

newgold

THERE'S MORE



Second Quarter Report
For the Quarter Ended June 30, 2011



Management's Discussion and Analysis

**For the quarter ended
June 30, 2011**

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NEW GOLD INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE QUARTER ENDED JUNE 30, 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 quarters ended June 30, 2011 and 2010 which are prepared in accordance with International Financial Reporting Standards and New Gold's audited consolidated financial statements for the years ended December 31, 2010 and 2009 and related notes thereto which have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP".) 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 MD&A. 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 Management's Discussion and Analysis has been prepared as of August 3, 2011. Additional information relating to the Company, including the Company's Annual Information Form, is available on SEDAR at www.sedar.com.

SECOND QUARTER 2011 FINANCIAL AND OPERATIONAL HIGHLIGHTS

- Second quarter total cash cost⁽¹⁾ per ounce sold, net of by-product sales, decreased by \$127 per ounce to \$354 per ounce from \$481 per ounce in the same period in 2010.
- Second quarter gold sales of 95,039 ounces, up 15% from 82,402 ounces in the same period in 2010.
- Quarterly gold production of 88,478 ounces compared to 89,919 ounces in the same period in 2010.
- Cash flow from operations, excluding tax payments, increased by 96% to \$87.6 million from \$44.6 million in the same period in 2010.
- Net cash flow from operations, including tax payments, was \$44.0 million compared to \$40.4 million in the same period in 2010.
- Net earnings from continuing operations during the second quarter of \$78.6 million or \$0.19 per basic share compared to a net loss of \$26.0 million or \$(0.07) per basic share in the same period in 2010. Results for 2010 have been restated to comply with IFRS which was adopted January 1, 2010.
- Adjusted net earnings⁽³⁾ from continuing operations during the second quarter of \$49.8 million or \$0.12 per basic share compared to \$14.1 million or \$0.04 per basic share in the same period in 2010.
- Quarterly earnings from mine operations of \$83.5 million, up from \$36.5 million in the same period in 2010.
- On June 1, 2011, New Gold closed its acquisition of Richfield Ventures Corp. ("Richfield"), and its flagship Blackwater Project in British Columbia.
- In the second quarter, underground development at New Afton advanced a total of 2,166 metres compared to an advance of 671 metres in the second quarter of 2010.

- Cash and cash equivalents totaled \$490.4 million at June 30, 2011 compared to \$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, a 30% interest in the El Morro copper-gold project ("El Morro") in Chile and the recently acquired Blackwater project ("Blackwater") in Canada. 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 entrenched in the concept of growing responsibly. This underlies management's belief that economic achievement, environmental performance and social contributions are indivisible components in the success of the Company.

The Company actively engages in meaningful dialogue with local community residents and organizations to identify economic, training, social and development priorities and contributes to the development of the communities surrounding its operations.

New Gold's corporate responsibility objectives are to operate in a responsible manner, 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 Canadian Business for Social Responsibility and is a partner 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 received 0.9217 of a New Gold share for each Richfield share held plus nominal cost consideration. Richfield’s flagship asset is the Blackwater Project, located in central British Columbia.

On June 1, 2011, the acquisition received final court approval. There were 48.1 million New Gold shares issued to Richfield shareholders representing consideration of approximately \$489.0 million, inclusive of transaction costs.

B. EI 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. The trial started in June 2011 and is currently recessed, but will resume in October 2011. New Gold believes the claim is without merit and intends to defend this action using all available legal avenues.

C. 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 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. 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.

In March 2011, the municipality of Cerro San Pedro approved a new municipal land use plan ("Plan"), after public consultation. The Plan clearly designates the area of the Cerro San Pedro Mine for mining.

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

The second quarter of 2011 has witnessed a continuation of the turbulent economic news that has characterized recent months. Volatility in most asset classes has remained high, in particular for equities, as demonstrated by the performance of the MSCI AC World Equity Index which performed erratically but started and ended the quarter at a similar level. Overall, investment returns have varied considerably depending on sector and class.

A number of major economic concerns continue to trouble investors, most importantly the ongoing Eurozone sovereign debt crisis, the equally severe and politically charged debt problems in the United States and the general reluctance of the global economy to approach anything close to the swift rate of growth that might have been expected in the years immediately following a financial crisis and recession.

In this environment, gold has continued to perform strongly, lifted by both its status as a safe haven investment in uncertain times and the decline of confidence in many fiat currencies, not least the US dollar and the euro. The gold price averaged \$1,507 per ounce during the quarter, ending at \$1,506 per ounce, and continuing the drive upwards past \$1,600 per ounce to new nominal record highs subsequent to June 30, 2011.

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 second quarter of 2011, New Gold had an average realized gold price⁽²⁾ of \$1,417 per ounce (including monthly deliveries of

5,500 ounces of gold hedged at the Mesquite Mine at \$801 per ounce) which was 6% below an average market gold price of \$1,507 per ounce.

SELECTED QUARTERLY FINANCIAL INFORMATION

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

	Three months ended June 30,		Six Months ended June 30,	
	2011	2010	2011	2010
Operating Data ⁽¹⁾				
Tonnes of ore mined (000's)	6,758	6,595	12,917	10,259
Tonnes of waste mined (000's)	13,846	13,666	29,034	24,667
Ratio of waste to ore	2.05	2.07	2.25	2.40
Gold (ounces):				
Produced	88,478	89,919	196,100	167,134
Sold	95,039	82,402	199,250	162,421
Silver (ounces):				
Produced	520,408	547,084	1,155,728	753,784
Sold	602,349	505,350	1,188,145	698,856
Copper (000's of pounds):				
Produced	3,359	4,009	6,851	7,968
Sold	3,637	3,027	7,542	7,082
Realized prices ⁽²⁾ :				
Gold (\$/ounce)	1,417	1,147	1,365	1,113
Silver (\$/ounce)	38.85	18.38	35.78	18.02
Copper (\$/lb)	4.05	3.09	4.12	3.26
Total cash cost per gold ounce sold ⁽³⁾⁽⁴⁾	\$354	\$481	\$353	\$475
Financial Data (000's)				
Revenues	\$171,635	\$112,359	\$342,848	\$213,979
Earnings from mine operations	\$83,498	\$36,480	\$163,968	\$73,251
Net earnings (loss) from continuing operations	\$78,602	\$(26,006)	\$103,321	\$(12,964)
Earnings (loss) per share – basic:				
From continuing operations	\$0.19	\$(0.07)	\$0.25	\$(0.03)
From discontinued operations	-	\$(0.03)	-	\$(0.03)
Total	\$0.19	\$(0.09)	\$0.25	\$(0.06)
Operating cash flows from continuing operations, excluding tax payments	\$87,555	\$44,558	\$148,553	\$76,632

(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 June 30, 2011 would be \$605 per ounce of gold (2010 - \$602), \$17.07 per ounce of silver (2010 - \$10.19); and \$1.69 per pound of copper (2010 - \$1.60).

(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 SECOND QUARTER FINANCIAL RESULTS

In the second quarter of 2011, adjusted net earnings⁽³⁾ from continuing operations was \$49.8 million, which increased from \$14.1 million in the prior year period. The increase in adjusted net earnings⁽³⁾ from operations is attributed to higher realized commodity prices, increased sales and lower cash cost per

ounce⁽¹⁾. 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 second quarter of 2011 was a gain of \$30.0 million, relative to a loss of \$29.3 million in the same prior year period. Adjusted net earnings⁽³⁾ is a non-IFRS financial performance measure. 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 30%, relative to reported effective tax rate of the 21%. The following table reconciles net earnings to adjusted net earnings⁽³⁾:

	Three Months Ended June 30,		Six Month Ended June 30,	
	2011	2010	2011	2010
Net earnings before taxes	\$99,552	\$(11,004)	\$144,370	\$11,474
Fair Value of embedded derivative in Senior Notes	(3,304)	1,255	(850)	(652)
(Gains) loss on FVTPL financial assets	-	(948)	(1,349)	(4,892)
Ineffectiveness on hedging instruments	1,859	-	3,686	-
Fair Value change of non-hedged derivatives	(30,036)	29,296	(5,681)	39,405
(Gain) loss on foreign exchanges	1,134	6,321	(1,981)	4,952
Other	1,927	606	2,153	2,329
Adjusted Net earnings before Tax	\$71,132	\$25,526	\$140,348	\$52,616
Unadjusted Tax	(20,950)	(15,002)	(41,049)	(24,438)
Add tax related to Other Gains and Losses	2,439	(3,612)	1,219	(5,713)
Adjust IFRS Entry- Deferred Tax (non-monetary assets/liabilities)	(2,842)	7,204	(3,963)	7,092
Adjusted Tax	\$(21,353)	\$(11,410)	\$(43,793)	\$(23,059)
Adjusted Net earnings	\$49,779	\$14,116	\$96,555	\$29,557
Adjusted EPS	\$0.12	\$0.04	\$0.24	\$0.08
Adjusted Effective Tax Rate	30%	45%	31%	44%

In the second quarter of 2011, net earnings from continuing operations was \$78.6 million, which increased from a loss of \$26.0 million in the prior year period. The increase in net earnings from continuing operations is attributed to higher realized commodity prices, increased sales and lower cash cost per ounce. Offsetting these benefits is the fair value change of share purchase warrants and convertible debt generating a gain of \$30.0 million relative to a loss of \$29.3 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 gain on revaluing the prepayment option related to the senior secured notes of \$3.3 million relative to a loss of \$1.3 million in the same prior year period.

The Company sold 95,039 ounces of gold during the second quarter of 2011, compared to 82,402 ounces in the same prior year period. In addition to increased ounces sold, the increase in average realized price⁽²⁾ of gold has increased from \$1,147 to \$1,417 per ounce which contributed to a 53% increase in revenues to \$171.6 million. Coupled with the revenue increase, the reduction in cash cost⁽¹⁾ per ounce of gold sold to \$354 per ounce from \$481 in the same prior year period caused earnings from mine operations to increase from \$36.5 million in the second quarter of 2010 to \$83.5 million in the second quarter of 2011.

Cash flow from operations, excluding tax payments, increased by 96% to \$87.6 million from \$44.6 million in 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. Net cash flow from continuing operations, including tax payments, for the second quarter of 2011 was \$44.0 million compared to \$40.4 million for the same period in 2010. Cash taxes paid in the second quarter of 2011 was \$43.6 million relative to \$4.2 million in the same period in 2010. The key factor contributing to this increase in cash taxes paid is that final payments relating to the 2010 tax year of \$20.0 million were made in the second quarter of 2011. This is a reflection that the installment payments made during 2010 were too low, keeping cash taxes paid in 2010 low at the expense of increased catch-up payments in 2011.

SIX MONTHS ENDED JUNE 30, 2011 COMPARED TO SIX MONTHS ENDED JUNE 30, 2010

In the first six month of 2011, adjusted net earnings⁽³⁾ from continuing operations was \$96.6 million, which increased from \$29.6 million in the prior year period. The increase in adjusted net earnings⁽³⁾ 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 six months of 2011 was a gain of \$5.7 million, relative to a loss of \$39.4 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%. The following table reconciles net earnings to adjusted net earnings⁽³⁾:

	Three Months Ended June 30,		Six Month Ended June 30,	
	2011	2010	2011	2010
Net earnings before taxes	\$99,552	\$(11,004)	\$144,370	\$11,474
Fair Value of embedded derivative in Senior Notes	(3,304)	1,255	(850)	(652)
(Gains) loss on FVTPL financial assets	-	(948)	(1,349)	(4,892)
Ineffectiveness on hedging instruments	1,859	-	3,686	-
Fair Value change of non-hedged derivatives	(30,036)	29,296	(5,681)	39,405
(Gain) loss on foreign exchanges	1,134	6,321	(1,981)	4,952
Other	1,927	606	2,153	2,329
Adjusted Net earnings before Tax	\$71,132	\$25,526	\$140,348	\$52,616
Unadjusted Tax	(20,950)	(15,002)	(41,049)	(24,438)
Add tax related to Other Gains and Losses	2,439	(3,612)	1,219	(5,713)
Adjust IFRS Entry - Deferred Tax (non-monetary assets/liabilities)	(2,842)	7,204	(3,963)	7,092
Adjusted Tax	\$(21,353)	\$(11,410)	\$(43,793)	\$(23,059)
Adjusted Net earnings	\$49,779	\$14,116	\$96,555	\$29,557
Adjusted EPS	\$0.12	\$0.04	\$0.24	\$0.08
Adjusted Effective Tax Rate	30%	45%	31%	44%

In the first six months of 2011, net earnings from continuing operations was \$103.3 million compared to a net loss from continuing operations of \$13.0 million in the prior year. The increase in net earnings from operations is attributed to higher realized commodity prices, increased production and related sales and a favourable exchange rate gain relative to a loss in the prior year period. Additionally, the fair value change of share purchase warrants and convertible debt generated a gain of \$5.7 million in the first half of 2011 relative to a loss of \$39.4 million in the same prior year period.

The Company sold 199,250 ounces of gold during the first six months of 2011, compared to 162,421 ounces in the same prior year period. In addition to increased ounces sold, the increase in average realized price⁽²⁾ of gold sold from \$1,113 to \$1,365 per ounce contributed to a 60% increase in revenues to \$342.8 million.

Cash flow from operations, excluding tax payments, increased by 94% to \$148.6 million from \$76.6 million in 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. Net cash flow from continuing operations, including tax payments, for the first six months of 2011 was \$93.7 million compared to \$63.4 million for the same period in 2010. Cash taxes paid in the first six months of 2011 was \$54.8 million relative to \$13.3 million in the same period in 2010. The key factor contributing to this increase in cash taxes paid is that final payments relating to the 2010 tax year of \$20.0 million were made in the second quarter of 2011. This is a reflection that the installment payments made during 2010 were too low, keeping cash taxes paid in 2010 low at the expense of increased catch-up payments in 2011.

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. Over the last 23 years, 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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Operating Data				
Tonnes of ore mined (000's)	2,440	3,109	4,716	5,482
Tonnes of waste mined (000's)	9,983	9,074	20,574	18,193
Ratio of waste to ore	4.09	2.92	4.36	3.32
Tonnes of ore to leach pad (000's)	2,440	3,109	4,716	5,482
Average gold grade (grams/tonne)	0.63	0.42	0.70	0.49
Gold (ounces):				
Produced ⁽¹⁾	33,764	38,849	82,619	82,883
Sold	34,582	38,786	85,000	88,288
Realized prices: ⁽²⁾				
Gold (\$/ ounce) ⁽³⁾	1,241	1,083	1,240	1,063
Total cash cost per gold ounce sold ⁽⁴⁾	\$654	\$616	\$588	\$576
Financial Data (000's)				
Revenues	\$42,912	\$42,000	\$105,360	\$93,835
Earnings from mine operations	\$15,246	\$9,396	\$43,979	\$26,779

(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 methodology which capitalizes significant property, plant and equipment components as defined by IFRS.

SECOND QUARTER OF 2011 COMPARED TO SECOND QUARTER OF 2010

Gold production for the quarter ended June 30, 2011 was 33,764 ounces compared to 38,849 ounces produced in the same period in 2010. Gold production was lower in the second quarter of 2011 compared to second quarter of 2010 due to fewer tonnes being placed on the leach pad as mining temporarily transitioned to an area of higher stripping, in addition to issues with cyanide availability in the second quarter of 2011 causing gold to leach at a slower rate than expected. Period over period, the average head grade increased to 0.63 g/t from 0.42 g/t.

Revenue for the quarter ended June 30, 2011 was \$42.9 million compared to \$42.0 million in the same period last year due largely to a decrease in ounces sold to 34,582 ounces in 2011 from 38,786 ounces in 2010, a decrease of 11%. The average realized gold price⁽²⁾ during the second quarter of 2011 of \$1,241 per ounce, including hedged gold ounce settlements at \$801 per ounce, was lower than the average London Metals Exchange PM gold fix price of \$1,507 per ounce. In the second quarter of 2010, the Mesquite Mine recognized an average realized gold price⁽²⁾ of \$1,083 per ounce of gold sold.

Total cash cost⁽¹⁾ per ounce of gold sold for the quarter ended June 30, 2011 was \$654 per ounce compared to \$616 per ounce in the same prior year period. The increase in total cash cost⁽¹⁾ was driven primarily by a decrease in ounces sold in the second quarter of 2011. In addition, the Mine experienced increases in consumables, primarily diesel, and maintenance costs incurred in the second quarter of 2011 compared to the same quarter in 2010.

Cash flow relating to capital expenditures totaled \$2.7 million and \$3.0 million for the three month periods ended June 30, 2011 and 2010, respectively and consisted primarily of major component replacements which are capitalized under IFRS.

FIRST SIX MONTHS OF 2011 COMPARED TO FIRST SIX MONTHS OF 2010

Gold production for the six months ended June 30, 2011 was 82,619 ounces compared to 82,883 ounces produced in the same period in 2010. Production was higher in 2010 mainly due to the increase in recoverable ounces placed on the leach pad during the fourth quarter of 2009. Production for the first half of 2011 was impacted by cyanide availability and higher percentage of non-oxide material placed on the leach pad. Total ore tonnes placed on the leach pad in the first six months of 2011 decreased by 14% to 4.7 million compared to 5.5 million in the same period last year. However, period over period, the average head grade increased to 0.70 g/t from 0.49 g/t.

Revenue for the six months ended June 30, 2011 was \$105.4 million compared to \$93.8 million in the same period last year mainly due to a higher realized gold price partially offset by lower ounces sold of 85,000 ounces in 2011 from 88,288 ounces in 2010, a decrease of 4%. The average realized gold price⁽²⁾ during the first six months of 2011 of \$1,240 per ounce, including hedged gold ounce settlements at \$801 per ounce, was lower than the average London Metals Exchange PM gold fix price of \$1,446 per ounce. In the first six months of 2010, the Mesquite Mine recognized an average realized gold price⁽²⁾ of \$1,063 per ounce of gold sold.

Total cash cost⁽¹⁾ per ounce of gold sold for the six months ended June 30, 2011 was \$588 per ounce compared to \$576 per ounce in the same prior year period.

Cash flow relating to capital expenditures totaled \$5.3 million and \$6.3 million respectively for the six months ended June 30, 2011 and 2010 and consisted primarily of major component replacements which are capitalized under IFRS.

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 of compliance 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. 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.

In March 2011, the municipality of Cerro San Pedro approved a new municipal land use plan ("Plan"), after public consultation. The Plan clearly designates the area of the Cerro San Pedro Mine for mining.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Operating Data				
Tonnes of ore mined (000's)	4,131	3,286	7,837	4,388
Tonnes of waste mined (000's)	3,863	4,592	8,460	6,474
Ratio of waste to ore	0.94	1.40	1.08	1.48
Tonnes of ore processed (000's)	4,131	3,286	7,837	4,388
Average gold grade (grams/tonne)	0.51	0.65	0.53	0.61
Average silver grade (grams/tonne)	25.12	39.98	26.31	36.51
Gold (ounces):				
Produced ⁽¹⁾	39,737	29,424	75,338	42,362
Sold	43,634	24,833	75,351	37,957
Silver (ounces):				
Produced ⁽¹⁾	520,408	547,084	1,155,728	753,784
Sold	602,349	505,350	1,188,145	698,856
Realized prices ⁽³⁾ :				
Gold (\$/ounce)	1,506	1,205	1,458	1,175
Silver (\$/ounce)	38.85	18.38	35.78	18.02
Total cash cost per gold ounce sold ⁽²⁾⁽⁴⁾	\$26	\$288	\$18	\$403
Financial Data (000's)				
Revenues	\$89,117	\$39,218	\$152,353	\$57,195
Earnings from mine operations	\$55,694	\$14,679	\$90,059	\$17,935

- (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 June 30, 2011 would be \$415 per ounce of gold (2010 - \$505) and \$10.69 per ounce of silver (2010 - \$7.70). For the six months ended June 30, 2011 the average total cash cost at Cerro San Pedro Mine would be \$420 per ounce of gold (2010 - \$573) and \$10.30 per ounce of silver (2010 - \$8.78).
- (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.

SECOND QUARTER OF 2011 COMPARED TO SECOND QUARTER OF 2010

Gold production for the second quarter of 2011 increased by 35% to 39,737 ounces, compared to 29,424 ounces produced in the same prior year period. The increased production resulted from higher ore tonnes mined quarter on quarter. Silver production was 520,408 ounces compared to 547,084 ounces in the same prior year period as mine sequencing is currently focusing on an area of less grade than prior year. Additionally, the Cerro San Pedro mine experienced issues with cyanide availability in the second quarter, causing gold and silver to leach at a slower rate than expected. This impact will reverse once the cyanide supply issue is resolved.

Revenue for the second quarter of 2011 was \$89.1 million, which was a 127% or \$49.9 million increase over the same prior year period. The main driver for this was an increase in gold sales of 18,801 ounces and an increase in the average realized price. The average realized gold price per ounce during the second quarter 2011 and 2010 was \$1,506 and \$1,205 respectively, which corresponds well to the average London Metals Exchange PM gold fix price of \$1,507 and \$1,196 per ounce, respectively. The average realized silver price per ounce during the second quarter 2011 and 2010 was \$38.85 and \$18.38 respectively, which also

correlates to the average London Metals Exchange silver fix price of \$38.17 and \$18.32 per ounce, respectively.

Total cash cost⁽¹⁾ per ounce of gold sold in the second quarter of 2011 was \$26 per ounce compared to \$288 per ounce in the same prior year period, representing a decrease of 91%. The decrease in total cash cost⁽¹⁾ is due to optimized mine planning, coupled with the benefit of higher by-product revenues resulting from higher silver prices during the second quarter of 2011 when compared to the same prior year period. These benefits are partially offset by the appreciation of the Mexican peso relative to prior year periods.

Cash flow relating to capital expenditures totaled \$0.8 million and \$1.7 million for the three month period ended June 30, 2011 and 2010, respectively.

FIRST SIX MONTHS OF 2011 COMPARED TO FIRST SIX MONTHS OF 2010

Gold production for the six months ended June 30, 2011 was 75,338 ounces compared to 42,362 ounces produced in the same period in 2010. Gold production was higher in the first six months of 2011 compared to the same period of 2010 due to the shortfall generated in the first quarter of 2010 due to a delay in receiving the renewal of the explosive permit. Also, the Cerro San Pedro mine experienced issues with cyanide availability in the second quarter, causing gold and silver to leach at a slower rate than expected. This impact will reverse once the cyanide supply issue is resolved.

Revenue for the six months ended June 30, 2011 was \$152.4 million compared to \$57.2 million in the same prior year period. The average realized gold price⁽²⁾ during the first six months of 2011 of \$1,458 per ounce compares favourably to the average London Metals Exchange PM gold fix price of \$1,446 per ounce. In the first six months of 2010, the Cerro San Pedro Mine recognized an average realized gold price⁽²⁾ of \$1,175 per ounce of gold sold. The average realized silver price per ounce during the first six months of 2011 and 2010 was \$35.78 and \$18.02 respectively, which also correlates to the average London Metals Exchange silver fix price of \$34.92 and \$17.62 per ounce, respectively.

Total cash cost⁽¹⁾ per ounce of gold sold for the six months ended June 30, 2011 was \$18 per ounce compared to \$403 per ounce in the same prior year period. The decrease in cash cost⁽¹⁾ was driven primarily by improved mine planning and higher by-product revenues in the first six months of 2011, offset partially by the appreciation of the Mexican peso relative to prior year periods.

Cash flow relating to capital expenditures totaled \$2.0 million and \$5.5 million respectively for the six months ended June 30, 2011 and 2010. Capital expenditures in 2011 were primarily associated with a plant and 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 second quarter of 2011 relative to the second quarter of 2010. The value of the Mexican peso increased from an average of 12.55 to the U.S. dollar in the second quarter of 2010 to 11.71 to the U.S. dollar in the second quarter of 2011. This had a negative impact of approximately \$38 per ounce of gold sold. This contributed to increased total cash costs⁽¹⁾ along with other factors described above.

The value of the Mexican peso increased from an average of 12.68 to the U.S. dollar in the first six months of 2010 compared to 11.88 to the U.S. dollar in the first nine months of 2011. This had a negative impact of approximately \$37 per ounce of gold sold. This contributed to increased total cash costs⁽¹⁾ along with other factors described above.

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 June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Operating Data				
Tonnes of ore processed (000's)	187	198	376	371
Average gold grade (grams/tonne)	2.92	3.74	3.59	3.74
Average copper grade (%)	1.05	1.02	1.02	1.07
Gold (ounces):				
Produced	14,977	21,646	38,143	41,889
Sold	16,823	18,783	38,899	36,176
Copper (thousands of pounds):				
Produced	3,359	4,009	6,851	7,968
Sold	3,637	3,027	7,542	7,082
Realized prices ⁽¹⁾ :				
Gold (\$/ ounce)	1,549	1,201	1,458	1,171
Copper (\$/ pound)	4.05	3.09	4.12	3.26
Total cash cost per gold ounce sold ⁽²⁾	\$585	\$459	\$488	\$303
Financial Data (000's)				
Revenues	\$39,606	\$31,141	\$85,135	\$62,949
Earnings from mine operations	\$12,618	\$12,405	\$30,054	\$28,537

(1) 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.

(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 June 30, 2011 would be \$1,004 per ounce of gold and \$2.44 per pound of copper, as compared to \$715 per ounce of gold and \$1.74 per pound of copper for the period ended June 30, 2010. For the six months ended June 30, 2011 the average cash cost at Peak Mines would be \$895 per ounce of gold (2010 - \$665) and \$2.23 per pound of copper (2010 - \$1.60).

SECOND QUARTER OF 2011 COMPARED TO SECOND QUARTER OF 2010

Peak Mines produced 14,977 ounces of gold and 3.4 million pounds of copper during the second quarter of 2011 compared to 21,646 ounces of gold and 4.0 million pounds of copper in the same prior year period. The decrease in gold production relative to the prior year period is mainly due to mine sequencing resulting in lower head grades. Mill feed grade was 22% lower in gold grade and 3% higher in copper grade.

Revenue for the second quarter of 2011 was higher than in the same quarter 2010 mainly due to higher realized gold prices⁽²⁾ of \$1,549 per ounce compared to \$1,201 per ounce and the higher realized copper prices of \$4.05 per pound compared to \$3.09 per pound in the same prior year period. This compares to the

average London Metals Exchange PM gold fix price of \$1,507 and \$1,196 per ounce for the second quarter of 2011 and 2010, respectively. The average London Metals Exchange copper fix price was \$4.15 for the second quarter of 2011.

Total cash cost⁽¹⁾ per ounce of gold sold, net of by-product sales, for the second quarter was \$585 compared to \$459 in the second quarter of 2010. The increase is attributable primarily to the appreciation of the Australian dollar in the second quarter of 2011 when compared to the same period in the prior year. These cost increases were partially offset by higher by-product revenues.

Capital expenditures totaled \$9.0 million and \$7.0 million for the three month period ended June 30, 2011 and 2010, respectively. Capital expenditures in 2011 were primarily associated with mine development, mill upgrades and capitalized exploration.

FIRST SIX MONTHS OF 2011 COMPARED TO FIRST SIX MONTHS OF 2010

Peak Mines produced 38,143 ounces of gold and 6.9 million pounds of copper during the first six months of 2011 compared to 41,889 ounces of gold and 8.0 million pounds of copper for the same prior year period. These variances are largely due to lower Mill feed grades and recoveries. Mill feed grade was 4% lower in gold grade and 5% lower in copper grade.

Revenue for the first six months of 2011 was higher than in the same six months in 2010 mainly due to higher realized gold prices⁽²⁾ of \$1,458 per ounce compared to \$1,171 per ounce and the higher realized copper prices of \$4.12 per pound compared to \$3.26 per pound in the same prior year period. This compares to the average London Metals Exchange PM gold fix price of \$1,446 and \$1,152 per ounce for the first six months of 2011 and 2010, respectively. The average London Metals Exchange copper fix price was \$4.26 for the first six months of 2011.

Total cash cost⁽¹⁾ per ounce of gold sold, net of by-product sales, for the first six months was \$488 compared to \$303 in the same period of 2010. The increase in total cash cost⁽¹⁾ was mainly attributable to a higher by-product revenue being offset by higher per unit production costs and the appreciation of the Australian dollar in the first six months of 2011 compared to the same period in 2010.

Capital expenditures totaled \$17.6 million and \$10.2 million for the six month period ended June 30, 2011 and 2010, respectively. Capital expenditures in 2011 were primarily associated with mine development, mill upgrades and capitalized exploration.

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 second quarter of 2011 averaged 1.06 compared to 1.13 in the second quarter of 2010 resulting in a negative impact on cash costs⁽¹⁾ of approximately \$91 per gold ounce sold.

The value of Australian dollar in the first six months of 2011 averaged 1.03 compared to 1.12 in the first six months of 2010 resulting in a negative impact on cash costs⁽¹⁾ of approximately \$102 per gold ounce sold.

PROJECT DEVELOPMENT REVIEW

A. 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 six months of 2011 was \$127.4 million compared to \$36.6 million in 2010.

Project spending for the second quarter of 2011 was \$82.8 million compared to \$24.9 in 2010.

Underground development advanced a total of 2,166 metres during the second quarter of 2011, compared to an advance of 1,580 metres during the first quarter of the year. The year to date advance is 3,746 metres.

Shotcrete support work during the second quarter included the spraying of 4,235 cubic metres in the development headings compared to 3,427 cubic metres in the first quarter of 2011. The total shotcrete sprayed year to date amounts to 7,662 cubic metres.

Excavation and ground support of the Development Crusher and Leg 4 Tail Pulley chamber, the fifth large bulk mining excavation at New Afton, was completed during the second quarter. Excavation continues on the extraction, undercut, and apex drifts in the ore-body at the mining level horizon. Six draw points were mined during the quarter, with road-way concrete and steel-set installation following mining. The first slot raise connecting the Undercut and Apex levels was successfully drilled and blasted during the quarter, initiating cave development at New Afton. Ore continues to be stockpiled on surface close to the mill for future concentration, with approximately 68,000 tonnes stockpiled to-date. Commissioning of the permanent fans was completed, supplying 650,000 cfm of fresh-air to the mine. Contract raise boring continued on the fourth main ventilation raise from the surface and on the second of four main internal raises, with completion of both expected in mid-July. The remainder of the Sandvik drill fleet required for development and production was received during the quarter, including two production drills, one cable bolting drill, and two rock bolters. In addition, one shotcrete sprayer and several man-carriers were received.

The electrical crews 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 and diamond drilling crews. The main substation was commissioned in the latter half of April, and cut-over of temporary and permanent services is ongoing. Several options remained under consideration regarding the permanent 13.8 kV power line to feed the lower reaches of the mine. Plans to replace the power line to the lake water pumping system also progressed to near completion.

Maintenance planning and supervision staff continued efforts to support inventory management initiatives, primarily focusing on cataloging 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.

Surface construction activities during the second quarter 2011 made good progress in spite of higher than normal rainfall. Placing concrete operating floor slabs in the concentrator was brought to 90% completion. The concrete structures supporting all of the flotation equipment have been completed and all of the flotation vessels have been installed in the mill building. Rough setting the first of the ancillary equipment which includes the blowers, the compressors and the grinding area lubrication equipment has commenced. The erection program for the U5 conveyor structure from the portal to the ore stacking structure has been completed. Surface earthworks included the completion and handing over of the coarse ore storage pad as well as continuing with final fills across the coarse ore reclaim area. Work on the tailings storage facility was initiated in the quarter and includes structural excavations and placement of special fills for each of the dam cores where applicable.

The following items were successfully commissioned in the period: site-wide fire suppression system, light vehicle wash bay, sewage treatment plant, two of the six mine ventilation fans, and the main electrical substation.

A local First Nations electrical contractor has completed and commissioned the high bay lighting in the Concentrator and is continuing with other low voltage services in the Mill Building as well as site wide temporary power installation and maintenance. The electrical substation serving the U5 Drive and Stacking tower has been outfitted and the Tailings and Reclaim water pipelines corridor civil work is substantially complete.

B. BLACKWATER PROJECT

On June 1, 2011, New Gold closed the acquisition of Richfield and its flagship Blackwater Project in British Columbia. Blackwater is located in central British Columbia, with New Gold's share of the initial mineral resource estimate including 1.8 million ounces of indicated gold resources and an additional 2.0 million ounces of inferred gold resources. On June 15, 2011, New Gold announced an expanded drill program that will see the company drill between 40,000 and 50,000 metres in the second half of 2011.

Since acquiring the project on June 1, 2011, the company has been very active in preparing for its continued exploration and development. New Gold has successfully retained the majority of geologic staff and consultants. Site safety and environmental standards consistent with New Gold standards have been established. New Gold has commenced the implementation of a sustainability program including proposed sourcing from local communities and related discussions with local First Nations, government and regulatory officials.

A 5th drill rig was added on June 15, 2011 and over 6,200 metres of drilling was completed in June (16 holes). An upgrade of 17 kilometre access road to site was initiated. New Gold commenced the installation of an upgraded 100 person operations camp including associated infrastructure. Work continued on an environmental baseline program and trade-off studies on potential site lay-outs.

New Gold is targeting an updated resource estimate in the fourth quarter of 2011.

C. EL MORRO PROJECT, ATACAMA REGION, CHILE

The Company's 30% owned El Morro copper-gold project 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 June 30, 2008. The project is a development stage project initially managed under a shareholder agreement between Xstrata, the previous project operator and owner of a 70% interest. Goldcorp currently owns the 70% interest and are the operators of the project. On March 16, 2011, Chilean authorities approved an Environmental Impact Assessment.

During the second quarter of 2011, Goldcorp worked to prepare the project for development on numerous fronts. An 18 kilometre road linking existing access road to the property was completed. Condemnation drilling commenced to verify infrastructure locations. The application process for additional construction permits commenced. Continued negotiations were conducted with potential providers of power and port facilities, engineering of pipelines and equipment manufacturers of long lead time items. Additionally, continued evaluation of optimum plant and other facility configuration was conducted. A further update to the feasibility study is expected in the third quarter of 2011.

New Gold's 30% of project spending, excluding interest, for the first three and six months of 2011 was \$3.6 million and \$7.2 million, respectively. Under the agreement with Goldcorp, they have 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. New Gold has had no cash outlay in 2011. 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). As at June 30, 2011, New Gold has drawn down \$15.6 million pursuant to this agreement.

On October 12, 2010, Barrick announced that it had entered into an agreement with Xstrata to acquire Xstrata's 70% interest in El Morro. New Gold held a right of first refusal over Xstrata's 70% interest which was triggered when the agreement with Barrick was announced. On January 7, 2011, the Company provided notice to Xstrata of the exercise of its right of first refusal to acquire 70% of the El Morro copper-gold project in Chile for \$463.0 million. The Company completed this transaction on February 16, 2011. Goldcorp loaned the \$463.0 million to the Company to fund the exercise of the right of first refusal. After acquisition of the 70% interest by a subsidiary of the Company, New Gold then completed a transaction with Goldcorp which resulted in a Goldcorp subsidiary now holding the 70% interest in El Morro. Through the subsequent transaction with Goldcorp, the Company received \$50.0 million and the terms of the shareholder agreement were amended. The Company continues to hold a 30% interest in the El Morro copper-gold project.

On January 13, 2011, 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. The trial started in June 2011 and is currently recessed, but will resume in October 2011. New Gold believes the claim is without merit and intends to defend this action using all available legal avenues.

D. CERRO SAN PEDRO MINE, SAN LUIS POTOSÍ, MEXICO

During the second quarter of 2011, the Cerro San Pedro Sulphide exploration project underwent a temporary delay due to a change over to a new drilling contractor for the project. At the end of the quarter, the new drilling contractor was mobilized to site and ready to resume drilling activities at the start of the third quarter. Year-to-date progress includes ongoing metallurgical test work and the completion of eleven holes totaling 6,751 meters of core drilling at the project.

The objective of the Cerro San Pedro Sulphide project is 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.

E. PEAK MINES, NEW SOUTH WALES, AUSTRALIA

During the second quarter of 2011, the Company's ongoing mineral resource development program at Peak Mines' operations resulted in the completion of 12,708 metres of exploration and delineation diamond drilling to replace mine depletion. This total includes 2,135 metres of underground drilling to delineate additional reserves in the Peak deposit, 2,127 metres of underground drilling to delineate and explore for additional reserves in the Perseverance deposit, 3,932 metres of underground drilling to delineate and explore for additional reserves in the New Cobar deposit, 3,548 metres of underground drilling to delineate and explore for additional reserves in the Chesney deposit, 102 metres of surface drilling to explore for new deposits at Norma Vale 100km south of the Peak Mines, and 864 metres of surface drilling to explore the Mafeesh prospect 60km south of the Company's Peak Mines. 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 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

SECOND QUARTER 2011 COMPARED TO SECOND QUARTER 2010

Revenues increased by 53% or \$59.3 million to \$171.6 million when comparing the second quarter of 2011 to 2010. The increase was attributed to an increase in average realized prices⁽²⁾ for gold, silver and copper to \$1,417 per ounce, \$38.85 per ounce, and \$4.05 per pound in the second quarter of 2011, respectively; compared to \$1,147 per ounce, \$18.38 per ounce and \$3.09 per pound in the second quarter of 2010, respectively. Additionally, sales of gold ounces increased to 95,039 ounces compared to 82,402 ounces in the same prior year period and sales of silver ounces increased to 602,349 from 505,350 in the same prior year period.

Operating expenses increased from \$57.2 million in 2010 to \$70.9 million in the second quarter of 2011. The increase is attributed to an increase gold ounces sold, 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 component replacements primarily at the Mesquite Mine.

Depreciation and depletion was \$17.2 million for the second quarter of 2011 compared to \$18.7 million for the second quarter of 2010.

For the three months ended June 30, 2011, New Gold had earnings from mine operations of \$83.5 million compared with \$36.5 million in the same prior year period.

Corporate administration costs were \$5.2 million in the second quarter of 2011 compared to \$6.1 million incurred in the same prior year period. The prior year period included some non-recurring consulting costs.

Share-based compensation costs were \$2.6 million and \$1.9 million in second quarters of 2011 and 2010, respectively.

Exploration expense is \$4.0 for the second quarter of 2011 relative to \$3.0 in the same prior year period. The increase is primarily related to \$2.1 million of exploration expense related to the Blackwater Project, offset by lower expensed exploration at Peak Mines relative to the same prior year period. New Gold acquired the Blackwater Project on June 1, 2011 and immediately accelerated the drilling program.

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 June 30, 2011, the Company’s Mesquite Mine realized losses of \$9.7 million within revenues for settlement of three months of gold hedge contracts totaling 16,500 ounces. As a result of the increased in the spot price of gold from \$1,439 per ounce to \$1,506 per ounce between March 31, 2011 and June 30, 2011, the Mesquite Mine recognized \$16.1 million of pre-tax unrealized losses in the mark-to-market of remaining contracts within Other Comprehensive Income.

For the three month period ended June 30, 2011, the company recorded a fair value change of share purchase warrants and convertible debt generating a gain of \$30.0 million relative to a loss of \$29.3 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.

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 \$8.5 million at June 30, 2011 generating an unrealized gain of \$3.3 million for the quarter. This compares to a fair value loss of \$1.3 million recognized in the same prior year period. This is an accounting transaction and has no cash impact.

The Company recognized a foreign exchange loss of \$1.1 million in the second quarter of 2011 compared to a loss of \$6.3 million in the same prior year period. This reflects minimal movement in the currencies that New Gold operates in relative to the US dollar in the second quarter of 2011. The prior period loss was generated on 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 weakening of these currencies during the second quarter of 2010 generated a foreign exchange loss 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 second quarter of 2011 was \$21.0 million compared to \$15.0 million in the same prior year period, reflecting an effective tax rate of 21% for the second quarter of 2011. The prior year period had a loss before tax, so there is no comparable effective tax rate. In the second quarter of 2011, the Company recorded an unrealized gain of \$30.0 million related to the mark to market for share purchase warrants and convertible debentures. The transaction increased earnings before tax with minimal offsetting tax expense, resulting in 21% effective tax rate. Ignoring the impact of this unrealized gain will result in an effective tax rate of 30% which is considered reasonable for the jurisdictions in which we are currently taxable. A similar issue impacts the prior year comparative in that there is a loss of \$29.3 million for which there is minimal tax impact causing a particularly high tax rate.

For the three months ended June 30, 2011, New Gold had net earnings from continuing operations⁽³⁾ of \$78.6 million, or \$0.19 per basic share. This compares with a net loss from continuing operations of \$26.0 million, or \$0.07 per basic share in the same prior year period. In the second quarter of 2011, net earnings, including earnings from discontinued operations, was \$78.6 million, or \$0.19 per basic share. This compares with net loss of \$36.2 million, or \$0.09 per basic share in 2010.

For the three months ended June 30, 2011, adjusted net earnings⁽³⁾ from continuing operations was \$49.8 million or \$0.12 per basic share, which increased from \$14.1 million or \$0.04 per basic share in the prior year period. Net earnings has been adjusted, including 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 second quarter of 2011 was a gain of \$30.0 million, relative to a loss of \$29.3 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 30%, relative to reported effective tax rate of the 21%.

SIX MONTHS ENDED JUNE 30, 2011 COMPARED TO SIX MONTHS ENDED JUNE 30, 2010

Revenues increased by 60% or by \$128.9 million when compared to \$214.0 million in the same prior year period. The increase is attributed to an increase in average realized gold prices⁽²⁾ from \$1,113 per ounce during the first six months of 2010 to \$1,365 per ounce in 2011. Additionally, sales of gold ounces increased to 199,250 ounces compared to 162,421 ounces in the same prior year period and sales of silver ounces increased to 1,188,145 from 698,856 in the same prior year period.

Operating expenses increased from \$109.1 million in the first six months of 2010 to \$141.7 million during the first six months of 2011. Increased production and related sales, higher consumable costs and adverse foreign exchange movements impacted operating costs year on year.

Depreciation and depletion for the six months ended June 30, 2011 was \$37.2 million compared to \$31.7 million for the same prior year period. This was primarily attributed an increase in production and related depreciation expense on a unit of production basis.

For the six months ended June 30, 2011, New Gold had earnings from mine operations of \$164.0 million compared with \$73.3 million in the same prior year period.

Corporate administration costs of \$11.2 million in the first six months of 2011 were 4% lower than \$11.6 million incurred in the same prior year period.

Exploration costs of \$6.3 million in the first six months of 2011 were higher than \$5.0 million for the same prior year period. The increase was driven the addition of the Blackwater project on June 1, 2011. \$2.1 million of expenditure was incurred at Blackwater for which there in no prior year comparative.

On July 1, 2010, the Company met the criteria for hedge accounting under the Canadian Institute of Chartered Accountants' Handbook section 3865 – *Hedges* in accounting 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.

For the six month period ended June 30, 2011, the Company's Mesquite Mine had realized losses of \$17.3 million within revenues for settlement of six months of gold hedge contracts totaling 49,500 ounces. As a result of the increased in the spot price of gold from \$1,406 per ounce to \$1,506 per ounce between December 31, 2010 and June 30, 2011, the Mesquite Mine recognized \$19.7 million of pre-tax unrealized losses in the mark-to-market of remaining contracts within Other Comprehensive Income.

The Company has a prepay option on the senior secured notes which was fair valued at \$8.5 million at June 30, 2011 generating an unrealized gain of \$0.9 million in the first six months of 2011. 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. This is an accounting transaction and has no cash impact. This compares to a fair value gain of \$0.7 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 \$2.0 million for the six month period ended June 30, 2011 compared to a loss of \$5.0 million in the same prior year period. During the first half of 2011, the U.S. dollar weakened against the foreign currencies that the Company operates in. 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 six months of 2011 was \$41.0 million compared to \$24.4 million in the same prior year period, reflecting an effective tax rate of 28% for the first six months of 2011. The prior year period had a loss before tax, so there is no comparable effective tax rate. In the first half of 2011, the Company recorded an unrealized gain of \$5.7 million related to the mark to market for share purchase warrants and convertible debentures. A similar issue impacts the prior year comparative in that there is a loss of \$39.4 million for which there is minimal tax impact causing a particularly high tax rate.

For the six months ended June 30, 2011, New Gold had net earnings from continuing operations of \$103.3 million, or \$0.25 per basic share. This compares with a net loss from continuing operations of \$13.0 million, or \$0.03 per basic share in the same prior year period. In the second quarter of 2011, net earnings, including earnings from discontinued operations, was \$103.3 million, or \$0.25 per basic share. This compares with net loss of \$22.9 million, or \$0.06 per basic share in 2010.

For the six months ended June 30, 2011, adjusted net earnings⁽³⁾ from continuing operations was \$96.6 million or \$0.24 per basic share, which increased from \$29.6 million or \$0.08 per basic share in the prior year period. Net earnings has been adjusted inclusive of 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 half of 2011 was a gain of \$5.7 million, relative to a loss of \$39.4 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. The reconciliation of net earning to adjusted net earnings⁽³⁾ is below.

QUARTERLY INFORMATION

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

	IFRS						CGAAP	
	2011	2011	2010	2010	2010	2010	2009	2009
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Gold sales (ounces)	95,039	104,211	116,964	89,692	82,401	80,020	106,475	77,645
Revenues	\$171,635	\$171,213	\$189,355	\$127,116	\$112,359	\$101,620	\$131,765	\$88,491
Net earnings (loss) from continuing operations	78,602	24,719	25,557	44,754	(26,006)	13,042	(2,295)	6,096
Earnings (loss) per share from continuing operations:								
Basic	0.19	0.06	0.15	0.11	(0.07)	0.03	(0.01)	0.02
Diluted	0.16	0.06	0.15	0.11	(0.07)	0.03	(0.01)	0.02
Net earnings (loss)	\$78,602	\$24,719	\$25,557	\$44,754	\$(36,197)	\$13,347	\$(7,650)	\$4,101
Earnings (loss) per share								
Basic	0.19	0.06	0.12	0.11	(0.09)	0.03	(0.02)	0.01
Diluted	0.16	0.06	0.12	0.11	(0.09)	0.03	(0.02)	0.01

BALANCE SHEET REVIEW

A. ASSETS

At June 30, 2011, New Gold held cash and cash equivalents of \$490.4 million. This compares to \$490.8 million held at December 31, 2010. As at June 30, 2011, \$299.2 million of the cash was held in Canadian dollars. Of the Company's holdings, \$131.4 million is held in Canadian federal and provincial treasury bills, \$89.8 million in Canadian Banker's Acceptances, and \$269.2 million in cash and near cash instruments including bank deposits, term deposits and guaranteed investment certificates.

B. GOLD HEDGE CONTRACTS

Under the terms of the term loan facility entered into by Western Mesquite Mines Inc. ("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 June 30, 2011, the remaining gold contracts

represent a commitment of 5,500 ounces per month for 42 months with the last commitment deliverable in December 2014 for a total of 231,000 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. 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 June 30, 2011 using the June 30, 2011 spot price of \$1,506 per ounce, resulting in a cumulative unrealized pre-tax loss of \$151.6 million that has been disclosed as a liability and a pre-tax adjustment of \$4.5 million to Other Comprehensive Income for the quarter ending June 30, 2011.

C. LONG-TERM DEBT

The majority of the Company's contractual obligations consist of long-term debt and interest payable. At June 30, 2011, the Company had \$246.7 million in long-term debt compared to \$239.6 at March 31, 2011 and \$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 June 30, 2011 the face value of the Notes totalled \$193.9 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 June 30, 2011 the redemption price was 105%. These Notes are secured by the New Afton Project assets. Capitalized interest relating to the Notes was \$5.3 million in the second quarter of 2011 compared to \$5.1 million during the second 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 June 30, 2011, the aggregate principal of the Debentures was \$57.0 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 June 30, 2011, the carrying amount of the liability of \$45.6 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 \$2.1 million in the second quarter of 2011 compared to \$1.8 million during the second quarter of 2010.

On December 16, 2010, the Company entered into an agreement for a \$150 million revolving credit facility “the 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 June 30, 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 were applicable and depended on the currency and type of credit selected by the Company. Thereafter, from July 1st, 2011 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 the Prime Rate, the interest rate at June 30, 2011 would be 5.5% if any funds had been drawn, declining to 5.0% from July 1st, 2011 under the process detailed above. The standby fee on undrawn amounts under the Facility was 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 June 30, 2011, \$120.9 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 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.

D. DEFERRED INCOME AND MINING TAXES

The net deferred income tax liability decreased from \$169.1 million on December 31, 2010 to \$156.0 million on June 30, 2011 (June 30, 2010 - \$221.5 million).

The current income tax liability decreased from \$31.4 million on December 31, 2010 to \$27.7 million on June 30, 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.

E. 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 June 30, 2011 is \$38.6 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⁽³⁾ (ADJUSTED NET EARNINGS PER SHARE)

Adjusted net earnings⁽³⁾ 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⁽³⁾ 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⁽³⁾ 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⁽³⁾ 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⁽³⁾ 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⁽³⁾

	Three Months Ended June 30,		Six Month Ended June 30,	
	2011	2010	2011	2010
Net earnings before taxes	\$99,552	\$(11,004)	\$144,370	\$11,474
Fair Value of embedded derivative in Senior Notes	(3,304)	1,255	(850)	(652)
(Gains) loss on FVTPL financial assets	-	(948)	(1,349)	(4,892)
Ineffectiveness on hedging instruments	1,859	-	3,686	-
Fair Value change of non-hedged derivatives	(30,036)	29,296	(5,681)	39,405
(Gain) loss on foreign exchanges	1,134	6,321	(1,981)	4,952
Other	1,927	606	2,153	2,329
Adjusted Net earnings before Tax	\$71,132	\$25,526	\$140,348	\$52,616
Unadjusted Tax	(20,950)	(15,002)	(41,049)	(24,438)
Add tax related to Other Gains and Losses	2,439	(3,612)	1,219	(5,713)
Adjust IFRS Entry - Deferred Tax (non-monetary assets/liabilities)	(2,842)	7,204	(3,963)	7,092
Adjusted Tax	\$(21,353)	\$(11,410)	\$(43,793)	\$(23,059)
Adjusted Net earnings	\$49,779	\$14,116	\$96,555	\$29,557
Adjusted EPS	\$0.12	\$0.04	\$0.24	\$0.08
Adjusted Effective Tax Rate	30%	45%	31%	44%

NON-IFRS MEASURE - TOTAL CASH COST⁽¹⁾ PER GOLD OUNCE CALCULATION

New Gold reports total cash cost⁽¹⁾ 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⁽¹⁾ per ounce of gold sold to the financial statements:

	Three months ended June 30,		Six months ended June 30,	
	2011	2010	2011	2010
Operating expenses from continuing operations	\$70,943	\$57,173	\$141,659	\$109,059
Operating expenses from discontinued operations	-	-	-	-
Treatment and refining charges on concentrate sales	1,997	1,308	4,349	3,632
By-product copper and silver sales	(38,940)	(19,175)	(75,262)	(36,813)
Non-cash adjustments	(402)	300	(443)	1,200
Total cash cost	\$33,598	\$39,606	\$70,303	\$77,078
Ounces of gold sold	95,039	82,402	199,250	162,421
Total cash cost⁽¹⁾ per ounce of gold sold	\$354	\$481	\$353	\$475

LIQUIDITY AND CAPITAL RESOURCES

As at June 30, 2011, the Company had cash and cash equivalents held by continuing operations of \$490.4 million compared to \$490.8 million at December 31, 2010. These balances exclude \$9.0 million at December 31, 2010 and June 30, 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 June 30, 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 \$1,507 and \$38.17 per ounce respectively during the quarter;
- Project spending at the New Afton project for the quarter ended June 30, 2011 of \$82.8 million;

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 June 30, 2011, the Company had working capital of \$483.9 million. In the opinion of Management, the working capital at June 30, 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 June 30, 2011, the Company had positive operating cash flows from continuing operations of \$44.0 million and invested a total of \$97.1 million in mining interests, including \$2.7 million at the Mesquite Mine, \$0.8 million at the Cerro San Pedro Mine, \$9.0 million at the Peak Mines, \$82.8 million at the New Afton project and \$1.5 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, El Morro and Blackwater projects; 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 in line with previous guidance with the exception of New Afton which is impacted by a higher Canadian dollar exchange rate and the addition of \$16.0 million to expand the exploration camp at Blackwater.

At the end of the second quarter the Company has significant cash and cash equivalents balance of \$490.4 million with 61% 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 \$1,506 per ounce at the end of the second quarter of 2011 from \$1,244 at June 30, 2010 and \$1,439 at March 31, 2011. Silver increased to \$35.02 at the end of the second quarter of 2011, compared to \$18.74 and \$37.87 per ounce at June 30, 2010 and March 31, 2011 respectively. The average gold and silver prices for the second quarter of 2011 were \$1,507 and \$38.17 per ounce, compared to the quarter ended March 31, 2010 when prices averaged \$1,196 and \$18.32 per ounce respectively. Copper prices declined slightly from \$4.26 per pound at December 31, 2010 to \$4.22 per pound at June 30, 2011. Copper averaged \$4.15 per pound during the quarter compared to \$3.19 per pound in the second 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 June 30, 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 production and cost guidance for 2011 the year remains at gold production of 380,000 - 400,000 ounces at total cash cost⁽¹⁾ per ounce sold, net of by-product sales, of \$390 to \$410 per ounce. The combination of operational execution and the continued strength of silver and copper prices have allowed the year-to-date total cash cost⁽¹⁾ to be below the guidance despite relative foreign exchange rates and industry-wide cost inflation negatively impacting costs.

Mine	Forecast 2011 Gold Production (ounces)	Forecast 2011 Total Cash Cost ⁽¹⁾
Mesquite Mine	145,000 – 155,000	\$660 - \$680
Cerro San Pedro Mine	135,000 – 145,000	\$90 - \$110
Peak Mines	90,000 – 100,000	\$410 - \$430
Total	380,000 – 400,000	\$390 - \$410

Assumptions used in the 2011 cost guidance 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 June 30, 2011, these commitments totaled \$98.3 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 June 30, 2011, these commitments totaled \$1.3 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

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. The trial started in June 2011 and is currently recessed, but will resume in October 2011. New Gold believes the claim is without merit and intends to defend this action using all available legal avenues.

B. CERRO SAN PEDRO MINE

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. 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.

C. MESQUITE MINE

New Gold and its subsidiary Western Mesquite Mines, Inc. ("WMMI") were 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 meal periods and rest breaks and penalties for willful failure to pay all wages due on termination of employment. This matter has been settled in the amount of \$1.8 million, subject to court approval and will not 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 \$1.2 million and \$4.3 million for the three and six months ended June 30, 2011 (2010 - \$0.7 million and \$2.1 million). At June 30, 2011, the Company had \$3.0 million included as accrued liabilities related to this company (December 31, 2010 - \$2.1 million).

RISK FACTORS

Readers of this Management's Discussion and Analysis should give careful consideration to the information included or incorporated by reference 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 the 2010 year-end audited consolidated financial statements, Management Discussion and Analysis and Annual Information Form filed on SEDAR at 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 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 June 30, 2011 is not considered to be high. The Company's maximum exposure to credit risk at June 30, 2011, is as follows:

<i>(U.S. dollars in thousands)</i>	June 30, 2011	December 31, 2010
	\$	\$
Cash and cash equivalents	490,446	490,754
Trade and Other Receivables	25,398	11,929
Investments	-	7,533
Reclamation deposits and other	24,239	31,295
	540,083	541,511

The aging of accounts receivable at June 30, 2011 was as follows:

<i>(U.S. dollars in thousands)</i>						June 30, 2011	December 31, 2010
	0-30 days	31-60 days	61-90 days	91-120 days	Over 120 days	Total	Total
	\$	\$	\$	\$	\$	\$	
Mesquite Mine	536	1	1	1	257	796	442
Cerro San Pedro	5,686	1,860	35	188	1,005	8,774	3,798
Peak Mines	5,295	-	-	-	17	5,312	3,176
New Afton	6,726	160	-	2	-	6,888	3,581
Corporate	1,783	-	-	-	1	1,784	932
Richfield	1,844	-	-	-	-	1,844	-
	21,870	2,021	36	191	1,280	25,398	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 June 30, 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.

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, 95%) of the concentrate and doré sales revenue.

<i>Metal sales</i> Customer	Three months ended June 30		Six Months Ended June 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
1	109,568	30,079	204,594	70,139
2	23,179	15,906	50,467	57,195
3	10,463	39,218	28,943	37,596
4	14,430	15,235	30,318	25,216
5	5,923	5,763	11,744	11,467
Total	163,563	106,201	326,066	201,613
% of total metal sales	95%	95%	95%	94%

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 statements of financial position.

(U.S. dollars in thousands)

	Less than 1 year	2-3 years	4-5 years	After 5 years	June 30 2011 Total	December 31, 2010 Total
	\$	\$	\$	\$	\$	\$
Accounts payable and accrued liabilities	69,930	-	-	-	69,930	72,006
Long-term debt	-	-	57,035	193,919	250,954	243,307
Interest payable on long-term debt	22,244	44,460	38,784	19,391	124,879	131,857
Gold contracts	45,016	85,650	20,903	-	151,569	153,375
	137,190	130,110	116,722	213,310	597,332	600,545

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, trade and other receivables, 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:

	June 30, 2011			
<i>(in thousands)</i>	Canadian dollar	Australian dollar	Mexican peso	Chilean peso
Cash and cash equivalents	276,427	26,541	543	110
Trade and Other Receivables	8,816	5,312	8,746	-
Prepayment option	5,225	-	-	-
Accounts payable and accruals	(28,555)	(13,745)	(37,863)	-
Reclamation and closure cost obligations	(3,900)	(15,109)	(10,578)	-
Share award units	(7,853)	-	-	-
Share Purchase warrants	(127,203)	-	-	-
Conversion option on debt	(37,510)	-	-	-
Long-term debt	(231,140)	-	-	-
Gross balance sheet exposure	<u>(145,693)</u>	<u>2,999</u>	<u>(39,152)</u>	<u>110</u>

	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	<u>(48,845)</u>	<u>6,397</u>	<u>(34,137)</u>	<u>50</u>

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 loss from the financial instruments presented by the amounts shown below.

<i>(in thousands)</i>	2011	2010
	\$	\$
Canadian dollar	(14,569)	(4,885)
Australian dollar	300	640
Mexican peso	(3,915)	(3,414)
Chilean peso	11	5
	<u>(18,173)</u>	<u>(7,654)</u>

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 June 30, 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. 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 our control, including:

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

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 12 (a) of the notes to the financial statements. At June 30, 2011 the Company had remaining gold forward sales contracts for 231,000 ounces of gold at a price of \$801 per ounce at a remaining commitment of 5,500 ounces per month for 42 months.

In the second quarter of 2011, the Company's revenues and cash flows were impacted by copper prices primarily in the range of \$3.87 and \$4.46 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 June 30, 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.

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 commodity prices would impact the Company's net earnings before taxes and other comprehensive income before taxes as follows:

<i>(U.S. dollars in thousands)</i>	Three Months ended June 30,			
	2011	2011	2010	2010
	Net	Other	Net	Other
	Earnings	Comprehensive	Earnings	Comprehensive
	\$	\$	\$	\$
Gold price	13,687	-	9,259	32,030
Copper price	1,473	-	935	-
Silver price	2,340	-	929	-
Fuel price	1,322	-	911	364
Share Purchase Warrants	1,753	-	2,018	-
Conversion Option on convertible debt	4,494	-	2,596	-
Share Award Unit	151	-	270	-

(U.S. dollars in thousands)

	Six Months ended June 30,			
	2011	2011	2010	2010
	Net	Other	Net	Other
	Earnings	Comprehensive	Earnings	Comprehensive
	\$	\$	\$	\$
Gold price	27,198	-	17,648	32,030
Copper price	3,107	-	2,295	-
Silver price	4,251	-	1,259	-
Fuel price	2,415	-	1,641	364
Share Purchase Warrants	12,833	-	5,943	-
Conversion Option on convertible debt	2,841	-	3,590	-
Share Award Unit	785	-	377	-

CONTRACTUAL OBLIGATIONS

(U.S. dollars in thousands)		Payments due by period			
Contractual obligations	Total	Less than 1 year	2 - 3 years	4 - 5 years	After 5 years
Long-term debt	250,954	-	57,035	-	193,919
Interest payable on long-term debt	124,880	22,244	44,460	38,784	19,392
Operating Leases and Other Commitments	180,333	121,762	14,708	14,640	29,223
Asset retirement obligations	56,114	1,342	1,823	1,424	51,526
Total contractual obligations	612,281	145,348	118,026	54,847	294,060

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 June 30, 2011, the face value of the Notes totaled \$193.9 million (Cdn\$187.0 million) with remaining interest payable totaling \$116.4 million (Cdn\$112.2 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 \$57.0 million (Cdn\$55.0 million) with remaining interest payable totaling \$8.5 million (Cdn\$8.2 million). Interest is payable in arrears in equal semi-annual installments on January 1 and July 1 each year.

OUTSTANDING SHARES

As at August 5, 2011, there were 449,892,156 common shares of the Company outstanding. The Company had 11,343,548 stock options outstanding under its share option plan, exercisable for 11,343,548 common shares. In addition, the Company had 319,211,530 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 significant accounting policies are described in Note 2 to the consolidated interim financial statements for the three and six months ended June 30, 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 second 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

On November 12, 2009, the IASB issued IFRS 9 *Financial Instruments* which addresses the classification and measurement of financial assets as the first step in its project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. Requirements for financial liabilities were added in October 2010. IFRS 9 must be applied starting January 1, 2013, with early adoption permitted. The Company has not early adopted IFRS 9 and is currently evaluating the expected impact on its consolidated financial statements.

On May 12, 2011, the IASB issued four new standards:

- (a) IFRS 10 *Consolidated Financial Statements* includes a new definition of control, which is used to determine which entities are consolidated, and describes consolidation procedures

- (b) IFRS 11 *Joint Arrangements* describes the accounting for joint arrangements with joint control; proportionate consolidation is not permitted for joint ventures (as newly defined)
- (c) IFRS 12 *Disclosures of Interests in Other Entities* includes all of the disclosure requirements for subsidiaries, joint ventures, associates, and "structured entities"
- (d) IFRS 13 *Fair Value Measurement* provides guidance on how to measure fair value, but does not change when fair value is required or permitted under IFRS

On June 22, 2011, the IASB proposed amendments to five standards:

- (a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* clarifies that an entity is required to apply IFRS 1 when the entity's most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs, even if the entity applied IFRS 1 in a reporting period before the period reported in the most recent previous annual financial statements. Clarifies that an entity that capitalized borrowing costs in accordance with its previous GAAP before the date of transition to IFRSs may carry forward without adjustment the amount previously capitalized in the opening statement of financial position at the date of transition. Also clarifies that borrowing costs incurred on or after the date of transition to IFRSs, including those incurred on qualifying assets under construction at the date of transition, should be accounted for in accordance with IAS 23, *Borrowing Costs*.
- (b) IAS 1 *Presentation of Financial Statements* clarifies that additional financial statement information is not necessary for periods beyond the minimum comparative information requirements. If additional comparative information is provided, the information should be presented in accordance with IFRSs.
- (c) IAS 16 *Property, Plant and Equipment* clarifies that servicing equipment should be classified as property, plant and equipment when it is used during more than one period and as inventory otherwise.
- (d) IAS 32 *Financial Instruments: Presentation* clarifies that income tax relating to distributions to holders of an equity instrument and income tax relating to transaction costs of an equity transaction should be accounted for in accordance with IAS 12 *Income Taxes*.
- (e) IAS 34 *Interim Financial Reporting* clarifies the requirements relating to segment information in interim reports by specifying that total assets for a particular reportable segment would be disclosed only when the amounts are regularly provided to the chief operating decision maker and there has been a material change in the total assets for that segment from the amount disclosed in the last annual financial statements.

These standards must be applied starting January 1, 2013, with early adoption permitted. The Company has not early adopted these new standards and is currently evaluating the expected impact on its consolidated 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 \$255.9 million decrease in the equity balance. Please refer to Note 21 of the consolidated interim financial statements for the reconciliations between IFRS and Canadian GAAP for the three and six months ended June 30, 2010 and for the statements of comprehensive income for the three and six months ended June 30, 2010. Reconciliations between IFRS and Canadian GAAP for the statements of cash flows for the three and six months ended June 30, 2010 are provided in Note 21; 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.
3. "Adjusted net earnings" is a non- GAAP financial measure with no standard definition under IFRS which management uses to internally evaluate the underlying operating performance of the Company as a whole for the reporting periods presented. While the adjustments to net earnings in this measure include items that are recurring, adjusted net earnings is a useful measure of the Company's performance as 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.

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 and this MD&A for the quarter ended June 30, 2011, both available at 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.

As at and for the three and six months ended June 30, 2011
(unaudited)

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New Gold Inc.

Condensed consolidated income statements

Three and six month periods ended June 30,

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

(Unaudited)

	Note	Three months ended		Six months ended	
		2011	2010	2011	2010
		\$	\$	\$	\$
			Note 21		Note 21
Revenues		171,635	112,359	342,848	213,979
Operating expenses		(70,943)	(57,173)	(141,659)	(109,059)
Depreciation and depletion		(17,194)	(18,706)	(37,221)	(31,669)
Earnings from mine operations		83,498	36,480	163,968	73,251
Corporate administration expenses		(5,172)	(6,137)	(11,178)	(11,607)
Share-based payment expenses		(2,563)	(1,907)	(5,419)	(3,847)
Exploration and corporate development expenses		(4,033)	(3,017)	(6,334)	(4,986)
Income from operations		71,730	25,419	141,037	52,811
Finance income	5	922	396	1,968	652
Finance costs	5	(1,520)	(289)	(2,657)	(847)
Other gains and losses	5	28,420	(36,530)	4,022	(41,142)
Earnings (loss) before taxes		99,552	(11,004)	144,370	11,474
Income tax expense	14	(20,950)	(15,002)	(41,049)	(24,438)
Net earnings (loss) from continuing operations		78,602	(26,006)	103,321	(12,964)
Loss from discontinued operations	9	-	(10,191)	-	(9,886)
Net earnings (loss)		78,602	(36,197)	103,321	(22,850)
Earnings (loss) per share from continuing operations					
Basic		0.19	(0.07)	0.25	(0.03)
Diluted		0.16	(0.07)	0.25	(0.03)
Earnings (loss) per share from discontinued operations					
Basic		-	(0.03)	-	(0.03)
Diluted		-	(0.03)	-	(0.03)
Earnings (loss) per share from continuing and discontinued operations					
Basic		0.19	(0.09)	0.25	(0.06)
Diluted		0.16	(0.09)	0.25	(0.06)
Weighted average number of shares outstanding (in thousands)					
Basic		416,372	389,885	407,901	389,423
Diluted		428,763	389,885	420,063	389,423

See accompanying notes to the condensed consolidated interim financial statements.

New Gold Inc.

Condensed consolidated statements of comprehensive income (loss)

Three and six month periods ended June 30,

(Expressed in thousands of U.S. dollars)

(Unaudited)

	Note	Three months ended		Six months ended	
		2011	2010	2011	2010
		\$		\$	
			Note 21		Note 21
Net earnings (loss)		78,602	(36,197)	103,321	(22,850)
Other comprehensive income (loss)					
Unrealized losses on mark-to-market of gold contracts	12	(14,186)	(34,622)	(16,052)	(40,651)
Realized losses on settlement of gold contracts	12	9,721	4,666	17,331	7,535
Unrealized losses on mark-to-market of fuel contracts	12	-	(423)	-	(338)
Unrealized loss on available-for-sale securities (net of tax of \$nil)		-	(3,014)	-	(3,014)
Cumulative translation adjustment		731	(8,484)	8,638	(900)
Income tax related to components of other comprehensive income (loss)		1,820	12,242	(449)	14,066
Total other comprehensive income (loss)		(1,914)	(29,635)	9,468	(23,302)
Total comprehensive income (loss)		76,688	(65,832)	112,789	(46,152)

See accompanying notes to the condensed consolidated interim financial statements.

New Gold Inc.

Condensed consolidated statements of financial position

(Expressed in thousands of U.S. dollars)

(Unaudited)

	Note	June 30 2011	December 31 2010
		\$	\$
Assets			
Current assets			
Cash and cash equivalents		490,446	490,754
Trade and other receivables		25,398	11,929
Inventories	7	118,895	103,055
Prepaid expenses and other		5,862	7,325
Total current assets		640,601	613,063
Investments	8	-	7,533
Mining interests	10	2,375,677	1,767,240
Deferred tax assets		18,800	10,058
Reclamation deposits and other		24,239	31,295
Total assets		3,059,317	2,429,189
Liabilities			
Current liabilities			
Trade and other payables	6	71,560	69,245
Current derivative liabilities	12	45,016	40,072
Current non-hedged derivative liabilities	12	12,405	-
Current tax liabilities		27,716	31,392
Total current liabilities		156,697	140,709
Reclamation and closure obligations	15	38,606	34,173
Provisions		14,661	9,227
Non-current derivative liabilities	12	106,553	113,303
Non-current non-hedged derivative liabilities	12	141,688	155,365
Deferred tax liabilities		174,754	179,180
Long-term debt	11	246,692	229,884
Deferred benefit		46,276	46,276
Other		651	577
Total liabilities		926,578	908,694
Equity			
Common shares	13	2,347,620	1,845,886
Contributed surplus		78,897	81,176
Other reserves		(42,445)	(51,913)
Deficit		(251,333)	(354,654)
Total equity		2,132,739	1,520,495
Total liabilities and equity		3,059,317	2,429,189

Commitments and contingencies (Note 19)

Subsequent events (Note 20)

Approved and authorized by the Board on August 3, 2011

"Robert Gallagher"

Robert Gallagher, Director

"James Estey"

James Estey, Director

See accompanying notes to the condensed consolidated interim financial statements.

New Gold Inc.

Condensed consolidated statements of changes in equity

Six month period ended June 30,

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

(Unaudited)

	Note	2011	2010
		\$	\$
Common shares			
Balance, beginning of period		1,845,886	1,810,039
Acquisition of Richfield	4	483,142	-
Exercise of options		18,592	11,347
Balance, end of period		2,347,620	1,821,386
Contributed surplus			
Balance, beginning of period		81,176	82,984
Exercise of options		(5,999)	(4,936)
Share-based payments		3,720	3,724
Balance, end of period		78,897	81,772
Share purchase warrants			
Balance, beginning of period		-	11,850
Exercise of warrants		-	-
Balance, end of period		-	11,850
Other reserves			
Balance, beginning of period		(51,913)	(27,639)
Other comprehensive income (loss)		9,468	(23,302)
Balance, end of period		(42,445)	(50,941)
Deficit			
Balance, beginning of period		(354,654)	(402,115)
Net earnings (loss)		103,321	(22,850)
Balance, end of period		(251,333)	(424,965)
Total equity		2,132,739	1,439,102

See accompanying notes to the condensed consolidated interim financial statements.

New Gold Inc.

Condensed consolidated statements of cash flows

Three and six month periods ended June 30,

(Expressed in thousands of U.S. dollars)

(Unaudited)

	Note	Three months ended		Six months ended	
		2011	2010	2011	2010
		\$	\$	\$	\$
			Note 21		Note 21
Operating activities					
Net earnings (loss)		78,602	(36,197)	103,321	(22,850)
Earnings from discontinued operations		-	10,191	-	9,886
Adjustments for:					
Unrealized gain on gold contracts		(2,208)	(2,089)	(4,210)	(4,165)
Unrealized loss on fuel contracts		-	118	-	183
Unrealized foreign exchange (gain) loss	5	1,134	6,321	(1,981)	4,952
Unrealized and realized gain on of investments	5	-	(948)	(1,349)	(4,892)
Unrealized (gain) loss on non-hedged derivatives	5	(30,036)	29,296	(5,681)	39,405
Loss on disposal of assets		144	1,019	252	1,417
Depreciation and depletion		17,218	18,692	36,855	31,762
Share-based payments		1,945	1,826	3,720	3,724
Unrealized (gain) loss on embedded derivative contract	5	(3,304)	1,255	(850)	(652)
Unrealized loss on cash flow hedging items	5	1,859	-	3,686	-
Income tax expense		20,950	15,002	41,049	24,438
Finance income		(922)	(396)	(1,968)	(652)
Finance costs		1,520	289	2,657	847
		86,902	44,379	175,501	83,403
Change in operating working capital	16	653	179	(26,948)	(6,771)
Cash generated from operations		87,555	44,558	148,553	76,632
Income taxes paid		(43,582)	(4,154)	(54,818)	(13,274)
Net cash generated from operations		43,973	40,404	93,735	63,358
Cash used in discontinued operations		-	-	-	(1,696)
Investing activities					
Mining interests		(85,903)	(26,460)	(143,085)	(48,462)
Interest paid		(11,147)	(10,295)	(11,412)	(10,501)
Recovery (contribution) of reclamation deposits		-	(2)	8,147	(43)
Cash acquired in asset acquisition, net of transaction costs		18,589	-	18,589	-
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
Interest received		495	560	1,541	792
Proceeds from disposal of assets		83	-	215	29
Cash used in continuing operations		(77,883)	(36,197)	(117,078)	(426,797)
Cash generated from discontinued operations		-	34,629	-	34,410
Financing activities					
Exercise of options to purchase common stock		1,353	5,645	12,593	6,410
El Morro loan		-	-	-	463,000
Revolving credit facility costs		(347)	-	(778)	-
Repayment of long-term debt		-	-	-	(27,235)
Cash generated by financing activities		1,006	5,645	11,815	442,175
Cash generated by (used in) discontinued operations		-	-	-	-
Effect of exchange rate changes on cash and cash equivalents		3,181	(13,005)	11,220	(7,710)
(Decrease) increase in cash and cash equivalents		(29,723)	31,476	(308)	103,740
Cash and cash equivalents, beginning of period		520,169	344,616	490,754	272,352
Cash and cash equivalents, end of period		490,446	376,092	490,446	376,092
Cash and cash equivalents are comprised of					
Cash		269,236	128,972	269,236	128,972
Short-term money market instruments		221,210	247,120	221,210	247,120
		490,446	376,092	490,446	376,092

Supplemental cash flow information (Note 16)

See accompanying notes to the condensed consolidated interim financial statements.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 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. (the "Company") and its 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, the Richfield exploration 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. Significant accounting policies

These unaudited condensed consolidated interim financial statements of the Company have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB") and using the accounting policies the Company expects to adopt in its consolidated financial statements as at and for the year ending December 31, 2011. The accounting policies the Company expects to adopt in its financial statements as at and for the year ending December 31, 2011 are disclosed in Note 2 of the Company's condensed consolidated interim financial statements as at and for the three months ended March 31, 2011.

As these condensed consolidated interim financial statements are prepared using International Financial Reporting Standards ("IFRS"), certain disclosures that are required to be included in annual financial statements prepared in accordance with IFRS that were not included in the Company's most recent annual financial statements prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP") were included in the Company's financial statements as at and for the three months ended March 31, 2011.

These condensed consolidated interim financial statements should be read in conjunction with the Company's 2010 annual financial statements and in consideration of the IFRS transition disclosures included in Note 21 to these financial statements and the additional annual disclosures required under IFRS included in the Company's condensed consolidated interim financial statements as at and for the three months ended March 31, 2011.

3. Changes in accounting standards

On November 12, 2009, the IASB issued IFRS 9 *Financial Instruments* which addresses the classification and measurement of financial assets as the first step in its project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. Requirements for financial liabilities were added in October 2010. IFRS 9 must be applied starting January 1, 2013, with early adoption permitted. The Company has not early adopted IFRS 9 and is currently evaluating the expected impact on its consolidated financial statements.

On May 12, 2011, the IASB issued four new standards:

- (a) IFRS 10 *Consolidated Financial Statements* includes a new definition of control, which is used to determine which entities are consolidated, and describes consolidation procedures
- (b) IFRS 11 *Joint Arrangements* describes the accounting for joint arrangements with joint control; proportionate consolidation is not permitted for joint ventures (as newly defined)
- (c) IFRS 12 *Disclosures of Interests in Other Entities* includes all of the disclosure requirements for subsidiaries, joint ventures, associates, and "structured entities"
- (d) IFRS 13 *Fair Value Measurement* provides guidance on how to measure fair value, but does not change when fair value is required or permitted under IFRS

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

3. Changes in accounting standards (continued)

On June 22, 2011, the IASB proposed amendments to five standards

- (a) IFRS 1 *First-time Adoption of International Financial Reporting Standards* clarifies that an entity is required to apply IFRS 1 when the entity's most recent previous annual financial statements did not contain an explicit and unreserved statement of compliance with IFRSs, even if the entity applied IFRS 1 in a reporting period before the period reported in the most recent previous annual financial statements. Clarifies that an entity that capitalized borrowing costs in accordance with its previous GAAP before the date of transition to IFRSs may carry forward without adjustment the amount previously capitalized in the opening statement of financial position at the date of transition. Also clarifies that borrowing costs incurred on or after the date of transition to IFRSs, including those incurred on qualifying assets under construction at the date of transition, should be accounted for in accordance with IAS 23, *Borrowing Costs*.
- (b) IAS 1 *Presentation of Financial Statements* clarifies that additional financial statement information is not necessary for periods beyond the minimum comparative information requirements. If additional comparative information is provided, the information should be presented in accordance with IFRSs.
- (c) IAS 16 *Property, Plant and Equipment* clarifies that servicing equipment should be classified as property, plant and equipment when it is used during more than one period and as inventory otherwise.
- (d) IAS 32 *Financial Instruments: Presentation* clarifies that income tax relating to distributions to holders of an equity instrument and income tax relating to transaction costs of an equity transaction should be accounted for in accordance with IAS 12 *Income Taxes*.
- (e) IAS 34 *Interim Financial Reporting* clarifies the requirements relating to segment information in interim reports by specifying that total assets for a particular reportable segment would be disclosed only when the amounts are regularly provided to the chief operating decision maker and there has been a material change in the total assets for that segment from the amount disclosed in the last annual financial statements.

These standards must be applied starting January 1, 2013, with early adoption permitted. The Company has not early adopted these new standards and is currently evaluating the expected impact on its consolidated financial statements.

4. Acquisition of Richfield Ventures Corp.

On April 4, 2011, the Company announced that it had entered into a definitive agreement whereby the Company would acquire, through a plan of arrangement ("the Arrangement"), all of the outstanding common shares of Richfield Ventures Corp. ("Richfield"). Under the terms of the Arrangement, each Richfield shareholder would receive 0.9217 of a New Gold share and a nominal cash payment of \$0.0001 for each Richfield share held. The acquisition received final court approval on June 1, 2011. 48,137,295 common shares issued to Richfield shareholders were valued at CAD\$9.75 per share. The value per share was determined using the June 1, 2011 opening share price of New Gold.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

4. Acquisition of Richfield Ventures Corp. (continued)

The allocation of the purchase price based on the consideration paid and on Richfield net assets acquired as of June 1, 2011 is as follows:

	\$
Issuance of New Gold shares (48,137,295 common shares)	483,142
Acquisition costs	5,826
Purchase consideration	488,968
Net assets acquired	
Net working capital (including cash of \$26,616)	21,235
Plant and equipment	2,601
Blackwater project	460,963
Exploration properties	3,849
Other assets	320
Net assets acquired	488,968

For purposes of these condensed consolidated interim financial statements, the transaction has been accounted for as a purchase of assets and assumption of liabilities of Richfield by the Company. The transaction does not qualify as a business combination under IFRS 3 *Business Combinations*, as the significant inputs and processes that constitute a business were not identified. Therefore the transaction was treated as an asset acquisition. The purchase consideration has been allocated to the fair value of the assets acquired and liabilities assumed based on management's best estimates and available information at the time of the acquisition.

5. Expenses

(a) Finance costs and income

	Three months ended		Six months ended	
	2011	2010	2011	2010
	\$	\$	\$	\$
Finance costs:				
Interest on convertible debentures	2,069	1,815	3,047	2,753
Interest on senior notes	5,297	5,143	10,302	9,670
Other interest	1,078	56	1,810	288
Unwinding of the discount on reclamation cost obligations	442	233	847	559
	8,886	7,247	16,006	13,270
Less: amounts included in cost of qualifying assets	(7,366)	(6,958)	(13,349)	(12,423)
	1,520	289	2,657	847
Finance income:				
Interest income	922	396	1,968	652

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

5. Expenses (continued)

(b) Other gains and losses

The following table summarizes other gains and (losses) for the three and six months ended June 30, 2011 and 2010.

	Three months ended		Six months ended	
	2011	2010	2011	2010
	\$	\$	\$	\$
Fair value change of				
embedded derivative in senior notes (i)	3,304	(1,255)	850	652
Gains on FVTPL financial assets	-	948	1,349	4,892
Ineffectiveness on hedging instruments (ii)	(1,859)	-	(3,686)	-
Fair value change of				
non-hedged derivatives (iii)	30,036	(29,296)	5,681	(39,405)
Gain (loss) on foreign exchange	(1,134)	(6,321)	1,981	(4,952)
Other	(1,927)	(606)	(2,153)	(2,329)
	28,420	(36,530)	4,022	(41,142)

- (i) The Company has the right to redeem the senior secured notes (“Notes”), as described in Note 11 (a) 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 June 30, 2011, the redemption price was 105% and is scheduled to decrease to 104% on June 28, 2013. The early redemption feature in the Notes qualifies as an embedded derivative that must be bifurcated for reporting purposes. At June 30, 2011, the fair value of the derivative asset was determined to be \$8.5 million (December 2010 - \$7.7 million).
- (ii) The Company has gold forward sales contracts that commenced in July 2008 the represent a commitment of 5,500 ounces per month ending in December 2014 (as described in Note 12 (a)). The effective portion of gold contracts is recorded in other comprehensive income until the forecasted gold sale impacts earnings. The ineffective portion is recorded in other gains and losses in the current period. The ineffective portion has resulted in a loss of \$1.9 million and \$3.7 million recorded in earnings for the three and six months ended June 30, 2011 (2010 - \$nil and \$nil).
- (iii) The Company issued 55,000 convertible debentures (“Debentures”) in 2007, as described in Note 11 (b). 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 derivatives (non-derivative financial assets and liabilities classified as fair value through profit and loss (“FVTPL”) are measured at fair value with unrealized gains and losses recognized on the income statement). At June 30, 2011, the fair value of the derivative liability was \$25.8 million (December 31, 2010 - \$29.4 million). The change in the fair value has resulted in a gain of \$11.3 million and \$4.0 million recorded in earnings for the three and six months ended June 30, 2011 (2010 - \$7.5 million and \$9.1 million loss). The debt component is measured at amortized cost and is accreted over the expected term to maturity using the effective interest method.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

5. Expenses (continued)

(iii) Fair value change on non-hedged derivatives (continued)

The Company has outstanding share purchase warrants ("Warrants"), as described in Note 12 (b). The Warrants have an exercise price denominated in a currency other than the Company's functional currency. The Warrants are classified 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 and is recorded in non-hedged derivatives. At June 30, 2011, the fair value of the derivative liability was \$128.3 million (Cdn\$123.8 million) (December 31, 2010 - \$125.9 million (Cdn\$125.3 million)). The change in the fair value has resulted in a gain of \$18.7 million and \$1.7 million recorded in earnings for the three and six months ended June 30, 2011 (2010 - \$21.8 million and \$30.3 million loss).

6. Trade and other payables

	June 30 2011	December 31 2010
	\$	\$
Trade payables	24,820	31,963
Payables to related parties	2,995	2,119
Accruals	42,431	33,848
Current portion of reclamation closure costs	1,314	1,315
	71,560	69,245

7. Inventories

	June 30 2011	December 31 2010
	\$	\$
Heap leach ore	74,446	61,738
Work-in-process	23,605	21,623
Finished goods	4,139	5,506
Stockpiled ore	79	79
Supplies	16,626	14,109
	118,895	103,055

The amount of inventories recognized in operating expenses for the three and six months ended June 30, 2011 is \$71.1 million and \$134.5 million (2010 - \$55.4 million and \$103.9 million). There were no write-downs or reversals of write-downs during the three and six months ended June 30, 2011 and 2010. The inventory is expected to be used within one year.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

8. Investments

(a) *Asset Backed Notes*

At December 31, 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 FVTPL 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 June 30, 2011, the Company no longer had a position in AB Notes.

(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 9). 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 (loss).

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.

9. 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 8 (b).

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

10. Mining interests

Mining Properties						
	Depletable	Non-depletable	Plant and equipment	Construction in progress	Exploration and evaluation	Total
	\$	\$	\$	\$		\$
Cost						
As at December 31, 2010	558,070	964,122	444,459	1,806	9,660	1,978,117
Additions	9,915	549,034	73,097	6,398	-	638,444
Disposals	-	-	(6,694)	-	-	(6,694)
Transfers	-	-	4,450	(4,450)	-	-
Foreign exchange translation	-	12,062	4,655	-	-	16,717
As at June 30, 2011	567,985	1,525,218	519,967	3,754	9,660	2,626,584
Accumulated depreciation						
As at December 31, 2010	113,476	-	97,401	-	-	210,877
Depreciation for the period	21,779	-	19,615	-	-	41,394
Disposals	-	-	(2,502)	-	-	(2,502)
Foreign exchange translation	-	-	1,138	-	-	1,138
As at June 30, 2011	135,255	-	115,652	-	-	250,907
Net book value						
As at December 31, 2010	444,594	964,122	347,058	1,806	9,660	1,767,240
As at June 30, 2011	432,730	1,525,218	404,315	3,754	9,660	2,375,677

The Company capitalized \$7.4 million and \$13.3 million of interest for the three and six months ended June 30, 2011 (2010 - \$7.0 million and \$12.4 million) related to the New Afton project.

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

	Mining properties				June 30 2011
	Depletable	Non-depletable	Total	Plant and equipment	
	\$	\$	\$	\$	\$
Mesquite Mine	161,893	46,153	208,046	100,283	308,329
Cerro San Pedro Mine	188,773	84,817	273,590	71,854	345,444
Peak Mine	82,064	46,671	128,735	70,820	199,555
New Afton Project	-	510,537	510,537	155,873	666,410
El Morro Project	-	376,172	376,172	-	376,172
Blackwater Project	-	464,622	464,622	4,264	468,886
Other projects	-	9,660	9,660	-	9,660
Corporate	-	-	-	1,221	1,221
	432,730	1,538,632	1,971,362	404,315	2,375,677

	Mining properties				December 31 2010
	Depletable	Non-depletable	Total	Plant and equipment	
	\$	\$	\$	\$	\$
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	-	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

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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11. Long-term debt

Long-term debt consists of the following:

	June 30 2011	December 31 2010
	\$	\$
Senior secured notes (a)	185,509	179,197
Subordinated convertible debentures (b)	45,631	42,635
El Morro project funding loan (c)	15,552	8,052
Revolving credit facility (d)	-	-
	246,692	229,884

(a) Senior secured notes

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 face value of the Notes at June 30, 2011 was \$193.9 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. Following the start of commercial production at New Afton, in the event that excess cash flow is generated by New Afton in a previous fiscal year (as defined by the Notes Indenture), the Company must offer to repurchase the Notes at 100% of face value on a pro rata basis up to an aggregate maximum equal to the amount of the excess cash flow. The offer may be accepted or declined by holders on an individual basis.

The Company has the right to redeem the Notes (as described in Note 5 (b)(i)) in whole or in part at any time prior to June 27, 2017. This early redemption feature in the Notes qualifies as an embedded derivative. The change in the fair value has resulted in a gain of \$3.3 million and \$1.0 million recorded in earnings for the three and six months ended June 30, 2011 (2010 - \$1.3 million loss and \$1.0 million gain for the three and six months ended June 30).

(b) Subordinated convertible debentures

In 2007, the Company issued 55,000 subordinated convertible debentures ("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.

The face value of the Debentures at June 30, 2011 was \$57.0 million (Cdn\$55.0 million) (2010 - \$54.2 million (Cdn\$55.0 million)).

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

New Gold Inc.

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11. Long-term debt (continued)

(b) *Subordinated convertible debentures (continued)*

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) *El Morro project funding loan*

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. 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.

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 until commencement of commercial production. These amounts, plus interest, would be repaid out 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.

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11. Long-term debt (continued)

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

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). Goldcorp assumed this loan at the new, lower interest rate from February 16, 2010. As at June 30, 2011, the outstanding loan balance was \$15.6 million including accrued interest. This includes non-cash investing activities includes \$3.6 million and \$7.2 million for the three and six months ended June 30, 2011 (2010 - \$4.4 million and \$5.5 million), and represents the Company's share of contributions to the El Morro project funded by the joint venture partner. The loan is secured against all rights and interests of the Company's El Morro subsidiaries, including a pledge of the El Morro shares.

(d) *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.

To the date of these condensed consolidated interim 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.

12. Derivative instruments

The following tables summarize derivative related liabilities.

	June 30 2011	December 31 2010
	\$	\$
Derivatives designated as hedging instruments		
Gold contracts	151,569	153,375
Less: Current portion	(45,016)	(40,072)
	106,553	113,303

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12. Derivative instruments (continued)

The following table summarizes realized derivative gains (losses) for the three and six months ended June 30, 2011 and 2010.

	Three months ended		Six months ended	
	2011	2010	2011	2010
	\$	\$	\$	\$
Derivatives designated as hedging instruments				
Gold hedging contracts	(9,721)	(4,666)	(17,331)	(7,535)
Fuel contracts	-	38	-	63
	(9,721)	(4,628)	(17,331)	(7,472)

Realized gains (losses) on derivatives not in a hedging relationship are classified in other gains and losses. 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 and six months ended June 30, 2011 and 2010.

	Three months ended		Six months ended	
	2011	2010	2011	2010
	\$	\$	\$	\$
Derivatives not classified as hedging instruments for accounting purposes				
Share purchase warrants	18,687	(21,847)	1,722	(30,348)
Conversion option on convertible debentures	11,349	(7,449)	3,959	(9,057)
Prepayment option embedded derivative	3,304	(1,255)	850	652
	33,340	(30,551)	6,531	(38,753)

For the three and six months ended June 30, 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 and six months ended June 30, 2011 and 2010.

	Three months ended		Six months ended	
	2011	2010	2011	2010
	\$	\$	\$	\$
Effective portion of change in fair value of hedging instruments				
Gold hedging contracts - unrealized	(16,045)	(34,622)	(19,738)	(40,651)
Gold hedging contracts - realized	9,721	4,666	17,331	7,535
Fuel contracts	-	(423)	-	(338)
Income tax	1,820	12,242	(449)	14,066
	(4,504)	(18,137)	(2,856)	(19,388)
Ineffective portion of change in fair value of hedging instruments				
Gold hedging contracts - unrealized	1,859	-	3,686	-

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12. 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 June 30, 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 \$35.6 million for gold hedging contracts.

(a) Gold hedging contracts

Under the terms of a previously held term loan facility, 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 June 30, 2011, the Company had remaining gold forward sales contracts for 231,000 ounces of gold at a price of \$801 per ounce at a remaining commitment of 5,500 ounces per month for 42 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 June 30, 2011.

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		

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12. Derivative instruments (continued)

(c) *Non-current derivative liabilities classified as FVTPL liabilities*

The following table summarizes fair value through profit and loss ("FVTPL") liabilities.

	June 30 2011	December 31 2010
	\$	\$
Equity conversion option on convertible debt	25,762	29,429
Share purchase warrants	128,331	125,936
Less: current portion of share purchase warrants	(12,405)	-
	141,688	155,365

13. Share capital

At June 30, 2011, the Company had unlimited authorized common shares and 449,341,000 common shares outstanding.

(a) *No par value common shares issued*

	Number of shares (000's)	\$
Balance, December 31, 2010	399,042	1,845,886
Acquisition of Richfield (i)	48,137	483,142
Exercise of options (ii)	2,162	18,592
Balance, June 30, 2011	449,341	2,347,620

(i) On June 1, 2011, the Company issued 48,137,295 common shares to effect the acquisition of Richfield Venture Corp., as described in Note 4. The shares were issued at the opening share price of the Company on June 1, 2011, the transaction completion date, of \$9.75 for a total consideration of \$483.1 million.

(ii) During the six months ended June 30, 2011, 2,162,000 common shares were issued pursuant to the exercise of stock options. The Company received proceeds of \$12.6 million from these exercises and transferred \$6.0 million from contributed surplus.

(b) *Stock options*

The following table presents changes in the stock options.

	Number of options (000's)	Weighted average exercise price Cdn\$
Balance, December 31, 2010	12,248	4.50
Granted	1,730	7.83
Exercised	(2,162)	5.65
Forfeited	(396)	7.66
Balance, June 30, 2011	11,420	4.68

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13. Share capital (continued)

(c) Earnings per share

The following table sets forth the computation of diluted earnings per share for the three and six months ended June 30, 2011 and 2010.

	Three months ended		Six months ended June	
	2011	2010	2011	2010
	\$	\$	\$	\$
Earnings (loss)				
Continuing operations	78,602	(26,006)	103,321	(12,964)
Discontinued operations, net of tax	-	(10,191)	-	(9,886)
Net earnings (loss)	78,602	(36,197)	103,321	(22,850)
Dilution of net earnings (loss)				
Warrants (net of tax)	-	-	4,538	-
Debentures (net of tax)	(8,512)	-	(2,969)	-
Net diluted earnings (loss)	70,090	(36,197)	104,890	(22,850)
<i>(in thousands)</i>				
Basic weighted average number of shares outstanding	416,372	389,885	407,901	389,423
Effective of diluted securities				
Stock options	5,951	-	5,850	-
Warrants	558	-	430	-
Debentures	5,882	-	5,882	-
Diluted weighted average number of shares outstanding	428,763	389,885	420,063	389,423
Earnings (loss) per share from continuing operations				
Basic	0.19	(0.07)	0.25	(0.03)
Diluted	0.16	(0.07)	0.25	(0.03)
Loss per share from discontinued operations				
Basic	-	(0.03)	-	(0.03)
Diluted	-	(0.03)	-	(0.03)
Earnings (loss) per share from continuing and discontinued operations				
Basic	0.19	(0.09)	0.25	(0.06)
Diluted	0.16	(0.09)	0.25	(0.06)

The following lists the equity securities excluded from the computation of diluted earnings per share. For the six months ended June 30, 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\$9.56 (2010 – Cdn\$5.31) for the period.

	2011	2010
	(000's)	(000's)
Stock options	152	4,289
Share purchase warrants	49,600	56,986
Convertible debentures	-	5,900

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14. Income and mining taxes

	Three months ended		Six months ended	
	June 30		June 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Current tax				
Canadian income tax	2,107	2,042	2,213	5,461
Foreign income tax and mining tax	26,424	10,641	48,327	17,725
Total current tax	28,531	12,683	50,540	23,186
Deferred tax				
Canadian income tax	186	(13,111)	(2,181)	(10,985)
Foreign income tax and mining tax	(7,767)	15,430	(7,310)	12,237
Total deferred tax	(7,581)	2,319	(9,491)	1,252
Income tax expense	20,950	15,002	41,049	24,438

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		Six months ended	
	June 30		June 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Earnings before income taxes	99,552	(11,004)	144,370	11,474
Canadian federal and provincial income tax rates	26.50%	28.50%	26.50%	28.50%
Income tax recovery based on above rates	26,381	(3,137)	38,258	3,270
Increase (decrease) due to				
Net non-deductible expenditures	(593)	9,955	(2,655)	6,626
Different statutory tax rates on earnings of foreign subsidiaries	2,934	(4,336)	8,640	2,853
Adjustment of prior year provision to statutory tax returns	-	3,828	-	8,451
Non-taxable gain	-	6,383	-	(741)
Withholding tax on repatriation	2,000	-	2,000	-
Benefit of losses not recognized in period	(19)	306	-	458
Deferred tax assets not recognized and other	(9,753)	2,003	(5,194)	3,521
Total	20,950	15,002	41,049	24,438

The tax rate used for the 2011 and 2010 reconciliations above is the corporate tax rate of 26.5% (2010 – 28.5%) payable by corporate entities in British Columbia, Canada, on taxable profits under the tax law in that jurisdiction.

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15. Reclamation and closure cost obligations

The Company's reclamation and closure cost obligations ("Obligations") consist of costs for the Mesquite Mine, Cerro San Pedro Mine, Peak Mine 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.

Each period the Company reviews costs estimates, discount rates and other assumptions in the valuation of the Obligation at each of its mining properties and development property to reflect events, changes in circumstances and new information available. Changes in these cost estimates and assumptions have a corresponding impact on the fair value of the Obligation. The fair values of the Obligations are measured by discounting the expected cash flows using a discount factor that reflects the risk-free rate of interest matching the duration and jurisdiction of the Obligation. The Company prepares estimates of the timing and amount of expected cash flows when an Obligation is incurred. Expected cash flows are updated each period to reflect changes in facts and circumstances and are impacted by changes in the discount rate.

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

	Mesquite Mine	Cerro San Pedro Mine	Peak Mine	New Afton Project	Total
	\$	\$	\$	\$	\$
Balance, December 31, 2010	8,488	8,911	14,434	3,655	35,488
Reclamation expenditures	-	-	(391)	-	(391)
Unwinding of discount	145	155	423	68	791
Revisions to expected cash flows	145	2,002	1,065	63	3,275
Foreign exchange movement	-	-	643	114	757
Balance, June 30, 2011	8,778	11,068	16,174	3,900	39,920
Less: current portion	8	490	816	-	1,314
	8,770	10,578	15,358	3,900	38,606

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

16. Supplemental cash flow information

	Three months ended June 30		Six months ended June 30	
	2011	2010	2011	2010
	\$	\$	\$	\$
Operating activities:				
Change in non-cash working capital				
Accounts receivable	9,642	202	(7,218)	5,039
Inventories and stockpiled ore	(6,932)	(6,477)	(12,536)	(6,586)
Trade and other payables	(1,482)	7,535	(8,844)	(6,277)
Prepays and other	(575)	(1,081)	1,650	1,053
	653	179	(26,948)	(6,771)

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17. 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 June 30, 2011				
	USA	Mexico	Australia	Other ⁽¹⁾	Total
	\$	\$	\$	\$	\$
Revenues	42,912	89,117	39,606	-	171,635
Operating expenses	(22,464)	(24,875)	(23,604)	-	(70,943)
Depreciation and depletion	(5,202)	(8,548)	(3,384)	(60)	(17,194)
Earnings from mine operations	15,246	55,694	12,618	(60)	83,498
Corporate administration expenses	-	-	-	(5,172)	(5,172)
Share-based payment expenses	-	-	-	(2,563)	(2,563)
Exploration expenses	(17)	(461)	(680)	(2,875)	(4,033)
Earnings (loss) from operations	15,229	55,233	11,938	(10,670)	71,730
Finance income	27	14	64	817	922
Finance costs	(115)	(83)	(436)	(886)	(1,520)
Other gains and losses	(3,942)	1,344	(2,220)	33,238	28,420
Earnings before taxes	11,199	56,508	9,346	22,499	99,552
Income tax (expense) recovery	(3,932)	(17,563)	882	(337)	(20,950)
Net earnings from continuing operations	7,267	38,945	10,228	22,162	78,602
	Six months ended June 30, 2011				
	USA	Mexico	Australia	Other ⁽¹⁾	Total
	\$	\$	\$	\$	\$
Revenues	105,360	152,353	85,135	-	342,848
Operating expenses	(49,505)	(44,579)	(47,575)	-	(141,659)
Depreciation and depletion	(11,876)	(17,715)	(7,506)	(124)	(37,221)
Earnings from mine operations	43,979	90,059	30,054	(124)	163,968
Corporate administration expenses	-	-	-	(11,178)	(11,178)
Share-based payment expenses	-	-	-	(5,419)	(5,419)
Exploration expenses	87	(1,516)	(1,155)	(3,750)	(6,334)
Earnings (loss) from operations	44,066	88,543	28,899	(20,471)	141,037
Finance income	53	66	123	1,726	1,968
Finance costs	(207)	(184)	(887)	(1,379)	(2,657)
Other gains and losses	(6,235)	694	(3,428)	12,991	4,022
Earnings before taxes	37,677	89,119	24,707	(7,133)	144,370
Income tax (expense) recovery	(10,648)	(26,796)	(3,773)	168	(41,049)
Net earnings (loss) from continuing operations	27,029	62,323	20,934	(6,965)	103,321

⁽¹⁾ 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.

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17. Segmented information (continued)

	Three months ended June 30, 2010				
	USA	Mexico	Australia	Other ⁽¹⁾	Total
	\$	\$	\$	\$	\$
Revenues	42,000	39,218	31,141	-	112,359
Operating expenses	(26,352)	(16,411)	(14,410)	-	(57,173)
Depreciation and depletion	(6,252)	(8,128)	(4,326)	-	(18,706)
Earnings from mine operations	9,396	14,679	12,405	-	36,480
Corporate administration expenses	-	-	-	(6,137)	(6,137)
Share-based payment expenses	-	-	-	(1,907)	(1,907)
Exploration expenses	-	(220)	(1,790)	(1,007)	(3,017)
Loss from operations	9,396	14,459	10,615	(9,051)	25,419
Finance income	15	-	-	381	396
Finance costs	(41)	(40)	(168)	(40)	(289)
Other gains and losses	(28)	(734)	2,438	(38,206)	(36,530)
Earnings (loss) before taxes	9,342	13,685	12,885	(46,916)	(11,004)
Income tax (expense) recovery	(5,812)	(3,216)	(1,298)	(4,676)	(15,002)
Net earnings (loss) from continuing operations	3,530	10,469	11,587	(51,592)	(26,006)

	Six months ended June 30, 2010				
	USA	Mexico	Australia	Other ⁽¹⁾	Total
	\$	\$	\$	\$	\$
Revenues	93,835	57,195	62,949	-	213,979
Operating expenses	(53,461)	(27,899)	(27,699)	-	(109,059)
Depreciation and depletion	(13,595)	(11,361)	(6,713)	-	(31,669)
Earnings from mine operations	26,779	17,935	28,537	-	73,251
Corporate administration expenses	-	-	-	(11,607)	(11,607)
Share-based payment expenses	-	-	-	(3,847)	(3,847)
Exploration expenses	-	(268)	(3,135)	(1,583)	(4,986)
Loss from operations	26,779	17,667	25,402	(17,037)	52,811
Finance income	31	23	72	526	652
Finance costs	(329)	(133)	(306)	(79)	(847)
Other gains and losses	5	(2,819)	38	(38,366)	(41,142)
Earnings (loss) before taxes	26,486	14,738	25,206	(54,956)	11,474
Income tax (expense) recovery	(13,103)	(3,888)	(5,728)	(1,719)	(24,438)
Net earnings (loss) from continuing operations	13,383	10,850	19,478	(56,675)	(12,964)

⁽¹⁾ 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) June 30, 2011

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

17. Segmented information (continued)

The following tables present the segmented assets and liabilities:

	June 30, 2011		December 31, 2010	
	Total assets	Total liabilities	Total assets	Total liabilities
	\$	\$	\$	\$
USA	452,585	279,731	423,395	211,837
Mexico	436,234	188,456	456,864	119,897
Australia	254,537	60,856	255,658	68,021
Canada	698,691	270,519	566,836	262,940
Chile	376,172	65,291	368,933	58,052
Other ⁽¹⁾	841,098	61,725	357,503	187,947
	3,059,317	926,578	2,429,189	908,694

⁽¹⁾ Other includes corporate balances and exploration properties.

18. 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 \$1.2 million and \$4.3 million for the three and six months ended June 30, 2011 (2010 - \$0.7 million and \$2.1 million). At June 30, 2011, the Company had \$3.0 million included as accrued liabilities related to this company (December 31, 2010 - \$2.1 million).

19. Commitments and contingencies

Certain conditions may exist as of the date the condensed consolidated interim 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 June 30, 2011, these commitments totaled \$113.6 million, of which all are expected to fall due over the next 12 months.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

19. Commitments and contingencies (continued)

(a) *Capital commitments (continued)*

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

	2011 \$	2010 \$
Property, plant and equipment	99,609	69,244
Other assets	14,000	13,573

(b) 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. During June 2011, litigation has started.

(c) 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.

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.

(d) New Gold and its subsidiary Western Mesquite Mines, Inc. ("WMMI") were 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 meal periods, and rest breaks and penalties for willful failure to pay all wages due on termination of employment. The complainants are seeking certification of the matter as a class action. This matter has been settled in the amount of \$1.8 million, subject to court approval and will not have a material effect on the financial conditions or future operations at the Mesquite Mine.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

20. Subsequent events

The settlement referred to in Note 19 (d) regarding the New Gold subsidiary WMMI was agreed to on July 11, 2011. The \$1.8 million settlement has been accrued as of June 30, 2011.

21. 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 of the March 31, 2011 condensed consolidated financial statements have been applied in preparing the financial statements for the period ended June 30, 2011 and the comparative information.

(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) June 30, 2011

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

21. 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 Decommissioning, 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, was 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, applied IAS 23 from this date onwards.

(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.

(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 June 30, 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) June 30, 2011

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

21. First-time adoption of IFRS (continued)

The Canadian GAAP statement of financial position and equity at June 30, 2010 has been reconciled to IFRS as follows:

	Notes	CGAAP	Effect of IFRS Transition	IFRS
Assets				
Current assets				
Cash and cash equivalents		376,092	-	376,092
Trade and other receivables		5,276	-	5,276
Inventories	e	96,579	596	92,624
	f		(4,551)	
Deferred income and mining taxes	a	9,499	(9,499)	-
Current portion of derivative asset		185	-	185
Prepaid expenses and other		3,430	-	3,430
Total current assets		491,061	(13,454)	477,607
Investments		18,645	-	18,645
Mining interests	b	2,030,479	(327,606)	1,693,273
	d		2,661	
	e		4,956	
	f		1,593	
	p		(18,810)	
Deferred tax assets	a	1,665	9,499	11,164
Reclamation deposits and other		18,158	-	18,158
Total assets		2,560,008	(341,161)	2,218,847
Liabilities				
Current liabilities				
Trade and other payables	h	41,143	(330)	40,813
Current portion of derivatives liabilities		28,602	-	28,602
Current tax liabilities	h	14,918	(2,372)	12,546
Total current liabilities		84,663	(2,702)	81,961
Reclamation and closure cost obligations	e	20,722	5,929	26,651
Provisions	l,h	-	7,210	7,210
Non-current portion of derivative liabilities		96,335	-	96,335
Non-hedged derivative liabilities	c	-	16,589	76,024
	j		59,435	
Deferred tax liabilities	b	298,581	(80,165)	232,648
	c		200	
	d		2,186	
	f		(448)	
	j		8,339	
	k		(7,487)	
	l		30,252	
	p		(18,810)	
Long-term debt		209,683	-	209,683
Deferred benefit		46,276	-	46,276
Employee benefits and other	i	7,465	(4,508)	2,957
Total liabilities		763,725	16,020	779,745
Equity				
Common shares	j	1,822,212	(826)	1,821,386
Contributed surplus	n	82,648	(876)	81,772
Share purchase warrants	j	150,656	(138,806)	11,850
Equity components of convertible debentures	c	21,604	(21,604)	-
Cumulative translation adjustment	d	-	(900)	(900)
Other reserves	m	(51,607)	1,566	(50,041)
Deficit	b	(229,230)	(246,361)	(424,965)
	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		(99,479)	
Total equity		1,796,283	(357,181)	1,439,102
Total liabilities and equity		2,560,008	(341,161)	2,218,847

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

21. First-time adoption of IFRS (continued)

The Canadian GAAP statement of cash flows for the three and six months ended June 30, 2010 has been reconciled to IFRS as follows:

Notes	Three months ended			Six months ended			
	CGAAP	Effect of IFRS Transition	IFRS	CGAAP	Effect of IFRS Transition	IFRS	
Operating activities							
Cash provided by continuing operations	per income statement	38,812	(43,424)	40,404	58,758	(47,570)	63,358
	c,j		29,296			39,405	
	c,d,j		11,830			5,649	
	c,e,f,j,k,l,n,p		4,271			7,523	
	o		(381)			(407)	
Cash used in discontinued operations		-	-	-	(1,696)	-	(1,696)
Investing activities							
Cash used in continuing operations	e,f	(34,605)	(1,973)	(36,197)	(412,996)	(5,007)	(426,797)
	o		381			(8,794)	
Cash used in discontinued operations		34,629	-	34,629	34,410	-	34,410
Financing activities							
Cash provided by continuing operations		5,645	-	5,645	442,175	-	442,175
Cash used in discontinued operations		-	-	-	-	-	-
Effect of exchange rates on cash and cash equivalents		(13,005)	-	(13,005)	(7,710)		(7,710)
Increase (decrease) in cash and cash equivalents		31,476	-	31,476	112,941	(9,201)	103,740
Cash and cash equivalents, beginning of period		344,616		344,616	263,151	9,201	272,352
Cash and cash equivalents, end of period		376,092	-	376,092	376,092	-	376,092

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 was 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 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 statement of financial position. 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.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

21. First-time adoption of IFRS (continued)

(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 continues 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.

(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 offset to the gain on sale recognized for Canadian GAAP purposes when the property was sold in Q2 2010.

(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.

New Gold Inc.

Notes to the condensed consolidated interim financial statements (unaudited) June 30, 2011

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

21. First-time adoption of IFRS (continued)

(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 21 (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.

(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) 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. 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.

(p) 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 Chief Executive Officer
James Estey ^{1,2}	Corporate Director
Vahan Kololian ^{2,3,4}	Managing Partner, TerraNova Partners LP
Martyn Konig ^{2,3}	Executive Chairman and President, European Goldfields Limited
Pierre Lassonde ^{1,3}	Chairman, Franco-Nevada Corporation
Craig Nelsen ^{1,4}	President and CEO, Avanti Mining Corporation
Raymond Threlkeld ⁴	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

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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) and in the United States (on EDGAR at 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.



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