

# **Malaga Inc.**

Unaudited Interim Consolidated Financial Statements  
for the three-month and nine-month periods ended September 30, 2009

# Malaga inc.

## Consolidated Balance Sheets as of

	September 30, 2009 (unaudited)	December 31, 2008 (audited)
	\$	\$
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	1,839,058	-
Short-term investments (Note 4)	100,000	800,000
Accounts receivable	2,290,139	2,100,552
Income taxes receivable	797,297	674,695
Inventories (Note 5)	1,670,562	1,459,409
Prepaid expenses	214,135	97,402
	<u>6,911,191</u>	<u>5,132,058</u>
Investments	4,905,515	4,847,645
Property, plant and equipment	9,266,627	8,751,905
Mining properties and deferred development and exploration expenses	5,683,344	5,294,282
	<u>26,766,677</u>	<u>24,025,890</u>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Bank overdraft	-	43,964
Bank loans (Note 6)	-	876,592
Accounts payable and accrued liabilities	5,775,227	5,176,805
Income taxes payable	142,665	139,093
Current portion of long-term debt (Note 7)	529,378	13,899
Current portion of obligations under capital leases	296,889	277,337
	<u>6,744,159</u>	<u>6,527,690</u>
Long-term debt (Note 7)	3,147,374	163,469
Deferred revenues (Note 7)	2,072,077	-
Obligations under capital leases	247,404	257,492
Asset retirement obligations	558,845	498,845
	<u>12,769,859</u>	<u>7,447,496</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 8)	39,346,003	38,445,305
Contributed surplus	3,443,533	3,386,533
Conversion option (Note 7)	319,903	-
Deficit	(29,112,621)	(25,253,444)
	<u>13,996,818</u>	<u>16,578,394</u>
	<u>26,766,677</u>	<u>24,025,890</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		Nine-month periods ended	
	September 30		September 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Sales</b>	<u>2,779,548</u>	<u>3,157,577</u>	<u>8,707,976</u>	<u>7,556,807</u>
Cost of sales	2,534,074	2,333,964	6,877,951	6,117,099
Amortization and depletion	993,261	506,112	3,017,691	1,398,116
Accretion expense of asset retirement obligations	<u>20,000</u>	<u>24,478</u>	<u>60,000</u>	<u>73,435</u>
Gross margin (loss)	<u>(767,787)</u>	<u>293,023</u>	<u>(1,247,666)</u>	<u>(31,843)</u>
<b>Expenses</b>				
General and administrative expenses	666,176	664,494	2,082,875	2,002,475
Stock-based compensation	19,200	63,224	57,000	286,429
Interest	38,102	92,933	331,578	181,781
Accretion expense of long-term debt	173,151	-	196,644	-
Gain on sale of property, plant and equipment	-	(115,165)	-	(115,165)
Foreign exchange loss (gain)	<u>184,199</u>	<u>6,214</u>	<u>1,284</u>	<u>(177,978)</u>
	<u>1,080,828</u>	<u>711,700</u>	<u>2,669,381</u>	<u>2,177,542</u>
Loss before undernoted	(1,848,615)	(418,677)	(3,917,047)	(2,209,385)
Share of earnings in investment using equity method	<u>(127,978)</u>	<u>5,000</u>	<u>57,870</u>	<u>41,457</u>
<b>Net loss and comprehensive loss</b>	<u>(1,976,593)</u>	<u>(413,677)</u>	<u>(3,859,177)</u>	<u>(2,167,928)</u>
Net loss per share, basic and diluted	(0.01)	0.00	(0.03)	(0.02)
Weighted average number of outstanding common shares, basic and diluted	<u>138,999,989</u>	<u>137,117,367</u>	<u>142,110,365</u>	<u>137,117,367</u>
<b>Deficit, beginning of period</b>	(27,136,028)	(23,489,075)	(25,253,444)	(21,734,824)
Loss for the period	<u>(1,976,593)</u>	<u>(413,677)</u>	<u>(3,859,177)</u>	<u>(2,167,928)</u>
<b>Deficit, end of period</b>	<u>(29,112,621)</u>	<u>(23,902,752)</u>	<u>(29,112,621)</u>	<u>(23,902,752)</u>

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 ended		Nine-month periods ended	
	September 30		September 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Operating activities</b>				
Loss from continuing operations	(1,976,593)	(413,677)	(3,859,177)	(2,167,928)
Items not affecting cash and cash equivalents				
Amortization and depletion	993,261	506,112	3,017,691	1,398,116
Amortization of deferred revenues	(189,561)	-	(230,232)	-
Accretion expense of asset retirement	20,000	24,478	60,000	73,435
Accretion expense of long-term debt	173,151	-	196,644	-
Stock-based compensation	19,200	63,224	57,000	286,429
Gain on sale of property, plant and equipment	-	(115,165)	-	(115,165)
Share of earnings in investments using equity method	24,624	(5,000)	(161,224)	(41,457)
Unrealized foreign exchange loss (gain)	(465,224)	(4,303)	(189,599)	28,569
	<u>(1,401,142)</u>	<u>55,669</u>	<u>(1,108,897)</u>	<u>(538,001)</u>
Change in non-cash working capital items (Note 8)	755,162	(940,454)	459,853	(111,585)
Cash flow from (used by) operating activities	<u>(645,980)</u>	<u>(884,785)</u>	<u>(649,044)</u>	<u>(649,586)</u>
<b>Investing activities</b>				
Short-term investments	-	940,000	700,000	2,513,053
Acquisition of property, plant and equipment	(1,276,517)	(232,233)	(1,984,194)	(1,113,550)
Addition to mining properties and deferred development and exploration expenses	(469,855)	(625,945)	(1,938,101)	(2,444,600)
Cash flow used by investing activities	<u>(1,746,372)</u>	<u>81,822</u>	<u>(3,222,295)</u>	<u>(1,045,097)</u>
<b>Financing activities</b>				
Proceeds of bank loans	63,800	1,598,868	2,441,427	1,598,868
Repayments of bank loans	(472,675)	(368,319)	(3,318,019)	(366,973)
Proceeds of new long-term debt	2,372,716	-	6,018,670	-
Issuance of shares	900,698	-	900,698	-
Advance from an affiliated company	-	(234,012)	-	216,901
Repayment of long-term debt	(1,634)	(2,673)	(3,585)	(8,019)
Obligations under capital lease	(115,186)	(41,029)	(284,830)	(79,661)
Cash flow from (used by) financing activities	<u>2,747,719</u>	<u>952,835</u>	<u>5,754,361</u>	<u>1,361,116</u>
Variation in cash and cash equivalents	355,367	149,872	1,883,022	(333,567)
Cash and cash equivalents, beginning of period	1,483,691	(103,139)	(43,964)	380,300
<b>Cash and cash equivalents, end of period</b>	<u>1,839,058</u>	<u>46,733</u>	<u>1,839,058</u>	<u>46,733</u>

Going concern assumption (Note 1)

Additional information on cash flow (Note 9)

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

# Malaga Inc.

Notes to consolidated financial statements

September 30, 2009

(unaudited)

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## 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 (Québec), 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 subsidiary also hold interests in mineral properties in Peru that are currently at the stage of exploration and development. Some of these properties are being evaluated in order to determine the profitability of their implementation. The recovery of expenses incurred on these properties and related deferred costs, if any, depend on the availability in sufficient quantity of ore, the ability to obtain required operating permits, the ability of the Company to obtain the necessary funding for the operation of these properties and the profitability of future production.

The Company has suffered operating losses in recent years and its sources of funding and cash flows from operation are limited. In addition, there is no guarantee that the Company has adequate financial resources, including adequate funding to meet its working capital requirements. Cash flows were negatively impacted by higher production costs and weak content of WO<sub>3</sub>; it is anticipated that the cash at September 30, 2009 will not be sufficient to fund ongoing activities of the Company. Although there is no assurance that the Company will be successful in securing sufficient financing, management will strive to do so through various means including share issuances, debt financing and selling a part of its investment in Dynacor Gold Mines Inc.

These financial statements have been prepared in accordance with generally accepted accounting principles of Canada (GAAP) and the assumption of a going concern. The application of generally accepted accounting principles on the assumption of a going concern of operations may be inappropriate as there is significant doubt about the validity of the hypothesis.

These consolidated financial statements do not reflect adjustments that should be made to the value of assets and liabilities, amounts for revenue and expenses and the classification of balance sheet accounts, if the assumption of going concern of the operation was unfounded, these adjustments could be significant. Management did not take into account these adjustments as it believes in the validity of the assumption of a going concern.

## 2. Presentation Basis

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, 2008.

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 as well as 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.

## Malaga Inc.

Notes to consolidated financial statements

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### 2. Presentation Basis (cont'd)

These unaudited interim consolidated financial statements have been prepared using the accounting policies applied to the December 31, 2008 consolidated financial statements with the exception of modifications specified below.

### 3. Change in Accounting Policies

On January 1, 2009, the Company adopted the following recommendations issued by the Emerging Issues Committee of the Canadian Institute of Chartered Accountants («CICA»).

In January 2009, the CICA Emerging Issues Committee (EIC) issued EIC-173, «Credit risk and fair value of financial assets and financial liabilities», which requires that entities take into account the credit risk of the counterparty and their own credit risk in determining the fair value of financial assets and financial liabilities, including derivatives. EIC-173 applies to interim and annual financial statements of the Company for fiscal years beginning on or after January 1, 2009. Adoption of this EIC did not have a significant impact on these consolidated financial statements.

On January 1, 2009, the Company adopted the new recommendations issued by the Emerging Issues Committee of the CICA of EIC-174 «exploration expenses» issued in March 2009. This EIC provides additional guidance to mining exploration companies in circumstances where it is necessary to perform an impairment test. The adoption of this EIC did not have a significant impact on these consolidated financial statements.

#### *Change in Accounting Estimates*

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. In December 2008, the Company received a technical report in compliance with National Policy 43-101. The reserves and resources amount used in the amortization calculation different from the previous therefore resulting in an increase in the amortization expense of the current quarters as well as the upcoming ones.

#### *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. It is 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

## Malaga Inc.

Notes to consolidated financial statements

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### 3. Change in Accounting Policies (cont'd)

reporting period beginning on or after January 1, 2011. Earlier application is permitted. The Company is currently evaluating the impact of the adoption of this new Section on these consolidated financial statements.

### 4. Short-Term Investments

	September 30, 2009 (unaudited) \$	December 31, 2008 (audited) \$
Guaranteed term deposits 1.6 %, maturing November 12, 2009	100,000	800,000

### 5. Inventories

	September 30, 2009 (unaudited) \$	December 31, 2008 (audited) \$
Finished products	270,641	283,228
Inventory in transit	754,964	664,262
Work in process	133,281	46,413
	<u>1,158,886</u>	<u>993,903</u>
Supplies	448,077	465,506
Other	63,599	-
	<u>1,670,562</u>	<u>1,459,409</u>

The cost of inventory that was charged to expense represents all cost of sales and essentially all of the amortization.

### 6. Bank Loans

	September 30, 2009 (unaudited) \$	December 31, 2008 (audited) \$
14.5% to 15% promissory note payable in US dollars, for a total amount of US\$351,882, paid in July and August 2009	-	-
11% to 14% promissory note payable in US dollars, for an amount of US\$715,000, paid in January and March 2009	-	876,592
	<u>-</u>	<u>876,592</u>

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### 7. Long-Term Debt

	September 30, 2009 (unaudited)	December 31, 2008 (audited)
	\$	\$
Advance on future sales payable to the customer, without interest, maturing February 28, 2014 ( US\$ 1,200,000 ) a)	634,046	-
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\$ 3,800,000 ) a)	2,873,838	-
7.6% unsecured loan payable to the Peru tax authorities in 120 monthly instalments of 2,544 peruvian soles maturing in April 2012	39,700	41,698
Interest due to the workers of Peru, without interest and repayable on the basis of profits earned in the subsidiary, unsecured	129,168	135,670
	<u>3,676,752</u>	<u>177,368</u>
Less: current portion	<u>(529,378)</u>	<u>(13,899)</u>
	<u>3,147,374</u>	<u>163,469</u>

a) On April 1 2009, the Company entered into a financing agreement whereby it has received an advance on sales of US\$1.2M, bearing no interest, repayable on the last deliveries of a supply agreement. This amount has been present valued with an effective rate of 17%, or US\$547,392 (\$ 692,068 CAD). The difference \$825,092 between the amount received and the liability was initially recorded as deferred revenue and will be recognized as revenue over the anticipated shipments under the sales agreement.

In addition, the Company received a loan of US\$3.8M secured by 3.5M common shares of Dynacor Gold Mines Inc. which the Company owns, is payable in monthly instalments from the thirteenth month after closing. 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 total common shares outstanding of the Company, at 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 present valued with an effective rate of 17%, or US\$2,555,606 (\$3,024,293 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 anticipated shipments under the sales agreement.

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Notes to consolidated financial statements  
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### 7. Long-Term Debt (cont'd)

The future capital payments over the next five years are as follows:

	\$
2009	12,289
2010	774,215
2011	1,028,506
2012	1,021,894
2013	1,017,165

### 8. Share Capital

Issued and paid

The variations in the Company's share capital are as follows:

	September 30, 2009 (unaudited)		December 31, 2008 (audited)	
	Number	Amount	Number	Amount
		\$		\$
Balance, beginning of period	137 117 367	38 445 305	137 117 367	38 445 305
Warrants exercised	9 006 976	900 698	-	-
Balance, end of period	<u>146 124 343</u>	<u>39 346 003</u>	<u>137 117 367</u>	<u>38 445 305</u>

Outstanding options as at September 30, 2009, are as follows:

Exercise price bracket \$	Weighted average number of years before expiry date	Outstanding options September 30, 2009 (unaudited) (in 000)	Exercisable options, September 30, 2009 (unaudited) (in 000)	Outstanding options December 31, 2008 (audited) (in 000)
0,18 to 0,27	1.2	165	165	380
0,28 to 0,42	5.2	3,835	2,930	3,965
0,43 to 0,69	1.9	1,345	1,345	1,345
0,70 to 0,77	7.8	470	470	470
<u>0,18 to 0,77</u>		<u>5,815</u>	<u>4,910</u>	<u>6,160</u>

For the three-month period ended September 30, 2009, the stock-based compensation charged against income was \$19,200 compared to \$63,224 in 2008. The offsetting credit has been recorded as contributed surplus. No options were issued during the nine-month periods ended September 30, 2009. For the nine-month period ended September 30, 2009, 345,000 options expired.

## Malaga Inc.

Notes to consolidated financial statements  
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### 9. Information Included in the Statements of Cash Flows

	For the three-month periods ended		For the Nine- month periods ended	
	ended September 30, 2009	2008	ended September 30, 2009	2008
	\$	\$	\$	\$
Changes in non-cash working capital				
Accounts receivable	(307 552 )	(793 133 )	(304 863 )	(546 342 )
Income taxes receivable	15 223	(155 210 )	(122 602 )	(304 098 )
Inventories	74 342	(12 362 )	111 358	(172 659 )
Prepaid expenses	181 483	71 857	(116 733 )	138 225
Accounts payable and accrued	792 635	(198 803 )	889 121	907 804
Income taxes payable	(969 )	(8 013 )	3 572	(438 613 )
	<u>755 162</u>	<u>(1 095 664 )</u>	<u>459 853</u>	<u>(415 683 )</u>
<b>Additional information:</b>				
Interest paid	35 270	103 229	334 519	239 075
Interest received	-	24 258	3 844	71 256
Income taxes paid	13 590	152 413	159 767	775 350
Non-cash working capital transactions:				
Depletion of inventory capitalized	135 906	-	322 511	-
Assets acquired through capital leases	321 691	-	321 691	125 102

### 10. Financial Instruments

#### Risk exposure and management

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

#### a) 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 majority of interest-bearing loans of the Company are at variable rates and are, therefore, subject to fluctuations and volatility of interest rates.

The Company manages its portfolio of short-term investments based on its cash flow needs and with a view to optimizing its interest income.

The Company does not use derivatives to mitigate its exposure to interest rate risk.

#### b) 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 and long-term debt 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 mitigate the exposure to foreign exchange risk.

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### 10. Financial Instruments (cont'd)

The Company carries commercial activities in other currencies than the Canadian dollar. Therefore, the Company has balances in cash, cash equivalents and receivables as well as payables in foreign currencies and is exposed to the foreign exchange risk regarding these amounts.

#### c) *Price Risk*

The Company's profitability is exposed to commercial risks notably those linked to the price of tungsten and the foreign exchange rate. The Company does not have hedges covering these risks.

#### d) *Liquidity Risk*

The liquidity risk is the risk that the Company will not be able to meet its obligations as they become due.

#### e) *Credit Risk*

The Company is exposed to a significant credit risk in regards to its trade accounts receivable as it has one customer. The Company conducts a review of all accounts receivable and records a provision for doubtful accounts when deemed uncollectable. There is no provision as of September 30, 2009.

The Company has reduced its credit risk by investing its cash, cash equivalents and its short-term investments with a Canadian chartered bank.

#### *Fair Value of Financial Instruments*

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, bank loans and accounts payable approximate fair values due to the immediate or short-term maturities of these financial instruments.

In addition, the fair value of obligations under capital leases equals approximately their carrying value.

### 11. 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	
	2009	2008	2009	2008
General and administrative expenses	\$ 137 794	\$ 115 831	\$ 402 902	\$ 406 296

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(unaudited)

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### 11. Related Party Transactions (cont'd)

At the end of the period, the amounts receivable from its affiliated Company were as follows

	<b>September 30 2009 (unaudited)</b>	<b>December 31 2008 (audited)</b>
Accounts receivable from an affiliated Company	<u>49 977</u>	<u>48 388</u>

These transactions are in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties).