

Malaga Inc.

Unaudited Interim Consolidated Financial Statements

For the Three-month and Nine-month periods ended September 30, 2010

Malaga Inc.

Consolidated Balance Sheets as at

	September 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
ASSETS		
CURRENT ASSETS		
Cash on hand	948,325	1,149,101
Accounts receivable (Note 3)	2,660,615	1,198,625
Income taxes receivable	805,386	695,432
Inventories (Note 4)	1,864,440	1,369,423
Prepaid expenses	328,566	182,204
	<u>6,607,332</u>	<u>4,594,785</u>
Investments (Note 5)	2,799,708	2,471,942
Property, plant and equipment (Note 6)	10,274,369	8,801,346
Mining properties and deferred development and exploration costs (Note 7)	4,846,425	6,034,270
	<u>24,527,834</u>	<u>21,902,343</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	4,052,478	4,126,056
Income taxes payable	80,108	45,996
Unearned revenues	723,364	199,065
Current portion of long-term debt (Note 8)	1,337,085	1,077,887
Current portion of obligations under capital leases	169,493	264,030
	<u>6,362,528</u>	<u>5,713,034</u>
Long-term debt (Note 8)	3,000,399	3,169,889
Deferred revenues (Note 8)	1,392,454	1,726,994
Obligations under capital leases	88,338	206,744
Asset retirement obligations	594,013	578,845
	<u>11,437,732</u>	<u>11,395,506</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 9)	43,892,233	39,536,003
Warrants	596,999	-
Contributed surplus	3,881,725	3,539,644
Conversion option	319,903	319,903
Deficit	(35,600,758)	(32,888,713)
	<u>13,090,102</u>	<u>10,506,837</u>
	<u>24,527,834</u>	<u>21,902,343</u>

Going concern assumption (Note 1)

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

Malaga Inc.

Consolidated Statements of Earnings, Comprehensive Loss and Deficit (unaudited)

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Sales (Note 10)	3,975,150	2,779,548	11,323,766	8,707,976
Cost of sales (excluding amortization and depletion) (Note 10)	(2,772,562)	(2,534,074)	(7,935,309)	(6,877,951)
Amortization and depletion	(963,901)	(993,261)	(2,908,160)	(3,017,691)
Accretion expense of the asset retirement obligations	(4,146)	(20,000)	(15,168)	(60,000)
Income (loss) from mining activities	234,541	(767,787)	465,129	(1,247,666)
General and administrative expenses	(695,952)	(666,176)	(2,040,318)	(2,082,875)
Stock-based compensation	(46,948)	(19,200)	(342,081)	(57,000)
Operating loss	(508,359)	(1,453,163)	(1,917,270)	(3,387,541)
Interest expense	(184,614)	(38,102)	(625,946)	(331,578)
Accretion expense of long-term debt	(147,778)	(173,151)	(444,883)	(196,644)
Foreign exchange gain (loss)	192,084	(184,199)	154,054	(1,284)
Loss before undernoted	(648,667)	(1,848,615)	(2,834,045)	(3,917,047)
Share of earnings (loss) in investment using equity method	29,000	(127,978)	122,000	57,870
Loss and comprehensive loss	(619,667)	(1,976,593)	(2,712,045)	(3,859,177)
Deficit, beginning of period	(34,981,091)	(27,136,028)	(32,888,713)	(25,253,444)
Loss and comprehensive loss	(619,667)	(1,976,593)	(2,712,045)	(3,859,177)
Deficit, end of period	(35,600,758)	(29,112,621)	(35,600,758)	(29,112,621)
Loss per share, basic and diluted	(0.00)	(0.01)	(0.02)	(0.03)
Weighted average number of outstanding common shares				
Basic	183,550,176	138,999,989	163,913,619	142,110,365
Diluted	185,114,926	138,999,989	165,033,927	142,110,365

Going concern assumption (Note 1)

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

Malaga Inc.

Consolidated Statements of Cash Flows (unaudited)

	Three-month periods		Nine-month periods	
	ended September 30,		ended September 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
Operating activities				
Net loss	(619,667)	(1,976,593)	(2,712,045)	(3,859,177)
Items not affecting cash and cash equivalents:				
Amortization and depletion	963,901	993,261	2,908,160	3,017,691
Amortization of deferred revenues	(100,470)	(189,561)	(300,482)	(230,232)
Accretion expense of the asset retirement obligation	4,146	20,000	15,168	60,000
Accretion expense of long term debt	147,778	173,151	444,883	196,644
Stock-based compensation	46,948	19,000	342,081	57,000
Share of loss (earnings) in investments using equity method	(29,000)	24,624	(122,000)	(161,224)
Interest to former workers of Peru (Note 8)	28,284	-	328,284	-
Realized foreign exchange gain	(32,675)	-	(71,027)	-
Unrealized foreign exchange gain	(155,332)	(465,224)	(31,438)	(189,599)
	253,913	(1,401,142)	801,584	(1,108,897)
Change in non-cash working capital items (Note 11)	408,556	755,162	(1,814,941)	459,853
	662,469	(645,980)	(1,013,357)	(649,044)
Investing activities				
Short-term investments	-	-	-	700,000
Acquisition of investment	-	-	(205,766)	-
Acquisitions of property, plant and equipment	(1,139,601)	(1,276,517)	(2,340,085)	(1,984,194)
Additions to mining properties and deferred development and exploration costs	(380,651)	(469,855)	(710,429)	(1,938,101)
	(1,520,252)	(1,746,372)	(3,256,280)	(3,222,295)
Financing activities				
Proceeds of bank loans	-	63,800	-	2,441,427
Repayments of bank loans	-	(472,675)	-	(3,318,019)
Proceeds of new long-term debt	-	2,372,716	-	6,018,670
Repayment of long-term debt	(353,001)	(1,634)	(671,425)	(3,585)
Proceeds of issuance of common shares	-	900,698	4,841,550	900,698
Share capital issuance cost	(8,388)	-	(426,271)	-
Proceeds of issuance of warrants	-	-	537,950	-
Obligations under capital leases	(81,181)	(115,186)	(212,943)	(284,830)
	(442,570)	2,747,719	4,068,861	5,754,361
Variation in cash and cash equivalents	(1,300,353)	355,367	(200,776)	1,883,022
Cash on hand (bank overdraft), beginning of period	2,248,678	1,483,691	1,149,101	(43,964)
Cash on hand, end of period	948,325	1,839,058	948,325	1,839,058

Going concern assumption (Note 1)
Additional information on cash flows (Note 11)

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

Malaga Inc.

Notes to consolidated financial statements

September 30, 2010

(unaudited)

1. Statute of Incorporation, Nature of Activities and Going Concern

Malaga Inc. ("Malaga" or the "Company"), is incorporated under Part 1A of the Companies Act (Quebec), as a mining company having its activities in Peru. The Company 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.

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 working capital requirements.

These consolidated financial statements have been prepared according to Canadian generally accepted accounting principles and on a going concern basis. The application of generally accepted accounting principles on a going concern basis may be inappropriate, since there is a significant doubt as to the validity of the going concern assumption.

These consolidated financial statements do not reflect the adjustments that should be made to the carrying values of assets and liabilities, the reported amounts of revenues and expenses and the classification of balance sheet items should the going concern assumption be inappropriate, and these adjustments could be material. Management did not take these adjustments into account as it believes in the validity of the going concern assumption.

2. Presentation Basis

These unaudited interim 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.

These unaudited interim consolidated financial statements are prepared in conformity with generally accepted accounting principles in Canada. These unaudited interim consolidated financial statements do not include all disclosures required by generally accepted accounting principles in Canada for audited annual financial statements. Therefore, they should be read in conjunction with the notes to the audited annual consolidated financial statements of the Company for the year ended December 31, 2009.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires estimates and assumptions on the part of management. These estimates affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of consolidated financial statements and the reported amounts of revenues and expenditures for the period. Actual results could differ from those estimates.

In management's opinion, all adjustments considered necessary for a fair presentation of results for the periods presented have been reflected in the unaudited interim consolidated financial statements.

These unaudited interim consolidated financial statements have been prepared using the accounting policies applied to the December 31, 2009 audited consolidated financial statements.

Malaga Inc.

Notes to consolidated financial statements
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(unaudited)

3. Accounts Receivable

	September 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
Accounts receivable	596,431	77,722
Sale taxes receivable	1,649,539	626,225
Advances to suppliers	75,880	30,057
Advances to a related company	73,507	238,304
Accounts receivable from an affiliated company	265,258	226,317
	<u>2,660,615</u>	<u>1,198,625</u>

4. Inventories

	September 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
Finished products	334,814	260,819
Inventory in transit	740,736	1,206,071
	<u>1,075,550</u>	<u>1,466,890</u>
Write-down of inventory value	-	(485,252)
	<u>1,075,550</u>	<u>981,638</u>
Work in process	214,625	56,247
Supplies	574,265	331,538
	<u>1,864,440</u>	<u>1,369,423</u>

5. Investments

	September 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
Dynacor		
Investment at beginning of period	952,424	2,255,130
Share of net earnings (loss)	122,000	(865,270)
Investment at end of period	<u>1,074,424</u>	<u>1,389,860</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	<u>1,519,518</u>	<u>2,586,414</u>
	<u>2,593,942</u>	<u>3,976,274</u>
Impairment in investment value	-	(1,504,332)
Total	<u>2,593,942</u>	<u>2,471,942</u>
Hydroeléctrica Pelagatos S.A.C. at equity	<u>205,766</u>	<u>-</u>
	<u>2,799,708</u>	<u>2,471,942</u>

As at September 30, 2010, the market value of the investment and the promissory note in Dynacor Gold Mines Inc. amounted to \$4,774,962. In October 2010, the Company requested payment of the promissory note and Dynacor has indicated that payment in shares, cash or a combination of both will be completed by mid-December 2010.

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

	September 30, 2010 (unaudited)			December 31, 2009 (audited)		
	Cost \$	Accumulated amortization & depletion \$	Net book value \$	Cost \$	Accumulated amortization & depletion \$	Net book value \$
Development costs	10,525,050	6,256,044	4,269,006	7,829,516	4,584,807	3,244,709
Land	113,656	-	113,656	113,656	-	113,656
Buildings	444,347	80,303	364,044	444,347	66,119	378,228
Plant and mining equipment	8,799,385	3,783,486	5,015,899	7,312,778	2,898,385	4,414,393
Vehicles	153,116	51,637	101,479	114,660	59,592	55,068
Office equipment	126,121	80,929	45,192	109,246	72,708	36,538
	20,161,675	10,252,399	9,909,276	15,924,203	7,681,611	8,242,592
Assets under capital leases						
Plant and mining equipment	702,366	384,142	318,224	702,366	226,110	476,256
Vehicles	190,023	143,154	46,869	190,023	107,525	82,498
TOTAL	21,054,064	10,779,695	10,274,369	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 were reclassified into development costs in property, plant and equipment. In addition, \$797,260 was capitalized in development costs for the first three quarters as a result of the replenishment of reserves in the areas currently in commercial operations.

7. Mining Properties and Deferred Development and Exploration Costs

	Huayllapon			Mining rights	Total 2010 (unaudited)
	II	Huaura II	Consuzo		
	\$	\$	\$	\$	\$
Mining properties					
Balance, beginning of period	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 period	156,944	571,373	114,320	300,413	1,143,050
Development and exploration costs					
Balance, beginning of period	674,125	3,463,986	316,635	-	4,454,746
Underground exploration and development expenses	314,946	392,535	2,948	-	710,429
Transferred to property, plant and equipment	(212,594)	(1,217,542)	(31,664)	-	(1,461,800)
Balance, end of period	776,477	2,638,979	287,919	-	3,703,375
TOTAL	933,421	3,210,352	402,239	300,413	4,846,425

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Notes to consolidated financial statements
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7. Mining Properties and Deferred Development and Exploration Costs (cont'd)

	Huayllapon I	Huayllapon II	Huaura II	Consuzo	Mining rights	Total 2009 (audited)
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	2,117,292	-	-	3,896,001
Underground exploration and development expenses	-	444,455	1,346,694	316,635	-	2,107,784
Transferred to property, plant & equipment	(1,549,039)	-	-	-	-	(1,549,039)
Balance, end of year	-	674,125	3,463,986	316,635	-	4,454,746
TOTAL	-	919,350	4,370,850	443,657	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 were reclassified into development costs in property, plant and equipment.

Projects in Development:

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

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8. Long-Term Debt

	September 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
Advance on future sales payable to customer, without interest, maturing February 28, 2014 (US\$ 1.2M, \$1.2M CAD (2009-US\$1.2M, \$1.3M CAD))	712,903	647,286
Loan payable to the 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\$ 3.3M, \$3.4M CAD (2009-US\$ 3.8M, \$4.0M CAD))	2,491,685	2,635,677
7.6% unsecured loan from the Peru tax authorities payable in 120 monthly instalments of 2,544 Peruvian soles maturing in April 2012	46,796	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	776,542	610,891
Due to suppliers of a subsidiary in Peru with no interest and no fixed terms of repayment	309,558	311,264
	<u>4,337,484</u>	<u>4,247,776</u>
Less: current portion	<u>1,337,085</u>	<u>1,077,887</u>
	<u>3,000,399</u>	<u>3,169,889</u>

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 will be recognized as revenue over the shipments expected under the sales agreement.

In addition, the Company received a loan of US\$3.8M (\$4.5 million CAD) secured by 3.5 million common shares of Dynacor Gold Mines Inc. which the Company owns, that is payable in monthly instalments from April 1, 2010. This loan is convertible at the option of the holder to a maximum of 19.99% of the Company's total common shares outstanding at the market price less a 15% discount. The discount was treated as a conversion option and recorded as a component of equity. The amount of the loan, net of the conversion option of \$319,903, has been discounted at an effective rate of 17%, or US\$2,285,556 (\$2,704,390 CAD). The difference of \$1,477,217 between the amount received and the liability was initially recorded as deferred revenue and will be recognized as revenue over the expected shipments under the sales agreement.

The assets of the subsidiaries have been pledged as collateral for the loan with the customer. As at September 30, 2010, the book value of assets pledged as security amounted to \$20M.

Malaga Inc.

Notes to consolidated financial statements
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9. Share Capital

a) Common Shares

	September 30, 2010 (unaudited)		December 31, 2009 (audited)	
	Number of shares	Amount	Number of shares	Amount
Balance, beginning of period	147,686,843	39,536,003	137,117,367	38,445,305
Warrants exercised	-	-	9,006,976	900,698
Shares issued ¹	35,863,333	4,841,550	1,562,500	250,000
Share issuance expenses ¹	-	(485,320)	-	(60,000)
Balance, end of period	183,550,176	43,892,233	147,686,843	39,536,003

¹ In the second quarter, the Company received gross proceeds of \$5,379,500 less share issuance expenses of \$485,320 (including broker warrants value of \$59,049 for the issuance of 1,405,933 broker warrants), following the 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.

b) Warrants, Ordinary and Broker

	September 30, 2010 (unaudited)		December 31, 2009 (audited)	
	Number of warrants	Amount \$	Number of warrants	Amount \$
Balance, beginning of period	-	-	-	-
Issuance ordinary	35,863,333	537,950	-	-
Issuance broker	1,405,933	59,049	-	-
Balance, end of period	37,269,266	596,999	-	-

In the second quarter, the Company issued 35,863,333 warrants and 1,405,933 broker warrants. Each warrant is exercisable at a price of \$0.25 until June 14, 2012. 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 2.9%, expected life of two years, and expected volatility of 90%. The ordinary warrants were assigned a value of \$537,950 and was recorded in the contributed surplus until they are exercised at which time they will be transferred to share capital. The value of the brokers warrants amounts to \$59,049 and was recorded as share issuance expenses.

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9. Share Capital (cont'd)

c) Share Purchase Options

	Septembre 30, 2010 (unaudited)		December 31, 2009 (audited)	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
	(in '000)	\$	(in '000)	\$
Balance, beginning of period	5,680	0.40	6,160	0.40
Granted	3,600	0.16	-	-
Cancelled or expired	(830)	0.44	(480)	0.31
Balance, end of period	8,450	0.29	5,680	0.40
Exercisable options	5,939	0.34	4,795	0.42

Outstanding options as at September 30, 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 0.27	6.6	3,540	0.16	1,605	0.15
0.28 to 0.42	4.3	3,540	0.31	2,964	0.31
0.43 to 0.69	1.7	900	0.54	900	0.54
0.70 to 0.77	7.0	470	0.77	470	0.77
0.14 to 0.77		8,450	0.29	5,939	0.34

For the nine-month period ended September 30, 2010, the stock-based compensation charged to the consolidated statement of earnings was \$342,081 compared to \$57,000 in 2009. The offsetting credit has been recorded as contributed surplus. As at September 30, 2010, 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 volatility	90%	90%
Dividend yield	nil	nil

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(unaudited)

10. Information Included in the Consolidated Statement of Earnings

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
Sales				
Tungsten	3,537,662	2,779,548	9,690,429	8,707,976
Copper	437,488	-	1,633,337	-
	<u>3,975,150</u>	<u>2,779,548</u>	<u>11,323,766</u>	<u>8,707,976</u>
Cost of Sales				
Tungsten	2,529,383	2,534,074	7,154,435	6,877,951
Copper	243,179	-	780,874	-
	<u>2,772,562</u>	<u>2,534,074</u>	<u>7,935,309</u>	<u>6,877,951</u>

11. Information Included in the Statements of Cash Flows

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
Changes in non-cash working capital items:				
Accounts receivable	257,655	(307,552)	(1,445,432)	(304,863)
Income taxes receivable	(53,035)	15,223	(95,377)	(122,602)
Inventories	(2,153)	74,342	(637,747)	111,358
Prepaid expenses	258,875	181,483	(146,362)	(116,733)
Accounts payable and accrued liabilities	(503,280)	792,635	(47,202)	889,121
Income taxes payable	(41,301)	(969)	32,880	3,572
Unearned revenue	491,795	-	524,299	-
	<u>408,556</u>	<u>755,162</u>	<u>(1,814,941)</u>	<u>459,853</u>
Additional information				
Interest paid	91,720	35,270	233,773	334,519
Interest received	-	-	721	3,844
Income taxes paid	-	13,590	11,905	159,767
Non cash transactions				
Net effect of depletion of development costs allocated in inventory	(9,486)	135,906	(142,730)	322,511
Interest to former workers in Peru in long term debt	28,284	-	328,284	-
Asset acquired through capital leases	-	321,691	-	321,691

Malaga Inc.

Notes to consolidated financial statements
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12. 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 and unearned revenues, 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 instrument measured at fair value is cash on hand, which is 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 September 30, 2010, the outstanding balance of the long term debt that bears interest at the 12 month LIBOR rate is \$3.3 million US (\$3.4 million CAD). For 2010, a variation in the 12 month LIBOR rate of 5% to 10% would not have a material impact on the consolidated financial statements.

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 new soles. The Company is, therefore, subject to gains and losses due to fluctuations in the United States dollars and the Peruvian new soles relative to the Canadian dollar. The Company does not use derivatives to manage the exposure to foreign exchange risk.

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.

Malaga Inc.

Notes to consolidated financial statements
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(unaudited)

12. Financial Instruments (cont'd)

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 on hand with a Canadian chartered bank.

C. Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due.

13. Related Party Transactions

The following summarizes the Company's related party transactions with its affiliated company Dynacor Gold Mines Inc., on which it exercises significant influence, that have not been previously disclosed:

	Three-month periods ended September 30,		Nine-month periods ended September 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
General and administrative expenses	<u>173,215</u>	<u>137,794</u>	<u>552,903</u>	<u>402,902</u>

These transactions take place in the Company's normal course of business and are measured at their exchange value, which is the amount of the consideration determined by and agreed to by the related parties.

14. Comparative figures

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current period.