

Malaga Inc.

Unaudited Condensed Interim
Consolidated Financial Statements

For the three-month and six-month periods ended
June 30, 2011

Malaga Inc.

Consolidated Statement of Financial Position as at
(Unaudited; Expressed in US dollars)

	June 30, 2011 \$	December 31, 2010 \$
ASSETS		
CURRENT ASSETS		
Cash	1,198,964	2,840,595
Trade and other receivables (Note 7)	1,605,701	2,013,770
Income tax instalments receivable	916,766	824,199
Inventories (Note 8)	1,809,206	2,100,100
Prepaid expenses	252,089	203,078
	<u>5,782,726</u>	<u>7,981,742</u>
NON-CURRENT ASSETS		
Investments in associates (Note 9)	206,354	200,000
Investment (Note 10)	3,188,207	4,644,534
Property, plant and equipment (Note 11)	15,672,662	13,076,045
Mining properties and deferred development and exploration costs (Note 12)	5,627,274	4,772,885
	<u>24,694,497</u>	<u>22,693,464</u>
	<u>30,477,223</u>	<u>30,675,206</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (Note 13)	2,665,638	3,442,905
Unearned revenues	890,842	896,777
Current portion of long-term debt (Note 14)	1,308,347	1,241,049
Current portion of obligations under finance leases	126,773	132,825
	<u>4,991,600</u>	<u>5,713,556</u>
NON-CURRENT LIABILITIES		
Long-term debt (Note 14)	2,957,402	3,324,188
Deferred revenues (Note 14)	818,086	966,832
Obligations under finance leases	214,397	65,817
Warrants liability (Note 15)	1,630,409	2,713,995
Asset retirement obligation	578,279	568,718
	<u>6,198,573</u>	<u>7,639,550</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 16)	39,238,796	39,200,848
Broker Warrants	30,381	30,381
Contributed surplus	3,781,669	3,466,211
Accumulated other comprehensive income	(831,030)	-
Deficit	(22,932,766)	(25,375,340)
	<u>19,287,050</u>	<u>17,322,100</u>
	<u>30,477,223</u>	<u>30,675,206</u>

On behalf of the Board of Directors

(s) Jean Martineau
Jean Martineau

(s) Gilles Masson
Gilles Masson

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

Malaga Inc.

Consolidated Statements of Comprehensive Income (Loss)

(Unaudited; Expressed in US dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Sales (Note 17)	5,329,425	3,462,901	10,585,955	7,056,913
Cost of sales (Note 17)	(3,191,546)	(3,049,241)	(6,725,979)	(6,481,450)
Income from mining operations	2,137,879	413,660	3,859,976	575,463
General and administrative expenses (Note 17)	(1,276,136)	(791,781)	(2,144,536)	(1,585,974)
Operating income (loss)	861,743	(378,121)	1,715,440	(1,010,511)
Financial expenses	(141,594)	(472,430)	(289,287)	(684,096)
Foreign exchange gain (loss)	12,255	(123,647)	(256,227)	76,802
Share of earnings in investment using equity method	52,696	78,189	6,354	98,551
Gain on sale of available-for-sale investment	82,379	-	98,247	-
Change in fair value of the promissory note receivable	-	1,153,998	-	803,898
Gain on revaluation of warrants (Note 15)	1,123,179	-	1,168,047	-
Income (loss) before income taxes	1,990,658	257,989	2,442,574	(715,356)
Future income tax expense	(361,450)	-	-	-
Net income (loss)	1,629,208	257,989	2,442,574	(715,356)
Other comprehensive income, net of income taxes:				
Net variation in the latent gain (loss) on available-for-sale investments	(2,879,249)	-	(831,030)	-
Comprehensive Income (loss) for the period	(1,250,041)	257,989	1,611,544	(715,356)
Earnings (loss) per share (Note 18)				
Basic	\$0.01	\$0.00	\$0.01	(\$0.01)
Diluted	\$0.01	\$0.00	\$0.01	(\$0.01)
Weighted average number of outstanding common shares				
Basic	183,582,044	160,109,737	183,566,198	153,932,607
Diluted	237,058,672	160,109,737	236,690,935	153,932,607

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

The consolidated statements of comprehensive income (loss) above is disclosed by function.

Malaga Inc.

Consolidated Statements of Changes in Equity

(Unaudited; Expressed in US dollars)

	Share Capital	Warrants	Contributed surplus	Accumulated other comprehensive income	Deficit	Total equity
	\$	\$	\$	\$	\$	\$
Balance, January 1, 2011	39,200,848	30,381	3,466,211	-	(25,375,340)	17,322,100
Net income for the period					2,442,574	2,442,574
Changes in fair value of available-for-sale assets (net of tax)				(831,030)		(831,030)
Comprehensive Income for the period				(831,030)	2,442,574	1,611,544
Stock-based compensation (Note 16)			332,442			332,442
Exercise of options (Note 16)	37,948		(16,984)			20,964
Balance – June 30, 2011	39,238,796	30,381	3,781,669	(831,030)	(22,932,766)	19,287,050
	Share Capital	Warrants	Contributed surplus	Accumulated other comprehensive income	Deficit	Total equity
	\$	\$	\$	\$	\$	\$
Balance, January 1, 2010	35,165,941	-	3,177,756	-	(26,611,322)	11,732,375
Net loss and comprehensive loss for the period					(715,356)	(715,356)
Common shares issued	4,479,372					4,479,372
Share issuance expenses (Note 16)	(434,448)					(434,448)
Issuance of broker warrants (Note 16)		30,381				30,381
Stock-based compensation (Note 16)			284,759			284,759
Balance – June 30, 2010	39,210,865	30,381	3,462,515	-	(27,326,678)	15,377,083

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

Malaga inc.

Consolidated Statements of Cash Flows

(Unaudited; Expressed in US dollars)

	Three month periods ended June 30,		Six-month period ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Operating activities				
Net income (loss)	1,629,208	257,989	2,442,574	(715,356)
Items not affecting cash				
Depreciation and depletion	560,247	704,702	1,274,544	1,491,114
Amortization of deferred revenues	(74,373)	(74,373)	(148,746)	(148,746)
Accretion expense of asset retirement obligation	4,909	4,583	9,561	9,168
Accretion expense of long-term debt	135,280	156,558	276,446	308,470
Stock-based compensation	307,400	93,781	332,442	284,759
Future income tax expense	361,450	-	-	-
Gain on settlement of debt	(55,046)	(59,303)	(111,187)	(59,303)
Share of earnings in investments using equity method	(52,696)	(78,189)	(6,354)	(98,551)
Interest to former workers and employees	-	288,573	-	288,573
Gain on sale of available-for-sale investment	(82,379)	-	(98,247)	-
Gain on revaluation of warrants	(1,123,179)	-	(1,168,047)	-
Loss on variation of the fair market value of the promissory note	-	(1,153,998)	-	(803,898)
Unrealized foreign exchange loss	18,132	80,877	179,029	120,255
	1,628,953	221,200	2,982,015	676,485
Change in non-cash working capital items (Note 19)	395,747	(1,747,633)	(297,643)	(2,311,859)
	2,024,700	(1,526,433)	2,684,372	(1,635,374)
Investing activities				
Net proceeds from sale of investment	671,471	-	723,544	-
Investment in Hidroeléctrica Pelagatos S.A.C.	-	(200,000)	-	(200,000)
Acquisition of property, plant and equipment	(2,103,197)	(793,178)	(3,554,263)	(1,151,678)
Additions to mining properties and deferred development and exploration costs	(682,745)	(147,756)	(854,389)	(318,740)
	(2,114,471)	(1,140,934)	(3,685,108)	(1,670,418)
Financing activities				
Repayment of long-term debt	(305,321)	(310,287)	(563,168)	(310,287)
Proceeds of issuance of common shares	20,964	4,479,372	20,964	4,479,372
Share capital issuance cost	-	(434,448)	-	(434,448)
Proceeds of issuance of ordinary warrants	-	30,381	-	30,381
Proceeds of issuance of broker warrants	-	689,150	-	689,150
Re-payment of obligations under finance leases	(61,563)	(60,398)	(98,691)	(129,489)
	(345,920)	4,393,770	(640,895)	4,324,679
Variation in cash during the period	(435,691)	1,726,403	(1,641,631)	1,018,887
Cash, beginning of the period	1,634,655	385,825	2,840,595	1,093,341
Cash, end of the period	1,198,964	2,112,228	1,198,964	2,112,228
Additional information:				
Interest paid	56,451	370,591	58,016	425,760
Income taxes paid	-	-	-	4,916

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

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars **except where otherwise indicated**)

1. Statute of Incorporation and Nature of Activities

Malaga Inc. ("Malaga" or the "Company"), is incorporated under Part 1A of the Companies Act (Quebec) and as of February 14, 2011 is governed under the Business Corporations Act (Québec). Malaga, including its subsidiaries, is a mining company that operates mainly in Peru at its tungsten mine in Pasto Bueno.

The Company and its subsidiaries also have interests in mining properties currently at the exploration or development stage. Certain of these properties are in the process of evaluation to determine the economics of putting them into production. The potential for recovery of the costs incurred on these properties and of the related deferred charges depends on the existence of sufficient quantities of reserves, obtaining all the required permits, the Company's ability to obtain appropriate financing to put these properties into production, and the ability to realize a profitable return.

2. Basis of preparation and first time adoption of IFRS

These condensed interim consolidated financial statements have been prepared by the Company's management in accordance with *International Financial Reporting Standards* ("IFRS"), and in accordance with International Accounting Standards "IAS" 34 "Interim Financial Reporting". They do not include all the information required in annual financial statements in accordance with IFRS. As these financial statements represent the Company's initial presentation of its results and financial position under IFRS, they have been prepared in accordance with IFRS 1, "First-time Adoption of International Financial Reporting Standards".

These condensed interim consolidated financial statements have been prepared in accordance with the accounting policies the Company expects to adopt in its December 31, 2011 financial statements. Those accounting policies are based on the published IFRS standards applicable at that time. The policies described in Note 3 were consistently applied to all the periods presented.. The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as at August 10, 2011, the date the Board of Directors approved these condensed interim consolidated financial statements for release. Any subsequent changes to IFRS that are issued and effective as at December 31, 2011 could result in a restatement of these condensed interim consolidated financial statements, including the transition adjustments recognized on conversion to IFRS.

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has reported on this basis in these interim condensed consolidated financial statements. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS. Subject to certain transition elections, which are disclosed in note 6, the Company has consistently applied the same accounting policies in its opening IFRS consolidated balance sheet as at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 6 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's last annual financial statements.

These condensed interim consolidated financial statements should be read in conjunction with the Company's 2010 annual financial statements, which were prepared in accordance with Canadian GAAP, as well as the Company's interim condensed consolidated financial statements for the quarter ended March 31, 2011 prepared in accordance with IFRS applicable to interim financial statements.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the company's accounting policies. Please refer to Note 3 for details.

3. Significant accounting policies

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value, including, investments, derivative instruments and available for sale financial assets.

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars **except where otherwise indicated**)

3. Significant accounting policies (cont'd)

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Dynacor Exploraciones del Perú SAC, Minera Pasto Bueno SAC, and Minera Malaga Santolalla SAC. Subsidiaries are those entities over which the company has the power to govern the financial and operating policies. All intercompany balances and transactions are eliminated on consolidation.

Investments in Associates

The investment in Hidroeléctrica Pelagatos S.A.C. (49%) for which the Company exercises significant influence, is accounted for using the equity method.

The investment in Dynacor Gold Mines Inc. over which significant influence was exercised, was accounted for using the equity method until December 17, 2010, after which it is accounted for as an available for sale investment.

According to the equity method, the investments are recorded at cost and the Company's share of profits or losses of associate is recognized in the statement of profit and loss and its share of other comprehensive income (loss) of associate is included in other comprehensive income (loss). Dilution gains and losses arising from changes in interests in investments in associates are recognized in the statement of operations.

The Company assesses at each financial statement reporting date whether there is any objective evidence that its interests in associates are impaired. If impaired, the carrying value of the Company's share of the underlying assets of associates is written down to its estimated recoverable amount and charged to the profit and loss statement.

In accordance with IAS 36, impairment losses on financial assets carried at amortized cost are reversed in subsequent years if the recoverable amount of the investment subsequently increases and the increase can be related objectively to an event occurring after the impairment was recognized.

Revenue recognition

The Company recognized revenue when the amount of revenue can be measured reliably; it is probable that future economic benefits will flow to the Company; the Company has transferred to the buyer the significant risks and rewards of ownership of the goods; retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Additional revenues from the sale of by-products, such as copper, are recorded in sales.

Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in United States dollars, which is the Company's and its principal subsidiaries' functional currency.

The financial statements of entities that have a functional currency different from that of Malaga Inc. ("foreign operations") are translated into United States dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – at the monthly average exchange rate. All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in profit or loss. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary are reallocated between controlling and non-controlling interests.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. At each consolidated statement of financial position date, monetary assets and liabilities are translated using the period end foreign exchange rate. Non-monetary assets and liabilities are translated using the historical rate on the date of the transaction. All gains and losses on translation of these foreign currency transactions are included in the consolidated statement of comprehensive income (loss) within foreign exchange gain or loss.

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars **except where otherwise indicated**)

3. Significant accounting policies (cont'd)

Cash and cash equivalents

Cash and cash equivalents are classified as loans and receivable and are carried at amortized cost. Cash and cash equivalents include cash, bank overdraft and short-term investments with original maturities at the date of purchase of 90 days or less.

Inventories

Finished goods, concentrate in process at the plant, and stockpiled ore are valued at the lower of average production cost and estimated net realizable value. Supplies are valued at the lower of average cost and replacement cost. Net realizable value is the estimated selling price less applicable selling expenses.

Borrowing costs

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as finance cost in the consolidated statement of comprehensive income (loss) in the year in which they are incurred.

Property, plant and equipment other than mining related assets

Property, plant and equipment including the assets under a finance lease are accounted for at cost less accumulated depreciation and impairment losses. Cost includes expenditures that are directly attributable to the acquisition, the development and construction of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the consolidated statement of comprehensive income (loss) during the year in which they are incurred.

Depreciation is based on the estimated useful life using the straight line method at the following annual rates:

	Years
Building	20-30
Vehicles	7
Plant and mining equipment	10
Office equipment	5

Depletion of the Mining properties and deferred exploration and development costs is based on the units of production method.

The Company allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. Residual values, method of amortization and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposals of property, plant and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of other losses (gains) – net in the consolidated statement of comprehensive income (loss).

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars **except where otherwise indicated**)

3. Significant accounting policies (cont'd)

Exploration and evaluation costs

Exploration and evaluation activity involves the search for mineral, the determination of technical feasibility and the assessment of commercial viability of an identified resource.

Exploration and evaluation activity includes:

- acquisition of rights to explore;
- researching and analyzing historical exploration data;
- gathering exploration data through topographical, geochemical and geophysical studies;
- exploratory drilling, trenching and sampling;
- determining and examining the volume and grade of the resource;
- surveying transportation and infrastructure requirements; and
- activities involved in evaluating the technical feasibility and commercial viability of extracting mineral resources. This includes the costs incurred in determining the most appropriate mining and processing methods.

All exploration and evaluation costs are capitalized as intangible assets in Mining properties and deferred development and exploration costs. As the assets are not available for use, they are not depreciated. All capitalized exploration and evaluation costs are recorded at acquisition cost and are monitored for indications of impairment. Where a potential impairment is indicated an assessment is performed for each area of interest in conjunction with the group of operating assets (representing a cash generating unit) to which the exploration is attributed. Exploration areas at which mineral resource have been discovered but that require major capital expenditure before production can begin are continually evaluated to ensure that commercial quantities of mineral resource exist or to ensure that additional exploration work is under way or planned. To the extent that capitalized expenditures are not expected to be recovered it is charged to the statement of operation.

Mining properties and deferred exploration and development costs

All costs related to the development of non-producing mining zones are capitalized by zone until the beginning of commercial production. When commercially profitable ore reserves are developed, the related capitalized costs in 'Mining properties and deferred development and exploration costs' are reclassified into property, plant and equipment and amortized using the units of production method.

The development costs are amortized using the units of production method based on the proven and probable reserves and the non-reserve material when sufficient objective evidence exists to support the conclusion that it is probable that the non-reserve material will be produced. Exploration costs incurred on a property in production are capitalized in property, plant and equipment.

The recoverability of amounts recorded for non-producing mining properties and deferred development costs is dependent upon the discovery of economically recoverable mineral reserves, the confirmation of the Company's interest in the mining properties, the ability of the Company to obtain the necessary financing to complete the development, and future profitable production or proceeds from the disposition thereof.

The amortization of property, plant and equipment during the exploration and development period up to the production period is capitalized in deferred exploration expenses.

The net proceeds from the sale of ore extracted from mining properties, obtained during the exploration and development period and prior to achieving commercial production levels, are recorded as a reduction to the related deferred exploration expenses.

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars **except where otherwise indicated**)

3. Significant accounting policies (cont'd)

Impairment of non-financial assets

Assets that are subject to depreciation are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount and is recorded in the profit and loss statement. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or cash-generating unit). These are typically the individual mining projects. If the Company does not have sufficient information on its Mining properties and deferred development and exploration costs to estimate the estimated cash flows to review the recoverability of capitalized costs, the Company determines impairment by comparing the fair value to book value, without first making a recoverability test. Costs not related to specific properties are accounted for in the consolidated statement of comprehensive income (loss).

Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date when events or circumstances warrant such consideration.

Leases

Assets held under leases which result in the Company receiving substantially all the risks and rewards of ownership of the asset (finance leases) are capitalized at the lower of the fair value of the property, plant and equipment or the estimated present value of the minimum lease payments. The corresponding finance lease obligation is included within interest bearing liabilities. The interest element is allocated to accounting years during the lease term to reflect a constant rate of interest on the remaining balance of the obligation.

Operating lease assets are not capitalized and rental payments are included in the consolidated statement of comprehensive income (loss) on a straight-line basis over the lease term. Provision is made for the present value of future operating lease payments in relation to surplus lease space when it is first determined that the space will be of no probable future benefit. Operating lease incentives are recognized as a liability when received and subsequently reduced by allocating lease payments between rental expense and reduction of the liability.

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument.

Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or when it expires.

Financial assets and liabilities are measured initially at fair value plus transaction costs, except for financial assets and financial liabilities carried at fair value through net earnings, which are measured initially at fair value. Financial assets and financial liabilities are measured subsequently as described below.

The Company uses different financial instruments. The Company classifies its financial instruments on initial recognition into one of the following categories based on the purpose for which the instrument was acquired. The Company's accounting policy for each category is as follows:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The company's loans and receivables are comprised of trade and other receivables, and cash and cash equivalents are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars **except where otherwise indicated**)

3. Significant accounting policies (cont'd)

Financial instruments (cont'd)

Financial assets and liabilities at fair value through statement of profit and loss

Financial instruments at fair value through statement of profit and loss include financial assets and liabilities that are either classified as held-for-trading or that meet certain conditions and are designated at fair value through the statement of profit and loss upon initial recognition. A financial asset or liability is classified as held for trading if acquired principally for the purpose of selling or repurchasing in the short-term or are derivatives.

Currently, the Company has issued warrants which are classified into this category. The Company has designated the note receivable from Dynacor (Note 7) as at fair value through profit and loss.

These instruments are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of comprehensive income (loss). Gains and losses arising from changes in fair value are presented in the consolidated statement of comprehensive income (loss) within "Gain/loss on revaluation of financial instruments" in the year in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be settled beyond twelve months of the balance sheet date, which is classified as non-current.

Available-for-sale investments

Available-for-sale financial assets are non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets. The Company's available-for-sale financial assets comprise the investment which is an investment of shares in a publicly-traded company.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains and losses arising from changes in fair value are recognized in other comprehensive income, except for impairment losses, which are recognized in the statement of profit and loss. When an available-for-sale investment is disposed of or is determined to be impaired, the cumulative gain or loss recognized in other comprehensive income is moved to the statement of profit and loss and presented in other gains and losses.

Financial liabilities at amortized cost

Financial liabilities at amortized cost include all financial liabilities other than those classified as held-for-trading and comprise, accounts payable and long-term debt. Payables and accrued liabilities are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables and accrued liabilities are measured at amortized cost using the effective interest method. Long-term debt are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

Impairment of financial assets

At each reporting date, the company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the company recognizes an impairment loss, as follows:

- (i) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.
- (ii) Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the consolidated statement of comprehensive income. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to net income.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Impairment losses on available-for-sale equity instruments are not reversed.

Malaga Inc.

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(Unaudited; Expressed in US dollars **except where otherwise indicated**)

3. Significant accounting policies (cont'd)

Stock-based Compensation Plan

The Company has a stock-based compensation plan under which equity-settled share-based payments are made in exchange for services received. The Company accounts for all stock-based compensation using the fair value method. Each tranche in an award is considered a separate award with its own vesting year and grant date fair value. This method consists of recording expenses at the grant date to the statement of comprehensive income based on the number of options expected to vest and the counterpart is accounted for in contributed surplus on the statement of financial position. Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately the consolidated statement of comprehensive income, with a corresponding adjustment to contributed surplus. The fair value is calculated based on the Black-Scholes valuation model at the grant date and recognized over the period during which the options vest. The volatility measured at the standard deviation of continuously compounded share returns is based on statistical analysis of daily share prices over a period of time consistent with the expected life of the option. When stock options are exercised, any consideration paid is credited to share capital, together with the related portion previously recorded to contributed surplus.

Provisions

Provisions are recognized when present obligations as a result of a past event will probably lead to an outflow of economic resources from the Company and amounts can be estimated reliably. Timing or amount of the outflow may still be uncertain. A present obligation arises from the presence of a legal or constructive commitment that has resulted from past events, for example, legal disputes, property, plant and equipment retirement obligations, and similar liabilities, or onerous contracts.

Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Provisions are discounted when the time value of money is significant.

All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

The Company is subject to environmental laws and regulations enacted by federal and provincial authorities. To take account of estimated cash flows required to settle the obligations arising from environmentally acceptable closure plans (such as dismantling and demolition of infrastructures, removal of residual matter and site restoration), provisions are recognized in the year that the harm to the environment occurs, that is when the Company has a legal or constructive obligation resulting from harm to the environment, it is likely that an outflow will be required in settlement of the obligation and the obligation is reasonably determinable. These provisions are determined on the basis of the best estimates of future costs, based on information available on the reporting date. Best estimates of future costs are the amount the Company would reasonably pay to settle its obligation on the closing date to transfer it to a third party on the same date. Future costs are discounted using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the liability. A corresponding asset is recognized in property, plant and equipment when establishing the provision.

The provision is reviewed at each reporting date to reflect changes in the estimated outflow of resources as a result of changes in obligations or legislation, changes in the current market-based discount rate or an increase that reflects the passage of time. The accretion expense is recognized in net earnings as a finance expense as incurred. The cost of the related asset is adjusted to reflect changes in the reporting period.

Costs of asset retirement are deducted from the provision when incurred.

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3. Significant accounting policies (cont'd)

Income Taxes

The income tax expense for the year comprises current and deferred tax. Income tax is recognized in the consolidated statement of comprehensive income (loss), except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case the tax is also recognized in other comprehensive income or directly in equity, respectively.

Current income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the consolidated statement of financial position date in the countries where the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Income tax expense in condensed interim periods is recognized based on the best estimate of the weighted average annual effective income tax rate expected for the full financial year.

Deferred income tax

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted on the consolidated statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Share Capital

Common shares, options and warrants granted as compensation for goods and services are classified as equity. Incremental costs directly attributable to the issue of new shares or warrants are shown in equity as a deduction, net of tax, from the proceeds.

Earnings per Share

Basic earnings (loss) per share is calculated by dividing the net income (loss) for the year attributable to owners of the company by the weighted average number of common shares outstanding during the period.

Diluted earnings (loss) per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method. The Company's potentially dilutive common shares comprise stock options, warrants and conversion option. In the case of a loss, the diluted earnings per share is equal to the basic earnings per share due to the anti-dilutive effect of the stock options and the warrants.

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4. Accounting standards issued but not yet applied

The IASB issued the following standards which are relevant but have not yet been adopted by the Company: IFRS 9, *Financial instruments*, IFRS 10, *Consolidated Financial Statement*, IFRS 12, *Disclosure of Interests in Other Entities*, IFRS 13, *Fair Value Measurement* and amended IAS 27, *Separate Financial Statements*. Each of the new standards and the amendments to IAS 27 and 28 are effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The amendment to IAS 1, *Presentation of Financial Statements* is however, to be applied to accounting periods beginning on or after July 1, 2012. The Company has not yet begun the process of assessing the impact that the new and amended standards/amendments will have on its financial statements or whether to early adopt any of the new requirements.

The following is a brief summary of the new standards:

IFRS 9 - Financial instruments - classification and measurement

IFRS 9, *Financial Instruments*, was issued in November 2009. It addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39, *Financial Instruments – Recognition and Measurement*, for debt instruments with a new mixed measurement model with only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

IFRS 9 required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted.

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation—Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 - Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

Amendments to Other Standards

An amendment to IAS 1, *Presentation of Financial Statements* was issued in June 2011 and will require companies to group together items within OCI that may be reclassified to profit and loss.

In addition, there have been amendments to existing standards, including IAS 27, *Separate Financial Statements* (IAS 27), and IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

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5. Critical accounting estimates and judgments

The preparation of consolidated financial statements requires the Company's management to make estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and revenues and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The estimates and assumptions that have a significant risk of causing material adjustments to the Company's financial statements are addressed below.

Mineral reserves and resources

Mineral reserves and resources are estimates of the quantity of ore that could be economically and legally extracted from a mine. The Company estimates its reserves using information compiled by qualified persons in accordance with the definitions and guidelines adopted by the Canadian Institutes of Mining, Metallurgy and Petroleum. This information relates to geological data on the size, depth and shape of the deposit and requires geological assessments to interpret the data. The assessment of recoverable reserves is based on factors such as the estimated exchange rate, price of metals, capital investments required and production costs stemming from geological assumptions based on the size and grade of the deposit.

Our reserve estimates may have a significant impact on the information contained in our consolidated financial statements. A number of accounting estimates, as described below, are formulated from the reserve estimate.

Impairment of non-financial assets

The Company's fair value measurement with respect to the carrying amount of non-financial assets are based on numerous assumptions and may differ significantly from actual fair values.

The fair values are based, in part, on certain factors that may be partially or totally outside of the company's control. This evaluation involves a comparison of the estimated fair values of non-financial assets to their carrying values. The Company's fair value estimates are based on numerous assumptions such as but not limited to estimated realized tungsten prices, operating costs, ore recovery, mineral reserves, capital and site restoration expenditures and estimated future foreign exchange rates, and may differ from actual fair values and these differences may be significant and could have a material impact on the Company's financial position and result of operations. Mineral reserve estimates are the most important variable in the Company's fair value estimates. A decrease in our reserves may result in an impairment charge, which could reduce the Company's earnings.

Management's estimate of future cash flows is subject to risk and uncertainties. Therefore, it is reasonably possible that changes could occur with evolving economic conditions, which may affect recoverability of the company's non-financial assets.

Assets are reviewed for an indication of impairment at each consolidated balance sheet or consolidated statement of financial position date. This determination requires significant judgment. Factors which could trigger an impairment review include, but are not limited to, significant negative industry or economic trends, and current, historical or projected losses that demonstrate continuing losses.

Depreciation of property, plant and equipment

A large portion of our property, plant and equipment is depreciated using the units of production method over the expected operating life of the mine based on estimated recoverable reserves and resources, which are the prime determinants of the life of a mine. Estimated recoverable reserves include proven and probable reserves and non-reserved material when sufficient objective evidence exists that it is probable the non-reserve material will be produced. Changes in mineral reserve estimates will result in changes to the depreciation charges over the remaining life of the operation. A decrease in our mineral reserves would increase depreciation expense, and this could have a material impact on our operating results.

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5. Critical accounting estimates and judgments (cont'd)

Asset retirement obligations

Asset retirement obligations arise from the development, construction and normal operation of mining property, plant and equipment as mining activities are subject to various laws and regulations governing the protection of the environment. In general, these laws and regulations are continually changing, and we have made, and intend to make in the future, expenditures to comply with such laws and regulations.

We record the estimated present value of reclamation liabilities in the year in which they are incurred. A corresponding increase to the carrying amount of the related asset is recorded and depreciated over the life of the asset. The liability will be increased each year to reflect the interest element and will also be adjusted for changes in the discount rates and in the estimate of the amount, timing and cost of the work to be carried out.

Future remediation costs are accrued based on management's best estimate at the end of each year of the undiscounted cash costs expected to be incurred at each site. Changes in estimates are reflected in earnings in the year during which an estimate is revised. Accounting for reclamation and remediation obligations requires management to make estimates of the future costs they will incur to complete the reclamation and remediation work required to comply with existing laws and regulations. The estimates are dependent on labor costs, known environmental impacts, the effectiveness of remedial and restoration measures, inflation rates and pre-tax interest rates that reflect current market assessment of time value for money and the risk specific to the obligation. The company also estimates the timing of the outlays, which is subject to change depending on continued exploitation and newly discovered mineral reserves.

Actual costs incurred may differ from those estimated amounts. Also, future changes to environmental laws and regulations could increase the extent of reclamation and remediation work required to be performed by the company. Increases in future costs could materially impact the amounts charged to the profit and loss statement for reclamation and remediation.

Share-based remuneration expense

The estimation of share-based payment costs requires the selection of an appropriate valuation model and consideration as to the inputs necessary for the valuation model chosen. The Company has made estimates as to the volatility of its own shares, the expected life of options, the time of exercise of those options and expected extinguishments. The model used by the Company is the Black-Scholes model.

Provisions and contingent liabilities

Judgments are made as to whether a past event has led to a liability that should be recognized in the consolidated financial statements or disclosed as a contingent liability. These judgments are based on a number of factors including the nature of the claims or dispute, the legal process and potential amount payable, legal advice received past experience and the probability of a loss being realized. Several of these factors are sources of estimation uncertainty.

Income taxes

The company is subject to income taxes in numerous jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes. There are transactions and calculations for which the ultimate tax determination is uncertain. The company recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the year in which such determination is made.

Periodically, judgment is required in determining whether deferred tax assets are recognized on the consolidated statement of financial position. Deferred tax assets, including those arising from unused tax losses, require management to assess the probability that the Company will generate taxable profits in future periods, in order to utilize deferred tax assets. Once the evaluation is completed, if we believe that it is probable that some portion our deferred tax assets will fail to be realized, deferred tax asset is derecognized. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted.

Additionally, future changes in tax laws in the jurisdictions in which the Company operates could limit its ability to obtain tax deductions in future periods.

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6. Transition to IFRS

The Company's consolidated financial statements for the year ending December 31, 2011 will be the first consolidated annual financial statements that comply with IFRS. These condensed interim consolidated financial statements were prepared as described in note 1, including the application of IFRS 1. The effect of the transition to IFRS on consolidated equity, consolidated comprehensive income and the consolidated cash flows is presented and described in this note, and is explained in greater detail in the notes associated with the tables.

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which the Company has applied IFRS was January 1, 2010 (the "transition date"). IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company will be December 31, 2011. However, it also provides for certain optional exemptions and certain mandatory exceptions for first-time IFRS adopters.

Exceptions and exemptions from full retrospective application elected by the Company

In preparing these consolidated financial statements in accordance with IFRS 1, the Company has applied mandatory transition exceptions and the following exemptions from full retrospective application of IFRS:

- Fair value as deemed cost : The Company elected to apply the exemption to measure an item of property, plant and equipment at its fair value and use that fair value as its deemed cost going forward as allowed under IFRS 1. As such, the Company re-measured its property, plant and equipment other than mining properties and deferred development cost and exploration and evaluation cost at January 1st, 2010 (Note 6c).
- *IFRS 3 Business combination* election: This election allows the Company to adopt IFRS 3(R) prospectively from the date of transition. In accordance with IFRS 1, the Company elected not to apply IFRS 3, Business Combinations, (as revised in 2008) to business combinations occurring before January 1, 2010. As such, Canadian GAAP balances relating to business combinations entered into before that date have been carried forward without adjustment.
- Leases election: In accordance with IFRS 1, the Company has elected to apply the transitional provisions in IFRIC 4, Determining whether an arrangement contains a lease, at the date of transition to all arrangements other than those entered into or modified since January 1, 2005, as such arrangements have already been assessed under requirements similar to those of IFRIC 4. No impact resulted from the review of arrangements.
- The Company has elected to apply the exemption from full retrospective application of decommissioning provisions as allowed under IFRS 1. As such, the Company has re-measured the provisions as at January 1, 2010 under IAS 37 Provisions, Contingent Liabilities and Contingent Assets, and estimated the amount to be included in the cost of the related asset by discounting the liability to the date at which the liability first arose. The Company did this using best estimate of the historical risk-adjusted discount rates, and recalculated the accumulated depreciation, depletion and depreciation under IFRS up to the transition date. No transition adjustment was recorded.
- The Company elected under IFRS 1 to apply IFRS 2, Share-based payments, to all equity instruments granted since January 1st, 2003.
- The Company elected to apply IAS 23 Borrowing costs prospectively from the date of transition, therefore the accounting of borrowing costs prior to the transition date was not reassessed in the opening IFRS consolidated statement of financial position.
- Reclassification of financial instruments: the Company elected to apply the exemption allowing a change in classification of financial assets/liabilities on first time adoption as allowed under IFRS 1. As such, cash and cash equivalents have been designated as loan and receivable instead as being held-for-trading and the note receivable from Dynacor has been classified as at fair value through profit and loss in accordance with IAS 39. At the date of transition the carrying value under CGAAP approximates the fair value (Note 6d).
- The Company elected under IFRS 1 to reset the cumulative translation gains and losses to zero at the transition date.
- Estimates: Hindsight is not used to create or revise estimates. The estimates previously made by the management of the Company under Canadian GAAP were not revised for application of IFRS except where necessary to reflect any difference in accounting policies.

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(Unaudited; Expressed in US dollars **except where otherwise indicated**)

6. Transition to IFRS

Reconciliation of IFRS and Canadian GAAP

IFRS employs a conceptual framework that is similar to Canadian GAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. While adoption of IFRS has not changed the Company's actual cash flows, it has resulted in changes to the Company's reported financial position and income statement. In order to allow the users of the condensed interim consolidated financial statements to better understand these changes, the Company's Canadian GAAP consolidated statements of operations and comprehensive loss for the three and six-month periods ended June 30, 2010 as well as the statements of financial position as at June 30, 2010 have been reconciled to IFRS, with the resulting differences explained.

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6. Transition to IFRS (cont'd)

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

	Note	CDN GAAP (CA\$)	CDN GAAP (US\$) (a)	Functional Currency Adjustment (b)	IFRS Adjustments	IFRS (US\$)
Assets						
Current assets						
Cash		2,248,678	2,112,228	-	-	2,112,228
Trade and other receivables		3,018,752	2,835,574	-	-	2,835,574
Income tax installments receivable		762,706	716,425	-	-	716,425
Inventories		1,871,773	1,758,194	42,280	-	1,800,474
Prepaid expenses		587,411	551,767	-	-	551,767
		8,489,320	7,974,188	42,280	-	8,016,468
Non-current assets						
Investment in associates	(d2)	2,770,708	2,602,581	37,574	(1,435,272)	1,204,883
Other long-term investments	(d1)	-	-	-	2,247,260	2,247,260
Property, plant and equipment	(c)	10,089,089	9,476,882	(96,354)	2,870,313	12,250,841
Mining properties and deferred development and exploration costs		4,465,774	4,194,791	(89,250)	-	4,105,541
		17,325,571	16,274,254	(148,030)	3,682,301	19,808,525
Total assets		25,814,891	24,248,442	(105,750)	3,682,301	27,824,993
Liabilities						
Current liabilities						
Accounts payable and accrued liabilities		4,617,657	4,337,457	-	-	4,337,457
Income tax payable		125,699	118,072	-	-	118,072
Unearned revenues		231,569	217,517	-	-	217,517
Current portion of long-term debt	(f1)	1,388,939	1,304,658	-	-	1,304,658
Current portion of finance lease liabilities		188,482	177,045	-	-	177,045
		6,552,346	6,154,749	-	-	6,154,749
Non-current liabilities						
Long-term debt	(f1)	3,307,406	3,106,712	-	695,808	3,802,520
Finance lease liabilities		150,530	141,396	-	-	141,396
Warrants liability	(e)	-	-	-	673,743	673,743
Deferred revenues	(f2)	1,543,533	1,449,871	-	(334,293)	1,115,578
Asset retirement obligation		589,867	554,074	7,338	(1,488)	559,924
		5,591,336	5,252,053	7,338	1,033,770	6,293,161
Shareholders' equity						
Share capital		43,748,732	39,210,865	-	-	39,210,865
Warrants	(e)	748,888	719,531	-	(689,150)	30,381
Contributed surplus		3,834,777	3,462,515	-	-	3,462,515
Conversion option	(f3)	319,903	270,050	-	(270,050)	-
Cumulative Translation Adjustment		-	665,620	(113,088)	(552,532)	-
Deficit	(g)	(34,981,091)	(31,486,941)	-	4,160,263	(27,326,678)
Total equity		13,671,209	12,841,640	(113,088)	2,648,531	15,377,083
Total liabilities and equity		25,814,891	24,248,442	(105,750)	3,682,301	27,824,993

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6. Transition to IFRS (cont'd)

Explanatory notes of material adjustments arising from the adoption of IFRS and significant differences in accounting policy between Canadian GAAP and IFRS applicable to the Company:

a) Presentation currency

In conjunction to the transition to IFRS, the Company elected to change its presentation currency from Canadian to United States dollar in order that the financial statements more accurately reflect the Company's true operating results and financial position since a majority of the Company's business is conducted in US dollar. Accordingly, the Canadian GAAP financial information previously expressed in Canadian dollars has been presented in U.S. dollars for all periods shown, using the exchange rate applicable at the balance sheet date for assets and liabilities, and the average exchange rate of the corresponding periods for the consolidated statements of income and consolidated statements of cash flows items. Equity transactions have been translated at historical rates for the last three fiscal years with opening equity on April 1, 2007, translated at the exchange rate on that date. The net adjustment arising from the effect of the translation was included in the cumulative translation adjustment account in shareholders' equity.

b) Functional currency

Under IFRS, the framework used to determine the functional currency is similar to that used to determine the currency of measurement under Canadian GAAP; however, under IAS 21, *The Effects of Changes in Foreign Exchange Rates*, the indicators for determining the functional currency are broken down into primary and secondary indicators when determining the functional currency. Primary indicators are closely linked to the primary economic environment in which the entity operates and are given more weight. Secondary indicators provide supporting evidence to determine an entity's functional currency. Primary indicators receive more weight under IFRS than Canadian GAAP. As a result of this difference, management has concluded that the most appropriate functional currency of the parent company and substantially all of its subsidiaries and associates is the US dollar. Historically, the currency of measurement of the company was the Canadian dollar and all subsidiaries and the most significant associates were considered integrated and accordingly, their currency of measurement was the Canadian dollar.

Accordingly, all non-monetary assets and liabilities have been converted at their respective historical dates. In addition, in accordance with IFRS 1, the company has elected to reset the cumulative translation adjustment account, which includes gains and losses arising from the translation of foreign operations and the effects of the different functional currency described above, to zero at the date of transition to IFRS.

c) Property, plant and equipment

	As at June 30, 2010
Canadian GAAP CA\$	10,089,089
Effect of change in Presentation Currency	(612,207)
Canadian GAAP US\$	9,476,882
Impact of Measuring opening balance at Fair Value	2,483,882
Cumulative Effect of Depreciation and Depletion	386,431
Effect of Change in Functional Currency	(96,354)
IFRS US\$	12,250,841

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6. Transition to IFRS (cont'd)

c) Property, plant and equipment (cont'd)

The Company elected to apply the exemption to measure an item of property, plant and equipment at its fair value and use that fair value as its deemed cost going forward as allowed under IFRS 1. As such, the Company re-measured its property, plant and equipment other than mining properties and deferred development cost and exploration and evaluation cost. In conjunction with the re-measurement of the property, plant and equipment at fair value, the component parts of these assets have also been reassessed, having a direct impact on the depreciation expense.

The adjustment at the transition date, amounts to \$2,483,882, has been recognized in property, plant and equipment with the corresponding adjustment in opening deficit. The aggregate fair value of those re-valued items amounts to \$7,737,920 as at January 1st 2010.

d) Investments

1) Promissory note

	As at June 30, 2010
Canadian GAAP CA\$	1,519,518
Effect of Change in Presentation Currency	(92,204)
Canadian GAAP US\$	1,427,314
Impact of Measuring at Fair Value	803,898
Effect of Change in Functional Currency	16,048
IFRS US\$	2,247,260

Under IFRS, the promissory note is a financial instrument designated at fair value through profit and loss financial asset, which must be measured at fair value due to the significant embedded derivative under the form of a written put option. The fair value of the promissory note is based on the fair value of the underlying common shares of Dynacor. Accordingly, this promissory note is classified as a level 2 financial instrument according to the fair value hierarchy as it is based on observable market data. The promissory note was classified as an investment in associate under CGAAP and as an investment under IFRS.

2) Shares in Dynacor

	As at June 30, 2010¹
Canadian GAAP CA\$	1,045,424
Effect of Change in Presentation Currency	(63,436)
Canadian GAAP US\$	981,988
Cumulative Effect of Share in Earnings	8,089
Effect of Change in Functional Currency	14,806
IFRS US\$	1,004,883

¹ Investment in associate

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6. Transition to IFRS (cont'd)

d) Investments (cont'd)

Under IFRS, when an investor loses significant influence over an associate, the retained investment shall be measured at its fair value. Any difference between the fair value of the retained investment and the carrying amount of the investment at the date when significant influence is lost shall be recognized in the statement of profit and loss as opposed to other comprehensive income in CGAAP. Accordingly, as at December 31, 2010, this investment is classified as a level 2 financial instrument according to our fair value hierarchy as it is based on observable market data.

Consequently, the Company is exposed to equity price risk because of its investment held and classified on the consolidated statement of financial position as available-for-sale. Equity price risk is the risk that the fair value of a financial instrument varies due to equity market changes.

e) Warrants

	As at June 30, 2010
Per Canadian GAAP CA\$	717,267
Effect of Change in Presentation Currency	(28,117)
Canadian GAAP US\$	689,150
Effect of measurement at fair value	-
Foreign Exchange Impact	(15,407)
IFRS US\$	673,743

The Company has issued warrants that entitle the holder to acquire a fixed number of common shares for a fixed Canadian dollar price per share. In accordance with IFRS, an obligation to issue shares for a price that is not fixed in the Company's functional currency, and that does not qualify as a rights offering to all shareholders of that class, must be classified as a derivative liability and measured at fair value with changes recognized in the consolidated statement of comprehensive income (loss) as they arise. The Company has recorded these charges in 'Gain/loss on revaluation of financial instruments'.

Under Canadian GAAP, the warrants were classified as equity and changes in fair value were not recognized. This change in accounting increased (decrease) liabilities and reduced (increased) "Gain/loss on revaluation of financial instruments". Accordingly, those warrants were classified as a level 3 financial instrument according to our fair value hierarchy as it is based on significant non-observable market data.

Consequently, the Company is exposed to valuation risk because of its warrants held and classified on the consolidated balance sheet as fair value through profit and loss. Equity price risk is the risk that the fair value of a financial instrument varies due to equity market changes.

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars **except where otherwise indicated**)

6. Transition to IFRS (cont'd)

f) Loan payable to a customer

1) Long term Debt

	As at June 30, 2010
Per Canadian GAAP CA\$	4,696,345
Change in Presentation Currency	(284,975)
Per Canadian GAAP US\$	4,411,370
IFRS Adjustment	732,221
Cumulative effect of accretion under IFRS	(36,413)
IFRS US\$	5,107,178

2) Deferred Revenues

	As at June 30, 2010
Per Canadian GAAP CA\$	1,543,533
Change in Presentation Currency	(93,662)
Per Canadian GAAP US\$	1,449,871
IFRS Adjustment	(378,867)
Cumulative effect of amortization	44,574
IFRS US\$	1,115,578

3) Conversion Option

	As at June 30, 2010
Per Canadian GAAP CA\$	319,903
Change in Presentation Currency	(49,853)
Per Canadian GAAP US\$	270,050
IFRS Adjustment	(270,050)
IFRS US\$	-

This loan is convertible at the option of the holder to a maximum of 19.99% of the Company's total common shares outstanding at the market price less a 15% discount.

In accordance with IAS 32, the convertible debt of the Company is a contract with an obligation to issue either cash or a variable number of shares whose value is also variable. The entire instrument is a liability on the grounds that the 'fixed for fixed' requirement in IAS 32 is not met for the instrument as a whole (that is, the instrument is settled in a variable number of shares).

Accordingly, there is no conversion option recognized in equity under IFRS. Furthermore, the fair value of the debt at initial recognition has been remeasured by assimilating the 15% discount to a premium on debt redemption. The corresponding adjustments have been recorded in deferred revenues and retained earnings.

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars except where otherwise indicated)

6. Transition to IFRS (cont'd)

g) Deficit

	As at June 30, 2010
Per Canadian GAAP CA\$	(34,981,091)
Change in Presentation Currency	4,159,770
Per Canadian GAAP US\$	(30,821,321)
Impact of Measuring property plant and equipment at Fair Value	2,870,313
Impact of Loan From Customer	(91,464)
Impact of measuring Warrants at fair Value	15,407
Change in Fair Value Promissory note	803,898
Change in share in earnings	8,089
Change in accretion on asset retirement obligation	1,488
Functional Currency	(113,088)
IFRS US\$	(27,326,678)

IFRS adjustments to the consolidated statement of comprehensive income

h) Comprehensive income for the period

Three months ended June 30, 2010	Net income (loss)	Other comprehensive income (loss)	Comprehensive income (loss)
Per Canadian GAAP CA\$	(1,399,405)	-	(1,399,405)
Change in presentation currency	38,513	-	38,513
Per Canadian GAAP US\$	(1,360,892)	-	(1,360,892)
Difference in Depletion and Depreciation	205,712	-	205,712
Amortization of deferred revenues	(22,287)	-	(22,287)
Net impact of accretion and gain on settlement of long term debt	48,053	-	48,053
Change in fair value of Promissory note	1,153,998	-	1,153,998
Equity pick-up	(12,272)	-	(12,272)
Accretion of asset retirement obligation	777	-	777
Foreign exchange gain on warrants	15,407	-	15,407
Change in functional Currency	28,496	-	28,496
	229,493	-	229,493
IFRS US\$	257,989	-	257,989

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars except where otherwise indicated)

6. Transition to IFRS (cont'd)

IFRS adjustments to the consolidated statement of comprehensive income

i) Comprehensive income for the period

	Net income (loss)	Other comprehensive income (loss)	Comprehensive income (loss)
Six months ended June 30, 2010			
Per Canadian GAAP CA\$	(2,092,377)	-	(2,092,377)
Change in presentation currency	65,230	-	65,230
Per Canadian GAAP US\$	(2,027,147)	-	(2,027,147)
		-	
Difference in Depletion and Depreciation	386,432	-	386,432
Amortization of deferred revenues	(44,574)	-	(44,574)
Net impact of accretion and gain on settlement of long term debt	36,413	-	36,413
Change in fair value of Promissory note	803,898	-	803,898
Equity pick-up	8,089	-	8,089
Accretion of asset retirement obligation	1,488	-	1,488
Foreign exchange gain on warrants	15,407	-	15,407
	(819,994)	-	(819,994)
Change in functional Currency	104,638	-	104,638
		-	
IFRS US\$	(715,356)	-	(715,356)

i) General and administration expenses

	Three-months ended June 30, 2010	Six-months ended June 30,2010
Per Canadian GAAP CA\$	715,307	1,344,366
Change in presentation currency	(17,307)	(43,151)
Per Canadian GAAP US\$	698,000	1,301,215
Stock-based compensation	93,781	284,759
IFRS US\$	791,781	1,585,974

For IFRS purposes, stock-based compensation is presented under general and administrative expenses.

k) Finance expense

	Three-months ended June 30, 2010	Six-months ended June 30,2010
Canadian GAAP, as reported	-	-
Interest on long term debt	-	-
Interest and banking fees	370,592	425,761
Accretion expense of long term debt	156,558	308,470
Gain on debt settlement	(59,303)	(59,303)
Accretion expense of asset retirement obligation	4,583	9,168
IFRS basis	472,430	684,096

For IFRS purposes, accretion expenses are combined with interest expense and are presented as Finance expenses on the consolidated statement of comprehensive income.

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars except where otherwise indicated)

6. Transition to IFRS (cont'd)

I) Comparative Figures

Certain Canadian GAAP comparative figures have been reclassified to conform to the financial presentation adopted at December 31, 2010.

Adjustments to the consolidated statement of cash flows

The transition from Canadian GAAP to IFRS had no significant impact on cash flows generated by the Company.

7. Trade and other receivables

	June 30, 2011 \$	December 31, 2010 \$
Trade receivables	69,844	714,630
Sale taxes receivable	1,139,528	1,104,006
Advances to suppliers	150,486	43,448
Accounts receivable from an associated Company	245,843	151,686
	<u>1,605,701</u>	<u>2,013,770</u>

8. Inventories

	June 30, 2011 \$	December 31, 2010 \$
Finished products	553,320	179,403
Inventory in transit	614,596	1,253,517
	<u>1,167,916</u>	<u>1,432,920</u>
Work in process	820	146,506
Supplies	640,470	520,674
	<u>1,809,206</u>	<u>2,100,100</u>

The cost of inventory charged to expense represents all cost of sales and essentially all depreciation and depletion. As at June 30, 2011 and December 31, 2010, there were no write-downs or reversal of write-downs of inventories.

9. Investments in Associates

	Three-months ended June 30,		Six-months ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
<i>Dynacor Gold Mines Inc. ("Dynacor")</i>				
Investment at beginning of period	-	926,694	-	906,332
Share of net earnings	-	78,189	-	98,551
Investment at end of period	<u>-</u>	<u>1,004,883</u>	<u>-</u>	<u>1,004,883</u>
<i>Hidroeléctrica Pelagatos S.A.C.</i>				
Investment at beginning of period	153,658	-	200,000	-
Purchase of shares	-	200,000	-	200,000
Share of net earnings	52,696	-	6,354	-
Investment at end of period	<u>206,354</u>	<u>200,000</u>	<u>206,354</u>	<u>200,000</u>

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars except where otherwise indicated)

9. Investments in Associates (cont'd)

Investment in Dynacor

As at June 30, 2011, the Company owned 3,075,026 (3,553,426 at December 31, 2010) common shares or 8.6% (10.2% at December 31, 2010) of Dynacor.

Change in status of investment in Dynacor:

Prior to December 17, 2010, the investment in Dynacor was accounted for by the equity method as the Company had the ability to exercise significant influence over Dynacor. Management determined that on December 17, 2010 the status of the investment in Dynacor changed as they lost the ability to exercise significant influence over this investee. The following facts were taken into consideration for their determination of the degree of influence they had over Dynacor:

- (1) on December 17, 2010, the ownership of common shares in Dynacor decreased to 10.2% from 13.5% at December 31, 2009 ;
- (2) the Company is gradually disinvesting of its shares in Dynacor;
- (3) the convertible promissory note was reimbursed;
- (4) representation on the Board of Directors of Dynacor is not sufficient to enable the Company to exercise any significant influence over the policy making process; and
- (5) there are no contracts signed between these two companies that would result in one company being dependent over the other one.

Under IAS 39, the investment was classified as "available-for-sale" and measured at fair value on the consolidated balance sheet, with unrealized gains and losses recognized in other comprehensive income.

10. Investments

a) Shares in Dynacor

	Three-months ended June 30,		Six-months ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Balance at the beginning of the period	7,017,998	-	4,644,534	-
Sale of shares	(589,091)	-	(625,297)	-
Net change in fair value recorded in other comprehensive income	(3,240,700)	-	(831,030)	-
Balance at the end of the period	3,188,207	-	3,188,207	-

For the three and six months ended June 30, 2011, the Company sold 478,400 shares of Dynacor at an average price of \$1.51 US per share for gross proceeds of \$723,544, and 450,700 shares of Dynacor at an average price of \$1.49 US per share for gross proceeds of \$671,471 respectively.

As at June 30, 2011, the Company owned 3,075,026, (3,553,426 at December 31, 2010) common shares of Dynacor, representing an ownership of approximately 7.6% (9.5% at December 31, 2010) on a fully diluted basis.

b) Promissory note

	Three-months ended June 30,		Six-months ended ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Balance at the beginning of the period	-	1,145,783	-	1,445,783
Net change in fair value recorded in statement of profit and loss	-	1,153,998	-	803,898
Foreign exchange gain	-	(52,521)	-	(2,421)
Balance at the end of the period	-	2,247,260	-	2,247,260

Malaga Inc.

Notes to the condensed interim consolidated financial statements

June 30, 2011 and 2010

(Unaudited; Expressed in US dollars except where otherwise indicated)

11. Property plant and equipment

	Mining properties and deferred exploration and development costs	Land	Buildings	Plant & Mining Equipment	Vehicles	Office equipment	Total
Cost							
Balance January 1, 2011	10,061,864	633,552	2,187,985	6,309,103	471,680	141,300	19,805,484
Additions	918,147	-	-	2,713,412	161,389	2,534	3,795,482
Balance June 30, 2011	10,980,011	633,552	2,187,985	9,022,515	633,069	143,834	23,600,966
Accumulated Depreciation and Depletion							
Balance January 1, 2011	6,029,279	-	112,500	507,681	57,299	22,680	6,729,439
Depreciation and Depletion	968,516	-	(41,872)	303,955	32,351	11,594	1,274,544
Net allocation to inventory	(75,679)	-	-	-	-	-	(75,679)
Balance June 30, 2011	6,922,116	-	70,628	811,636	89,650	34,274	7,928,304
Net Book Value June 30, 2011	4,057,895	633,552	2,117,357	8,210,879	543,419	109,560	15,672,662
Cost							
Balance January 1, 2010	6,927,317	633,552	2,187,985	4,387,505	444,324	117,516	14,698,199
Additions	1,386,238	-	-	1,921,598	27,356	23,784	3,358,976
Transfers	1,748,309	-	-	-	-	-	1,748,309
Balance December 31, 2010	10,061,864	633,552	2,187,985	6,309,103	471,680	141,300	19,805,484
Accumulated Depreciation and Depletion							
Balance January 1, 2010	3,984,943	-	-	-	-	-	3,984,943
Depreciation and Depletion	2,125,924	-	112,500	507,681	57,299	22,680	2,826,084
Net allocation to inventory	(81,588)	-	-	-	-	-	(81,588)
Balance December 31, 2010	6,029,279	-	112,500	507,681	57,299	22,680	6,729,439
Net Book Value December 31, 2010	4,032,585	633,552	2,075,485	5,801,422	414,381	118,620	13,076,045

For the three and six month periods ended June 30, 2011, the Company recorded to property, plant and equipment additions pursuant to capital leases obligations in the amount of \$241,219.

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(Unaudited; Expressed in US dollars except where otherwise indicated)

12. Mining properties and deferred development costs

	Huayllapon II	Huara II	Consuzo	Other	Total
	\$	\$	\$	\$	\$
Mining properties					
Balance January 1, 2011	143,962	524,060	95,289	280,851	1,044,162
Additions	-	-	-	63,401	63,401
Transfers	-	-	-	-	-
Balance June 30, 2011	143,962	524,060	95,289	344,252	1,107,563
Deferred development and exploration costs					
Balance January 1, 2011	757,785	2,712,399	258,539	-	3,728,723
Additions	744,498	45,666	824	-	790,988
Transfers	-	-	-	-	-
Balance June 30, 2011	1,502,283	2,758,065	259,363	-	4,519,711
TOTAL	1,646,245	3,282,125	354,652	344,252	5,627,274

Mining properties					
Balance January 1, 2010	224,940	831,771	105,876	280,851	1,443,438
Transfers	(80,978)	(307,711)	(10,587)	-	(399,276)
Balance December 31, 2010	143,962	524,060	95,289	280,851	1,044,162
Deferred development and exploration costs					
Balance January 1, 2010	592,878	3,229,531	269,263	-	4,091,672
Additions	351,879	618,002	16,203	-	986,084
Transfers	(186,972)	(1,135,134)	(26,927)	-	(1,349,033)
Balance December 31, 2010	757,785	2,712,399	258,539	-	3,728,723
TOTAL	901,747	3,236,459	353,828	280,851	4,772,885

The Company owns the Pasto Bueno tungsten mine. The Pasto Bueno mine is located in northern Peru, 830 km from the City of Lima. The property consists of 24 concessions for a total of 627 hectares. Certain zones of the Huayllapon II, Huaura II and Consuzo areas were put into commercial operation during 2010. Therefore, the development and exploration costs in the amount of \$1,748,309 were reclassified into development costs in property, plant and equipment.

Projects in Development:

Exploration work was performed at Huayllapon II, Huaura II and Consuzo areas. The Huayllapon II sector includes the Chabuca, St. Augustin, Paraiso and Limbo veins. The Huaura II sector includes the Alonso Fenix, Santa Marta, Sauco, Violeta, Candela veins as well as the area not in production of the Consuelo vein. The Consuzo sector includes the Loreta and Maria Ofelia veins.

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(Unaudited; Expressed in US dollars except where otherwise indicated)

13. Accounts payable and accrued liabilities

	As at June 30, 2011 \$	As at December 31, 2010 \$
Trade accounts payable and accrued liabilities	2,009,468	2,776,008
Salaries and other	656,170	666,897
	<u>2,665,638</u>	<u>3,442,905</u>

14. Long-Term Debt

	As at June 30, 2011 \$	As at December 31, 2010 \$
Advance on future sales payable to customer, without interest, maturing March 31, 2014 (\$1.2M) ¹	779,356	720,535
Loan payable to a customer, without interest, until March 31, 2010 and bearing interest at the 12 month LIBOR rate, maturing March 31, 2014, convertible to a maximum of 19.99% of shares outstanding as of April 1st, 2010 at the holder's option ²	2,525,038	2,814,433
7.6% unsecured loan from the Peru tax authorities payable in 120 monthly instalments of 2,544 Peruvian Nuevo soles maturing in April 2012	48,819	44,494
Due to former workers and employees of a subsidiary in Peru including interest settlement, with no additional interest, repayable in monthly instalments maturing in 2015 ³	622,235	715,745
Due to suppliers of a subsidiary in Peru with no interest and no fixed terms of repayment	290,301	270,030
	<u>4,265,749</u>	<u>4,565,237</u>
Less: current portion	<u>1,308,347</u>	<u>1,241,049</u>
	<u>2,957,402</u>	<u>3,324,188</u>

¹ On April 1 2009, the Company entered into a financing agreement whereby it received an advance on sales of \$1.2M, bearing no interest, repayable on the last sales of the sales agreement. This amount has been discounted at an effective rate of 17%, or \$547,392. The difference of \$652,608 between the amount received and the liability was initially recorded as deferred revenue and is recognized as revenue over the shipments expected under the sales agreement.

Malaga Inc.

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(Unaudited; Expressed in US dollars except where otherwise indicated)

14. Long-Term Debt (cont'd)

² In addition, the Company received a loan of \$3.8M initially secured by 3.5 million common shares of Dynacor Gold Mines Inc. which the Company owns (this security was reduced to 1.5 million common shares at December 31, 2010), that is payable in monthly instalments from the thirteenth month after closing the agreement. This loan is convertible at the option of the holder commencing on the twelfth month after closing, and to a maximum of 19.99% of the Company's total common shares outstanding at the market price less a 15% discount. As at June 30, 2011, the outstanding capital balance was \$2.61M (\$3.01M as at December 31, 2010). In accordance with IAS 32, the convertible debt of the Company is a contract with an obligation to issue either cash or a variable number of shares whose value is also variable. The entire instrument is a liability on the grounds that the 'fixed for fixed' requirement in IAS 32 is not met for the instrument as a whole (that is, the instrument is settled in a variable number of shares); the movement in share price determining the number of shares to be delivered under the contract is outside the control of the Company and the holder. In addition, the 15% discount has been assimilated to a premium on debt redemption. The value of the liability component was determined at issuance of the debt. The fair value of the liability component, included in long term debt, was calculated using a market interest rate for an equivalent non-convertible bond.

The amount of the loan has been discounted at an effective rate of 17%, or \$2,988,044. The difference of \$811,956 between the amount received and the liability, was initially recorded as deferred revenue and is recognized as revenue over the expected shipments under the sales agreement.

In addition, the assets of the subsidiary have been pledged as collateral for the loan with the customer. As at June 30, 2011, the book value of assets pledged as security amounted to \$16.5M.

³ Relative to the acquisition of a Peruvian subsidiary in 2006, the Company had assumed a long term debt regarding amounts due to workers of Peru. This long term debt was included as part of the purchase price allocation. These workers have claimed interest on the outstanding balance. Accordingly, the Company concluded an agreement whereby the new outstanding balance would be 2.5M nuevo soles (\$0.9M) which will not bear any interest. As a result, a non-recurring expense in the amount of \$0.3M has been recorded as interest expense in the 2010 fiscal year.

The future capital payments including the impact of the implicit interest over the next five years are as follows:

	\$
2011	666,719
2012	1,203,014
2013	1,054,973
2014	1,455,612
2015	303,733

15. Warrants liability

	As at June 30, 2011		As at June 30, 2010	
	Number of warrants	Amount \$	Number of warrants	Amount \$
Balance at the beginning of the period	35,863,333	2,713,995	-	-
Change in fair value		(1,168,047)		-
Foreign Exchange impact		84,461		-
Balance at the end of the period	35,863,333	1,630,409	-	-

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15. Warrants liability (cont'd)

In 2010, as part of the two tranche private placement, the Company issued 35,863,333 ordinary warrants. Each warrant is exercisable at a price of \$0.25 with 18,321,667 ordinary warrants expiring on May 6, 2012 and 17,541,666 ordinary warrants expiring on June 23, 2012. The ordinary warrants were assigned a value of \$689,150, and were recorded as a derivative liability. At each reporting date they are measured at fair value with the change in fair value recorded in the consolidated statement of comprehensive income until they are exercised at which time they will be transferred to share capital. The ordinary warrants were re-valued at June 30, 2011 using the Black-Scholes valuation model with the following inputs into the model: dividend yield of 0%, credit adjusted risk free interest rate of 1.55%, expected life of 0.92 years, and expected volatility of 81%.

Outstanding ordinary warrants as at June 30, 2011 are as follows:

<u>Expiry Date</u>	<u>Number of Warrants</u>	<u>Exercise Price</u>
May 6, 2012	18,321,667	\$CA 0.25
June 23, 2012	17,541,666	\$CA 0.25
Total	<u>35,863,333</u>	<u>\$CA 0.25</u>

16. Share Capital

a) Common Shares Authorized

Unlimited number of common shares, without par value.

Unlimited number of preferred shares, without par value, non cumulative annual dividend of 8%, redeemable at their issue price, non-participating, non-voting.

Issued and fully paid

Movements in the Company's share capital are as follows:

	<u>Six-months ended</u>		<u>Six-months ended</u>	
	<u>June 30, 2011</u>		<u>June 30, 2010</u>	
	<u>Number of common shares</u>	<u>Amount</u>	<u>Number of common shares</u>	<u>Amount</u>
Balance, beginning of period	183,550,176	39,200,848	147,686,843	35,165,941
Exercise of Stock options ¹	125,000	37,948	-	-
Shares issued ²	-	-	35,863,333	4,479,372
Share issuance expenses ²	-	-	-	(434,448)
Balance, end of period	<u>183,675,176</u>	<u>39,238,796</u>	<u>183,550,176</u>	<u>39,210,865</u>

¹ A total of 125,000 stock options were exercised during the six-month period ended June 30, 2011 under the plan for a cash consideration of \$20,964 (100,000 options at CA\$0.16 and 25,000 options at CA\$0.18). An amount of \$16,984 from the exercise of the stock options was reclassified from contributed surplus to share capital.

² During Q2-2010, the Company completed a two tranche private placement of 35,863,333 units at a price of CA\$0.15 per unit for a cash consideration of \$5,198,903. Each unit consists of one common share and one warrant which entitles the holder to purchase one common share at a price of CA\$0.25 with a two year maturity. From the total proceeds received, \$4,479,372 was assigned to share capital, \$689,150 was assigned to the ordinary warrants and \$30,381 was assigned to the broker warrants, according to their respective estimated fair value. Share issuance expenses for this private placement amounted to \$434,448 which includes an amount of \$30,381 as a result of the issuance of 1,405,933 broker warrants. Certain directors and officers and their immediate family purchased 815,000 units for gross proceeds of \$117,458.

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16. Share Capital (cont'd)

b) Share Purchase Options

The Company has a stock option plan whereby the Board of Directors, may grant to directors, officers, employees, or consultants of the Company options to acquire common shares. The Board of Directors of the Company has the authority to determine the terms, limits, restrictions and conditions of the grant of options, to interpret the Plan and make all decisions relating thereto. The plan was amended at the annual shareholder's meeting of June 26, 2007 in order to set the maximum number of common shares that may be reserved for issuance to 10,000,000. The maximum number of shares that may be reserved for issuance to any one option holder may not exceed 5% of the common shares outstanding at the time of grant.

The option exercise price is established by the Board of Directors and may not be lower than the market price of the common shares at the time of grant. The options may be exercised during the option period determined by the Board of Directors, which may vary, but will not exceed ten years from the date of the grant. There are 10,000,000 of the Company's common shares which may be issued pursuant to the exercise of share options granted under the Plan. Of this number, 125,000 shares were exercised as at June 30, 2011. As at June 30, 2011, the Company had issued options, allowing for the subscription of 7,520,000 common shares of its share capital.

	Six-months ended		Six-months ended	
	June 30, 2011		June 30, 2010	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	(in '000)	\$CA	(in '000)	\$CA
Balance, beginning of period	8,150	0.29	5,680	0.40
Granted	1,500	0.24	3,600	0.16
Forfeited	(30)	0.32	-	-
Exercised	(125)	0.16	-	-
Expired	(1,975)	0.32	(830)	0.44
Balance, end of period	7,520	0.27	8,450	0.29
Exercisable options	5,707	0.31	6,060	0.34

Outstanding options as at June 30, 2011 are as follows:

Range of exercise prices (\$CA)	Weighted average residual life span (in years)	Outstanding options (in '000)	Weighted average exercise price (\$CA)	Exercisable options (in '000)	Weighted average exercise price (\$CA)
0.14 to 0.18	5.6	3,400	0.16	1,837	0.15
0.23 to 0.33	6.7	2,950	0.26	2,700	0.26
0.50 to 0.69	0.7	700	0.55	700	0.55
0.70 to 0.77	5.9	470	0.77	470	0.77
0.14 to 0.77	5.6	7,520	0.27	5,707	0.31

The following share options were exercised during year:

	Number exercised	Exercise date	Share price at exercise date (\$CA)
Granted on January 11, 2010	100,000	27-May-11	0.285
Granted on June 22, 2001	25,000	20-Jun-11	0.250
	125,000		

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(Unaudited; Expressed in US dollars **except where otherwise indicated**)

16. Share Capital (cont'd)

On May 5, 2011 and June 16, 2011, the Company granted 1,150,000 and 350,000 options respectively to key management and Directors. The weighted average fair value of options granted in 2011 was \$0.18. This estimate was obtained using the Black-Scholes valuation model based on the following inputs:

	<u>June 16, 2011</u>	<u>May 5, 2011</u>
Number of options	350,000	1,150,000
Risk-free interest rate	2.55%	2.55%
Expected life	84 months	84 months
Expected estimated volatility	87%	87%
Dividend yield	nil	nil

For the three and six month periods ended June 30, 2011, the stock-based compensation charged to the consolidated statement of operations was \$307,400 and \$332,442, respectively (\$93,781 and \$284,759 in Q2-2010). The offsetting credit has been recorded as contributed surplus. The stock based compensation expense was calculated according to the weighted average fair value of options granted based on the Black-Scholes valuation model using the assumptions shown above based on the expected number of options to vest.

17. Information Included in the consolidated statement of comprehensive income (loss)

	<u>Three-months ended June 30,</u>		<u>Six-months ended June 30,</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Sales				
Tungsten	4,702,879	3,178,405	9,370,699	5,904,159
Copper	626,546	284,496	1,215,256	1,152,754
	<u>5,329,425</u>	<u>3,462,901</u>	<u>10,585,955</u>	<u>7,056,913</u>
Cost of Sales				
Tungsten	2,411,951	2,104,878	4,951,596	4,470,655
Copper	219,348	239,661	499,839	519,681
Depreciation and depletion of property plant and equipment	560,247	704,702	1,274,544	1,491,114
	<u>3,191,546</u>	<u>3,049,241</u>	<u>6,725,979</u>	<u>6,481,450</u>

Malaga Inc.

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17. Information Included in the consolidated statement of comprehensive income (loss) (cont'd)

General and Administration Expenses

	Three-months ended June 30,		Six-months ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Wages and Benefits	442,504	313,339	824,322	603,297
Professional Fees	190,359	129,614	413,203	230,100
Investor Relations	123,154	61,864	212,675	110,080
Office Expenses	87,053	81,337	162,696	138,783
Travel Expenses	69,566	58,130	116,147	99,017
Other	56,100	53,716	83,051	119,938
	<u>968,736</u>	<u>698,000</u>	<u>1,812,094</u>	<u>1,301,215</u>
Stock-based compensation	<u>307,400</u>	<u>93,781</u>	<u>332,442</u>	<u>284,759</u>
	<u>1,276,136</u>	<u>791,781</u>	<u>2,144,536</u>	<u>1,585,974</u>

Net finance expenses

	Three-months ended June 30,		Six-months ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Financial expenses	56,451	370,592	114,467	425,761
Accretion expense on long-term debt	135,280	156,558	276,446	308,470
Accretion expense on asset retirement obligation	4,909	4,583	9,561	9,168
Gain on settlement of debt	(55,046)	(59,303)	(111,187)	(59,303)
	<u>141,594</u>	<u>472,430</u>	<u>289,287</u>	<u>684,096</u>

18. Earnings per share

a. Basic

Basic earnings per common share are calculated by dividing the net income attributable to the owners of the Company by the weighted average number of outstanding common shares in issue during the year.

	Three-months ended June 30,		Six-months ended June 30,	
	2011	2010	2011	2010
Net income (loss) for the period	1,629,208	257,989	2,442,574	(715,356)
Weighted average number of common shares outstanding	<u>183,582,044</u>	<u>160,109,737</u>	<u>183,566,198</u>	<u>153,932,607</u>

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(Unaudited; Expressed in US dollars except where otherwise indicated)

18. Earnings per share (cont'd)

b. Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares. The Company has three categories of dilutive potential ordinary shares: convertible debt, warrants and share options. The convertible debt is assumed to have been converted into ordinary shares, and the net profit is adjusted to eliminate the interest expense. For the share options and warrants, a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options and warrants. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options and warrants.

	Three-months ended June 30,		Six-months ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Net income (loss) for the period	1,629,208	257,989	2,442,574	(715,356)
Interest expense on debt	85,373	-	99,601	-
Profit used to determine diluted earnings per share	<u>1,711,581</u>	<u>257,989</u>	<u>2,542,175</u>	<u>(715,356)</u>
Weighted average number of outstanding common shares in issue	183,582,044	160,109,737	183,566,198	153,932,607
Assumed conversion of convertible debt	12,099,670	-	12,099,670	-
Share options	4,107,692	-	3,755,801	-
Warrants	37,269,266	-	37,269,266	-
Weighted average number of outstanding shares for diluted earnings per share	<u>237,058,672</u>	<u>160,109,737</u>	<u>236,690,935</u>	<u>153,932,607</u>

19. Information Included in the Statements of Cash Flows

	Three-months ended June 30,		Six-months ended June 30,	
	2011 \$	2010 \$	2011 \$	2010 \$
Changes in non-cash working capital items				
Accounts receivable	416,929	(1,156,925)	397,698	(1,784,610)
Income taxes receivable	(94,642)	(27,390)	(100,450)	(65,175)
Inventories	(51,930)	(369,754)	215,215	(632,384)
Prepaid expenses	(56,415)	279,064	(49,011)	(378,404)
Accounts payable and accrued liabilities	363,640	(541,995)	(755,160)	438,422
Income taxes payable	-	53,863	-	82,181
Unearned revenues	(181,835)	15,504	(5,935)	28,111
	<u>395,747</u>	<u>(1,747,633)</u>	<u>(297,643)</u>	<u>(2,311,859)</u>