

Malaga Inc.

Unaudited Interim Consolidated Financial Statements

For the Three-month and Six-month Periods ended June 30, 2010

Malaga Inc.

Consolidated Balance Sheets as at

	June 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
ASSETS		
CURRENT ASSETS		
Cash on hand	2,248,678	1,149,101
Accounts receivable (Note 3)	3,018,752	1,198,625
Income taxes receivable	762,706	695,432
Inventories (Note 4)	1,871,773	1,369,423
Prepaid expenses	587,411	182,204
	<u>8,489,320</u>	<u>4,594,785</u>
Investments (Note 5)	2,770,708	2,471,942
Property, plant and equipment (Note 6)	10,089,089	8,801,346
Mining properties and deferred development and exploration costs (Note 7)	4,465,774	6,034,270
	<u>25,814,891</u>	<u>21,902,343</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	4,929,447	4,371,622
Income taxes payable	125,699	45,996
Unearned revenues	231,569	199,065
Current portion of long-term debt	1,388,939	1,081,129
Current portion of obligations under capital leases	188,482	264,030
	<u>6,864,136</u>	<u>5,961,842</u>
Long-term debt	2,995,616	2,921,081
Deferred revenues	1,543,533	1,726,994
Obligations under capital leases	150,530	206,744
Asset retirement obligations	589,867	578,845
	<u>12,143,682</u>	<u>11,395,506</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 8)	43,900,621	39,536,003
Warrants	596,999	-
Contributed surplus	3,834,777	3,539,644
Conversion option	319,903	319,903
Deficit	(34,981,091)	(32,888,713)
	<u>13,671,209</u>	<u>10,506,837</u>
	<u>25,814,891</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 June 30,		Six-month Periods ended June 30,	
	2010 \$	2009 \$	2010 \$	2009 \$
Sales (Note 9)	3,571,080	2,489,252	7,348,616	5,928,428
Cost of sales (excluding amortization and depletion) (Note 9)	(2,411,081)	(1,960,311)	(5,162,747)	(4,343,877)
Amortization and depletion	(937,551)	(1,146,409)	(1,944,259)	(2,024,430)
Accretion expense of the asset retirement obligations	(5,511)	(20,000)	(11,022)	(40,000)
Income (loss) from mining activities	216,937	(637,468)	230,588	(479,879)
General and administrative expenses	(715,307)	(683,024)	(1,344,366)	(1,416,699)
Stock-based compensation	(96,377)	(18,800)	(295,133)	(37,800)
Operating loss	(594,747)	(1,339,292)	(1,408,911)	(1,934,378)
Interest expense	(384,567)	(127,081)	(441,332)	(293,476)
Accretion expense of long-term debt	(151,110)	(23,493)	(297,105)	(23,493)
Foreign exchange gain (loss)	(361,982)	87,141	(38,030)	182,915
Loss before undernoted	(1,492,406)	(1,402,725)	(2,185,378)	(2,068,432)
Share of earnings in investment using equity method	93,000	74,462	93,000	185,848
Loss and comprehensive loss	(1,399,406)	(1,328,263)	(2,092,378)	(1,882,584)
Deficit, beginning of period	(33,581,685)	(25,807,765)	(32,888,713)	(25,253,444)
Loss and comprehensive loss	(1,399,406)	(1,328,263)	(2,092,378)	(1,882,584)
Deficit, end of period	(34,981,091)	(27,136,028)	(34,981,091)	(27,136,028)
Loss per share, basic and diluted	(0.01)	(0.01)	(0.01)	(0.02)
Weighted average number of outstanding common shares				
Basic and diluted	160,109,737	137,117,367	153,932,607	137,117,367

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 June 30,		Six-month Periods ended June 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
Operating activities				
Net loss	(1,399,406)	(1,328,263)	(2,092,378)	(1,882,584)
Items not affecting cash and cash equivalents:				
Amortization and depletion	937,551	1,146,409	1,944,259	2,024,430
Amortization of deferred revenues	(99,400)	(40,671)	(200,012)	(40,671)
Accretion expense of the asset retirement obligation	5,511	20,000	11,022	40,000
Accretion expense of long term debt	151,110	23,493	297,105	23,493
Stock-based compensation	96,377	18,800	295,133	37,800
Share of earnings in investments using equity method	(93,000)	(74,462)	(93,000)	(185,848)
Interest to workers of Peru (Note 10)	300,000	-	300,000	-
Realized foreign exchange gain	(38,352)	-	(38,352)	-
Unrealized foreign exchange loss	370,760	240,849	123,894	275,625
	<u>231,151</u>	<u>6,155</u>	<u>547,671</u>	<u>292,245</u>
Change in non-cash working capital items (Note 10)	<u>(1,766,693)</u>	<u>(948,261)</u>	<u>(2,223,497)</u>	<u>(295,309)</u>
	<u>(1,535,542)</u>	<u>(942,106)</u>	<u>(1,675,826)</u>	<u>(3,064)</u>
Investing activities				
Short-term investments	-	200,000	-	700,000
Acquisition of investment	(205,766)	-	(205,766)	-
Acquisitions of property, plant and equipment	(828,369)	(113,114)	(1,200,484)	(707,677)
Additions to mining properties and deferred development and exploration costs	(151,937)	(686,792)	(329,778)	(1,468,246)
	<u>(1,186,072)</u>	<u>(859,901)</u>	<u>(1,736,028)</u>	<u>(1,475,923)</u>
Financing activities				
Proceeds of bank loans	-	552,368	-	2,377,627
Repayments of bank loans	-	(1,180,069)	-	(2,845,344)
Proceeds of new long-term debt	-	3,645,954	-	3,645,954
Repayment of long-term debt	(318,424)	(1,951)	(318,424)	(1,951)
Proceeds of issuance of common shares	4,841,550	-	4,841,550	-
Share capital issuance cost	(417,883)	-	(417,883)	-
Proceeds of issuance of warrants	537,950	-	537,950	-
Obligations under capital leases	(64,822)	(98,354)	(131,762)	(169,644)
	<u>4,578,371</u>	<u>(2,917,948)</u>	<u>4,511,431</u>	<u>3,006,642</u>
Variation in cash and cash equivalents	1,856,757	1,115,941	1,099,577	1,527,655
Cash on hand (bank overdraft), beginning of period	<u>391,921</u>	<u>367,750</u>	<u>1,149,101</u>	<u>(43,964)</u>
Cash on hand, end of period	<u>2,248,678</u>	<u>1,483,691</u>	<u>2,248,678</u>	<u>1,483,691</u>

Going concern assumption (Note 1)

Additional information on cash flows (Note 10)

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

Malaga Inc.

Notes to consolidated financial statements

June 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 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
June 30, 2010
(unaudited)

3. Accounts Receivable

	June 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
Accounts receivable	615,453	77,722
Sale taxes receivable	1,955,669	626,225
Advances to suppliers	76,590	30,057
Advances to a related company	301,298	238,304
Accounts receivable from an affiliated company	69,742	226,317
	<u>3,018,752</u>	<u>1,198,625</u>

4. Inventories

	June 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
Finished products	357,951	260,819
Inventory in transit	736,657	1,206,071
	<u>1,094,608</u>	<u>1,466,890</u>
Write-down of inventory value	-	(485,252)
	<u>1,094,608</u>	<u>981,638</u>
Work in process	206,410	56,247
Supplies	570,755	331,538
	<u>1,871,773</u>	<u>1,369,423</u>

5. Investments

	June 30, 2010 (unaudited) \$	December 31, 2009 (audited) \$
Dynacor		
Investment at beginning of period	952,424	2,255,130
Share of net earnings (loss)	93,000	(865,270)
Investment at end of period	<u>1,045,424</u>	<u>1,389,860</u>
Promissory note receivable from Dynacor, without interest, convertible into common shares at \$0.40 per share (6,466,035 shares) at the option of Dynacor	1,519,518	2,586,414
	<u>2,564,942</u>	<u>3,976,274</u>
Impairment in investment value	-	(1,504,332)
Total investment in Dynacor	<u>2,564,942</u>	<u>2,471,942</u>
Hidroeléctrica Pelagatos S.A.C. at equity	205,766	-
	<u>2,770,708</u>	<u>2,471,942</u>

Malaga Inc.

Notes to consolidated financial statements
June 30, 2010
(unaudited)

6. Property, Plant and Equipment

	June 30, 2010 (unaudited)			December 31, 2009 (audited)		
	Cost \$	Accumulated amortization & depletion \$	Net book value \$	Cost \$	Accumulated amortization & depletion \$	Net book value \$
Development costs	10,221,972	5,694,356	4,527,616	7,829,516	4,584,807	3,244,709
Land	113,656	-	113,656	113,656	-	113,656
Building	444,347	75,575	368,772	444,347	66,119	378,228
Plant and mining equipment	8,008,290	3,461,035	4,547,255	7,312,778	2,898,385	4,414,393
Vehicles	124,471	53,386	71,085	114,660	59,592	55,068
Office equipment	109,246	78,188	31,058	109,246	72,708	36,538
	19,021,982	9,362,540	9,659,442	15,924,203	7,681,611	8,242,592
Assets under capital leases						
Plant and mining equipment	702,366	331,465	370,901	702,366	226,110	476,256
Vehicles	190,023	131,277	58,746	190,023	107,525	82,498
TOTAL	19,914,371	9,825,282	10,089,089	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, \$494,182 was capitalized in development costs for the first two 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 II			Mining rights	Total 2010 (unaudited)
	\$	\$	\$		
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	206,008	123,383	387	-	329,778
Transferred to property, plant and equipment	(212,594)	(1,217,542)	(31,664)	-	(1,461,800)
Balance, end of period	667,539	2,369,827	285,358	-	3,322,724
TOTAL	824,483	2,941,200	399,678	300,413	4,465,774

Malaga Inc.

Notes to consolidated financial statements

June 30, 2010

(unaudited)

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.

8. Share Capital

a) Common Shares

	June 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	-	(476,932)	-	(60,000)
Balance, end of period	183,550,176	43,900,621	147,686,843	39,536,003

¹ In the quarter, the Company received gross proceeds of \$5,379,500 less share issuance expenses of \$476,932 (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.

Malaga Inc.

Notes to consolidated financial statements
June 30, 2010
(unaudited)

8. Share Capital (cont'd)

b) Warrants, Ordinary and Broker

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

In the 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.

c) Share Purchase Options

	June 30, 2010 (unaudited)		December 31, 2009 (audited)	
	Number of options (in '000)	Weighted average exercise price \$	Number of options (in '000)	Weighted average exercise price \$
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	6,060	0.34	4,795	0.42

Outstanding options as at June 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 (\$)
0.16 to 0.27	6.6	3,540	0.16	1,705	0.15
0.28 to 0.42	4.3	3,540	0.31	2,985	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
0.16 to 0.77		8,450	0.29	6,060	0.34

Malaga Inc.

Notes to consolidated financial statements

June 30, 2010

(unaudited)

8. Share Capital (cont'd)

For the six-month period ended June 30, 2010, the stock-based compensation charged to the consolidated statement of earnings was \$295,133 compared to \$37,800 in 2009. The offsetting credit has been recorded as contributed surplus. As at June 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

9. Information Included in the Consolidated Statement of Earnings

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
Sales				
Tungsten	3,278,533	2,489,252	6,152,767	5,928,428
Copper	292,547	-	1,195,849	-
	<u>3,571,080</u>	<u>2,489,252</u>	<u>7,348,616</u>	<u>5,928,428</u>
Cost of Sales				
Tungsten	2,164,635	1,960,311	4,625,052	4,343,877
Copper	246,446	-	537,695	-
	<u>2,411,081</u>	<u>1,960,311</u>	<u>5,162,747</u>	<u>4,343,877</u>

Malaga Inc.

Notes to consolidated financial statements
June 30, 2010
(unaudited)

10. Information Included in the Statements of Cash Flows

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
Changes in non-cash working capital items:				
Accounts receivable	(1,047,166)	444,848	(1,703,087)	2,689
Income taxes receivable	(5,333)	(59,167)	(42,342)	(137,825)
Inventories	(405,984)	(165,575)	(635,594)	37,016
Prepaid expenses	256,517	(178,670)	(405,237)	(298,216)
Accounts payable and accrued liabilities	(711,381)	(1,011,975)	380,648	96,486
Income taxes payable	44,860	22,278	74,181	4,541
Unearned revenue	26,364	-	32,504	-
	<u>(1,842,123)</u>	<u>(948,261)</u>	<u>(2,298,927)</u>	<u>(295,309)</u>
Additional information				
Interest paid	85,288	130,495	142,053	299,249
Interest received	721	1,595	721	3,844
Income taxes paid	6,846	36,732	11,905	146,177
Non cash transactions				
Depletion of development costs capitalized in inventory	133,552	43,416	309,077	186,605
Write-down of inventory value	-	-	92,723	-
Interest to workers in Peru in long term debt	300,000	-	300,000	-

11. 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.

Malaga Inc.

Notes to consolidated financial statements

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(unaudited)

11. Financial Instruments (cont'd)

ii. Hierarchy of Assessments at Fair Value

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

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

The only financial instruments measured at fair value are cash 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 June 30, 2010, the outstanding balance of the long term debt that bears interest at the 12 month LIBOR rate is \$3.6 million US (\$4.2 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.

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.

Malaga Inc.

Notes to consolidated financial statements

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(unaudited)

12. 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 June 30,		Six-month periods ended June 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
General and administrative expenses	185,741	132,904	379,688	264,523

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.

13. Comparative figures

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