

## Management Report

### Introduction

This management report for Malaga Inc. ("Malaga" or the "Company") is to comment the major activities of the Company which occurred during the three and nine-month periods ended September 30, 2010, as well as the subsequent period up to November 11, 2010.

The financial information presented herein was established according to generally accepted accounting principles (GAAP) in Canada, which are identical to those used in the year ended December 31, 2009. This management report must be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2009, and the unaudited interim financial statements for the three and nine-month periods ended September 30, 2010, as well as the accompanying notes. 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 Canadian dollars unless otherwise specified. This management report as well as the unaudited interim consolidated financial statements have been prepared by management, and were not reviewed by the Company's external auditors.

The Company's management is responsible for the preparation of the interim 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 the consolidated financial statement.

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) and 11.8% (13.4% until November 2, 2010) of Dynacor Gold Mines Inc. (Dynacor). The information provided herein, effective as of November 11, 2010, 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, exploration, development and mining concession operations in Peru.

**Financial Information**

(in \$'000)	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2010	2009	2010	2009
Sales	3,975	2,780	11,324	8,708
Cost of sales (excluding amortization and depletion)	2,773	2,534	7,935	6,878
Amortization and depletion	964	993	2,908	3,018
Income (loss) from mining activities	235	(768)	465	(1,248)
General and administrative expenses	696	666	2,040	2,083
Net loss	(620)	(1,977)	(2,712)	(3,859)
EBITDA <sup>(1)</sup>	677	(772)	1,267	(313)
Loss per share basic and diluted	(\$0.00)	(\$0.01)	(\$0.02)	(\$0.03)
Cash cost of sales (CDN\$/MTU)	136	148	129	140
Cash flow from operating activities before changes in non-cash working capital items	254	(1,401)	802	(1,109)
Cash flow from (used for) operating activities	662	(646)	(1,013)	(649)
Acquisitions of property, plant and equipment	1,140	1,277	2,340	1,984
Additions to deferred development and exploration costs	381	470	710	1,938
<b>Reconciliation of Net loss to EBITDA</b>				
Net loss	(620)	(1,977)	(2,712)	(3,859)
Interest expense	185	38	626	331
Accretion expense of long term debt	148	173	445	197
Amortization and depletion	964	993	2,908	3,018
EBITDA	677	(772)	1,267	(313)
			<b>At September 30, 2010</b>	<b>At December 31, 2009</b>
Cash on hand			948	1,149
Total assets			24,528	21,902
Long term debts (excluding current portion)			3,000	3,170
Obligations under capital leases (excluding current portion)			88	207
Shareholders' equity			13,090	10,507
<b>Other</b>				
Outstanding shares ('000)			183,550	147,687
Weighted average outstanding shares ('000)			163,914	140,770
Closing share price			0.17	0.135

(1) EBITDA: "Earnings before interest, taxes, depreciation and amortization" is a non-GAAP performance measure. The Company believes that, in addition to conventional measures prepared in accordance with GAAP, the Company and certain investors use this information to evaluate the Company's performance accordingly, it is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance to GAAP.

**Highlights**

- APT average reference selling price increase from US\$180 in Q3-2009 to US\$240 in Q3-2010. On November 11, 2010 the APT price was at US\$280.
- Sales volume for the quarter was 18,619 MTU's an increase of 20% over same period last year.
- An improvement of \$1.0M in income from mining activities (\$0.2M compared to a loss of \$0.8 in Q-3 2009).
- Positive cash flow from operations before changes in non-cash working capital items of \$0.3M (use of \$1.4M in Q3-2009).
- An improvement in cash cost of sales of \$12 per MTU (\$136 compared to \$148 in Q-3 2009).

**Status of 2010 Objectives**

Increase Production Capacity to 500 tpd During the Second Quarter of 2010 and then 600 tpd by the end of the Year 2010

The Company achieved an average output of 392 tonnes per day (“tpd”) during the current quarter. The missing parts to increase the capacity to 500 tpd are all received and installed as of today.

The installation of ultrasound screens, the addition of vibration tables and the mine development will increase the installed capacity furthermore.

Accelerate the Development and Exploration of the Mine in Order to Sustain the Increased Production Output and to Increase the Reserves as well as the Measured and Indicated Resources.

The Company obtained an independent technical report as required by the standard 43-101. Pursuant to this report completed by Vector Engineering Inc., the Pasto Bueno property has the following reserves and resources as at January 4, 2010

<b>Category</b>	<b>Metric Tonnes</b>	<b>WO3 Grade</b>
<b>Reserves</b>		
Proven	81,686	0.71%
Probable	87,731	0.68%
	<u>169,417</u>	<u>0.70%</u>
<b>Resources</b>		
Measured	64,757	0.81%
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.

Reduce its Cash Cost of Sales from US\$135 to US\$105 per MTU

In the third quarter of 2010, the cash cost of sales was US\$130 per MTU (US\$134 in Q3-2009). The increase in production capacity, improvement of the recovery rate and the implementation of certain operational process changes will help to reduce furthermore the cash cost of sales

Due to the delays in the reception of the magnets, the Company believes that the US\$105 per MTU cash cost objective will be achieved in 2011 instead of Q4-2010.

Generate a Positive Cash Flow from Operations Before Changes in Non Cash Working Capital Items in the Second Quarter of 2010.

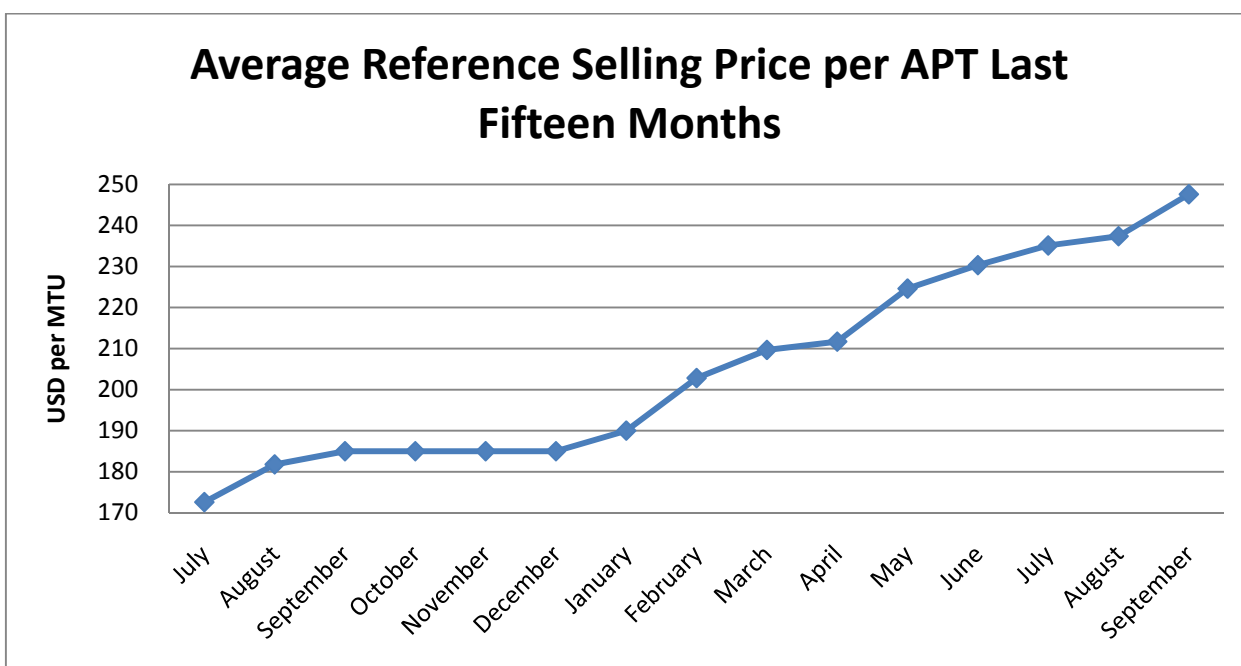
The Company has surpassed this objective since it generated a positive cash flow from operation before changes in non cash working capital items in all three quarters of 2010.

Generate Net Income by the Fourth Quarter

The Company still aims to achieve a net income in the fourth quarter 2010 due to the expected gain on disposal of a portion of its investment in Dynacor and the repayment of the promissory note with Dynacor.

**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 US\$232/MTU to US\$253/MTU, with an average at US\$240/MTU for Q3-2010, compared US\$180/MTU in Q3-2009. As at November 11, 2010, the price per metric tonne unit (MTU) was US\$280.



In June 2010, the European Commission published a report identifying 14 critical minerals for the European industry and, tungsten was considered one of them. The unique characteristics of tungsten make it difficult to substitute. This coupled with the fact that there is no new significant capacity expected to come on-line before 2015, should consequently result in the increase of the APT selling price.

**Exchange Rate**

The exchange rates for the fiscal years are as follows:

	<b>\$CA/\$US</b>		<b>\$CA/sol</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
March 31 (closing rate)	1.02	1.25	2.80	2.54
June 30 (closing rate)	1.06	1.16	2.67	2.59
September 30 (closing rate)	1.03	1.07	2.71	2.69
Q-1 (average rate)	1.04	1.24	2.74	2.60
Q-2 (average rate)	1.03	1.17	2.76	2.59
Q-3 (average rate)	1.04	1.10	2.70	2.69

The Company has not entered into any hedging contracts.

**Metal Sales and Production**

Metal sales and production is as follows:

	Three-month periods ended		Nine-month periods ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Sales (in MTU)	18,619	15,529	55,528	46,466
Production:				
Tonnes extracted	34,281	24,111	93,793	66,831
Yield (%)	0.55	0.71	0.59	0.71
Production Output (MTU)	18,724	17,177	55,656	47,713

The sales for the three-month period ended September 30, 2010 amounted to \$4.0M (\$2.8M in 2009) representing an increase of 43% and for the nine month period ended September 30, 2010 amounted to \$11.3M (\$8.7M in 2009) representing an increase of 30%. The sales are broken down as follows;

	Three-month periods ended		Nine month periods ended	
	September 30,		September 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
In \$'000				
Tungsten	3,538	2,780	9,691	8,708
Copper	437	-	1,633	-
	<u>3,975</u>	<u>2,780</u>	<u>11,324</u>	<u>8,708</u>

In the current quarter, the average APT selling price increased compared to the same period last year, and there was an increase in the sales volume of 20% from 15,529 MTU to 18,619 MTU due to the greater installed capacity at the mine and the plant, which explains the variation in the sales of tungsten.

The yield has decreased in the quarter due to the inefficiencies caused by the aging electro magnets which have now been replaced by the new magnets made of rare-earth materials.

The cost of sales is as follows:

	Three-month periods		Nine-month periods	
	ended September 30,		ended September 30,	
In \$US per MTU	2010	2009	2010	2009
Average cash cost of sales	130	134	127	120
Write-down of inventory to net realizable value	-	14	2	7
Amortization and depletion	50	58	51	56
Total cost	<u>180</u>	<u>206</u>	<u>180</u>	<u>183</u>
In \$CA per MTU				
Average cash cost of sales	136	148	129	140
Write-down of inventory to net realizable value	-	15	2	8
Amortization and depletion	52	64	52	65
Total cost	<u>188</u>	<u>227</u>	<u>183</u>	<u>213</u>

The average cash cost of sales in the current quarter was \$136 per MTU (\$148 per MTU in 2009), a decrease of 8% while it was \$129 for the nine-month period ended September 30, 2010 compared to \$140 in 2009, an 8% decrease.

The variations in the average cash cost of sales from Q3-2009 to Q3-2010 are detailed as follows:

	In \$CDN/MTU	In \$US/MTU
Q3-2009	148	134
Increase in cost due to the decrease in head grade and recovery rate in 2010	10	9
Decrease due to the increase in sales volume, due to the increase in installed capacity, resulting in an improvement of the fixed cost absorption rate	(14)	(13)
Efficiency in electricity	(3)	(3)
Other	(4)	(4)
Foreign exchange	(1)	7
Q3-2010	136	130

The amortization and depletion per MTU decreased from \$64 to \$52 in the current quarter. It decreased from \$65 to \$52 for the nine-month period. The decreases are due to the fact that the development costs are being amortized over a larger quantity of reserves and resources as a result of the new technical report.

**Operating Activities**

The Company recorded a net loss for the quarter of \$0.6M (\$2.0M in Q3-2009) for a loss per share of \$0.00 (\$0.01 in Q3-2009) and a net loss for the nine-month period ended September 30, 2010 of \$2.7M (\$3.9M in 2009) for a loss per share of \$0.02 (\$0.03 in 2009). These decreases in the net loss are explained mainly by:

	Three-month period ended	Nine-month period ended
	September 30, 2010	
	in \$M	in \$M
Increase of income from mining activities	1.0	1.7
Increase in stock-based compensation	-	(0.3)
Increase in accretion expense of long-term debt	-	(0.2)
Increase in interest expense	(0.1)	(0.3)
Increase in foreign exchange gain	0.4	0.2
Other	0.1	0.1
Total	1.4	1.2

For the nine-month period ended September 30, 2010, the Company recorded a non-recurring interest expense of \$0.3M with respect to an agreement concluded with the former workers of a subsidiary in Peru relative to a long-term debt that was assumed in the acquisition of the Peruvian subsidiary in 2006.

The stock-based compensation expense of \$0.1M is calculated over the vesting period of outstanding share options. There were no stock options granted during the current quarter though 3.6M options were granted for the nine-month period ended September 30, 2010.

The Company is unable to realize a tax benefit from the tax loss to recover income taxes paid in previous years in Peru. Therefore, there is no income tax expense or recovery in 2010 (same as 2009).

**Cash Flow****Operating Activities**

In the current quarter, the cash flow generated from operating activities before changes in non-cash working capital items amounted to \$0.3M (use of \$1.4M in Q3-2009). The improvement comes from the increase of income from mining operations explained previously. The changes in the non-cash working capital item amounted to a \$0.4M (\$0.8M in Q3-2009) resulting in cash generated from operating activities in the amount of \$0.7M in the current quarter compared to a use of \$0.6M in Q3-2009.

**Investing Activities**

The work relative to the expansion project to increase capacity continued in the third quarter. During Q3 2010, the Company invested \$1.1M for the acquisition of property, plant and equipment (\$1.3M for the corresponding period in 2009). The Company also invested \$0.4M (\$0.5M for the corresponding period in 2009) in exploration and development work in order to replenish and develop new sources of ore to support the increase in production capacity.

During the nine-month period ended September 30, 2010, the Company invested \$0.2M in Hidropesac which allowed it to increase its ownership to 49%.

**Financing Activities**

In the current quarter, the cash flow used for financing activities amounted to \$0.4M. In Q3-2009, the Company issued shares for proceeds of \$0.9M and received proceeds of \$2.4 from the issuance of a long term debt.

For the nine-month period ended September 30, 2010, the Company completed a two tranche private placement and raised gross proceeds of \$5.4M less share issuance expenses of \$0.5M, pursuant to issuance of 35,863,333 common shares and 35,863,333 warrants at a price of \$0.15 for one common share and one warrant.

**Liquidity**

As at September 30, 2010, the working capital continued to be in a positive position in the amount of \$0.2M compared to a deficit of \$1.1M as at December 31, 2009. This is mainly due to the capital raised as part of the private placement in the second quarter.

In October, Malaga requested payment of the \$2.6M promissory note with Dynacor. Dynacor has the option of paying the promissory note in proceeds or issuing Dynacor shares at \$0.40 per share. It is expected that the payment, either in cash or shares, will be received by the mid-December 2010. In addition, the Company sold 500,000 shares of Dynacor and generated proceeds of \$0.7M. This transaction generated a pre-tax gain on disposition of \$0.6M. The Company still owns 3.5M shares of Dynacor. At November 10, 2010, the stock price of Dynacor closed at \$1.39 per share.

The development, exploration and complete commercialization of certain mining properties may require considerably more financial resources. The Company is also affected by the instability of the market prices of metals and the fluctuation of foreign exchange rates. The Company has incurred operating losses over the past few fiscal years, has limited financial resources and operating cash flow, and there is no assurance that sufficient funding, including adequate financing, will be available to satisfy capital requirements. As a result of the private placement, the Company has a much better liquidity position. Moreover, the APT market price is currently at US\$280 per MTU compared to US\$185 as at December 31, 2009. Considering the estimated production capacity for the remaining three months of 2010 and the current market price, the cash flow from operations should increase significantly.

As at September 30, 2010, the Company had no financial commitments besides those disclosed in the section Long-term Liabilities and Contractual Obligations.

**Assets**

As at September 30, 2010, total assets amounted to \$24.5M (\$21.9M as at December 31, 2009).

**Long-Term Liabilities and Contractual Obligations**

**Payment due by (in \$'000)**

	2010	2011 to 2013	2014	Beyond 2014	Total
Contractual commitments					
Long term debts	316	3,653	1,498	400	5,867
Operating leases	26	122	-	-	148
Capital leases	58	218	-	-	276
Purchase commitments	324	-	-	-	324
Asset retirement obligation for property, plant and equipment	-	-	-	594	594
	<u>724</u>	<u>3,993</u>	<u>1,498</u>	<u>994</u>	<u>7,209</u>

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. These disbursements are expected to be made in the years 2027 and 2028. These estimates are subject to change following modifications to laws and regulations, or as new information become available.

**Shareholder Equity**

In the quarter, no stock options were granted (nil in 2009). For the nine-month period ended September 30, 2010, 3,600,000 stock options were granted (nil in 2009).

**Contingencies**

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. Malaga is awaiting for final documentation in order to obtain the operating permits to produce above 375 tpd. This does not prevent the Company to produce 500 tpd meanwhile. To the best of knowledge of management, the Company is presently operating in compliance with the Peruvian practices.

**Off-Balance Sheet Transactions**

As at September 30, 2010, the Company had not entered into any off-balance sheet transactions.

**Related Party Transactions**

The Company shares the same senior management as Dynacor. Thus, shared expenses are billed to Dynacor according to their usage. The statement of earnings for 2010 includes a chargeback of general and administration expenses totalling \$0.2M (\$0.1M in Q3 2009) to Dynacor. These transactions are measured at their fair exchange value, which represents the amount of the consideration determined and agreed by the related parties.

**Quarterly Review**

(in \$'000)	2010			2009				2008
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
<b>Financial</b>								
Revenues	3,975	3,571	3,778	2,470	2,780	2,489	3,439	3,065
Cash cost of sales	2,773	2,411	2,752	2,698	2,534	1,960	2,384	2,418
Amortization and depletion	964	938	1,007	1,071	993	1,146	878	506
General and administrative expenses	696	715	629	523	666	683	734	782
Net loss	(620)	(1,399)	(693)	(3,776)	(1,977)	(1,328)	(554)	(961)
Cash and cash equivalents and short term investments	948	2,249	392	1,149	1,939	1,584	668	800
Working capital	244	1,625	(2,113)	(1,367)	167	192	(2,174)	(1,396)
Total assets	24,528	25,815	22,232	21,902	26,767	25,684	24,705	24,026
Shareholders' equity	13,090	13,671	10,013	10,507	13,997	14,915	16,043	16,578
Cash flow from (used by) operating activities	662	(1,536)	(140)	(29)	(646)	(942)	939	1,041
Acquisition of property, plant and equipment	1,140	828	372	819	1,277	373	335	199
Development and deferred exploration costs	381	152	178	351	470	687	781	857
<b>Per Share</b>								
Loss per share basic and diluted	(0.00)	(0.01)	(0.00)	(0.02)	(0.02)	(0.01)	(0.00)	(0.01)
Weighted average shares outstanding ('000)								
Basic	183,550	160,110	147,689	140,770	139,000	137,117	137,117	137,117
Diluted	185,115	160,110	147,689	140,770	139,000	137,117	137,117	137,117

**Data on Available Outstanding Shares (as at November 11, 2010)**

Common shares	183,550,176
Warrants	37,269,266
Options	8,450,000

**Pasto Bueno Property**

Pursuant to the press release issued March 12, 2010, the Company obtained a new 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 4, 2010:

<b>Category</b>	<b>Metric Tonnes</b>	<b>WO3 Grade</b>
<b>Reserves</b>		
Proven	81,686	0.71%
Probable	87,731	0.68%
	<u>169,417</u>	<u>0.70%</u>
<b>Resources</b>		
Measured	64,757	0.81%
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.

These results are excellent in that the reserves have increased by 72% over last year and the measured and indicated resources have increased by 180%, an increase of more than 250,000 tonnes in comparison to last year, including the production output in 2009. The results are very encouraging because the development and exploration work was undertaken to support the production output and not to increase the volume of reserves and resources. Seventy-eight (78) veins were identified of which 25 are considered significant. Management believes that the potential of the mine could be even greater than indicated in the report as the study covered only a portion of the mining property.

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.

**Development Program**

The Company has prepared a program of exploration and development for 2010 with the objective of supporting a production output of 500 tpd.

During the nine months ended September 30, 2010, more than 1,941 meters of underground development work was completed in four different structures: Candela, Alonso Fenix, Candela Techo and Chabuca. The current production is being extracted from only five veins (Consuelo, Candela, Alonso Fenix, Chabuca, and Violeta).

In the current quarter, rehabilitation work continued in the Consuzo sector which was the first sector put in commercial operations in the 1940's and 1950's. At that time large structures were developed. The Company's objective in the current year is to re-open this sector as it is a very promising area for production as well as continue to develop new sectors for production.

In the quarter, Malaga launched a new exploration program. The exploration will continue in Q4 and will accelerate in 2011. One of the main targets will be the Manto Santa. Management expects to receive the results of the drill holes in Q1-2011.

**Plant**

Many new pieces of equipment have been added to the mill in recent months. Having renewed the entire crushing circuit in late 2009, the Company has now added new, more powerful equipment throughout the milling circuit. A new rod mill was commissioned in the past few months, and several shaking tables have been added. An entire series of state-of-the-art control devices have also just been installed. The tungsten ore is milled solely by gravity methods, and requires high-performance magnets at the end of the circuit. Given the very strong growth of the Peruvian economy largely due to the mining industry, there have been substantial delays in the delivery of numerous pieces of equipment (mainly the magnets made of rare-earth materials) that have in turn caused a delay in meeting the 500 tpd objective. The new magnets have been received and installed. Now that the magnets are installed, the new mill will be able to produce over 500 tpd.

**Hydro-electricity**

With a temporary hydroelectric concession permit in hand allowing to study the feasibility of building a hydroelectric plant using the hydrological resources of the Pelagatos and Plata rivers, Hidropesac studied and analyzed several options ranging from the installation of 19 MW to 28 MW hydro power plants. The current studies show that all the options combining the hydrological resources from the two rivers are both technically feasible and financially profitable. According to a preliminary report, the installation of a 28 MW hydro power plant is the best option with a power generation potential of between 113 to 141 GWh per year and the highest internal rate of return.

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. The complete pre-project study (which is a step further than a feasibility study) detailing the economic parameters and the financial requirements has been completed and Hidropesac is currently reviewing it. Concurrently, Hidropesac will then carry out the environmental and archeological studies required by the Peruvian authorities, in order to obtain the permanent hydroelectrical concession. Agreements with regional governmental bodies and local communities will be concluded with the objective to start construction in late 2011.

**Outlook**

The Company expects to increase its recovery rate through improvements in process controls and improved operational procedures. It will also accelerate the installed capacity to 600 tonnes per day as well as accelerate its exploration and development work on its mining properties in order to increase its reserves and resources.. On November 11, 2010 the APT price is US\$280 per MTU. The Company believes that the APT price will continue to rise in the current year due to favourable market conditions at a slow and constant pace based on the fact that the market demand exceeds the current production capacity. In fact, there are no new production capacity increases outside of China envisioned between now and the year 2015. Moreover, on May 2, Australia announced a plan to impose a new tax on resource projects from July 2012, and its intention to introduce a "Resources Super Profits Tax (RSPT)". This should have a negative impact on several Australian projects going forward and this bodes well for producers or near term producers, who have resources outside of Australia.

**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.

**Risk Factors**

The Company operates in the mining industry which is subject to numerous significant risks that can influence the profitability of a company. The 2010 Annual Information Form of the Company includes a list of the risk factors.

**Principal 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).

**Estimation of Reserves and Resources**

The estimation of mineral reserves is a complex process involving variables of very uncertain nature and requiring that important and advisable decisions be taken. This process involves variables such as geological data on the structure of each pit, production cost estimates and future market prices of tungsten. The Company's mineral reserve estimates are calculated by qualified persons in accordance with National Policy 43-101. At January 4, 2010, the Company's measured and indicated mineral resources amounted to 398,845 tonnes which includes the proven and probable mineral reserves of 169,427 tonnes. Mineral reserve estimations may vary as a result of changes in selling prices of tungsten and production costs as well with the additional knowledge of the ore deposits and mining conditions. The Company's reserve estimates may have a significant impact on the information contained in the Company's financial statements.

The development costs are amortized using the units of production method over the proven and probable reserves and the non-reserve mineral resources when significant objective evidence exists that it is probable that the non-reserve resources will be produced. A decrease in the mineral reserves and the measured and indicated mineral resources would increase the amortization expense, and thus could have a material impact on the Company's operating results. Periodically, the Company performs an impairment test to assess the realizable value of its property, plant and equipment and mining assets. Mineral reserve estimates are the most important variable in the asset impairment evaluation. A decrease in the Company's reserves could jeopardize the net realizable value of the assets and could lead to a significant loss.

**Evaluation of Mining Properties and Deferred Development and Exploration Expenses**

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 from expected use and eventual disposal of 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 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 making a recoverability test. The determination of the future cash flows require numerous assumptions and estimates with regards to the future events, including the price of tungsten, the cost of operations, the recovery rates, the level of mineral reserves and resources and the amount of capital expenditures.

**Long-term Depreciation of Assets**

We revise the book value of long-term assets by comparing the book value of the asset or group of assets with the forecast undiscounted future monetary cash flows that will be generated by the asset or group of assets when an event indicates that its book value will not be recoverable. The events that could bring about a depreciation test include the asset being out of commission, a reduced price for the asset in the marketplace, and an operating or cash flow loss generated by this asset.

An indicator of the loss in value exists when the book value of an asset or group of assets is greater than the sum of undiscounted cash flows that should come from the use and eventual disposal of the asset or group of assets. The loss in value is evaluated as the excess of book value of the asset or group of assets above the fair value.

**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 September 30, 2010, the total market value of its investment and the promissory note in Dynacor amounted to \$4.8M.

**Asset Retirement Obligations**

The future costs of the restoration of a mining site are estimated according to the projected cost of labour, the known environmental impact and the effectiveness of measures to repair and restore the site. The time frame for making the expenditures is subject to changes related to the continuity of operations. The actual costs that will be incurred may differ from the estimate. In addition, changes in legislation and environmental regulation can increase the costs to restore the site.

**Option-based Compensation**

The Company grants stock options as part of its compensation program. The prevalent Black-Scholes model is used to evaluate the cost of these options. This model requires management to make a certain number of estimates.

**Changes in Accounting Policies**

There were no changes in accounting policies in the current period.

**New Accounting Standards Issued But Not Yet in Force**

In January 2009, the CICA issued Section 1601 "Consolidated Financial Statements" and Section 1602, "Non-controlling Interests," which together replaces Section 1600, "Consolidated Financial Statements." Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are equivalent to the corresponding provisions of IFRS standard, IAS 27 (Revised), "Consolidated and Separate Financial Statements." The sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Company is currently evaluating the impact of the adoption of this new Section on these consolidated financial statements.

In January 2009, the CICA issued Section 1582, "Business Combinations" which replaces Section 1581, "Business Combinations." The Section establishes standards for the accounting for a business combination. It provides the Canadian equivalent to the IFRS standard, IFRS 3 (Revised), "Business Combinations". The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted. The Company is currently evaluating the impact of the adoption of these new standards on its consolidated financial statements.

**Adoption of New Conceptual Framework**

In 2008, the Accounting Standards Board announced the adoption of International Financial Reporting Standards (IFRS) for fiscal years beginning on or after January 1, 2011. The proposed transition date of January 1<sup>st</sup> will require the restating for comparative purposes of amounts presented by Malaga for its fiscal year ending December 31, 2010 and its opening balance sheet as at January 1, 2010.

Malaga has developed a conversion plan for the adoption of IFRS. An implementation team has been established to ensure a smooth transition into IFRS whereby external resources have been retained to assist, under the direction of Malaga's management team, with certain aspects of the project in order to complete the transition plan on a timely basis. The external auditors are also involved in the conversion process of the project. Quarterly status reports are issued to the Audit Committee.

Malaga's proposed conversion to IFRS has three phases;

**Phase 1 – Preliminary Study**

This phase involves performing a high-level assessment to identify areas of accounting differences and their impact that may arise from the transition to IFRS. Completed in Q2-2009.

**Phase 2 – Evaluation of Project Components**

During this phase which began in Q2-2009, the Company prioritizes the areas identified in phase 1 and performs an evaluation of the key areas that may be impacted by the transition to IFRS. A detailed conversion plan was then developed.

Based on our analysis, we have identified various differences between IFRS and Canadian GAAP that can have a significant impact on the financial statements. The Company is currently in the process of quantifying all of the differences in order to prepare itself for phase 3.

Based on our assessment, we have not identified any significant changes necessary to the information technology and data systems, as well as, the routine accounting processes. These will be updated if necessary to insure compliance with disclosure requirement under IFRS. Some modifications in addition to the internal control framework over financial reporting will be required due to the fact that IFRS requires more judgement with respect to various accounting treatments.

The key exemptions under IFRS 1 have been approved by management and the Audit Committee in September 2010.

**Phase 3 – Preparation of Financial Statements and Integration of Changes**

The objective of this final phase is to enable continued IFRS reporting and to facilitate knowledge sharing. The changes identified in phase 2 will be implemented and tested to ensure that any difference is addressed prior to the changeover date. Implementation also involves further training of staff as revised systems begin to take effect and will continue until completion of the implementation. We will also assess the impacts on all areas of the business, including contractual arrangements, financial covenant calculations, incentive plans, budgeting and other areas of importance.

The project will culminate in the collection of financial information necessary to compile IFRS-compliant financial statements, embedding IFRS in business processes, eliminating unnecessary data collection processes and submitting IFRS financial statements to the Audit Committee for approval.

Progress reporting to the Audit Committee on the status of the IFRS implementation project has been instituted. Management has made significant progress quantifying the financial statement impacts of the key difference between the company's current accounting policies under Canadian GAAP and those it expects to apply in preparing its first IFRS financial statements. The IFRS team will now focus on the detailed conversion plan and, concurrently, will start the Phase 3 in the fourth quarter of 2010.

**POTENTIAL IMPACT OF IMPLEMENTATION ON MALAGA**

The comparisons of IFRS with Canadian GAAP, which are currently reflected in the Company's accounting policies, have helped identify a number of areas of differences.

IFRS 1, First-Time Adoption of International Financial Reporting Standards, provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement for full retrospective application of IFRS. The Company is analyzing the various accounting policy choices available and will implement those determined to be most appropriate in the circumstances.

As permitted by IFRS 1, the Company is considering electing to measure its mining properties and property, plant and equipment at deemed cost on January 1, 2010, being the related assets' fair values on that date. This review is in progress and will be completed during the fourth quarter of 2010.

In addition, the resulting Cumulative Translation Adjustment that will be generated from the change to the United States dollars as the functional currency will be eliminated upon the transition date as governed by IFRS 1.

The following are selected key areas of accounting differences where changes in accounting policies in conversion to IFRS may impact the Company's consolidated financial statements. The list highlights those areas of accounting differences that the Company currently believes to be most significant. Notwithstanding, analysis of changes is still in progress and certain decisions remain to be made where choices relating to accounting policies are available. The areas of differences highlighted below are based on existing Canadian GAAP and IFRS effective at December 31, 2009. At this stage, the Company is not able to reliably quantify the full impact of these and other differences on Malaga's consolidated financial statements.

#### Functional Currency and Reporting Currency

Based on the economic analysis of the operations of the Company, it was concluded that the United States dollar is the functional currency instead of the Canadian dollar. The quantitative adjustment of this change is in the process of being calculated and will be terminated in the fourth quarter. In addition, the Company will also use the United States dollar as the reporting currency to match the functional currency.

#### Capitalized Interest

The Company will change its accounting policy in order to capitalize interest for qualifying assets.

#### Property, Plant and Equipment

IAS 16 - Property, plant and equipment requires a more rigorous and broader separation accounting for the asset's components and different useful lives for these components. In addition, on the transition date, fair value can be used as deemed cost under IFRS 1.

#### Impairment of Assets

Mainly IAS 36 - Impairment of Assets. IFRS contains a single comprehensive impairment standard under which assets are tested for impairment either individually or within cash-generating units (CGUs). CGUs will have to be established and are typically identified at a lower level within the Company than an operating unit under Canadian GAAP. Differences also exist in the measurement methods of impairment charges and rules may more frequently conclude to an impairment charge.

#### Provisions

IAS 37 - Provisions, Contingent Liabilities and Contingent Assets, requires a provision to be recognized when: there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation. "Probable" in this context means more likely than not. Under Canadian GAAP, the criterion for recognition in the financial statements is "likely", which is a higher threshold than "probable". Therefore, it is possible that there may be some provisions or contingent liabilities which would meet the recognition criteria under IFRS that were not recognized under Canadian GAAP.

Other differences between IFRS and Canadian GAAP exist in relation to the measurement of provisions, such as the methodology for determining the best estimate where there is a range of equally possible outcomes (IFRS uses the mid-point of the range, whereas Canadian GAAP uses the low-end of the range), and the requirement under IFRS for provisions to be discounted where material.

Management expect to complete its first interim consolidated financial statements prepared under IFRS for the three months end March 31, 2011 with no significant issues or delays.

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.

***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 September 30, 2010 the Company's design and operation of its disclosure controls and procedures were effective.

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. The Chief Executive Officer and the Chief Financial Officer evaluated the design of the ICFR as at September 30, 2010. 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 their development.

***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

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Jean Martineau

President and Chief Executive Officer

(s)Pierre Monet

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Pierre Monet

Vice-President and Chief Financial Officer