

## 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 six-month periods ended June 30, 2010, as well as the subsequent period up to August 6, 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 consolidated financial statements for the year ended December 31, 2009, and the unaudited interim financial statements for the three and six-month periods ended June 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 audited 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 13.4% of Dynacor Gold Mines Inc. (Dynacor). The information provided herein, effective as of August 6, 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 acquisition, exploration, development and mining concession operations in Peru.

**Quarterly Information**

Financial (in \$'000)	Three-month periods ended June 30,	
	2010	2009
Sales	3,571	2,489
Cost of sales (excluding amortization and depletion)	2,411	1,960
Amortization and depletion	938	1,146
Income (loss) from mining activities	217	(637)
General and administrative expenses	715	683
Net loss	(1,399)	(1,328)
Loss per share basic and diluted	(\$0.01)	(\$0.01)
Cash cost of sales (CDN\$/MTU)	115	140
Cash flow from operating activities before changes in non-cash working capital items	231	6
Cash flow used for operating activities	(1,536)	(942)
Acquisitions of property, plant and equipment	828	113
Additions to deferred development and exploration costs	152	687
	<b>At June 30, 2010</b>	<b>At December 31, 2009</b>
Cash on hand	2,249	1,149
Total assets	25,815	21,902
Long term debts (excluding current portion)	2,996	2,921
Obligations under capital leases (excluding current portion)	151	207
Shareholders' equity	13,671	10,507
<u>Other</u>		
Outstanding shares ('000)	183,550	147,687
Weighted average outstanding shares ('000)	153,933	140,770
Closing share price	0.110	0.135

**Highlights**

- During the quarter, the Company completed a two tranche private placement and raised gross proceeds of \$5.4M, net of share issuance expenses of \$0.5M, 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.
- Sales volume for the quarter was 18,801 MTU's an increase of 36% over same period last year. The quarterly sales volume is the greatest quantity that the Company has ever achieved.
- Positive cash flow from operations before changes in non-cash working capital items of \$0.2M (\$0.0M in Q2-2009).
- An improvement of \$0.8M in income from mining activities (\$0.2M compared to a loss of \$0.6M in Q-2 2009).
- An improvement in cash cost of sales of \$25 per MTU (\$115 compared to \$140 in Q-2 2009).
- APT average reference selling price increase from US\$189 in Q2-2009 to US\$222 in Q2-2010.
- Additional investment of \$0.2M in Hidropesac to bring up ownership percentage to 49%.

**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

Currently, the installed production capacity is 375 tons per day and the Company achieved an average output 360 tonnes per day during the current quarter. Achieving an installed production capacity of 500 tpd is delayed to third quarter of 2010 because there was a supplier delay in receiving all the parts to start-up the plant and the foundation of the rod mill had to be reinforced. Thereafter, 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>	0.70%
<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, while still supporting 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. In the current quarter, the Company has been successful in replenishing the reserves extracted for production.

With such success the Company has the intention to accelerate its development and exploration work in 2010 in order to continue to replace the reserves extracted for the production output, but as well to increase its measured, indicated and inferred resources.

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

In the second quarter of 2010, the cash cost of sales was US\$112 per MTU (US\$124 in Q1-2010). The Company believes that in the remaining part of the year the increase in production capacity, improving the recovery rate as a result of the increased capacity, and the implementation of certain operational process changes, the cash cost of sales should reduce to US\$105 by the end of the year.

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

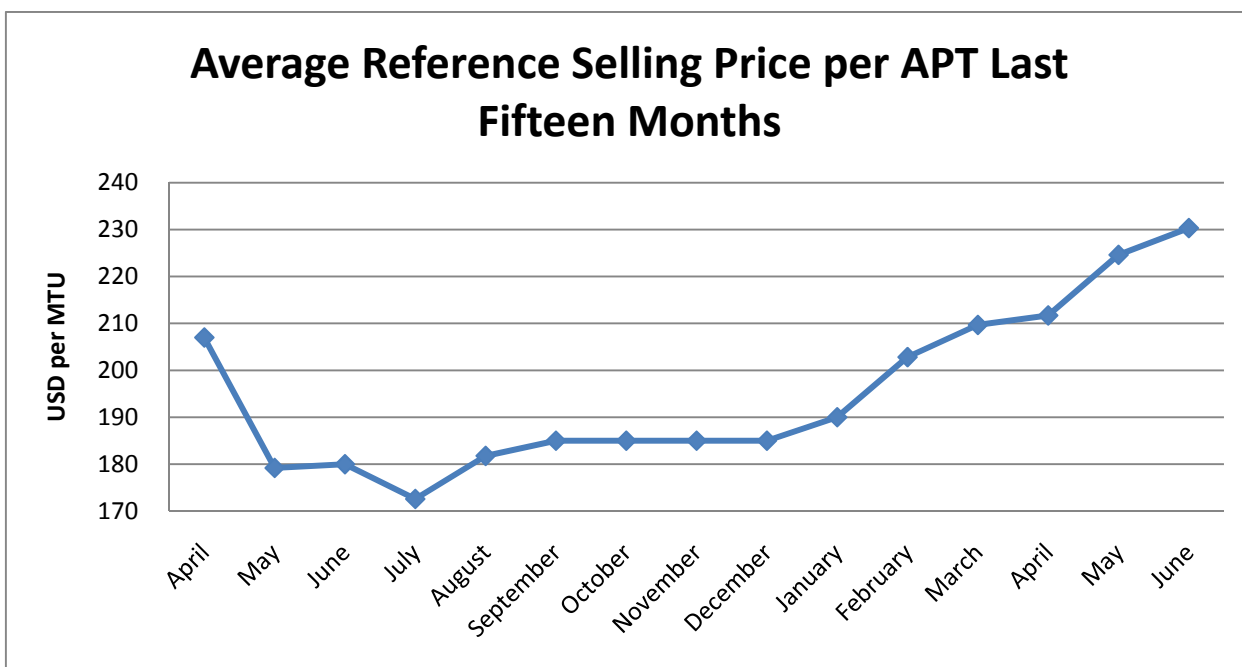
The Company has surpassed this objective since it generated a positive cash flow from operation before changes in non cash working capital items in both quarters. Copper will be sold on a progressive basis for the remaining part of the year.

Generate Net Income by the Fourth Quarter

The Company still aims to achieve this profitability objective in the fourth quarter 2010 despite the reduction in copper by-product revenues compared to its expectations at the beginning of the year and the delay in the capacity increase.

**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\$210/MTU to US\$232/MTU, with an average at US\$222/MTU for Q2-2010, compared US\$189/MTU in Q2-2009. As at August 6, 2010, the price per metric tonne unit (MTU) was US\$237.



On March 12, 2010, the China Ministry of Land and Resources (“MLR”) announced on its Web site that it had stopped accepting applications for new mines to produce tungsten. In addition, on May 20, 2010, MLR announced that China would begin in June 2010 a five-month long crackdown on illegal mining of rare earth. MLR stated that the campaign would target precious metal mines like rare earth and tungsten. The initiative is to clamp down on illegal mining activities like mining without licenses, over-exploration, and environmental damage. In addition, every mining area will gradually have a supervisor under the local land and resources bureau whose name and telephone will be open to the public to prevent illegal exploration. MLR will ban the mining or detecting of metal resources and hand down punishments to violators.

**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
Q-1 (average rate)	1.04	1.24	2.74	2.60
Q-2 (average rate)	1.03	1.17	2.76	2.59

The Company has not entered into any hedging contracts.

**Metal Sales and Production**

Metal sales and production is as follows:

	<b>Three-month periods ended</b>		<b>Six-month periods ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Sales (in MTU)	18,801	13,845	36,909	30,937
Production:				
Tonnes extracted	31,322	22,541	59,512	42,720
Yield (%)	0.62	0.66	0.62	0.71
Production Output (MTU)	19,321	14,934	36,932	30,536

The sales for the three-month period ended June 30, 2010 amounted to \$3.6M (\$2.5M in 2009) representing an increase of 44% and for the six month period ended June 30, 2010 amounted to \$7.3M (\$5.9M in 2009) representing an increase of 24%. The sales are broken down as follows;

	<b>Three-month periods ended</b>		<b>Six-month periods ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
In \$'000				
Tungsten	3,278	2,489	6,153	5,928
Copper	293	-	1,196	-
	<u>3,571</u>	<u>2,489</u>	<u>7,349</u>	<u>5,928</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 36% from 13,845 MTU to 18,801 MTU due to the greater installed capacity at the mine and the plant, which explains the variation in the sales of tungsten.

The cost of sales is as follows:

In \$US per MTU	Three-month periods ended June 30,		Six-month periods ended March 31,	
	2010	2009	2010	2009
Average cash cost of sales	112	120	121	116
Write-down of inventory to net realizable value	-	1	-	-
Amortization and depletion	48	71	51	54
Total cost	<u>160</u>	<u>192</u>	<u>172</u>	<u>170</u>
In \$CA per MTU	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Average cash cost of sales	115	140	125	140
Write-down of inventory to net realizable value	-	1	-	-
Amortization and depletion	50	83	53	65
Total cost	<u>165</u>	<u>224</u>	<u>178</u>	<u>205</u>

The average cash cost of sales in the current quarter was \$115 per MTU (\$140 per MTU in 2009), a decrease of 18% while it was \$125 for the six-month period ended June 30, 2010 compared to \$140 in 2009, a 11% decrease.

The variations in the average cash cost of sales from Q2-2009 to Q2-2010 are detailed as follows:

	In \$CDN/MTU	In \$US/MTU
Q2-2009	140	120
Increase in cost due to the decrease in head grade and recovery rate in 2010	7	7
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	(17)	(16)
Efficiency in electricity	(1)	(1)
Other	(6)	(6)
Foreign exchange	(8)	8
Q2-2010	<u>115</u>	<u>112</u>

The amortization and depletion per MTU decreased from \$83 to \$50 in the current quarter. It decreased from \$65 to \$53 for the six-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 \$1.4M (\$1.3M in Q2-2009) for a loss per share of \$0.01 (\$0.01 in Q2-2009) and a net loss for the six-month period ended June 30, 2010 of \$2.1M (\$1.9M in 2009) for a loss per share of \$0.01 (\$0.02 in 2009). These decreases in the net loss are explained mainly by:

	Three-month period ended	Six-month period ended
	June 30, 2010	
	in \$M	in \$M
Increase of income from mining activities	0.9	0.7
Increase in stock-based compensation	(0.1)	(0.3)
Increase in accretion expense of long-term debt	(0.1)	(0.3)
Increase in interest expense	(0.3)	(0.3)
Increase in foreign exchange loss	(0.4)	(0.2)
Other	(0.1)	0.1
Total	<u>(0.1)</u>	<u>(0.2)</u>

The stock-based compensation expense of \$0.1M is calculated over the vesting period of outstanding share options. There were 610,000 stock options granted during the current quarter.

Relative to the acquisition of a Peruvian subsidiary in 2006, the Company had assumed a long term debt regarding amounts due to workers of Peru. This long term debt was included as part of the purchase price allocation. These workers have claimed interest on the outstanding balance. Accordingly, the Company has concluded an agreement whereby the new outstanding balance would be 2.5M new soles (\$0.9M) which will not bear any interest. As a result, a non-recurring \$0.3M has been recorded as interest expense.

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 \$0.2M (\$0.0M in Q2-2009). The changes in the non-cash working capital item amounted to a deficit of \$1.8M (deficit of \$0.9M in Q2-2009) resulting in cash used from operating activities in the amount of \$1.5M in the current quarter compared \$0.9M in Q2-2009.

**Investing Activities**

The work relative to the expansion project to increase capacity continued in the second quarter. During Q2 2010, the Company invested \$0.8M for the acquisition of property, plant and equipment (\$0.1M for the corresponding period in 2009). The Company also invested \$0.2M (\$0.7M 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. The Company increased its holding in Hidropesac by investing \$0.2M in common shares bring the ownership percentage to 49%.

**Financing Activities**

In the current quarter, the cash flow from financing activities amounted to \$4.6M (\$2.9M in Q2-2009). During the quarter, the Company completed a two tranche private placement and raised gross proceeds of \$5.4M less share issuance expenses of \$0.5M, 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.

**Liquidity**

As at June 30, 2010, the working capital returned to a positive position in the amount of \$1.6M compared to a deficit of \$1.4M as at December 31, 2009. This is mainly due to the capital raised as part of the private placement.

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\$237 per MTU compared to US\$185 as at December 31, 2009. Considering the estimated production capacity for the remaining six months of 2010 and the current market price, this should increase cash flow from operations significantly. Lastly, the Company could request repayment of a portion of its investment in Dynacor.

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

**Assets**

As at June 30, 2010, total assets amounted to \$25.8M (\$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	719	3,729	1,504	130	6,082
Operating leases	52	105	-	-	157
Capital leases	140	199	-	-	339
Purchase commitments	2,209	-	-	-	2,209
Asset retirement obligation for property, plant and equipment	-	-	-	590	590
	<u>3,119</u>	<u>4,033</u>	<u>1,504</u>	<u>720</u>	<u>9,377</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, 610,000 stock options were granted (nil in 2009). For the six-month period ended June 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 June 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 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**

	2010		2009				2008	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
(in \$'000)								
<b>Financial</b>								
Revenues	3,571	3,778	2,470	2,780	2,489	3,439	3,065	3,157
Cash cost of sales	2,411	2,752	2,698	2,534	1,960	2,384	2,418	2,334
Amortization and depletion	938	1,007	1,071	993	1,146	878	506	506
General and administrative expenses	715	629	523	666	683	734	782	664
Net loss	(1,399)	(693)	(3,776)	(1,977)	(1,328)	(554)	(961)	(414)
Cash and cash equivalents and short term investments	2,249	392	1,149	1,939	1,584	668	800	1,097
Working capital	1,625	(2,113)	(1,367)	167	192	(2,174)	(1,396)	286
Total assets	25,815	22,232	21,902	26,767	25,684	24,705	24,026	25,449
Shareholders' equity	13,671	10,013	10,507	13,997	14,915	16,043	16,578	17,945
Cash flow from (used by) operating activities	(1,536)	(140)	(29)	(646)	(942)	939	1,041	(885)
Acquisition of property, plant and equipment	828	372	819	1,277	373	335	199	232
Development and deferred exploration costs	152	178	351	470	687	781	857	626
<b>Per Share</b>								
Loss per share basic and diluted	(0.01)	0.00	(0.02)	(0.02)	(0.01)	0.00	(0.01)	(0.00)
Weighted average shares outstanding ('000), basic and diluted	160,110	147,689	140,770	139,000	137,117	137,117	137,117	137,117

**Data on Available Outstanding Shares (as at August 6, 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. Considering that only 77 veins were sampled and that 25 were considered significant, management believes that the potential of the mine could be even greater than that 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 six months ended June 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.

**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. New electromagnets have therefore been purchased and will be installed as soon as they are

delivered to Peru in the coming days. Once these electromagnets are installed, the new mill will be able to produce over 500 tpd. 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 that have in turn caused a delay in meeting the 500 tpd objective. The mill is nevertheless expected to be fully operational at 500 tpd during the month of August.

#### **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 feasibility study detailing the economic parameters and financial requirements should be finalized late Q3 or early Q4 of 2010. 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 2011.

#### **Outlook**

The Company expects to gradually increase installed capacity to 500 tpd during the third quarter of 2010 which will help improve the Company's profitability. With the proceeds received from the private placement, the Company will 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. In addition, the Company will improve its process controls and procedures in order to increase the yield of its production process. On August 6, 2010 the APT price is US\$237 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 2014. 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 June 30, 2010, the total market value of its investment in Dynacor amounted to \$3.9M.

**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 began its project to convert to IFRS in 2008 and has established a governance structure of the project. Regular reports are submitted to the Audit committee. Malaga continues to assess the impact of IFRS adoption on the financial presentation and, at this time, the impact on the financial position and future results of operation that cannot be reasonably determined or estimated.

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.

**Phase 2 – Evaluation of Project Components**

During this phase 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 will then be developed. In addition, the Company will design and develop solutions to address the differences identified. The changes required to the existing accounting policies, information systems, business processes and internal controls over financial reporting will be identified in order to perform conversion to IFRS.

**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.

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. The Company completed the Phase 1 in July 2009 and began the Phase 2 in the third quarter of 2009. 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.

Most adjustments required on transition to IFRS will be made, retrospectively, against opening retained earnings as of the date of the first comparative balance sheet presented based on standards applicable at that time. Transitional adjustments relating to those standards where comparative figures are not required to be restated will only be made as of the first day of the year of adoption.

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.

#### 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.

***Disclosure Controls and Procedures***

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of the Company are responsible for establishing and maintaining the Company's disclosure controls and procedures, including adherence to the Disclosure Policy adopted by the Company. The Disclosure Policy requires all staff to keep senior management fully apprised of all material information affecting the Company so that they may evaluate and discuss this information and determine the appropriateness and timing for public release. The CEO and CFO evaluated the effectiveness of the Company's disclosure controls and procedures as required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators. They concluded that as of June 30, 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 June 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 \_\_\_\_\_

Jean Martineau  
President and Chief Executive Officer

(s) Pierre Monet \_\_\_\_\_

Pierre Monet  
Vice-President and Chief Financial Officer