1,691,682
	d		21,065	
	e		4,311	
	f		(27)	
	q		(18,810)	
Deferred tax assets	a	2,028	6,934	8,962
Reclamation deposits and other		19,739	-	19,739
Assets of operations held for sale	g	27,009	51,909	78,918
<b>Total assets</b>		<b>2,536,560</b>	<b>(271,822)</b>	<b>2,264,738</b>
<b>Liabilities</b>				
Current liabilities				
Trade and other payables	h	40,610	2,173	42,783
Current portion of derivatives liabilities		20,288	-	20,288
Current tax liabilities	h	15,067	(2,173)	12,894
Assets of operations held for sale		8,943	-	8,943
<b>Total current liabilities</b>		<b>84,908</b>	<b>-</b>	<b>84,908</b>
Reclamation and closure cost obligations	e	21,040	4,875	25,915
Provisions	i	-	4,583	4,583
Non-current portion of derivative liabilities		76,782	-	76,782
Non-hedged derivative liabilities	c	-	9,544	48,794
	j		39,250	
Deferred tax liabilities	b	314,606	(83,739)	242,007
	c		2,550	
	d		2,186	
	f		(754)	
	j		10,862	
	k		(7,942)	
	l		23,048	
	q		(18,810)	
Long-term debt		217,704	-	217,704
Deferred benefit		46,276	-	46,276
Employee benefits and other	i	5,618	(4,583)	1,035
Liabilities of operations held for sale		19,272	-	19,272
<b>Total liabilities</b>		<b>786,206</b>	<b>(18,930)</b>	<b>767,276</b>

# New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

## 25. First time adoption of IFRS (continued)

	Notes	March 31, 2010		
		CGAAP	Effect of IFRS Transition	IFRS
<b>Equity</b>				
Common shares	j	1,812,625	(826)	1,811,799
Contributed surplus	n	84,291	(404)	83,887
Share purchase w arrants	j	150,656	(138,806)	11,850
Equity components of convertible debentures	c	21,604	(21,604)	-
Currency translation adjustment	d	-	7,584	7,584
Other reserves	m	(30,456)	1,566	(28,890)
Deficit	b	(288,366)	(246,361)	(388,768)
	c		11,303	
	d		6,557	
	e		(564)	
	f		(1,759)	
	g		51,909	
	j		97,878	
	k		9,507	
	l		(23,160)	
	m		(1,566)	
	Per Income statement		(4,146)	
<b>Total equity</b>		<b>1,750,354</b>	<b>(252,892)</b>	<b>1,497,462</b>
<b>Total liabilities and equity</b>		<b>2,536,560</b>	<b>(271,822)</b>	<b>2,264,738</b>

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 25. First time adoption of IFRS (continued)

The Canadian GAAP statement of financial position at December 31, 2010 has been reconciled to IFRS as follows:

	Notes	December 31, 2010		
		CGAAP audited	Effect of IFRS Transition	IFRS unaudited
<b>Assets</b>				
Current assets				
Cash and cash equivalents		490,754	-	490,754
Trade and other receivables		11,929	-	11,929
Inventories	e	106,325	347	103,055
	f		(3,617)	
Deferred income and mining taxes	a	9,127	(9,127)	-
Prepaid expenses and other		7,325	-	7,325
<b>Total current assets</b>		<b>625,460</b>	<b>(12,397)</b>	<b>613,063</b>
Investments		7,533	-	7,533
Mining interests	b	2,073,695	(327,606)	1,767,240
	d		33,052	
	e		5,637	
	f		1,272	
	q		(18,810)	
Deferred tax assets	a	931	9,127	10,058
Reclamation deposits and other		31,295	-	31,295
<b>Total assets</b>		<b>2,738,914</b>	<b>(309,725)</b>	<b>2,429,189</b>
<b>Liabilities</b>				
Current liabilities				
Trade and other payables	h	66,654	2,591	69,245
Current portion of derivative liability		40,072	-	40,072
Current tax liabilities	h	33,983	(2,591)	31,392
<b>Total current liabilities</b>		<b>140,709</b>	<b>-</b>	<b>140,709</b>
Reclamation and closure cost obligations	e	25,721	8,452	34,173
Provisions	i		9,227	9,227
Non-current portion of derivative liabilities		113,303	-	113,303
Non-hedged derivative liabilities	c	-	29,429	155,365
	j		125,936	
Deferred tax liabilities	b	280,026	(85,522)	179,180
	d		2,186	
	f		(448)	
	j		26	
	k		(987)	
	l		4,518	
	o		960	
	q		(21,579)	
Long-term debt		229,884	-	229,884
Deferred benefit		46,276	-	46,276
Employee benefits and other	i	9,804	(9,227)	577
<b>Total liabilities</b>		<b>845,723</b>	<b>62,971</b>	<b>908,694</b>

# New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

## 25. First time adoption of IFRS (continued)

	Notes	December 31, 2010		
		CGAAP audited	Effect of IFRS Transition	IFRS unaudited
<b>Equity</b>				
Common shares	j	1,846,712	(826)	1,845,886
Contributed surplus	n	82,787	(1,611)	81,176
Share purchase w arrants	j	138,806	(138,806)	-
Equity components of convertible debentures	c	21,604	(21,604)	-
Currency translation adjustment	d	-	14,334	14,334
Other reserves	m	(67,813)	1,566	(66,247)
Deficit	b	(128,905)	(246,361)	(354,654)
	c		11,303	
	d		6,557	
	e		(564)	
	f		(1,759)	
	g		51,909	
	j		97,878	
	k		9,507	
	l		(23,160)	
	m		(1,566)	
	Per income statement		(129,493)	
<b>Total equity</b>		<b>1,893,191</b>	<b>(372,696)</b>	<b>1,520,495</b>
<b>Total liabilities and equity</b>		<b>2,738,914</b>	<b>(309,725)</b>	<b>2,429,189</b>

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

### 25. First time adoption of IFRS (continued)

The reconciliation of the statement of cash flows for the three months ended March 31, 2010:

	Notes	3 months ended March 31, 2010		
		CGAAP	Effect of IFRS transition	IFRS
<b>Operating activities</b>				
Net earnings		17,493	(4,146)	13,347
Loss (earnings) from discontinued operations		(305)	-	(305)
Adjustments for:				
Unrealized gain on gold contracts		(2,076)	-	(2,076)
Unrealized gain on fuel contracts		65	-	65
Unrealized gain (loss) on non-hedge derivatives	c,j	-	10,109	10,109
Unrealized foreign exchange loss	c,d,j	4,812	(6,181)	(1,369)
Unrealized and realized gain on of investments		(3,944)	-	(3,944)
Loss on disposal of assets		398	-	398
Depreciation and depletion	e,f	12,522	548	13,070
Share-based payments	n	2,302	(404)	1,898
Unrealized (gain) loss on embedded derivative contract		(1,907)	-	(1,907)
Income tax expense	c,j,k,l	(1,067)	444	9,436
	p		939	
	p		9,120	
Income tax paid	p	-	(9,120)	(9,120)
Finance income	p	-	(256)	(256)
Finance costs	e,p	-	558	558
Interest received	p	-	232	232
Interest paid	p	-	(206)	(206)
Change in non-cash working capital	f	(8,347)	1,397	(6,950)
Cash provided by (used in) continuing operations		19,946	3,034	22,980
Cash provided by (used in) discontinued operations		(1,696)	-	(1,696)
<b>Investing activities</b>				
Mining interests	f	(18,968)	(3,034)	(22,002)
Reclamation deposits		(41)	-	(41)
Reduction of restricted cash	p	9,201	(9,201)	-
Proceeds from disposal of assets		29	-	29
Cash received in El Morro transaction, net of transaction costs		46,276	-	46,276
Investment in El Morro		(463,000)	-	(463,000)
Proceeds from settlement of investments		48,112	-	48,112
Cash provided by (used in) continuing operations		(378,391)	(12,235)	(390,626)
Cash used in discontinued operations		(219)	-	(219)
<b>Financing activities</b>				
Exercise of options to purchase common stock		765	-	765
El Morro loan		463,000	-	463,000
Repayment of long-term debt		(27,235)	-	(27,235)
Cash provided by (used in) continuing operations		436,530	-	436,530
Cash provided by (used in) discontinued operations		-	-	-
Effect of exchange rate changes on cash and cash equivalents		5,295	-	5,295
Increase (decrease) in cash and cash equivalents	p	81,465	(9,201)	72,264
Cash and cash equivalents, beginning of period	p	263,151	9,201	272,352
<b>Cash and cash equivalents, end of period</b>		<b>344,616</b>	<b>-</b>	<b>344,616</b>

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

### 25. First time adoption of IFRS (continued)

The reconciliation of the statement of cash flows for the year ended December 31, 2010:

		Year ended December 31, 2010		
	Notes	CGAAP	Effect of IFRS transition	IFRS
<b>Operating activities</b>				
Net earnings		176,954	(129,493)	47,461
Loss (earnings) from discontinued operations	g	(42,023)	51,909	9,886
Adjustments for:				-
Unrealized gain on gold contracts		(8,425)	-	(8,425)
Unrealized gain on fuel contracts		340	-	340
Unrealized gain (loss) on non-hedge derivatives	c,j	-	113,336	113,336
Unrealized foreign exchange loss	c,d,j	21,816	(12,157)	9,659
Unrealized and realized gain on of investments		(9,128)	-	(9,128)
Gain on sale of Beadell shares		(39,710)	-	(39,710)
Loss on disposal of assets	f	1,054	884	1,938
Impairment charge of exploration asset		15,728	-	15,728
Depreciation and depletion	e,f	76,307	2,782	79,089
Share-based payments	n	8,151	(1,611)	6,540
Unrealized (gain) loss on embedded derivative contract		(7,679)	-	(7,679)
Income tax expense	c,j,k,l,o	(17,197)	(23,101)	18,009
	p		58,307	
Income tax paid	p	-	(41,855)	(41,855)
Finance income	p	-	(3,258)	(3,258)
Interest received	p	-	1,417	1,417
Finance costs	p	-	2,054	2,054
Interest paid	p	-	(20,895)	(20,895)
Change in non-cash working capital	f	6,072	3,270	(7,323)
	p		41,855	
	p		(58,307)	
	p		(2,054)	
	p		1,841	
Cash provided by (used in) continuing operations		182,260	(15,076)	167,184
Cash provided by (used in) discontinued operations		(1,696)	-	(1,696)
<b>Investing activities</b>				
Mining interests	f	(149,165)	(5,819)	(134,089)
	p		20,895	
Reclamation deposits		(1,590)	-	(1,590)
Reduction of restricted cash	p	9,201	(9,201)	-
Proceeds from disposal of assets		439	-	439
Cash received in El Morro transaction, net of transaction costs		46,276	-	46,276
Investment in El Morro		(463,000)	-	(463,000)
Proceeds from the sale of Beadell shares		58,364	-	58,364
Proceeds from settlement of investments		48,112	-	48,112
Cash provided by (used in) continuing operations		(451,363)	5,875	(445,488)
Cash used in discontinued operations		34,410	-	34,410
<b>Financing activities</b>				
Exercise of options to purchase common stock		15,649	-	15,649
El Morro loan		463,000	-	463,000
Revolving credit facility initiation costs		(4,225)	-	(4,225)
Repayment of long-term debt		(27,235)	-	(27,235)
Cash provided by (used in) continuing operations		447,189	-	447,189
Cash provided by (used in) discontinued operations		-	-	-
Effect of exchange rate changes on cash and cash equivalents		16,803	-	16,803
Increase (decrease) in cash and cash equivalents	p	227,603	(9,201)	218,402
Cash and cash equivalents, beginning of period	p	263,151	9,201	272,352
<b>Cash and cash equivalents, end of period</b>		<b>490,754</b>	<b>-</b>	<b>490,754</b>

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

---

### 25. First time adoption of IFRS (continued)

Notes to the IFRS reconciliations above:

(a) Deferred tax classified as current

IFRS does not permit deferred tax to be classified as current. Reclassification from current to non-current is therefore required.

(b) Fair value as deemed cost

Under IFRS 1, the Company elected to measure the New Afton project at fair value on transition to IFRS and use that fair value as its deemed cost (please refer above for further details on the IFRS 1 exemption). The Company has calculated the fair value of the project using a discounted cash flow methodology. Under Canadian GAAP, the estimates of future cash flows used to test the recoverability were on an undiscounted basis.

(c) Convertible debentures

Under IFRS, the conversion option of the Company's convertible debentures does not meet the criteria for equity classification and accordingly, is treated as a derivative liability that is measured at fair value on initial recognition. Under Canadian GAAP, the conversion option was classified as equity in the Company's balance sheet. Under IFRS, the conversion option derivative is re-measured at fair value at each statement of financial position date, while under Canadian GAAP the equity portion was not re-measured.

Due to the Company's election of the IFRS 1 exemption for business combinations (see above), the initial recognition and subsequent measurement of the debt component of the convertible debentures was unchanged on transition to IFRS.

(d) Foreign currency translation

IFRS does not have the concept of group functional currency and requires a separate functional currency assessment for each entity within the consolidated group. Under Canadian GAAP, all the Company's entities had U.S. dollar functional currencies.

Under IFRS, the Company will continue with U.S. dollar functional currencies for all entities, with the exception of the New Afton project. The Canadian dollar was determined to be the functional currency for New Afton under IFRS. The project was considered an integrated operation under Canadian GAAP.

(e) Decommissioning liabilities (Reclamation and closure cost obligations)

IFRS requires provisions to be updated at each statement of financial position date using a current pre-tax discount rate (which reflects current market assessment of the time value of money and the risk specific to the liability). Canadian GAAP required the use of a current credit-adjusted, risk-free rate for upward adjustments, and the original credit-adjusted, risk-free rate for downward revisions.

This difference resulted in different discount rates being applicable for IFRS purposes than the discount rates used for Canadian GAAP. Accordingly, the Company was required to recalculate its reclamation and closure costs obligations and related asset amounts on transition. In performing the calculations, the IFRS 1 elective exemption for decommissioning liabilities was applied (see IFRS 1 above).

Under Canadian GAAP, the unwinding of the discount was presented as an operating expense. Under IFRS, the unwinding of the discount is presented as a finance cost. Adjustments were required in the Company's 2010 income statements to reclassify these amounts to finance costs and to adjust the Canadian GAAP amounts to the IFRS amounts.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited) March 31, 2011

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

---

### 25. First time adoption of IFRS (continued)

(f) Property, plant and equipment

IFRS requires identifying and measuring the cost of significant individual components of assets which have different useful lives than the core asset. Significant components are then separately depreciated based on their individual useful lives.

(g) Reversal of impairment loss

Under IFRS, previous impairment losses recognized must be reversed where circumstances have changed such that the impairments have reduced (other than for impairments of goodwill, which are not reversed). Reversals of impairment losses were not permitted under Canadian GAAP.

The Company increased the carrying value of the Amapari property to reverse an impairment charge that was recognized in 2008. The increase resulted in an impairment reversal to the fair value of the property, less estimated costs to sell, at January 1, 2010. As the Amapari property was held for sale at January 1, 2010, the adjustment resulted in an increase to assets of operations held for sale.

(h) Interest and penalties related to income taxes payable

IFRS does not permit interest and penalties related to income taxes to be classified as income and mining taxes payable.

(i) Provisions

IFRS requires provisions to be disclosed separately from other liabilities.

(j) Share purchase warrants

Under IFRS, share purchase warrants with an exercise price denominated in a currency other than the Company's functional currency are required to be classified and accounted for as financial liabilities at their fair values, with changes in fair values being included in the consolidated income statement. Under Canadian GAAP, all the Company's outstanding share purchase warrants were classified and accounted for as equity.

(k) Deferred taxes

Under Canadian GAAP, a deferred tax asset was not recognized on the disposition of the AB Notes, as it was assumed there was no future source of capital gains. Under IFRS, due to the deferred tax liability recognized on the warrants (refer to Note 25 (j) above), a deferred tax asset is required to be recognized on disposition of the notes.

(l) Deferred taxes

IFRS requires a deferred tax asset or liability to be recognized for exchange gains and losses related to non-monetary assets and liabilities that are re-measured into the functional currency using the historical exchange rates. Under Canadian GAAP, a deferred tax asset or liability was not recognized for a temporary difference arising from the difference between the historical exchange rate and the current exchange rate translations of the cost of non-monetary assets and liabilities of integrated foreign operations.

# New Gold Inc.

## Notes to the condensed consolidated interim financial statements (unaudited)

March 31, 2011

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

---

### 25. First time adoption of IFRS (continued)

#### (m) Foreign currency IFRS 1 transitional provision

IFRS 1 allows cumulative translation differences for all foreign operations to be reset to zero at the date of transition to IFRS. The Company had \$1.6m in accumulated other comprehensive income which was reset to zero on transition.

#### (n) Share-based payment

Under Canadian GAAP, the Company recognized each share-based payment award as a single pool with a fair value based on the specified vesting period for the overall arrangement. Under IFRS, the fair value of each tranche of a share-based payment award is considered a separate grant based on the vesting period with the fair value of each tranche determined separately and recognized as compensation expense over the term of its respective vesting period. In addition, IFRS requires that forfeitures be estimated in advance, whereas a policy choice existed under Canadian GAAP.

#### (o) Deferred taxes

Under IFRS, the Company was required to recognize a deferred tax liability on the prepayment option embedded derivative.

#### (p) Statement of cash flows

Reclassification adjustments were required in the Consolidated Statement of Cash Flows to conform to the presentation required under IFRS. Interest paid and income taxes paid are presented as separate line items in the Consolidated Statement of Cash Flows, whereas they were previously disclosed as changes in non-cash working capital under Canadian GAAP. Borrowing costs capitalized in relation to qualifying assets are presented as interest paid in operating activities, whereas they were previously included in investing activities. Restricted cash has been included in the cash and cash equivalents balance for IFRS purposes, but was separately reported as restricted cash under Canadian GAAP.

#### (q) Other

On transition to IFRS, certain non-material adjustments totaling \$18.8 million related to deferred tax liabilities have been made to the amounts previously reported under Canadian GAAP.



## DIRECTORS

Randall Oliphant	Executive Chairman
Robert Gallagher	President and CEO
James Estey <sup>1,2</sup>	Corporate Director
Vahan Kololian <sup>2,3,4</sup>	Managing Partner, TerraNova Partners LP
Martyn Konig <sup>1,2</sup>	Executive Chairman and President, European Goldfields Limited
Pierre Lassonde <sup>3</sup>	Chairman, Franco-Nevada Corporation
Craig Nelsen <sup>4</sup>	President and CEO, Avanti Mining Corporation
Ian Telfer <sup>1,3</sup>	Chairman, Goldcorp Inc.
Raymond Threlkeld <sup>4</sup>	President and CEO, Rainy River Resources Ltd.

## Board Committees

- (1) Corporate Governance and Nominating Committee  
 (2) Audit Committee  
 (3) Compensation Committee  
 (4) Health, Safety, Environment and Sustainability Committee

## OFFICERS

Randall Oliphant	Executive Chairman
Robert Gallagher	President and Chief Executive Officer
Brian Penny	Executive Vice President, Chief Financial Officer
James Currie	Executive Vice President, Chief Operating Officer
Ron Allum	Vice President, Operations (Canada)
Brett Gagnon	Vice President, Information Technology
John Marshall	Vice President, Human Resources
Barry O'Shea	Vice President, Corporate Controller
Armando Ortega	Vice President, Latin America
Mark Petersen	Vice President, Exploration
Hannes Portmann	Vice President, Corporate Development
Susan Toews	Vice President, Legal Affairs, Corporate Secretary
Martin Wallace	Treasurer

## COMPANY INFORMATION 2010

### Vancouver Corporate Office

666 Burrard Street, Suite 3110 Vancouver, BC V6C 2X8  
 T: +1-604-696-4100  
 F: +1-604-696-4110  
 Toll Free: +1-888-315-9715

### Toronto Corporate Office

200 Bay Street, Suite 3120 Toronto, ON M4J 2J4  
 T: +1-416-324-6000  
 F: +1-416-324-9494

## Annual General Meeting

May 4, 2011 at 4:00 PM  
 Toronto Board of Trade  
 First Canadian Place  
 77 Adelaide Street West Toronto, ON M5X 1C1

## Investor Relations

Toll Free: +1-888-315-9715  
 F: +1-416-324-9494  
 E: info@newgold.com

## Media Inquiries

T: +1-416-324-6015  
 F: +1-416-324-9494  
 E: julie.taylor@newgold.com

## Transfer Agent

Computershare Investor Services Inc.  
 Toll Free: +1-800-564-6253 (North America)  
 T: +1-514-982-7555 (International)  
 F: +1-604-661-9401

## Additional Information

New Gold encourages the electronic delivery of correspondence and supports responsible use of forest resources. For any inquiries, or to request printed or electronic delivery of correspondence, please email us at info@newgold.com.

## CAUTION REGARDING FORWARD-LOOKING STATEMENTS

This document contains statements about expected future events and financial and operating results of New Gold that are forward-looking. By their nature, forward-looking statements require New Gold to make assumptions and are subject to inherent risks and uncertainties. There is significant risk that the assumptions, predictions and other forward-looking statements will not prove to be accurate. You are cautioned not to place undue reliance on forward-looking statements. A number of factors could cause assumptions, actual future results and events to differ materially from those expressed in the forward-looking statements. Accordingly, this document is qualified in its entirety by the assumptions, qualification and risk factors referred to in the Management's Discussion and Analysis section of this document and in other New Gold public disclosure documents and filings with securities commissions in Canada (on [sedar.com](http://sedar.com)) and in the United States (on EDGAR at [sec.gov](http://sec.gov)). New Gold does not undertake to update any forward-looking statements, except in accordance with applicable securities laws.

All dollar amounts are noted in US dollars unless otherwise indicated.



**NEW GOLD INC.**

**Vancouver Office**

Park Place  
666 Burrard Street, Suite 3110 Vancouver, British Columbia  
Canada V6C 2X8  
**T** +1 604 696 4100  
**F** +1 604 696 4110

**Toronto Office**

Royal Bank Plaza, South Tower  
200 Bay Street, Suite 3120 Toronto, Ontario  
Canada M4J 2J4  
**T** +1 416 324 6000  
**F** +1 416 324 9494

**Investor Relations**

**Toll Free** +1 888 315 9715  
**F** +1 416 324 9494  
**E** [info@newgold.com](mailto:info@newgold.com)  
**www.newgold.com**

TSX/NYSE AMEX:NGD