

## Management Discussion and Analysis

### Introduction

This management Discussion and Analysis (“MD&A”) for Malaga Inc. (“Malaga” or the “Company”) is to comment the major activities of the Company which occurred during the three and six month periods ended June 30, 2011, as well as the subsequent period up to August 10, 2011.

The Company’s financial statements have been prepared using accounting policies consistent with International Financial Reporting Standards (“IFRS”) and in accordance with International Accounting Standards 34 (“IAS 34”) – Interim Financial Reporting. Previously, the Corporation prepared its interim and annual consolidated financial statements in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). The Company’s 2010 comparatives in this MD&A have been presented in accordance with IFRS. As the Company’s IFRS transition date was January 1, 2010, 2009 comparative information included in this MD&A has not been restated. This MD&A must be read in conjunction with the consolidated financial statements for the year ended December 31, 2010, and the unaudited interim financial statements for the three and six month period ended June 30, 2011 including the accompanying notes, as well as the unaudited interim financial statements for the three month period ended March 31, 2011. These documents have been filed electronically on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com). All currency figures appear in United States Dollars unless otherwise specified. This MD&A as well as the unaudited interim consolidated financial statements have been prepared by management, and were not audited by the Company’s external auditors.

The Company’s management is responsible for the preparation of the consolidated financial statements as well as other information contained in this report.

The Board of Directors is required to ensure that management assumes their responsibility with regards to the preparation of the Company’s financial statements. To assist management, the Board has created an Audit Committee. The Audit Committee meets with members of the management team to discuss the operating results and the financial situation of the Company. It then makes its recommendations and submits the financial statements to the Board of Directors for their examination and approval. Following the recommendation of the Audit Committee, the Board of Directors have approved these consolidated financial statements.

For all purposes below, the “Company” refers to Malaga and its wholly-owned subsidiaries Dynacor Exploraciones del Peru SAC, Minera Malaga Santolalla SAC., and Minera Pasto Bueno SAC. The Company also holds 49% of Hidroelectrica Pelagatos S.A.C. (Hidropesac). The information provided herein, effective as of August 10, 2011, is based on assumptions related to future events and results, which may vary. Further information on the Company and its operations has been filed electronically on SEDAR in Canada at [www.sedar.com](http://www.sedar.com).

### Overview

Malaga is a publicly traded company listed on the Toronto Stock Exchange (TSX) under the symbol “MLG.” Malaga is a mining company with acquisition, exploration, development and mining concession operations in Peru.

**1-Q2 FINANCIAL HIGHLIGHTS**

**Second Quarter Information**

(in \$'000)	For the three-month periods ended June 30,		For the six-month periods ended June 30,	
	2011	2010	2011	2010
Sales	5,329	3,463	10,586	7,057
Cost of sales (including depreciation and depletion)	3,192	3,049	6,726	6,481
Depreciation and depletion	560	705	1,275	1,491
Income from mining activities	2,138	414	3,860	576
General and administrative expenses	1,276	792	2,145	1,586
Operating income (loss)	862	(378)	1,715	(1,011)
Net income (loss)	1,629	258	2,443	(715)
Adjusted Net income <sup>(1)</sup>	506	(896)	1,275	(1,519)
Adjusted EBITDA <sup>(2)</sup>	1,569	281	2,839	656
Earnings (loss) per share basic and diluted	\$0.01	\$0.00	\$0.01	(\$0.01)
Average cash cost of production <sup>(3)</sup> (\$/MTU)	\$189	\$122	\$155	\$129
MTU = metric tonne unit = 10 kg				
Cash flow from operating activities before changes in non-cash working capital items	1,629	221	2,982	677
Cash flow from (used for) operating activities	2,025	(1,526)	2,684	(1,635)
Acquisitions of property, plant and equipment	2,103	793	3,554	1,512
Additions to deferred development and exploration costs	683	148	854	319
<b>Reconciliation of Net income to Adjusted net income <sup>(1)</sup></b>				
Net income (loss)	1,629	258	2,443	(715)
Change in fair value of promissory note receivable	-	(1,154)	-	(804)
Gain on revaluation of warrants	(1,123)	-	(1,168)	-
Adjusted net income	506	(896)	1,275	(1,519)
<b>Reconciliation of Net income to Adjusted EBITDA <sup>(2)</sup></b>				
Net income (loss)	1,629	258	2,443	(715)
Future income tax expense	361	-	-	-
Financial expenses	142	472	289	684
Amortization and depletion	560	705	1,275	1,491
Change in fair value of promissory note receivable	-	(1,154)	-	(804)
Gain on revaluation of warrants	(1,123)	-	(1,168)	-
Adjusted EBITDA	1,569	281	2,839	656

<sup>(1)</sup> Adjusted net income: is a non-GAAP financial performance measure with no standard definition under IFRS and Canadian GAAP. See the 'Non-GAAP Measures' section of this MDA.

<sup>(2)</sup> Adjusted EBITDA: "Adjusted Earnings before interest, taxes, depreciation and amortization" is a non-GAAP financial performance measure with no standard definition under IFRS and Canadian GAAP. See the 'Non-GAAP Measures' section of this MDA.

<sup>(3)</sup> Average cash cost of production is calculated by dividing the direct mine and milling operating costs by the production volume in MTU's and is a non-GAAP financial performance measure with no standard definition under IFRS and Canadian GAAP. See the 'Non-GAAP Measures' section of this MDA.

	As at June 30 2011	As at December 31 2010
Cash	1,199	2,841
Total assets	30,477	30,675
Long term debts	4,265	4,565
Obligations under finance leases	341	199
Shareholders' equity	19,287	17,322
<u>Other</u>		
Outstanding shares ('000)	183,675	183,550
Weighted average outstanding shares ('000)		
Basic	183,566	168,813
Diluted	236,691	193,953
Closing share price	\$0.245	\$0.275

### Q2-2011 Highlights

- Net income for Q2-2011 of \$1.6M compared to \$0.3M in Q2-2010 and \$2.4M compared to a net loss of \$0.7M for the six-month period ended June 30, 2011
- Income from mining activities for the quarter of \$2.1M compared to \$0.4M in Q2-2010 and \$3.9M compared to \$0.6M for the six-month period ended June 30, 2011
- Adjusted EBITDA of \$1.6M in Q2-2011 compared to \$0.3M in Q2-2010 and \$2.8M for the six-month period ended June 30, 2011 compared to \$0.7M in 2010.
- Cash flow from operations before changes in non-cash working capital items of \$1.6M an improvement of \$1.4M over Q2-2010 and \$3.0M for the six-month period ended June 30, 2011 compared to \$0.7M in 2010.
- Sales revenue for the quarter of \$5.3M compared to \$3.5M in Q2-2010, an increase of 51% and a 50% increase on sales for the six-month period ended June 30, 2011 amounting to \$10.6M
- APT average reference selling price increase from \$222 in Q2-2010 to \$439 in Q2-2011, an increase of 98%. On August 10, 2011 the APT price was at \$460.
- The mine development program is underway and 1,309 meters of advances were completed in Q2-2011.

### Status of 2011 Objectives

Accelerate the development and exploration of the mine in order to sustain the increased production output and to increase the reserves as well as all mineral resources.

In the current year, the Company planned an extensive development and exploration program in the amount of \$3 to \$4 million whereby 7,300 meters of underground advances was initially forecasted. In Q2-2011, 1,309 meters of underground development work was performed resulting in a total of 2,481 meters completed to date. Due to the lack of qualified miners available to perform the work, the estimate has been revised to 4,400 meters of advancements that will be completed in the current year for a total investment of \$2.1M.

In addition, the Company has announced a \$1.5M exploration program. The drilling campaign began in Q2 2011 and Malaga intends to drill 12 short and long range holes adding up to a total of 6,300 meters. The two main objectives are: 1) to explore the deeper extensions of the Loreto vein; and 2) to explore in depth for the first time the four Manto structures in the southern part of the property. As at August 10, 2011, three drill holes have been completed.

Increase plant's production capacity to 600 tpd by the end of 2011 and produce 80,000 MTU in 2011

The Company has produced 13,073 MTU's in the current quarter. The plant has a production capacity of 500 tpd but the mine has been bottleneck producing between 325-400 tpd. This shortfall comes from less stopes in production due to personnel turnover. Actual production amounts to 30,566 MTU for the six-month period ended June 30, 2011. Hence, the annual production estimate has been lowered to between 60,000 MTU and 65,000 MTU.

Generate net income for the entire 2011 fiscal year

Net income amounts to \$2.4M for the six-month period ended June 30, 2011. The Company expects to maintain profitability over the second half of 2011.

Reduce average cash cost of production <sup>(3)</sup> to US\$115 per MTU

Average cash cost of production was \$189 per MTU in Q2-2011 compared to \$122 in Q2-2010. This increase stemmed mainly from the lower production volume caused by lower quantity of mineral processed in the plant coupled by a lower yield. In addition there was a wage increase to miners, an increase in the cost of electricity, and a weakening of the US dollar to further explain the cost increase. The Company does not expect to meet this target at current production levels.

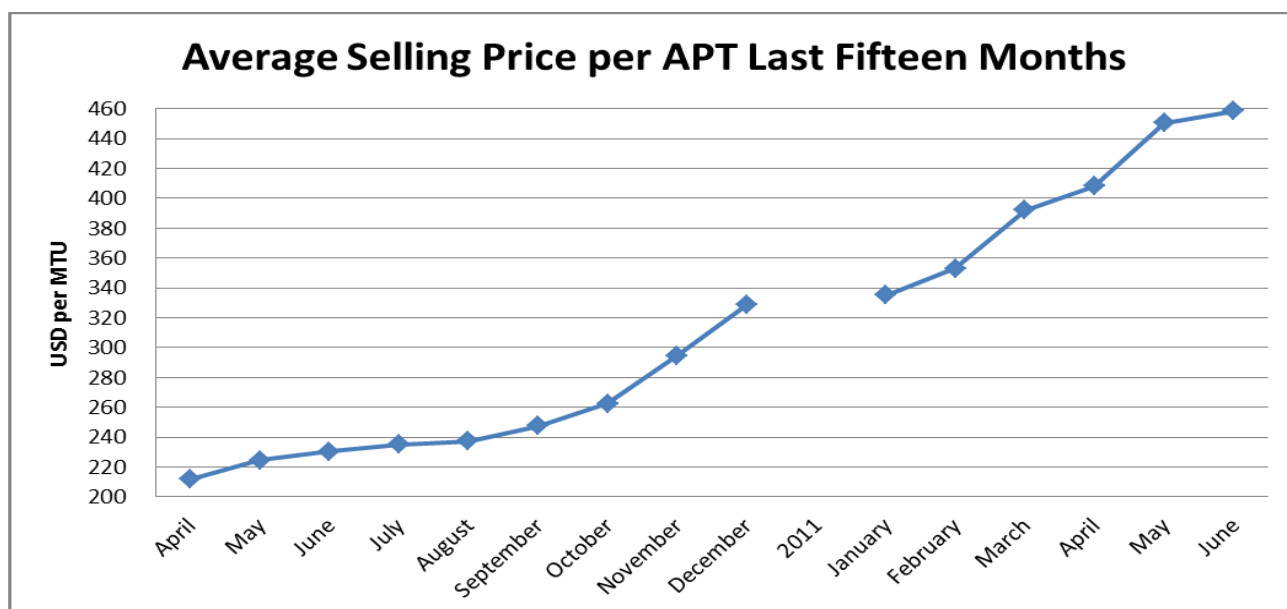
**2-KEY ECONOMIC TRENDS**

***Tungsten Market***

The Company's selling price of tungsten is based on the sale price of APT (ammonium paratungstate). The APT selling price ranged from \$400/MTU to \$460/MTU, with an average at \$439/MTU for Q2-2011, compared \$222/MTU in Q2-2010. As at August 10, 2011, the APT selling price per MTU was US\$460.

In Q1-2011, China's Ministry of Land and Resources announced that authorities in the country have found and ordered the clean-up of more than 280 illegal mines in an effort to regulate the exploration of valuable minerals. The number of explorations for minerals such as rare earth, tungsten, tin, and antimony were reduced to 116 from 400 in 11 provinces and regions in the country in spot checks led by teams dispatched by the ministry, a statement on its website. The campaign, initiated last June by the ministry, has aimed to end the illegal and sometimes widespread excavation of valuable minerals. The ministry earlier ordered that the clean-up of illegal mines should be completed before the end of November.

In addition, in an effort to conserve resources, the Ministry of Land and Resources extended a suspension on approving new-mine applications for tungsten, rare earths and antimony to June 30, 2012.



<sup>(3)</sup> Average cash cost of production is calculated by dividing the direct mine and milling operating costs by the production volume in MTU's and is a non-GAAP financial performance measure with no standard definition under IFRS and Canadian GAAP. See the 'Non-GAAP Measures' section of this MDA.

**Exchange Rate**

The exchange rates are as follows:

	\$US/\$CA		\$US/Sol	
	2011	2010	2011	2010
March 31 (closing rate)	0.9696	1.0233	2.802	2.795
June 30 (closing rate)	0.9645	1.0646	2.749	2.825
1 <sup>st</sup> Quarter (average rate)	0.9856	1.0401	2.784	2.815
2 <sup>nd</sup> Quarter (average rate)	0.9676	1.0283	2.784	2.850

The Company has not entered into any hedging contracts.

**3-CONSOLIDATED RESULTS AND MINING OPERATIONS**

**Metal sales and production**

Metal sales and production is as follows:

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2011	2010	2011	2010
Sales (in MTU)	15,607	18,801	33,697	36,909
Production:				
Tonnes extracted	29,420	31,322	60,808	59,512
Yield (%)	45%	62%	50%	62%
Production Output (MTU)	13,073	19,321	30,566	36,932

Total sales for the current quarter amounted to \$5.3M (\$3.5M in Q2-2010). Tungsten sales increased by \$1.5M (or 48%) in the current quarter compared to Q2-2010 from \$3.2M to \$4.7M. The increase in tungsten revenues is a result of a 98% increase in average APT selling price. In addition, the Company was able to generate sales revenue of \$0.6M from copper (\$0.3M in Q2-2010).

In Q2-2011, less tonnes were extracted from the mine because of the two accidents which forced the closure for a temporary period of time two stopes. In addition, working conditions are very competitive in Peru and retaining staff is more difficult. Therefore, the subcontractors have lost some miners and have not been able to replace all of them so far. Malaga has undertaken measures to improve wages, camp conditions in order to attract and retain miners. In addition, the yield has decreased due to the lower head grade of the mineral ore extracted in Q2-2011 compared to Q2-2010. Historical average of head grade has been 0.70% while it was 0.90% in Q2-2010.

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2011	2010	2011	2010
Sales	\$	\$	\$	\$
In \$'000				
Tungsten	4,703	3,178	9,371	5,904
Copper	626	285	1,215	1,153
	<u>5,329</u>	<u>3,463</u>	<u>10,586</u>	<u>7,057</u>

The cost of sales is as follows:

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2011	2010	2011	2010
Operating costs (000\$)				
	\$	\$	\$	\$
Mining	1,217	1,296	2,309	2,612
Milling	375	330	745	656
Plant and site services	873	739	1,684	1,489
Operating costs	<u>2,465</u>	<u>2,365</u>	<u>4,738</u>	<u>4,757</u>
Inventory change	(52)	(261)	215	(396)
Inventory Write-down	-	-	-	109
Cost of sales Tungsten	<u>2,413</u>	<u>2,104</u>	<u>4,953</u>	<u>4,470</u>
Cost of sales Copper	<u>219</u>	<u>240</u>	<u>499</u>	<u>520</u>
Cash cost of Sales	<u>2,632</u>	<u>2,344</u>	<u>5,452</u>	<u>4,990</u>
Depreciation and depletion	<u>560</u>	<u>705</u>	<u>1,274</u>	<u>1,491</u>
Total Cost of Sales	<u>3,192</u>	<u>3,049</u>	<u>6,726</u>	<u>6,481</u>

	Three-months period ended June 30,		Six-months period ended June 30,	
	2011	2010	2011	2010
In \$US per MTU				
Mining	93	67	76	71
Milling	29	17	24	18
Plant and site services	67	38	55	10
Average cash cost of production <sup>(3)</sup>	<u>189</u>	<u>122</u>	<u>155</u>	<u>129</u>

As explained above, the average cash cost of production<sup>(3)</sup> in the current quarter was \$189 per MTU (\$122 per MTU in Q2-2010), an increase of 55%.

The mining cost per MTU has increased in Q2-2011 due to the lower volume, grade and recovery rate in the current quarter, which resulted in 13,073 MTUs produced, or a 25% decrease compared to the three-month period ended June 30, 2010. The increase is explained as follows:

	In \$/MTU
2010	122
Increase in cost due to the decrease in production volume	
Mining	22
Milling	8
Plant services	<u>18</u>
Salaries	5
Increase in electricity rate	4
Additional maintenance in plant and site services	3
Foreign exchange	4
Others	<u>3</u>
2011	<u>189</u>

<sup>(3)</sup> Average cash cost of production is calculated by dividing the direct mine and milling operating costs by the production volume in MTU's and is a non-GAAP financial performance measure with no standard definition under IFRS and Canadian GAAP. See the 'Non-GAAP Measures' section of this MDA.

During the six-month period ended June 30, 2011 the average cash cost of production was 20% higher compared to Q2-2010 with 30,566 MTUs produced. On a year-to-date basis, MTUs produced were 17% lower compared to same period in 2010.

The amortization and depletion per MTU decreased from \$37 in Q2-2010 to \$36 in Q2-2011. On year-to-date basis amortization and depletion per MTU decreased 5% from \$40 in 2010 to \$38 in 2011.

**Operating Activities**

The Company generated a net income of \$1.6M for the three month period ended June 30, 2011 (\$0.3M in Q2-2010) for an earnings per share of \$0.01 (\$0.00 in Q2-2010) and a net income for the six month period ended June 30, 2011 of \$2.4M (net loss \$0.7M in 2010) for an earnings per share of \$0.01 (loss per share of \$0.01 in 2010). The increase in the net income is explained in the table below.

	<b>Three-month period ended</b>	<b>Six-month period ended</b>
	<b>June 30, 2011</b>	
	<u>In \$M</u>	<u>In \$M</u>
Increase in income from mining activities	1.7	3.2
Increase in general and administrative expenses	(0.5)	(0.6)
Decrease in financial expenses	0.3	0.4
Increase in foreign exchange gain/loss	0.1	(0.3)
Increase in gains related to warrants	1.1	1.1
Decrease in loss related to promissory note	(1.2)	(0.8)
Increase in gains on sale of Dynacor shares	0.1	0.1
Increase in reversal of future tax recoveries	(0.4)	-
Other	0.1	-
<b>Total increase</b>	<b>1.4</b>	<b>3.1</b>

The increase in income from mining activities is a result of the increase in the APT selling price of 98% in Q2-2011 compared to Q2-2010 (an 88% increase in 2011 compared to the six-month period ending June 30, 2010) partially offset by decrease in sales volume for the comparative three and six month period of 17% and 9%, respectively.

With the transition to IFRS, the Company recorded a gain in the amount of \$1.1M on the re-evaluation of the outstanding warrants in Q2-2011. The warrants are classified as a liability and are a level 3 financial instrument that are carried at fair value. This liability is calculated in relation to the quoted stock price of the Company which varied from \$0.275 at March 31, 2011 to \$0.245 at June 30, 2011 and is calculated at each reporting date.

Almost 45% of the increase in general and administrative expenses is a result of the increase in stock based compensation. The remaining reasons come from more activities into investor relations, more wages as well as an increase in professional fees related to the final phases of the transition to IFRS.

The financial expenses have decreased in Q2-2011 because in Q2-2010 the Company recorded a non-recurring interest expense of \$0.3M to the workers of Peru as part of the settlement of the debt amount.

In Q2-2011, a reversal of a Q1-2011 recovery of future income taxes in the amount of \$0.4M was recorded (nil in Q2-2010) related to the re-measurement of the available-for-sale investment. The investment in Dynacor is classified as “available-for-sale” and measured at fair value, with unrealized gains and losses recognized in other comprehensive income net of taxes. The Company is unable to realize all of its tax benefit from the tax loss to recover income taxes paid in previous years in Peru and Canada.

**4-CASH FLOW AND LIQUIDITY****Operating Activities**

In Q2-2011, the cash flow generated from operating activities before changes in non-cash working capital items amounted to \$1.6M (\$0.2M in Q2-2010). The improvement comes from the increase of income from mining operations, which has been driven by the increase in tungsten sales. The changes in the non-cash working capital item amounted to \$0.4M (a use of \$1.7M in Q2-2010) resulting in cash flow from operating activities in the amount of \$2.0M in Q2-2011 compared to a use of \$1.5M in Q2-2010.

**Investing Activities**

In Q2-2011, the Company invested another \$2.1M for the acquisition of property, plant and equipment (\$0.8M in Q2-2010). Of the \$2.1M, \$1.3M was invested in the tailings ponds and \$0.4M in 1,309 meters of advancements with the objective of replenishing the reserves that were extracted.

The Company also invested \$0.7M (\$0.1M in Q2-2010) in exploration and development work in order to develop new sources of ore to support the increase in production capacity.

**Financing Activities**

During the quarter, the cash flow used for financing activities amounted to \$0.3M for the reimbursement of the long-term debt and re-payment of the obligation under capital leases. In Q2-2010, cash flow from financing activities was \$4.4M coming mainly from the net proceeds of issuance of common shares and warrants of \$4.7M.

**Liquidity**

As at June 30, 2011, cash amounted to \$1.2M and the working capital to \$0.8M. The Company continued to sell its shares of Dynacor during 2011 with 478,700 sold for the six months ended June 30, 2011. The market value of these remaining shares amounted to \$3.2 million as at June 30, 2011. Malaga intends to continue selling them over the remaining of 2011. As at June 30, 2011, the Company had no financial commitments besides those disclosed in the section Long-term Liabilities and Contractual Obligations.

**5-STATEMENTS OF FINANCIAL POSITION****Assets**

As at June 30, 2011, total assets amounted to \$30.5M (\$30.7M as at December 31, 2010).

***Long-Term Liabilities and Contractual Obligations***

Payment due by (in '\$'000)

	2011	2012 to 2014	2015	Beyond 2015	Total
Contractual commitments					
Long term debts	682	3,734	304	-	4,720
Operating leases	52	17	-	-	69
Capital leases	168	319	-	-	487
Asset retirement obligation for property, plant and equipment	-	-	-	717	717
	902	4,070	304	717	5,993

The Company's operations are governed by regulations regarding the protection of the environment. Subject to these regulations, the Company must implement progressive measures for rehabilitation work as part of its operations. The Company recorded asset retirement obligations for the property, plant and equipment in the amount of \$0.6M at June 30, 2011 and December 31, 2010. These disbursements are expected to be made in the years 2027 and 2028. This estimate is subject to change following modifications to laws and regulations, or as new information becomes available.

**Contingencies and subsequent events**

The Company's operations are subject to governmental laws on the protection of the environment. The environmental consequences are difficult to identify, whether in terms of their outcomes, their dates or their impacts. To the best of knowledge of management, the Company is presently operating in compliance, in all material respects, with the laws and regulations already in place. Commitments are presented in the section Long-term Liabilities and Contractual Obligations.

**Off-Balance Sheet Transactions**

As at June 30, 2011, the Company had not entered into any off-balance sheet transactions.

**6-QUARTERLY REVIEW**

(unaudited in accordance with IFRS (Canadian GAAP Canadian dollar for 2009))

(in \$'000)	2011		2010				2009	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
<b>Financial</b>								
Revenues	5,329	5,257	3,337	3,791	3,463	3,594	2,470	2,780
Cost of sales	3,192	3,534	2,582	3,383	3,049	3,432	2,698	2,534
Amortization and depletion	560	714	618	717	705	786	1,071	993
General and administrative expenses	1,276	868	695	715	792	794	523	666
Net (loss) income	1,629	813	2,880	(928)	257	(973)	(3,776)	(1,977)
Cash and cash equivalents	1,199	1,635	2,841	922	2,112	386	1,149	1,939
Working capital	791	1,688	2,268	230	1,569	(2,091)	(1,367)	167
Total assets	30,477	32,463	30,675	27,126	27,825	23,346	21,902	26,767
Shareholders' equity	19,287	20,209	17,322	14,486	15,377	10,950	10,507	13,997
Acquisition of property, plant and equipment	2,103	1,451	1,098	1,087	793	359	819	1,277
Development and deferred exploration costs	683	172	301	366	148	171	351	470
<b>Per Share</b>								
Earnings (loss) per share basic and diluted	0.01	0.00	0.01	(0.00)	0.00	(0.01)	(0.02)	(0.02)
Weighted average shares outstanding ('000)								
Basic	183,582	183,550	183,550	183,550	160,110	147,687	140,770	139,000
Diluted	237,059	235,500	224,289	185,115	160,110	147,687	140,770	139,000

**7-INFORMATION ON OUTSTANDING SHARES**

**Data on Available Outstanding Shares (as at August 10, 2011)**

	Number
Common shares	183,675,176
Ordinary Warrants	35,863,333
Broker Warrants	1,405,933
Options	7,520,000

**8-RESERVES AND EXPLORATION AND DEVELOPMENT ACTIVITIES*****Pasto Bueno Property***

Pursuant to the press release issued March 12, 2010, the Company obtained an independent technical report as required under standard 43-101. The report was performed by Vector Engineering Inc., and the Pasto Bueno property contains the following reserves and resources as at January 1, 2010:

<b>Category</b>	<b>Metric Tonnes</b>	<b>WO3 Grade</b>
<b>Reserves</b>		
Proven	81,696	0.71%
Probable	87,731	0.68%
	<u>169,427</u>	<u>0.70%</u>
<b>Resources</b>		
Measured	64,757	0.91%
Indicated	334,088	0.73%
Measured & indicated	<u>398,845</u>	
Inferred	<u>1,820,641</u>	0.70%

The reserves are included in the measured and indicated resources. The economic viability of the mineral resources that are not mineral reserves has not been demonstrated.

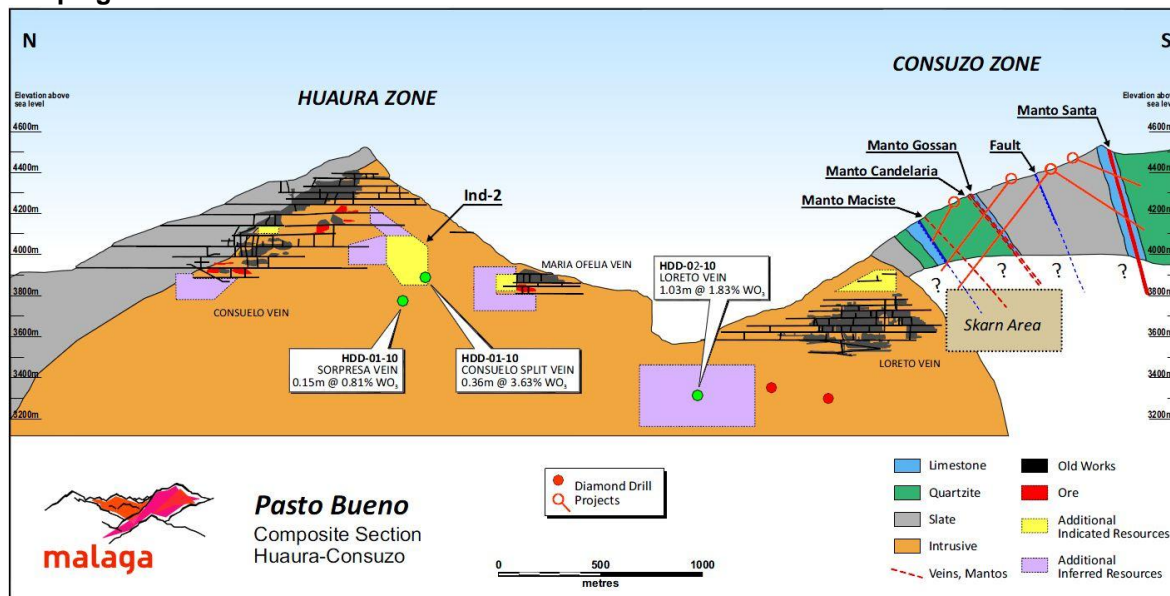
***Development Program***

In the current year, the Company planned an extensive development in the amount of \$3M to \$4M in ongoing underground development work in the Huaura and Huayllapon sectors that are currently being mined. The objective of this underground development is to replace the mined reserves and define new additional reserves and resources. 7,300 meters of underground advancements is forecasted. During the quarter, 1,309 meters of underground development work was completed, in line with the program that was set out at the beginning of the year. The current production is being extracted from four veins (Consuelo, Candela, Alonso Fenix, and Chabuca). Considering the shortage of qualified workers, it is expected that instead of 7,300 meters 4,400 meters of advancement will be achieved in the current year.

**2011 Drilling Campaign**

In addition, the Company has announced the commencement of an \$1.5M exploration campaign. In 2010, Malaga partially reopened the old mine at the Consuzo zone and extracted more than 1,000 tonnes at an average grade of 1.5% WO<sub>3</sub>. Malaga also drilled an exploratory hole HDD 02 10 in this zone which was 390.8 meters long and intersected the northern extension of the Loreto vein, 250 meters below the level corresponding to the Pelagatos river which runs alongside the old Consuzo mine and plant. This hole intersected a section containing 1.83% WO<sub>3</sub> over a width of 1.03 meter. The company thus decided to further explore this old mine at the Consuzo zone and drilled two long range drill holes. Results will be published during Q3. Immediately after drilling these two holes the company started drilling the four manto structures: Maciste, Gossan, Candelaria and Santa. Malaga plans to drill 10 holes adding up to a total of 4,900 meters in these promising structures. The Manto Santa is particularly interesting since it is the thickest manto structure and a channel sample taken in 2010 found a grade of 1.17% WO<sub>3</sub> over 6.8 meters. It will be one of the focal exploration points during the 2011 drilling campaign that is expected to be completed by the end of the year.

### Map showing the Consuzo zone and the 4 Manto structures that are the targets of the 2011 drilling campaign



M. Alonso Sanchez, Chief Geologist of the Company, is Malaga's "Qualified Person" for all matters related to sampling procedures, technical information and the supervision of ongoing development work through his regular visits to the site. Thus, he can confirm the precision and accuracy of the data and the mining and geological data and knowledge of the property, as required by National Instrument 43-101 and its annexes.

#### Accidents at the Pasto Bueno mine results in two fatalities

The Company had two accidents at the Pasto Bueno mine during Q2 2011 resulting in the death of two workers employed by two of Malaga's subcontractors. Official investigations by the Peruvian authorities have been completed to determine the circumstances that led to the accidents. The investigations concluded that in both cases they were accidents and that no fault was attributed to the Company. Six safety and worker training recommendations were made and Malaga has implemented these recommendations to ensure that we continue to maintain the highest safety standards. Malaga has a special health and safety unit that oversees and ensures that Malaga complies with all the mandatory mining safety rules and regulations. This unit is composed of 9 health and safety officers under the supervision of a professional health and safety superintendent.

#### 9-MILLING OPERATIONS

##### *Plant*

The project consisting in adding screens expected to be initiated in Q3 has been postponed. Some technicals analyses need to be completed before undertaking such project. This would increase the recovery rate. Other projects that would provide yield and recovery improvements will also be evaluated based on their internal rate of return and payback.

##### *Hydro-electricity*

In light of building of new 19 to 35 MW hydro power plant, Hidropesac is carrying out environmental and archeological studies required by the Peruvian authorities in order to obtain the permanent hydro-electrical concession. Agreements with regional governmental bodies and local communities will be concluded with the objective to start construction in late 2012. This major project would give Malaga complete autonomy in terms of power generation, would sustain its planned production growth, decrease its production costs permanently and eventually generate important value. In Q2-2011, energy cost accounted for 9% of Malaga's cash cost.

**Environment**

The Company recorded an asset retirement obligations for the mine in the amount of \$0.6M. This liability is related to the Company's obligation to conform to the Peruvian governmental regulations concerning environmental protection.

The construction of the new tailings pond is on-going. It is scheduled to be completed by Q4-2011 in order to support the installed capacity of 500 tpd. Its expected life is five years at 600 tpd. After its construction, the Peruvian authorities should deliver the operating permits.

**10-OUTLOOK FOR 2011**

The Company has an installed capacity of 500 tpd at the plant. Currently the mine is unable to support the plant at that rate. However, the Company has commenced an extensive capital expenditure program to bring the mine capacity to 500 tpd. It is not expected that the mine will be able to produce more than 400 tpd for the remaining of the year. This will have an impact on the estimated plant production in 2011. Malaga revised its annual production forecast to between 60,000 and 65,000 MTUs for 2011.

In 2011, the Company has undertaken a development program in the amount of \$3.0M to \$4.0M. This investment is made to increase the reserves and resources to support the increasing production capacity at the plant and demonstrate the potential of the property. In addition, the Company has initiated a \$1.5M exploration campaign which will have the mantos as its main focus. The exploration program should be completed by year-end.

Current market conditions, show continued growth for the demand of tungsten and there is no new significant production capacity increases outside of China envisioned before at least 2014. As such, APT price has increased 78% in 2010 and for the first eight months of 2011 APT price has increased by 38%. The Company believes that market prices will remain strong based on the fact that the market demand exceeds the current production capacity and the current demand of tungsten is growing as there is no replacement product for tungsten in the market currently. The tight supply of tungsten is not expected to be alleviated in the short term. New mining operations are not likely to come online and supply the market with the needed tonnage. This factor, as well as increasing demand for the metal, should support prices going forward. In addition, in June 2010, the European Commission published a report identifying 14 critical minerals for Europe which includes tungsten. Tungsten is also considered a critical mineral by the United States.

**11-CRITICAL ACCOUNTING ESTIMATES**

The critical accounting estimates are those that require assumptions on matters that are substantially uncertain at the time of the estimate, that should the assumptions be modified, it would have a material impact on the reported earnings or the financial position of the Company. The principle accounting estimates relate to the value of mining properties and deferred exploration costs, among other things. A description of the Company's main accounting policies can be found in the Company's audited consolidated financial statements filed electronically on the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com).

**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. The Company's mineral reserve estimates are calculated by qualified persons in accordance with National Policy 43-101. At January 1, 2010, the Company's measured and indicated mineral resources amounted to 398,845 tonnes which include the proven and probable mineral reserves of 169,427 tonnes.

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 exchanges 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.

**Investments**

The Company monitors the events or changes in circumstances that would require the evaluation of a possible impairment in the value of its investment in Dynacor. As at June 30, 2011, the total market value of its investment in Dynacor amounted to \$3.2M.

**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.

The Company records 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 probable 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.

**12- 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.

### 13-INTERNATIONAL FINANCIAL REPORTING STANDARDS

Effective January 1, 2011, International Financial Reporting Standards (“IFRS”) became Canadian GAAP (“CDN GAAP”) for publicly accountable enterprises. As a result, our interim condensed consolidated have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting and IFRS 1 First Time Adoption of International Financial Reporting Standards (“IFRS 1”) using accounting policies consistent with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”). As the transition date to IFRS was January 1, 2010, the Company prepared the opening IFRS consolidated statement of financial position at that date.

The Company has developed and executed a changeover plan in order to begin reporting in accordance with IFRS from January 1, 2011. The changeover plan included an scoping and diagnostic phase, a impact analysis, evaluation and design phase, and the implementation and review phase, each of which set out activities to be performed over the life of the project, resulting in the Corporation’s first interim reporting under IFRS for the first quarter of 2011. The implementation phase will continue to culminate in the preparation of our financial reporting under IFRS in 2011.

Throughout 2011, we will continue to execute the final phase of our changeover plan. Activities in this respect include continuing to execute business process and internal control changes, testing internal controls impacted by our IFRS changeover in connection with our 2011 annual internal controls program, monitoring accounting and regulatory developments and evaluating impacts on our financial reporting, and continuing to fulfill presentation and reporting requirements.

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 above, including the application of IFRS 1. The effect of the transition to IFRS on equity, comprehensive income and the cash flows is presented and described in this note, and is explained in greater detail in the notes associated with the tables.

The Company has previously disclosed in its first quarter report for the three months ended March 31, 2011, reconciliations of the Company’s condensed IFRS balance sheet as at January 1, 2010, March 31, 2010 and December 31, 2010 and condensed comparative interim consolidated IFRS statements of earnings and comprehensive income for the three months ended March 31, 2010 and the year ended December 31, 2010.

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 1<sup>st</sup>, 2010.
- *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 1<sup>st</sup>, 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 Canadian GAAP approximates the fair value.
- 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.

**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.

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\$)
<b>Assets</b>						
<b>Current assets</b>						
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
<b>Non-current assets</b>						
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
<b>Total assets</b>		<b>25,814,891</b>	<b>24,248,442</b>	<b>(105,750)</b>	<b>3,682,301</b>	<b>27,824,993</b>
<b>Liabilities</b>						
<b>Current liabilities</b>						
Accounts payable and accrued liabilities		4,617,657	4,337,457	-	-	4,337,457
Income tax payable	(f1)	125,699	118,072	-	-	118,072
Unearned revenues		231,569	217,517	-	-	217,517
Current portion of long-term debt		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
<b>Non-current liabilities</b>						
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
<b>Shareholders' equity</b>						
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)
<b>Total equity</b>		<b>13,671,209</b>	<b>12,841,640</b>	<b>(113,088)</b>	<b>2,648,531</b>	<b>15,377,083</b>
<b>Total liabilities and equity</b>		<b>25,814,891</b>	<b>24,248,442</b>	<b>(105,750)</b>	<b>3,682,301</b>	<b>27,824,993</b>

**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**

	<b>As at June 30, 2010</b>
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

**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

	<b>As at June 30, 2010</b>
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 as 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

	<b>As at June 30, 2010<sup>1</sup></b>
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

<sup>1</sup> Investment in associate

**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**

	<b>As at June 30, 2010</b>
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.

## f) Loan payable to a customer

## 1) Long term Debt

	<b>As at June 30, 2010</b>
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

	<b>As at June 30, 2010</b>
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

	<b>As at June 30, 2010</b>
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.

**g) Deficit**

	<b>As at June 30, 2010</b>
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	<b>Net income (loss)</b>	<b>Other comprehensive income (loss)</b>	<b>Comprehensive income (loss)</b>
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
	28,496	-	28,496
Change in functional Currency	229,493	-	229,493
		-	
IFRS US\$	257,989	-	257,989

**i) Comprehensive income for the period**

Six months ended June 30, 2010	Net income (loss)	Other comprehensive income (loss)	Comprehensive income (loss)
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.

**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.

The International Accounting Standards Board (IASB) continues to amend and add to current IFRS standard with several projects underway. The Company's transition plan includes monitoring actual and anticipated changes to IFRS, including interpretations thereof, and related rules and regulations and assessing the impacts of these changes on the Company and its financial statements, including expected dates of when such impacts are effective.

**14-NON-GAAP MEASURES**

Throughout this document, the Company has provided measures prepared according to IFRS and Canadian GAAP, as well as some non -GAAP financial performance measures. Because the non-GAAP performance measures do not have any standardized definition prescribed by IFRS and Canadian GAAP, they may not be comparable to similar measures presented by other companies. The Company provides these non-GAAP financial performance measures as they may be used by some investors to evaluate our financial performance. Accordingly, they are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS and Canadian GAAP. These non-GAAP financial performance measures not already reconciled within the document, we have defined the non-GAAP financial performance measures were reconciled to reported IFRS and Canadian GAAP measures within the document.

**15-RISKS AND UNCERTAINTIES**

The exploration for development and mining of mineral deposits involves significant risks, which even a combination of careful evaluation, experience and knowledge may not eliminate. For additional discussion of risk factors, please refer to the Company's Annual Information Form which is available upon request from the Company or on its profile at [www.sedar.com](http://www.sedar.com).

**16-DISCLOSURE CONTROLS AND PROCEDURES**

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of the Company are responsible for establishing and maintaining the Company's disclosure controls and procedures, including adherence to the Disclosure Policy adopted by the Company. The Disclosure Policy requires all staff to keep senior management fully apprised of all material information affecting the Company so that they may evaluate and discuss this information and determine the appropriateness and timing for public release. The CEO and CFO evaluated the effectiveness of the Company's disclosure controls and procedures as required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators. They concluded that as of June 30, 2011 the Company's design and operation of its disclosure controls and procedures were effective in providing reasonable assurance that material information regarding this report, and the consolidated financial statements and other disclosures was made known to them on a timely basis.

Management has developed a system for internal controls over financial reporting (ICFR) in order to provide reasonable assurance with regards to the reliability of the financial information published and the preparation of the financial statements in accordance with Generally Accepted Accounting Principles in Canada.

ICFR relating to the implementation of the relevant controls that ensure management that, as part of the IFRS transition and the change in functional currency of the Peruvian subsidiaries, the analysis of the potential income tax impact on the financial statement is complete was implemented effectively from April 1, 2011 through June 30, 2011.

The Chief Executive Officer and the Chief Financial Officer evaluated the design of the ICFR as at June 30, 2011. Pursuant to their evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the internal controls over financial reporting (ICFR) are effective. In addition, the Chief Executive Officer and the Chief Financial Officer of the Company are responsible for developing internal controls over financial reporting or the supervision of their development.

**17-CAUTION REGARDING FORWARD LOOKING STATEMENTS**

Statements contained in this document that are not historical facts are regarded as forward-looking statements. These statements may involve risk, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. Many factors could cause such differences, including: volatility in market metal prices; changes in foreign currency exchange rates and interest rates; unexpected variations in geological conditions of a property of erroneous geological data; environmental risks including increased regulatory constraints; unexpected adverse mining conditions; adverse political conditions, and changes in government regulations and policies. Although the Company believes that the assumptions inherent in the forward-looking statements are reasonable, undue reliance should not be placed on these statements, which only apply as of the date of this document. The Company has not committed to maintaining this forward-looking information unless so required by law.

(s) Jean Martineau \_\_\_\_\_

Jean Martineau

Chairman and Chief Executive Officer

(s) Joey Trombino \_\_\_\_\_

Joey Trombino

Vice-President and Chief Financial Officer