

Malaga Inc.

Consolidated Financial Statements

Years Ended December 31, 2010 and 2009

March 29, 2011

Independent Auditor's Report

To the Shareholders of Malaga inc.

We have audited the accompanying consolidated financial statements of **Malaga inc.**, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, comprehensive income, accumulated other comprehensive income and deficit, and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Malaga inc. as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PriceWaterhouseCoopers LLP¹

¹ Chartered accountant auditor, permit No. 14707

Malaga Inc.

Consolidated Balance Sheets as of December 31

	2010	2009
	\$	\$
ASSETS		
CURRENT ASSETS		
Cash	2,825,256	1,149,101
Accounts receivable (Note 4)	2,002,896	1,198,625
Income tax instalments receivable	819,748	695,432
Inventories (Note 5)	2,116,901	1,369,423
Prepaid expenses	201,981	182,204
	<u>7,966,782</u>	<u>4,594,785</u>
Investments in associates (Note 6)	205,766	2,471,942
Investment (Note 7)	4,619,454	-
Property, plant and equipment (Note 8)	10,448,476	8,801,346
Mining properties and deferred development and exploration costs (Note 9)	5,151,527	6,034,270
	<u>28,392,005</u>	<u>21,902,343</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (Note 10)	3,424,313	4,126,056
Income taxes payable	-	45,996
Unearned revenues	891,934	199,065
Current portion of long-term debt (Note 11)	1,234,347	1,077,887
Current portion of obligations under capital leases (Note 12)	132,108	264,030
	<u>5,682,702</u>	<u>5,713,034</u>
Long-term debt (Note 11)	2,709,810	3,169,889
Deferred revenues (Note 11)	1,249,766	1,726,994
Obligations under capital leases (Note 12)	65,462	206,744
Asset retirement obligations (Note 13)	600,890	578,845
	<u>10,308,630</u>	<u>11,395,506</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 14)	43,738,368	39,536,003
Warrants (Note 14)	748,888	-
Contributed surplus (Note 15)	3,838,464	3,539,644
Conversion option (Note 11)	319,903	319,903
Deficit	(33,784,355)	(32,888,713)
Accumulated other comprehensive income	3,222,107	-
	<u>18,083,375</u>	<u>10,506,837</u>
	<u>28,392,005</u>	<u>21,902,343</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 the consolidated financial statements.

Malaga Inc.**Consolidated Statements of Operations for the years ended December 31**

	2010	2009
	\$	\$
Sales (Note 17)	14,831,380	11,177,720
Cost of sales (excluding amortization and depletion) (Note 17)	(9,924,844)	(9,575,834)
Amortization and depletion	(3,778,764)	(4,087,901)
Accretion expense of asset retirement obligations (Note 13)	(22,045)	(80,000)
Gain on sale of property, plant and equipment	-	25,142
Income (loss) from mining activities	1,105,727	(2,540,873)
General and administrative expenses (Note 18)	(2,786,192)	(2,605,539)
Stock-based compensation	(298,820)	(153,111)
Operating loss	(1,979,285)	(5,299,523)
Interest expense	(755,556)	(395,965)
Accretion expense of long-term debt	(584,385)	(320,811)
Foreign exchange gain	206,765	756,733
Loss before undernoted	(3,112,461)	(5,259,566)
Share of loss in investment using equity method	(336,657)	(871,371)
Gain on sale of investment in company under significant influence	572,467	-
Gain on reimbursement of the promissory note receivable	1,066,896	-
Dilution gain on investment in company under significant influence	345,513	-
Impairment in investment value (Note 6)	-	(1,504,332)
Loss before income taxes	(1,464,242)	(7,635,269)
Recovery of future income taxes (Note 16)	568,600	-
Net loss	(895,642)	(7,635,269)
Loss per share, basic and diluted	(0.01)	(0.05)
Weighted average number of outstanding common shares		
Basic	168,812,911	140,770,271
Diluted	193,953,302	140,770,271

The accompanying notes are an integral part of the consolidated financial statements.

Malaga Inc.

Consolidated Statements of Comprehensive Income, Accumulated Other Comprehensive Income and Deficit, for the years ended December 31

	2010	2009
	\$	\$
Net loss	(895,642)	(7,635,269)
Other comprehensive income, net of income taxes:		
Net variation in the latent gain on available-for-sale investments	3,222,107	-
Comprehensive Income (loss)	<u>2,326,465</u>	<u>(7,635,269)</u>
Accumulated other comprehensive income, beginning of year	-	-
Other comprehensive income	3,222,107	-
Accumulated other comprehensive income, end of year	<u>3,222,107</u>	<u>-</u>
Deficit, beginning of year	(32,888,713)	(25,253,444)
Net loss	(895,642)	(7,635,269)
Deficit, end of year	<u>(33,784,355)</u>	<u>(32,888,713)</u>

The accompanying notes are an integral part of the consolidated financial statements.

Malaga inc.**Consolidated Statements of Cash Flows for the years ended December 31**

	2010	2009
	\$	\$
Operating activities		
Net loss	(895,642)	(7,635,269)
Items not affecting cash		
Amortization and depletion	3,778,764	4,087,901
Amortization of deferred revenues	(398,408)	(278,767)
Accretion expense of asset retirement obligation (Note 13)	22,045	80,000
Accretion expense of long-term debt	584,385	320,811
Stock-based compensation (Note 14)	298,820	153,111
Recovery of future income taxes (Note 16)	(568,600)	-
Gain on sale of property, plant and equipment	-	(25,142)
Gain on sale of investment in company under significant influence	(572,467)	-
Gain on reimbursement of the promissory note receivable	(1,066,896)	-
Share of loss in investments using equity method	336,657	871,371
Dilution gain on investment in company under significant influence	(345,513)	-
Impairment in investment value (Note 6)	-	1,504,332
Interest on due to the workers in Peru (Note 11)	328,284	-
Foreign exchange gain on long-term debt reimbursement	(125,870)	-
Unrealized foreign exchange gain	(161,590)	(966,126)
	<u>1,213,969</u>	<u>(1,887,778)</u>
Change in non-cash working capital items (Note 19)	(1,786,297)	1,209,405
	<u>(572,328)</u>	<u>(678,373)</u>
Investing activities		
Short-term investments	-	800,000
Proceeds from sale of property, plant and equipment	17,763	253,193
Net proceeds from sale of investment	705,000	-
Proceeds from the reimbursement of the promissory note	2,586,414	-
Investment in entity under significantly influence	(205,766)	-
Acquisition of property, plant and equipment	(3,462,677)	(2,803,740)
Additions to mining properties and deferred development and exploration costs	(1,015,531)	(2,289,027)
	<u>(1,374,797)</u>	<u>(4,039,574)</u>
Financing activities		
Proceeds of bank loans	-	2,441,427
Repayments of bank loans	-	(3,318,019)
Proceeds of long-term debt	-	6,018,670
Repayment of long-term debt	(1,054,769)	(10,849)
Issuance of shares	4,662,233	1,150,698
Share issuance expenses	(428,247)	(60,000)
Issuance of warrants	717,267	-
Re-payment of obligations under capital lease	(273,204)	(310,915)
	<u>3,623,280</u>	<u>5,911,012</u>
Increase in cash during the year	1,676,155	1,193,065
Cash (bank indebtedness), beginning of the year	1,149,101	(43,964)
Cash, end of the year	<u>2,825,256</u>	<u>1,149,101</u>

Additional information on cash flows (Note 19)

The accompanying notes are an integral part of the consolidated financial statements.

Malaga Inc.

Notes to consolidated financial statements
December 31, 2010 and 2009

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. Significant accounting policies

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. All intercompany balances and transactions are eliminated on consolidation.

Investments in Associates

The investments in Hidroeléctrica Pelagatos S.A.C. (49%) and Dynacor Gold Mines Inc. (10.2%) for which the Company exercises significant influence, are accounted for using the equity method. The Company ceased to exercise significant influence over Dynacor Gold Mines Inc. on December 17, 2010, and therefore the equity method was used up to the date that significant influence ceased. According to this method, the investments are recorded at cost and the Company's share of profits or losses of associate is recognized in the statement of operations 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 year-end 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 statement of income.

Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities shown on the consolidated balance sheet, the contingency mentioned at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period.

The significant estimates in connection with these consolidated financial statements are those related to the useful life and residual value of property, plant and equipment, the recoverable value of mining properties and deferred development and exploration expenses, the assessment of reserves and resources, stock-based compensation, warrants, contingent liabilities, the asset retirement obligation for property, plant and equipment, and the impairment in the value of investments. Actual results could differ from these estimates.

Revenue recognition

Revenue is recorded when convincing evidence of an arrangement exists, delivery has occurred under the terms of the arrangement and these are no longer under the physical control of the Company, the price is fixed or determinable and collection is reasonably assured. Additional revenues from the sale of by-products, such as copper, are recorded in sales.

Malaga Inc.

Notes to consolidated financial statements
December 31, 2010 and 2009

2. Significant accounting policies (cont'd)

Cash and cash equivalents

Cash and cash equivalents are classified as held for trading and are valued at their fair market value. 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.

Investments

Investments, over which the Company exerts significant influence, are accounted for using the equity method. Under this method, the Company's share of the earnings and losses is included in operations and the investment therein is adjusted by a like amount. When in management's opinion there has been a loss in value that is other than a temporary decline, the carrying value is reduced to estimated realizable value.

Property, plant and equipment

Property, plant and equipment including the assets under a capital lease are accounted for at cost. Amortization is based on their estimated life using the diminishing balance method at the following annual rates:

	Rates
Building	5%
Vehicles	25%
Plant and mining equipment	30%
Office equipment	30%

When a project is put into commercial production, mining properties, deferred development and exploration costs are transferred to property, plant and equipment. Amortization is calculated using the units of production method based on the proven and probable reserves and the non-reserve resources when sufficient objective evidence exists to support the conclusion that it is probable that the non-reserve resources will be produced. Exploration and development costs incurred on a property in production are capitalized in property, plant and equipment.

Mining properties and deferred development and exploration expenses

Exploration properties comprise mining rights and deferred exploration and development costs on properties at the exploration and development stages and are recorded at their acquisition cost or at their fair value in the case of a devaluation caused by an impairment of value. Each property is accounted for as a separate project. Costs related to the acquisition, exploration and development of non-producing mining properties are capitalized by property until the beginning of commercial production. When commercially profitable ore reserves are developed, related capitalized costs are reclassified to property, plant and equipment as mining assets and amortized using the units of production method.

The mining assets are tested for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable, which is determined by comparing the asset's book value with estimated future undiscounted cash flows for expected use and for eventual disposal of the assets. The impairment loss represents the excess carrying value over the fair value, which is mainly calculated by discounting estimated future cash flows to be derived from the use and eventual disposal of the assets. If the Company does not have sufficient information on its mining assets 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 operations.

Malaga Inc.

Notes to consolidated financial statements
December 31, 2010 and 2009

2. Significant accounting policies (cont'd)

Mining properties and deferred development and exploration expenses (cont'd)

The recoverability of amounts recorded for non-producing mining properties and deferred exploration expenses is dependent upon the discovery of economically recoverable 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.

Impairment of long-lived assets

The Company monitors events and changes in circumstances, which may require an assessment of the recoverability of its long-lived assets. The Company assesses recoverability using estimated undiscounted future cash flows from its use and residual value. If it is determined that the net recoverable amount of a long-lived asset is less than the carrying amount, determined according to the discounted future cash flows, long-lived assets are written down to the net recoverable amount and a corresponding impairment loss is recorded on the statement of operations.

Management's estimate of future cash flows is subject to risks and uncertainties. Therefore, it is reasonably possible that changes could occur which may affect the recoverability of the Company's property, plant and equipment.

Foreign currency translation and integrated foreign subsidiaries

The accounts of the Company's integrated subsidiaries and balances denominated in foreign currencies are translated using the temporal method. This method translates foreign currency monetary assets and liabilities into Canadian dollars at the rate of exchange at the consolidated balance sheet dates, non-monetary balances at historical exchange rates and revenue and expense items at transaction dates. The resulting gains and losses are included in the consolidated statements of operations.

Financial instruments

The Company uses different financial instruments. All financial instruments are required to be measured at fair value on initial recognition, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held for trading, available for sale, held to maturity, loans and receivables, or other liabilities. The Company classifies its financial instruments into one of the following categories based on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Held-for-trading

This category is comprised of certain investments in debt instruments, stand-alone derivatives, other than those designated as hedging items, and embedded derivatives requiring separation. They are carried in the balance sheet at fair value with changes in fair value recognized in the consolidated statement of operations.

Loans and receivables

These assets are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on specified dates, or on demand. They arise principally through the provision of goods and services to customers, but also incorporate other types of contractual monetary assets. They are initially recognized at fair value and subsequently carried at amortized cost, using the effective interest rate method, less any provision for impairment recorded on the consolidated statement of operations.

Malaga Inc.

Notes to consolidated financial statements
December 31, 2010 and 2009

2. Significant accounting policies (cont'd)

Available-for-sale investments

Available-for-sale financial assets are required to be measured at fair value, with unrealized gains and losses recognized in other comprehensive income. If an available for sale investment is sold or disposed of, the gains or losses will be recorded in statement of operations. Investments in equity instruments classified as available for sale that do not have a quoted market price in an active market should be measured at cost

Held-to-maturity investments

These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the company's management has the positive intention and ability to hold to maturity. These assets are initially recognized at fair value and subsequently carried at amortized cost, using the effective interest rate method, less any provision for impairment recorded on the consolidated statement of operations.

Other financial liabilities

Other financial liabilities include all financial liabilities other than those classified as held-for-trading and comprises bank loans, accounts payable and long-term debt. These liabilities are initially recognized at fair value and subsequently carried at amortized cost using the effective interest rate method.

The Company classified financial instruments as follows:

- Cash and short-term investments are classified as held-for-trading
- Investments are classified as available-for-sale ;
- Trade accounts receivable, advances and other receivables classified as loans and receivables
- Bank loans, accounts payable, obligation under capital lease and long term debts classified as other liabilities.

Income Taxes

The Company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse.

The Company establishes a valuation allowance against future income tax assets if, based upon available information, it is more likely than not that some or all of the income tax assets will not be realized.

Share Issuance Expenses

The share capital is presented net of share issuance expenses.

Earnings Per Share

Earnings per share are calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share reflect the potential dilution of common share equivalents, such as outstanding stock options, warrants and convertible debt, in the weighted average number of common shares outstanding during the year, if dilutive.

In the case of a net 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.

Malaga Inc.

Notes to consolidated financial statements
December 31, 2010 and 2009

2. Significant accounting policies (cont'd)

Asset Retirement Obligations

The total amount of the estimated cash flow required to settle the obligations arising from regulatory requirements for acceptable closure and post-closure plans is discounted based on the Company's credit-adjusted risk-free rate and is recorded as a liability. The counterpart of these obligations is capitalized to property, plant and equipment. The asset retirement obligations recorded are adjusted for accumulated accretion in accordance with the expected timing of cash flow payments required to settle these obligations

Stock-based Compensation Plan

The Company has a stock-based compensation plan, which is described in Note 14. The Company accounts for all stock-based compensation using the fair value method. This method consists of recording expenses to the statement of operations based on the vesting of the options granted and the counterpart is accounted for in contributed surplus on the balance sheet. The fair value is calculated based on the Black-Scholes valuation model. When stock options are exercised, any consideration paid is credited to share capital, together with the related portion previously recorded to contributed surplus.

3. Future Accounting Changes

The Company will cease to prepare its consolidated financial statements in accordance with Canadian GAAP as set out in Part V of the CICA Handbook - Accounting ("Canadian GAAP") for the periods beginning on January 1, 2011 when it will start to apply International Financial Reporting Standards as published by the International Accounting Standards Board as set out in Part I of the CICA Handbook – Accounting as its primary basis of accounting. Consequently, future accounting changes to Canadian GAAP are not discussed in these consolidated financial statements as they will never be applied by Malaga.

4. Accounts Receivable

	2010	2009
	\$	\$
Accounts receivable	710,771	77,722
Sale taxes receivable	1,098,044	626,225
Advances to suppliers	43,213	30,057
Accounts receivable from a company under significant influence	150,868	238,304
Accounts receivable from a related company ¹	-	226,317
	<u>2,002,896</u>	<u>1,198,625</u>

¹ Dynacor Gold Mines Inc. was a company over which the Company exercised significant influence until December 17, 2010, the date it ceased its ability to exercise significant influence. The Company's ownership percentage of Dynacor Gold Mines Inc. at December 31, 2010 was 10.2% (13.5% at December 31, 2009). (see Notes 6 and 7).

Malaga Inc.

Notes to consolidated financial statements
December 31, 2010 and 2009

5. Inventories

	2010	2009
	\$	\$
Finished products	180,838	260,819
Inventory in transit	1,263,545	1,206,071
	<u>1,444,383</u>	<u>1,466,890</u>
Write-down of inventory value	-	(485,252)
	<u>1,444,383</u>	<u>981,638</u>
Work in process	147,678	56,247
Supplies	524,840	331,538
	<u>2,116,901</u>	<u>1,369,423</u>

The cost of inventory charged to expense represents all cost of sales and essentially all amortization and depletion. As at December 31, 2010, no write-down of inventories (\$485,252 in 2009) was included in the cost of sales to reflect the net realizable value.

6. Investments in Associates

	2010	2009
	\$	\$
<i>Dynacor Gold Mines Inc.</i>		
Investment at beginning of year	952,424	2,255,130
Sale of shares	(132,533)	-
Share of net loss	(336,657)	(865,270)
Dilution gain	345,513	-
Transfer to available for sale investments	(828,747)	-
Impairment	-	(437,436)
Investment at end of year	<u>-</u>	<u>952,424</u>
Promissory note receivable in the amount of \$2,586,414 from Dynacor, without interest, convertible into common shares at \$0.40 per share (6,466,035 shares) at the option of Dynacor	-	2,586,414
Impairment	-	(1,066,896)
	<u>-</u>	<u>1,519,518</u>
Total	<u>-</u>	<u>2,471,942</u>
<i>Hidroeléctrica Pelagatos S.A.C.</i>		
Investment at beginning of year	-	6,101
Purchase of shares	205,766	-
Share of net loss	-	(6,101)
Investment at end of year	<u>205,766</u>	<u>-</u>
	<u>205,766</u>	<u>2,471,942</u>

During the current year, the Company sold 500,000 shares of Dynacor at a price of \$1.42 for gross proceeds of \$710,000, less \$5,000 in commission. The Company has also received the reimbursement of the entire promissory note for proceeds of \$2,586,414. In addition, the Company has invested \$205,766 in common shares of Hidroeléctrica Pelagatos S.A.C.

Based on the share price of Dynacor Gold Mines Inc. at December 31, 2009, a reduction in the value of the investment of \$1,504,332 was recorded to reflect its fair value.

Malaga Inc.

Notes to consolidated financial statements
December 31, 2010 and 2009

6. Investments in Associates (cont'd)

Investment in Dynacor Gold Mines Inc. ("Dynacor")

As at December 31, 2010, the Company owned 3,553,426 (4,053,426 in 2009) common shares or 10.2% (13.5% in 2009) of Dynacor. At December 31, 2010, the fair value of the investment in Dynacor was \$4,619,454 (\$972,822 in 2009) based on quoted market prices.

Change in status of investment in Dynacor Gold Mines Inc.:

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 CICA Section 3855, 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. On December 17, 2010, the Company recorded the following transition adjustments in its consolidated financial statements as resulting from the change in status of the investment: a reclassification of the carrying amount of the investment (Note 7) of \$828,747 and a re-measurement at its fair value through other comprehensive income of \$3,790,707 less taxes of \$568,600 giving a net amount 3,222,107.

7. Investments

	2010	2009
	\$	\$
Balance at the beginning of the year	-	-
Transfer from investment in associate	828,747	-
Net change in fair value recorded in other comprehensive income (Note 6)	3,790,707	-
Balance at the end of the year	<u>4,619,454</u>	<u>-</u>

As at December 31, 2010, the Company owned 3,553,426 common shares of Dynacor, representing an ownership 9.5% on a fully diluted basis.

Malaga Inc.

Notes to consolidated financial statements
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8. Property, Plant and Equipment

	2010			2009		
	Cost \$	Accumulated amortization & depletion \$	Net book value \$	Cost \$	Accumulated amortization & depletion \$	Net book value \$
Mining properties and deferred development and exploration costs	11,159,619	6,773,166	4,386,453	7,829,516	4,584,807	3,244,709
Land	113,656	-	113,656	113,656	-	113,656
Buildings	444,347	85,030	359,317	444,347	66,119	378,228
Plant and mining equipment	9,445,596	4,288,319	5,157,277	7,312,778	2,898,385	4,414,393
Vehicles	333,328	205,508	127,820	114,660	59,592	55,068
Office equipment	131,746	84,795	46,951	109,246	72,708	36,538
	21,628,292	11,436,818	10,191,474	15,924,203	7,681,611	8,242,592
Assets under capital leases						
Plant and mining equipment	531,487	274,485	257,002	702,366	226,110	476,256
Vehicles	-	-	-	190,023	107,525	82,498
TOTAL	22,159,779	11,711,303	10,448,476	16,816,592	8,015,246	8,801,346

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 \$1,898,274 (\$1,549,039 in 2009) were reclassified into mining properties and deferred development and exploration costs in property, plant and equipment. In addition, \$1,431,829 was capitalized in mining properties and deferred development and exploration costs for the year as a result of the replenishment of reserves in the areas currently in commercial operations.

As at January 1, 2010, the Company reassessed the expected operating life of the mine. This is a change to the accounting estimate resulting from new information and, therefore, requires prospective application from January 1, 2010. Since the quantities of reserves and resources significantly differ from the previous base used, this resulted in reducing the amortization expense for 2010. The amortization base is updated on an annual basis based on the technical report in compliance with National Instrument 43-101 *Standards of Disclosure for Mineral Projects*.

Malaga Inc.

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9. Mining Properties and Deferred Development and Exploration Costs

	Huayllapon II	Huaura II	Consuzo	Mining rights	Total 2010
	\$	\$	\$	\$	\$
Mining properties					
Balance, beginning of year	245,225	906,864	127,022	300,413	1,579,524
Acquisitions	-	-	-	-	-
Transferred to property, plant and equipment	(88,281)	(335,491)	(12,702)	-	(436,474)
Balance, end of year	156,944	571,373	114,320	300,413	1,143,050
Development and exploration costs					
Balance, beginning of year	674,125	3,463,986	316,635	-	4,454,746
Underground exploration and development expenses	362,901	635,977	16,653	-	1,015,531
Transferred to property, plant and equipment	(212,594)	(1,217,542)	(31,664)	-	(1,461,800)
Balance, end of year	824,432	2,882,421	301,624	-	4,008,477
TOTAL	981,376	3,453,794	415,944	300,413	5,151,527

	Huayllapon I	Huayllapon II	Huaura II	Consuzo	Mining rights	Total 2009
	\$	\$	\$	\$	\$	\$
Mining properties						
Balance, beginning of year	-	245,225	906,864	127,022	300,413	1,579,524
Acquisitions	-	-	-	-	-	-
Balance, end of year	-	245,225	906,864	127,022	300,413	1,579,524
Development and exploration costs						
Balance, beginning of year	1,549,039	229,670	1,936,049	-	-	3,714,758
Underground exploration and development expenses	-	444,455	1,346,694	497,878	-	2,289,027
Transferred to property, plant & equipment	(1,549,039)	-	-	-	-	(1,549,039)
Balance, end of year	-	674,125	3,282,743	497,878	-	4,454,746
TOTAL	-	919,350	4,189,607	624,900	300,413	6,034,270

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 \$1,898,274 (\$1,549,039 in 2009) 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, Saucó, Violeta, Candela veins as well as the area not in production of the Consuelo vein. The Consuzo sector includes the Loreta and María Ofelia veins.

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10. Accounts payable and accrued liabilities

	2010 \$	2009 \$
Accounts payable and accrued liabilities	2,761,017	3,580,363
Salaries and other	663,296	545,693
	<u>3,424,313</u>	<u>4,216,056</u>

11. Long-Term Debt

	2010 \$	2009 \$
Advance on future sales payable to customer, without interest, maturing March 31, 2014 (US\$1.2M) ¹	716,645	647,286
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 (US\$3.0M) ²	2,202,804	2,635,677
7.6% unsecured loan from the Peru tax authorities payable in 120 monthly instalments of 2,544 Peruvian Nuevo soles maturing in April 2012	44,254	42,658
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	711,880	610,891
Due to suppliers of a subsidiary in Peru with no interest and no fixed terms of repayment	268,574	311,264
	<u>3,944,157</u>	<u>4,247,776</u>
Less: current portion	<u>1,234,347</u>	<u>1,077,887</u>
	<u>2,709,810</u>	<u>3,169,889</u>

¹ On April 1 2009, the Company entered into a financing agreement whereby it received an advance on sales of US\$1.2M (\$1.5M CAD), bearing no interest, repayable on the last sales of the sales agreement. This amount has been discounted at an effective rate of 17%, or US\$547,392 (\$692,068 CAD). The difference of \$825,092 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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11. Long-Term Debt (Cont'd)

² In addition, the Company received a loan of US\$3.8M (\$4.5M CAD) 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 will be 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. The values of the liability component and the equity conversion component were 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 fair value of the conversion option, included in shareholders' equity, was calculated using the conversion probability given the facts at issuance of the debt.

The amount of the loan, net of the conversion option of \$319,903 (US\$270,050), has been discounted at an effective rate of 17%, or \$2,704,390 (US\$2,285,556). The difference of \$1,477,217 (US\$1,244,394) between the amount received and the liability, including the conversion option, was initially recorded as deferred revenue and is recognized as revenue over the expected shipments under the sales agreement.

The assets of the subsidiary have been pledged as collateral for the loan with the customer. As at December 31, 2010, the book value of assets pledged as security amounted to \$10.4M (\$8.4M in 2009).

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 \$328,284 has been recorded as interest expense in the current year.

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

	\$
2011	1,234,347
2012	1,191,455
2013	1,047,175
2014	1,447,390
2015	289,950

12. Obligations under capital leases

The future minimum lease payments due for the next two years are as follows:

	2010	2009
	\$	\$
2010	-	294,685
2011	142,470	156,972
2012	67,466	63,563
	<u>209,936</u>	<u>515,220</u>
Less: implicit interest from 9% to 14% (2009 – 8% to 14%)	<u>(12,366)</u>	<u>(44,446)</u>
	197,570	470,774
Less: amount due within one year	<u>132,108</u>	<u>264,030</u>
	<u>65,462</u>	<u>206,744</u>

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Notes to consolidated financial statements
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13. Asset retirement obligations for property, plant and equipment

The Company's operations are governed by a mining agreement covering the protection of the environment. The Company will implement progressive measures for rehabilitation work during the operation, closing down and follow-up work upon closing of the mine. Consequently, the Company accounted for its asset retirement obligations for the property, plant and equipment using cost estimates. These estimates are subject to change following modifications to laws and regulations or as new information become available.

The table below presents the evolution of the asset retirement obligations for the mining operations for the year.

	2010	2009
	\$	\$
Balance at the beginning of the year	578,845	498,845
Increase due to accretion expense	22,045	80,000
Balance at the end of the year	<u>600,890</u>	<u>578,845</u>

The estimated undiscounted cash flows required to settle the asset retirement obligations for the transformation plant is \$1,107,000. These disbursements are expected to be made in the years 2027 and 2028. A 9% discount rate was used to evaluate these obligations.

14. Share Capital

a) Common Shares

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 paid

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

	2010		2009	
	Number of shares	Amount	Number of shares	Amount
Balance, beginning of year	147,686,843	39,536,003	137,117,367	38,445,305
Rights exercised	-	-	9,006,976	900,698
Shares issued ¹	35,863,333	4,662,233	1,562,500	250,000
Share issuance expenses ¹	-	(459,868)	-	(60,000)
Balance, end of year	<u>183,550,176</u>	<u>43,738,368</u>	<u>147,686,843</u>	<u>39,536,003</u>

¹ During the year, the Company completed a two tranche private placement of 35,863,333 units at a price of \$0.15 per unit for a cash consideration of \$5,379,500. Each unit consists of one common share and one warrant which entitles the holder to purchase one common share at a price of \$0.25 with a two year maturity. From the total proceeds received, \$4,662,233 was assigned to share capital and \$717,267 was assigned to the warrants, according to their respective estimated fair value. Share issuance expenses for this private placement amounted to \$459,868 which includes an amount of \$31,621 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 \$122,250.

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Notes to consolidated financial statements
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14. Share Capital (cont'd)

In 2009, the Company received gross proceeds of \$840,698, net of share issuance expenses of \$60,000, following the exercise of 9,006,976 rights issued in June 2009 which led to the issuance of 9,006,976 common shares at \$0.10 per share.

In addition, in 2009, the Company received gross proceeds of \$250,000 following the issuance of 1,562,500 common shares at \$0.16 per share.

b) Warrants, Ordinary and Broker

	2010		2009	
	Number of warrants	Amount	Number of warrants	Amount
		\$		\$
Balance, beginning of year	-	-	-	-
Issuance ordinary	35,863,333	717,267	-	-
Issuance broker	1,405,933	31,621	-	-
Balance, end of year	37,269,266	748,888	-	-

During the year, as part of the two tranche private placement, the Company issued 35,863,333 ordinary warrants and 1,405,933 broker warrants. Each warrant is exercisable at a price of \$0.25 with 18,321,667 ordinary warrants and 1,405,933 broker warrants expiring on May 6, 2012 and 17,541,666 ordinary warrants expiring on June 23, 2012. The ordinary warrants and the broker warrants were valued using the Black-Scholes valuation model using the following assumptions: dividend yield of 0%, credit adjusted risk free interest rate of 1.9%, expected life of two years, and expected volatility of 90%. The ordinary warrants were assigned a value of \$717,267 and was recorded as part of shareholder equity until they are exercised at which time they will be transferred to share capital. The value of the brokers warrants amounts to \$31,621 and was recorded as share issuance expenses.

Outstanding ordinary and broker warrants as at December 31, 2010 are as follows:

Expiry Date	Number of Warrants	Exercise Price (\$)
May 6, 2012	19,727,600	0.25
June 23, 2012	17,541,666	0.25
Total	37,269,266	

Malaga Inc.

Notes to consolidated financial statements
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14. Share Capital (cont'd)

c) 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, no shares were issued as at December 31, 2010 (nil in 2009). As at December 31, 2010, the company had issued options, allowing for the subscription of 8,150,000 common shares of its share capital.

	2010		2009	
	Number of options (in '000)	Weighted average exercise price \$	Number of options (in '000)	Weighted average exercise price \$
Balance, beginning of year	5,680	0.40	6,160	0.40
Granted	3,600	0.16	-	-
Forfeited	(680)	0.32	(50)	0.33
Expired	(450)	0.56	(430)	0.31
Balance, end of year	8,150	0.29	5,680	0.40
Exercisable options	5,558	0.34	4,795	0.42

Outstanding options as at December 31, 2010 are as follows:

Range of exercise prices (\$)	Average residual life span (in years)	Outstanding options (in '000)	Weighted average exercise price (\$)	Exercisable options (in '000)	Weighted average exercise price (\$)
0.14 to 0.18	6.0	3,540	0.16	1,476	0.15
0.28 to 0.42	3.7	3,340	0.31	2,812	0.31
0.50 to 0.69	1.1	800	0.55	800	0.55
0.70 to 0.77	6.5	470	0.77	470	0.77
0.14 to 0.77		8,150	0.29	5,558	0.34

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Notes to consolidated financial statements
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14. Share Capital (cont'd)

As at December 31, 2010, a total of 3,600,000 new stock options were granted (nil in 2009) and the fair value of the options granted was estimated at \$432,500 (nil in 2009). The fair value assigned to the options was estimated using the Black-Scholes valuation model based on the following assumptions:

	2010	
	June 17	January 11
Number of options	610,000	2,990,000
Risk-free interest rate	2.9%	3.0%
Expected life	84 months	84 months
Expected estimated volatility	90%	90%
Dividend yield	nil	nil

For the year ended December 31, 2010, the stock-based compensation charged to the consolidated statement of operations was \$298,820 (\$153,111 in 2009). 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 and considering the vesting requirements.

d) *Capital Management*

The Company's capital structure consists of common shares, warrants, long-term debt and stock options. The Company manages its capital structure and makes changes pursuant to economic conditions and conditions related to its assets. The Company has the ability to raise capital as required to meet its requirements, therefore it does not have a targeted debt to capital ratio. The Company also possesses the ability to raise debt financing to maintain equilibrium debt and shareholder equity.

The Company is not subject to any requirements with regards to capital.

The Company's objectives in managing capital are the following:

1. to preserve its capacity to continue operations in order to maximize the return to its shareholders and maintain an optimal capital structure in order to increase the value of shareholders' capital in the long term;
2. to ensure the Company has sufficient capital to meet its short-term needs and ensure the development of its projects and mining activities;
3. to satisfy the external requirements with regards to the capital needed to respect any lending agreements
4. to maintain an optimal capital structure in order to minimize the cost of debt financing.

The shares and warrants issued during 2010 form part of the Company's capital management.

The Company objectives remain unchanged from 2009.

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Notes to consolidated financial statements
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15. Contributed Surplus

Net change in contributed surplus is as follows:

	2010	2009
	\$	\$
Balance at the beginning of year	3,539,644	3,386,533
Stock-based compensation	<u>298,820</u>	<u>153,111</u>
Balance at the end of year	<u>3,838,464</u>	<u>3,539,644</u>

16. Income taxes

The reconciliation of the income tax expense calculated using the combined federal and Quebec statutory tax rate and the Peruvian statutory tax rate to the income tax expense per the financial statements as of December 31, 2010 and 2009 is as follows:

	Canada	Peru	Total 2010
	29,90%	30,00%	
	\$	\$	\$
Tax rates	29,90%	30,00%	
Loss before income taxes	(837,757)	(626,485)	(1,464,242)
Income taxes at the composite statutory rates	(250,489)	(187,946)	(438,435)
Differences attributable to:			
Non deductible expenses	(19,068)	(182,619)	(201,687)
Change in statutory rates	(21,753)	-	(21,753)
Losses from previous years expired	6,171	-	6,171
Deductible temporary differences not previously accounted for	(60,408)	155,046	94,638
Other	10,878	-	10,878
Valuation allowance	<u>(233,331)</u>	<u>215,519</u>	<u>(17,812)</u>
Recovery of future income taxes	<u>(568,600)</u>	<u>-</u>	<u>(568,600)</u>
	30.90%	30.00%	
	\$	\$	\$
Loss before income taxes	(5,294,686)	(2,340,583)	(7,635,269)
Income taxes at the composite statutory rates	(1,636,058)	(702,175)	(2,338,233)
Differences attributable to:			
Non deductible expenses	678,384	107,651	786,035
Change in statutory rates	141,349	-	141,349
Losses from previous years expired	177,031	-	177,031
Deductible temporary differences not previously accounted for	4,585	461,117	465,702
Other	1,111	-	1,111
Valuation allowance	<u>633,598</u>	<u>133,407</u>	<u>767,005</u>
Current income tax expense	<u>-</u>	<u>-</u>	<u>-</u>

Malaga Inc.

Notes to consolidated financial statements
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16. Income taxes (cont'd)

	2010	2009
	\$	\$
Future Income tax assets		
Share issuance expenses	113,079	80,927
Mining properties and deferred development and exploration costs	1,763,187	1,193,705
Non-capital losses	3,617,787	2,590,285
Re-evaluation of investments	-	318,711
Unrealized foreign exchange losses	96,492	38,468
Capital losses	84,325	165,881
	<u>5,674,870</u>	<u>4,387,977</u>
Future income tax liabilities		
Property, plant and equipment	(1,053,814)	(429,167)
Re-evaluation of investments	(405,410)	-
Valuation allowance	<u>(4,215,646)</u>	<u>(3,958,810)</u>
	<u>-</u>	<u>-</u>

As at December 31, 2010, the Company had non-capital losses for Canadian income tax purposes which expire as follows:

	Federal	Provincial
	\$	\$
2014	433,121	424,268
2015	760,134	755,483
2016	1,508,225	1,504,100
2027	2,044,826	2,040,619
2028	1,501,923	1,501,923
2029	2,145,039	2,145,039
2030	1,522,147	1,522,147
	<u>9,915,415</u>	<u>9,893,579</u>

In addition, the Company has accumulated non-capital losses in the foreign subsidiaries that can be used in deductions of future foreign taxable income. As at December 31, 2010, subsidiaries located in Peru had non-capital losses available to carry forward expiring as follows:

	\$
2012	159,435
2013	1,252,306
2014	783,046
2015	982,344
	<u>3,177,131</u>

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17. Information Included in the Consolidated Statement of Operations

	2010 \$	2009 \$
Sales		
Tungsten	12,824,410	11,177,720
Copper	2,006,970	-
	<u>14,831,380</u>	<u>11,177,720</u>
Cost of Sales		
Tungsten	9,060,017	9,575,834
Copper	864,827	-
	<u>9,924,844</u>	<u>9,575,834</u>

18. General and Administrative Expenses

	2010 \$	2009 \$
Wages and Benefits	1,265,939	1,104,888
Professional Fees	507,963	802,300
Investor Relations	278,459	164,816
Office Expenses	338,640	277,609
Travel Expenses	174,377	144,427
Other	220,814	111,499
	<u>2,786,192</u>	<u>2,605,539</u>

19. Information Included in the Statements of Cash Flows

	2010 \$	2009 \$
Changes in non-cash working capital items		
Accounts receivable	(871,527)	737,674
Income taxes receivable	(143,516)	(74,276)
Inventories	(830,184)	399,063
Prepaid expenses	(19,777)	(84,802)
Accounts payable and accrued liabilities	(567,874)	125,778
Income taxes payable	(46,288)	(93,097)
Unearned revenue	692,869	199,065
	<u>(1,786,297)</u>	<u>1,209,405</u>
Additional information:		
Interest paid	363,385	376,957
Interest received	-	8,091
Income taxes paid	11,905	59,655
Non-cash transactions:		
Net effect of depletion of development costs allocated to inventory	(82,706)	309,077
Interest to former workers in Peru capitalized in long term debt	328,284	-
Assets acquired through capital leases	-	321,691

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Notes to consolidated financial statements
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20. Commitments

The future minimum lease payments under operating leases for office space expiring in 2012 are as follows:

	\$
2011	104,456
2012	17,410
	<u>121,866</u>

For the fiscal year 2011, the Company has contractual commitments for the acquisition of property, plant and equipment totalling \$292,220.

21. Financial Instruments

Exposure and Management of Risk

The Company is exposed to a certain number of risks at different levels.

A. Market Risk

i. Fair Value

The carrying amounts of financial instruments are presented in the consolidated balance sheet at fair value or amortized cost according to the Company's accounting policies. Short-term financial assets and liabilities, which include short-term investments, accounts receivable, and accounts payable approximate fair values due to the immediate or short-term maturities of these financial instruments. In addition the fair value of the long-term debt and obligations under capital leases are approximately equal to their book value.

ii. Hierarchy of Assessments at Fair Value

The three levels of hierarchy of assessments at fair value are as follows:

- Level 1 – the unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – data other than quoted prices that are observable for the asset or liability, directly or indirectly;
- Level 3 – data that are not based on observable market data.

The only financial instruments measured at fair value are cash and the investment, which are classified as Level 1.

iii. Interest Rate Risk

Current financial assets and financial liabilities are generally not exposed to interest rate risk due to their short term nature and/or because they do not bear interest.

The advance on future sales does not bear interest and is therefore not subject to the risk of interest rate fluctuations.

As a borrower of funds, the Company is subject to risks associated to fluctuations in interest rates. The Company entered into a long term financing agreement that bears interest at the 12 month LIBOR rate. As at December 31, 2010, the outstanding balance of the long term debt that bears interest at the 12 month LIBOR rate is \$3 million US (\$3 million CAD). Based on the balance outstanding on December 31, 2010, a variation in the 12 month LIBOR rate of 1% would not have a material impact on the consolidated financial statements.

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Notes to consolidated financial statements
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21. Financial Instruments (Cont'd)

iv. Foreign Exchange Risk

The functional currency of the Company is the Canadian Dollar. The Company is subject to foreign exchange risk as a significant portion of its operating costs and revenues are denominated in United States dollars and in Peruvian nuevo soles. The Company is, therefore, subject to gains and losses due to fluctuations in the United States dollars and the Peruvian nuevo soles relative to the Canadian dollar. The Company does not use derivatives to manage the exposure to foreign exchange risk.

The Company has balances of cash, receivables, payables as well as long-term debt in foreign currencies and is therefore exposed to foreign exchange risk on these amounts. The balances in foreign currencies as at December 31, 2010 are as follows:

	2010		2009	
	United States dollars	Nuevo soles	United States dollars	Nuevo soles
Cash	693,325	108,128	637,008	249,295
Accounts receivable	824,564	3,091,080	407,793	946,525
Accounts payable	(2,021,140)	(2,339,635)	(2,296,770)	(4,225,037)
Long-term debt	(3,008,333)	(2,008,712)	(3,800,000)	(1,686,120)
Net balance	<u>(3,511,584)</u>	<u>(1,149,139)</u>	<u>(5,051,969)</u>	<u>(4,715,337)</u>
Equivalent in Canadian \$	<u>(3,492,621)</u>	<u>(407,251)</u>	<u>(5,309,619)</u>	<u>(1,708,394)</u>

Assuming all other variables constant, given an increase or a decrease in the Canadian dollar of 5% against the Peruvian nuevo soles, the net income of the Company for the year ended December 31, 2010 would have varied by approximately \$21,000 (\$85,000 as at December 31, 2009).

Assuming all other variables constant, given an increase or a decrease in the Canadian dollar of 5% against the United States dollar, the net income of the Company for the year ended December 31, 2010 would have varied by approximately \$175,000 (\$265,000 as at December 31, 2009).

In addition, the Company has income tax instalments receivable in the amount of 2,313,083 nuevo soles (\$819,748)

v. Price Risk

The Company's profitability is exposed to commercial risks notably those linked to the price of tungsten. The Company does not have financial instruments exposed to price risk.

The fair value of the investment is subject to other price risk. Given an increase or a decrease in the quoted price of the investment of 5%, the other comprehensive income of the Company for the year ended December 31, 2010 would have varied by approximately \$230,000.

B. Credit Risk

The Company is exposed to a significant credit risk in regards to its trade accounts receivable since it has only one customer. The Company conducts a review of all accounts receivable and records a provision for doubtful accounts when they are deemed uncollectable.

The Company has reduced its credit risk by investing its cash with a Canadian chartered bank.

