



**CONSOLIDATED FINANCIAL STATEMENTS**

**For the year ended May 31, 2010**

## AUDITORS' REPORT

To the Shareholders of  
Rio Alto Mining Limited

We have audited the consolidated balance sheets of Rio Alto Mining Limited as at May 31, 2010 and 2009 and the consolidated statements of operations, comprehensive loss, deficit, cash flows and shareholders' equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**“DAVIDSON & COMPANY LLP”**

Vancouver, Canada

Chartered Accountants

August 16, 2010



**RIO ALTO MINING LIMITED**  
**CONSOLIDATED BALANCE SHEETS**  
As at May 31,

	<u>2010</u>	<u>2009</u>
<b>Assets</b>		
Current		
Cash	\$ 5,677,030	\$ 5,702,661
Receivables	88,124	143,348
Subscriptions receivable (Note 10)	608,060	-
Promissory note receivable (Note 7)	121,603	-
Prepaid expenses	164,442	27,078
	<u>6,659,259</u>	<u>5,873,087</u>
Deferred financing costs (Note 5)	24,965	-
Value added tax receivable	-	427,200
Promissory note and deferred costs (Note 4)	-	248,978
Equipment (Note 6)	271,302	356,723
Mineral property deposits (Note 7)	-	123,185
Mineral properties and evaluation costs (Note 7)	20,795,584	8,022,067
	<u>27,751,110</u>	<u>15,051,240</u>
<b>Total Assets</b>		
<b>Liabilities and Shareholders' Equity</b>		
Current		
Accounts payable and accrued liabilities	\$ 524,668	\$ 416,198
Due to related parties (Note 8)	75,392	112,130
	<u>600,060</u>	<u>528,328</u>
Future income taxes (Note 12)	2,642,326	-
	<u>3,242,386</u>	<u>528,328</u>
Shareholders' equity		
Capital stock (Note 10)	42,524,047	20,008,292
Contributed surplus (Note 10)	2,631,040	1,745,906
Deficit	(20,646,363)	(7,231,286)
	<u>24,508,724</u>	<u>14,522,912</u>
	<u>27,751,110</u>	<u>15,051,240</u>
<b>Total Liabilities and Shareholders' Equity</b>		

**Nature of business and continuance of operations** (Note 2)

**Commitments** (Note 14)

**Subsequent events** (Note 16)

On behalf of the Board:

**"Anthony Hawkshaw"**

\_\_\_\_\_  
Director

**"Daniel Kenney"**

\_\_\_\_\_  
Director

See accompanying notes to the consolidated financial statements.

**RIO ALTO MINING LIMITED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT**  
For the years ended May 31,

	<u>2010</u>	<u>2009</u>
<b>General and administrative expenses</b>		
Administration fees	\$ 752,156	\$ 207,709
Accounting and audit	214,299	137,820
Amortization	67,830	35,903
Consulting	56,331	42,802
Directors' fees	95,088	-
Exploration expenses	485,286	109,356
Insurance	51,638	40,730
Investor relations and promotion	464,555	176,914
Foreign exchange (gain) loss	225,143	97,255
Management fees	835,964	345,396
Office and miscellaneous	167,343	53,845
Legal fees	132,793	90,037
Regulatory and transfer agent fees	77,722	14,187
Rent and utilities	108,374	28,363
Repairs and maintenance	-	15,428
Stock-based compensation (Note 10)	474,782	64,084
Travel	196,066	129,586
	<u>(4,405,370)</u>	<u>(1,589,415)</u>
<b>Loss before other items</b>		
<b>Other items</b>		
Write-off of mineral property deposit (Note 7)	(123,185)	-
Extinguishment of payables	176,791	-
Loss on disposal of equipment (Note 6)	(35,050)	-
Loss on sale of mineral property interests (Note 7)	(9,178,970)	-
Interest income	284	138,545
	<u>(9,160,130)</u>	<u>138,545</u>
<b>Loss before income taxes</b>	(13,565,500)	(1,450,870)
<b>Future income tax recovery</b>	150,423	-
<b>Net loss and comprehensive loss for the year</b>	(13,415,077)	(1,450,870)
<b>Deficit, beginning of the year</b>	(7,231,286)	(5,780,416)
<b>Deficit, end of the year</b>	<u><u>\$(20,646,363)</u></u>	<u><u>\$(7,231,286)</u></u>
<b>Basic and diluted loss per common share</b>	\$ (0.16)	\$ (0.04)
<b>Weighted average number of common shares outstanding</b>	<u>82,649,411</u>	<u>40,407,013</u>

See accompanying notes to the consolidated financial statements.

**RIO ALTO MINING LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the years ended May 31,

	<b>2010</b>	2009
<b>OPERATING ACTIVITIES</b>		
Loss for the year	\$ (13,415,077)	\$(1,450,870)
Items not affecting cash:		
Amortization	67,830	35,903
Stock-based compensation	474,782	64,084
Loss on disposal of equipment	35,050	-
Write-off of mineral property deposit	123,185	-
Extinguishment of payables	(176,791)	-
Loss on sale of mineral property interests	9,178,970	-
Future income tax recovery	(150,423)	-
Changes in non-cash working capital items		
Decrease in receivables	270,132	160,617
Increase in prepaid expenses	(101,270)	(3,601)
Increase in value added tax receivable	(9,682)	(112,407)
Increase (decrease) in accounts payable and accrued liabilities	(162,451)	76,371
Increase (decrease) in due to related parties	(174,280)	53,044
Net cash used in operating activities	<u>(4,040,025)</u>	<u>(1,176,859)</u>
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of share capital	15,852,469	-
Share issue costs	(1,003,591)	-
Deferred financing costs	(24,965)	-
Net cash provided by financing activities	<u>14,823,913</u>	<u>-</u>
<b>INVESTING ACTIVITIES</b>		
Promissory note and deferred costs	-	(248,978)
Purchase of equipment	(284,783)	(10,638)
Proceeds from disposal of equipment	86,712	-
Cash acquired in RAML asset acquisition	2,322,963	-
Cash used in RAML asset acquisition	(800,000)	-
Transaction costs	(347,924)	-
Mineral property expenditures	(11,711,333)	(1,219,273)
Cash disposed of in sale of Materias	(75,154)	-
Net cash used in investing activities	<u>(10,809,519)</u>	<u>(1,478,889)</u>
Decrease in cash during the year	(25,631)	(2,655,748)
Cash, beginning of the year	5,702,661	8,358,409
<b>Cash, end of the year</b>	<u>\$ 5,677,030</u>	<u>\$ 5,702,661</u>
Supplemental cash flow disclosure (Note 15)		
Income taxes paid	<u>\$ -</u>	<u>\$ -</u>
Interest paid	<u>\$ 1,335</u>	<u>\$ -</u>

See accompanying notes to the consolidated financial statements.

**RIO ALTO MINING LIMITED**  
**Consolidated Statements of Shareholders' Equity**  
**For the year ended May 31, 2010**

	Common Shares		Contributed	Deficit	Comprehensive	Total
	Shares	Amount	Surplus		Income (loss)	
Balance, May 31, 2008	40,407,013	\$ 20,008,292	\$ 1,681,822	\$ (5,780,416)	\$ -	\$15,909,698
Stock-based compensation	-	-	64,084	-	-	64,084
<b>Net loss for the year</b>	-	-	-	<b>(1,450,870)</b>	-	<b>(1,450,870)</b>
Balance, May 31, 2009	40,407,013	20,008,292	1,745,906	(7,231,286)	-	14,522,912
Shares issued on RAML asset acquisition	35,143,411	7,028,682	-	-	-	7,028,682
Fair value of warrants issued on asset acquisition of RAML	-	-	492,987	-	-	492,987
Shares issued for private placements	28,399,566	14,589,281	-	-	-	14,589,281
Share issue costs related to private placements	-	(1,056,091)	-	-	-	(1,056,091)
Shares issued on exercise of warrants	3,582,585	1,758,740	(11,242)	-	-	1,747,498
Shares issued on exercise of options	503,000	195,143	(71,393)	-	-	123,750
Stock-based compensation	-	-	474,782	-	-	474,782
<b>Net loss for the year</b>	-	-	-	<b>(13,415,077)</b>	-	<b>(13,415,077)</b>
<b>Balance, May 31, 2010</b>	<b>108,035,575</b>	<b>\$ 42,524,047</b>	<b>\$ 2,631,040</b>	<b>\$ 20,646,363)</b>	<b>\$ -</b>	<b>\$24,508,724</b>

See accompanying notes to the consolidated financial statements.

**RIO ALTO MINING LIMITED**  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
For the years ended May 31, 2010 and 2009

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**1. BASIS OF PRESENTATION**

Rio Alto Mining Limited, formerly Mexican Silver Mines Ltd., (the "Company"), is incorporated under the laws of the Province of Alberta and was primarily engaged in the acquisition and exploration of mineral properties in Mexico. On June 25, 2009, the Company acquired Rio Alto Mining Limited ("RAML"), a company primarily engaged in the development of the La Arena gold oxide/copper - gold porphyry project, in Peru, and changed its name to Rio Alto Mining Limited. These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Mexican Silver Mines (Guernsey) Limited ("MSM Guernsey"), located in Guernsey, Materias Primas Minerales La Iguana S.A. de C.V. ("Materias"), located in Mexico and Rio Alto S.A.C. located in Peru.

These consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles ("GAAP") on a comparative and consistent basis.

**2. NATURE OF BUSINESS AND CONTINUANCE OF OPERATIONS**

The Company is in the development stage and has not generated any significant revenues.

These consolidated financial statements have been prepared on the assumption that the Company will realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation. At May 31, 2010, the Company had \$6,059,199 of working capital (2009 - \$5,344,759) and a deficit of \$20,646,363 (2009 - \$7,231,280). The Company's ability to continue as a going concern and the recoverability of the amounts comprising mineral properties are dependent upon the confirmation of economically recoverable reserves, the ability of the Company to obtain necessary financing to successfully complete its development activities and upon future profitable production from or the sale of its mineral property interests. There can be no assurance that the Company will be able to obtain additional financing, in which case the Company may not be able to discharge its obligations. Should the Company be unable to realize its assets or discharge its liabilities in the normal course of business, the net realizable value of its assets may be materially less than the amounts recorded in the consolidated financial statements. These consolidated financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern. Management pursues relationships and alliances with financial, exploration and mining entities in order to attract additional sources of funds or other transactions that would assure the continuance of the Company's operations.

**3. SIGNIFICANT ACCOUNTING POLICIES**

**Estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses. Actual results could differ from such estimates.

Significant accounts that require estimates as the basis for determining the stated amounts include receivables, value added tax receivable, mineral properties and evaluation costs, stock-based compensation, future income taxes and allocation of purchase price.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**Principles of consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company transactions and balances have been eliminated.

**Comparative figures**

Comparative figures have been reclassified, where applicable, to conform to the current year's presentation.

**Equipment**

Equipment is recorded at cost less accumulated amortization. Amortization is recorded on a straight-line basis at the following annual rates:

Automobile	20% - 30%		
Computer equipment and office equipment	10%	-	30%
Drill equipment and other equipment	20%		

**Loss per share**

Basic loss per common share is calculated by dividing the loss for the period by the weighted average number of common shares outstanding during the financial reporting period.

Diluted earnings (loss) per share is calculated by the treasury stock method which adjusts the weighted average number of shares for the dilutive effect of options and warrants. The computation of diluted loss per share assumes the conversion, exercise or contingent issuance of securities only when such conversion would have a dilutive effect on earnings. Under the treasury stock method it is assumed that outstanding options, warrants and similar items are exercised or converted into shares and that the proceeds that would be realized upon such exercise or conversion are used to purchase common shares at the average market price per share during the relevant financial reporting period. Diluted loss per share is not presented separately from basic loss per share because the conversion of outstanding potentially dilutive instruments would be anti-dilutive.

**Deferred financing costs**

Deferred financing costs consist of all direct costs incurred to obtain financing and the Company uses the effective interest method of amortization for these costs.

**Mineral properties and evaluation costs**

Interests in mineral properties and areas of geological interest are recorded at cost. All direct costs relating to the acquisition and development of these interests are deferred on the basis of specific claims or area of interest until the properties they relate to are placed into production, divested, surrendered, abandoned or deemed to be impaired. Deferred mineral property and development costs include cash consideration paid, the assigned value of any share consideration paid and the evaluation costs incurred. The recorded amount of deferred costs may not reflect recoverable value, which is dependent on development programs, the nature of any mineral deposit, commodity prices and the Company's ability to obtain adequate funding to bring its projects into production.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**Mineral properties and evaluation costs (cont'd...)**

Once a property is placed into production deferred costs will be amortized on a units of production basis over the expected life of the property's proven and probable reserves. Revenues from the sale of any mineral properties will be credited against related deferred costs with any residual amounts recognized as a gain or loss. Deferred costs relating to property interests that are surrendered or abandoned will be written off and recognized in the determination of income.

Mineral property interests are reviewed for impairment at each financial statement preparation date or whenever events or circumstances indicate that the carrying value of such interests may not be recoverable. Impairment charges are recognized in the determination of income. Prospecting and initial exploration costs are expensed as incurred.

**Asset retirement obligations**

The Company recognizes the fair value of an estimated liability for the future cost of restoring exploration and development sites with a corresponding increase to the carrying value of the related mineral property interest. The Company amortizes the amount added to mineral property interests using the amortization method established for the related asset. Changes in asset retirement obligations due to the passage of time are measured by an interest method of allocation whereby the change is recognized as an increase in the associated liability by an accretion expense in the statement of operations. Changes resulting from revisions to the timing or amount of the original estimate of undiscounted retirement obligation cash flows are recognized as an increase or decrease in the carrying amount of the asset retirement obligation with a corresponding increase or decrease in the carrying value of the related asset. The Company does not have any significant asset retirement obligations.

**Impairment of long-lived asset**

A long-lived asset is tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds its fair value. For purposes of recognition and measurement of an impairment loss, a long-lived asset is grouped with other assets and liabilities to form an asset group at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Estimates of future cash flows used to test recoverability of a long-lived asset include only the future cash flows that are directly associated with, and that are expected to arise as a direct result of, its use and eventual disposition.

**Foreign currency translation**

The Company's subsidiaries are integrated foreign operations whose accounts are translated into Canadian dollars using the temporal method. Under this method foreign currency denominated monetary items are translated into Canadian dollars at the exchange rate in effect at the balance sheet date. Foreign currency denominated, non-monetary items are translated at historical exchange rates. Transactions denominated in foreign currencies are translated at the exchange rate prevailing on the respective transaction dates. Translation gains and losses are reflected in the determination of income for the period in which they arise.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**Future income taxes**

Future income taxes are recorded using the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to be applicable at the time those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in the determination of income in the period that enactment or substantive enactment of the tax rate change occurs. To the extent that the Company does not consider it to be more likely than not that a future income tax asset will be recovered, it provides a valuation allowance against such asset.

**Stock-based compensation**

The Company accounts for all stock-based payments using the fair value method. Stock-based compensation costs attributable to stock options are measured at fair value at the grant date and recognized in the determination of income over the vesting period of the underlying option. Fair value is determined by using a Black-Scholes option pricing model.

**Financial Instruments – Recognition and Measurement**

All financial instruments are classified into one of five categories; held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale assets and other financial liabilities. All financial instruments and derivatives are measured in the balance sheet at fair value, except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired.

The Company has classified its financial instruments as follows:

- Cash is classified as held-for-trading.
- Receivables and promissory note are classified as loans and receivables.
- Accounts payable and accrued liabilities and due to related parties are classified as other financial liabilities.

**Comprehensive income**

Comprehensive income is the change in the Company's shareholders' equity that results from transactions and other events arising from other than the Company's shareholders and includes items that would not normally be included in net earnings, such as unrealized gains and losses on available-for-sale investments. Comprehensive income accounting recommendations require certain gains or losses that would otherwise be recorded as part of net earnings to be presented in other comprehensive income until it is considered appropriate to recognize such gains or losses in net earnings.

Accumulated other comprehensive income is presented as a separate component within shareholders' equity. The presentation of accumulated other comprehensive loss in the shareholders' equity section of the consolidated balance sheet is not required because there has been no separate comprehensive income (loss) for the periods presented.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**Changes in and future accounting policies**

The Company is or will be subject to the following accounting pronouncements:

**a) Goodwill and intangible assets – Section 3064**

In February 2008, the Canadian Institute of Chartered Accountants (“CICA”) replaced Section 3062 – Goodwill and other intangible assets with Section 3064 – Goodwill and intangible assets. This section defines goodwill and intangible assets and establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. Accounting for goodwill and intangible assets following a business combination remains unchanged.

Section 3064 also provides accounting guidance for internally generated intangible assets. The section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. Application of these standards does not have a material affect on the Company’s consolidated financial statements.

**b) Amendment to Financial Instruments – Disclosures – Section 3862**

CICA Handbook Section 3862, Financial instruments – disclosures was amended to require disclosure about the inputs used in making fair value measurements, including their classification within a hierarchy that prioritizes their significance.

The three levels of the fair value hierarchy are:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

Level 2 – Input prices, other than quoted prices, included in Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 - Inputs for assets or liabilities that are not based on observable market data.

The fair value disclosures amendments to Section 3862 apply to annual financial statements relating to fiscal years ending after September 30, 2009. See Note 11 for relevant disclosures.

**c) Business combinations; Consolidated financial statements; and Non-controlling interests**

The CICA issued three new accounting standards in January 2009: Section 1582 – Business combinations; Section 1601 – Consolidated financial statements; and Section 1602 – Non-controlling interests. These standards will be effective for fiscal years beginning after January 1, 2011 (the Company’s 2012 fiscal year). Early adoption of these standards is permitted. The Company is in the process of evaluating the potential effects of the requirements of these new standards.

Section 1582 replaces Section 1581 and establishes standards for the accounting for a business combination and essentially provides the Canadian equivalent of International Financial Reporting Standards IFRS 3 – Business Combinations.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**c) Business combinations; Consolidated financial statements; and Non-controlling interests (cont'd...)**

Sections 1601 and 1602 together replace Section 1600 – Consolidated financial statements. Section 1601 establishes the standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary within consolidated financial statements subsequent to a business combination and is substantially equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27 – Consolidated and separate financial statements.

**d) International Financial Reporting Standards (“IFRS”)**

In 2006, the CICA published a strategic plan that outlines the convergence of GAAP with IFRS over an expected five-year transitional period. In February 2008, the CICA announced that 2011 is the year during which publicly-listed companies are required to adopt IFRS. The transition date of June 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended May 31, 2011. The first interim reporting period under IFRS will be August 31, 2011, when a reconciliation from GAAP to IFRS must be presented for the comparative period ending August 31, 2010. While the Company is assessing the effects of adopting IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

**4. ACQUISITION**

Effective June 25, 2009 Mexican Silver Mines Ltd. (“MSM”) and Rio Alto Mining Limited (“RAML”) entered into an agreement to combine their respective assets and liabilities (the “Transaction”). The Transaction was accounted for as an acquisition of the assets of RAML. The primary asset in RAML is the La Arena agreement as outlined in Note 7. The difference between the carrying amount and tax bases of the assets acquired resulted in a future income tax liability of \$2,792,749 and is included as part of the cost of the asset acquisition.

During the year ended May 31, 2009, MSM issued a \$200,000, 8 per cent per annum convertible promissory note (the “Note”) in favour of RAML. Immediately prior to the Transaction, the Note was converted into 1,000,000 common shares of RAML. Also prior to completion of Transaction on June 25, 2009, MSM subscribed for an additional 4,000,000 million common shares of RAML for consideration of \$800,000. During the year ended May 31, 2009, the Company incurred \$48,978 of costs in relation to the Transaction.

Before the Transaction RAML had 40,143,411 common shares issued and outstanding, of which 5,000,000 common shares were held by MSM and 4,329,000 warrants outstanding comprised of 1,500,000 warrants expiring on June 25, 2012 held by IAMGOLD Corporation (“IMG”) convertible into 1,500,000 common shares of RAML at \$0.30 per common share, 2,500,000 warrants convertible into 2,500,000 common shares of RAML at \$0.20 per common share that expire on June 25, 2012, and 329,000 Finders’ Warrants convertible into 329,000 common shares at \$0.20 per common share that expire June 25, 2010.

On June 25, 2009, MSM issued 35,143,411 common shares with a value of \$7,028,682 to RAML shareholders in order to acquire RAML at which time RAML became a wholly-owned subsidiary of MSM. Of the 35,143,411 common shares issued 8,537,990 common shares were placed in escrow as described in Note 10.

**RIO ALTO MINING LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the years ended May 31, 2010 and 2009

**4. ACQUISITION (cont'd...)**

Additionally, MSM issued 4,329,000 warrants with each warrant having the same terms and conditions as the pre-existing, outstanding RAML warrants. The value of the warrants, calculated using a Black-Scholes pricing model, was \$492,987. The assumptions used in the calculation were:

	Finders Warrants	IMG Warrants	Other Warrants	<b>Total</b>
Number of Warrants	329,000	1,500,000	2,500,000	<b>4,329,000</b>
Grant Date	June 25, 2009	June 25, 2009	June 25, 2009	
Exercise Price	\$0.20	\$0.30	\$0.20	
Expected Life	1 year	3 years	3 years	
Volatility	100.00%	100.00%	100.00%	
Risk-free rate	0.24%	0.24%	0.24%	
	\$			
<b>Fair Value</b>	<b>25,245</b>	<b>\$ 160,286</b>	<b>\$ 307,456</b>	<b>\$ 492,987</b>

The purchase price allocation is as follows:

Purchase price:	
Issuance of MSM shares	\$ 7,028,682
Fair value of MSM warrants granted	492,987
Conversion of promissory note	200,000
Additional RAML shares subscribed by MSM	800,000
Transaction costs	<u>396,902</u>
	<b>\$ 8,918,571</b>

Purchase price allocation:	
Cash	\$ 2,322,963
Receivables	214,908
Prepaid expenses	36,094
Value added tax receivable	69,993
Equipment	18,997
Mineral properties	9,541,531
Accounts payable and accrued liabilities	(355,299)
Due to related parties	(137,867)
Future income tax liability	<u>(2,792,749)</u>
	<b>\$ 8,918,571</b>

On July 24, 2009 MSM and RAML completed a vertical amalgamation and changed the Company name from Mexican Silver Mines Ltd. to Rio Alto Mining Limited.

**RIO ALTO MINING LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
For the years ended May 31, 2010 and 2009

**5. DEFERRED FINANCING COSTS**

On April 19, 2010 the Company agreed to terms of a US\$25 million gold prepayment facility. Closing is subject to the completion and execution of definitive documentation, regulatory approval and certain conditions precedent typical of a transaction of this nature. At closing the Company will pay a cash fee of US\$750,000 for assistance in arranging the prepayment agreement. The funds advanced under the facility are to be repaid by delivery of 36,800 ounces of gold over a forty-month period commencing eight months after drawdown. As at May 31, 2010, costs related to this prepayment agreement were recorded as deferred financing costs.

**6. EQUIPMENT**

Equipment consists of:

	May 31, 2010			May 31, 2009		
	Cost	Accumulated Amortization	Carrying Value	Cost	Accumulated Amortization	Carrying Value
Automobile	\$ 104,252	\$ 11,265	\$ 92,987	\$ 45,465	\$ 25,057	\$ 20,408
Office equipment	135,341	11,137	124,204	1,993	116	1,877
Computer equipment	34,738	7,492	27,246	56,852	22,835	34,017
Drill equipment	-	-	-	392,566	118,784	273,782
Equipment	28,951	2,086	26,865	44,244	17,605	26,639
	<u>\$ 303,282</u>	<u>\$ 31,980</u>	<u>\$ 271,302</u>	<u>\$ 541,120</u>	<u>\$ 184,397</u>	<u>\$ 356,723</u>

During the year ended May 31, 2010, the Company sold a drill rig (included in drill equipment) with net book value of \$121,762 for total proceeds of \$86,712, resulting in a loss on disposal of equipment of \$35,050. The remaining drill equipment was sold as part of the Mexican property sale (Note 7).

**7. MINERAL PROPERTIES AND EVALUATION COSTS**

The validity of title to mining property interests involves certain uncertainties, risk due to the difficulty of determining the ownership of claims as well as the potential for conflicts to arise due to ambiguous title conveyancing history characteristic of many mining properties. In accordance with industry practice the Company has investigated rights of ownership of all of the mineral licences in which it has an interest and, to the best of its knowledge, all agreements relating to such ownership rights are in good standing. However, such investigations may not provide a guarantee of title. Mineral licences may be subject to prior claims, agreements or transfers and rights of ownership may be affected by undetected defects.

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**7. MINERAL PROPERTIES AND EVALUATION COSTS (cont'd...)**

Mineral property expenditures are summarized as follows:

	La Arena, Peru	Providencia, Mexico	Ral, Mexico	Anillo de Fuego, Mexico	Voladora, Mexico	Total
Total mineral properties and deferred exploration costs May 31, 2008	\$ -	\$ 2,894,563	\$ 2,067,881	\$ 1,542,549	\$ 137,708	\$ 6,642,701
Deferred exploration costs during the year:						
Assays and laboratory tests	-	9,052	19,007	29,675	438	58,172
Camp costs	-	13,591	16,189	46,793	13,141	89,714
Courier, freight and transportation	-	(1,093)	751	371	-	29
Drilling	-	652	-	356,942	-	357,594
Equipment rental	-	1,922	-	4,539	-	6,461
IP Survey/Topographical survey	-	93,054	-	-	-	93,054
Geological consulting	-	78,279	59,957	104,754	58,525	301,515
Consulting and labour	-	40,548	20,480	165,498	7,226	233,752
Materials and supplies	-	3,014	223	8,273	300	11,810
Meals and accommodation	-	12,227	9,074	8,726	9,035	39,062
Mobilization/demobilization	-	(372)	(372)	(372)	-	(1,116)
Staking, permits and licenses	-	83,073	11,893	74,057	201	169,224
Telephone and communication	-	5,013	4,870	5,225	4,987	20,095
	-	338,960	142,072	804,481	93,853	1,379,366
Total mineral properties and deferred exploration costs May 31, 2009	-	3,233,523	2,209,953	2,347,030	231,561	8,022,067
Acquisition during the year	9,541,531	-	-	-	-	9,541,531
Deferred exploration costs during the year:						
Assays and laboratory tests	-	11,385	-	-	-	11,385
Office and camp costs	636,236	4,266	4,108	11,552	5,383	661,545
Drilling	-	94,753	-	56,864	-	151,617
Geological consulting	-	52,327	23,109	25,418	23,109	123,963
Consulting and labour	-	3,133	2,611	4,459	2,611	12,814
Materials and supplies	-	2,884	-	(11)	-	2,873
Meals, travel and accommodation	-	2,985	2,985	2,985	2,985	11,940
Staking, permits and licenses	-	146,262	11,105	46,845	9,345	213,557
Telephone and communication	-	3,184	3,184	3,184	3,363	12,915
Engineering and design	3,955,765	-	-	-	-	3,955,765
Construction	500,285	-	-	-	-	500,285
Payroll	311,389	-	-	-	-	311,389
Value added taxes	414,940	-	-	-	-	414,940
Concessions and property payments	1,078,610	-	-	-	-	1,078,610
Development advance	4,356,828	-	-	-	-	4,356,828
	20,795,584	321,179	47,102	151,296	46,796	21,361,957
Sale of mineral property Interests	-	(3,554,702)	(2,257,055)	(2,498,326)	(278,357)	(8,588,440)
	20,795,584	-	-	-	-	-
Total mineral properties and deferred exploration costs May 31, 2010	\$ 20,795,584	\$ -	\$ -	\$ -	\$ -	\$ 20,795,584

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**7. MINERAL PROPERTIES AND EVALUATION COSTS** (cont'd...)

*Providencia, Ral, Anillo de Fuego and Voladora, Mexico*

On May 7, 2007, the Company acquired interests in mineral licenses comprising three mineral projects through the acquisition of MSM Guernsey. These projects are known as Providencia, Ral and Anillo de Fuego, located in the state of Nuevo Leon, Mexico. The properties are subject to a 3% overriding royalty in relation to the petroleum substances and mineral products produced from the properties payable to a company related by virtue of common shareholders and directors.

On December 12, 2007, the Company entered into a Letter of Intent ("LOI") to acquire a 100% interest in the Voladora mine located in the state of Nuevo Leon, Mexico. The terms of the LOI to acquire the interest consisted of an initial US\$100,000 payment (paid) for a three-year option on the property.

At any time during the three-year period ending December 12, 2010 the Company could exercise its option for an additional payment of US\$900,000.

On May 31, 2010, the Company sold its subsidiary, Materias, which is the holder of a 100% interest in the mineral interests of Providencia, Ral, Anillo de Fuego and Voladora. The purchaser, a former director of the Company, agreed to pay the Company US\$115,371 for the Company's issued and outstanding shares of Materias and a 1 per cent net smelter return royalty. The purchaser issued a promissory note to the Company for the sale price of US\$115,371 and the note bears interest at 15% per annum on the principal sum outstanding after the maturity date of May 31, 2011. The sale of Materias is effectively a sale of mineral property interests and its related net assets and resulted in a loss on sale of \$9,178,970.

The net assets sold are as follows:

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Cash	\$ 75,154
Value added tax receivable	506,875
Equipment	142,816
Mineral property interests	8,588,440
Accounts payable and accrued liabilities	(12,387)
Due to related parties	<u>(325)</u>
<b>Net assets sold</b>	<b><u>\$ 9,300,573</u></b>

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*La Arena Option and Earn-in Right Purchase Agreement*

As part of the acquisition of RAML, 8,024,511 common shares with a value of \$1,604,902 and 1,500,000 warrants with a value of \$160,286 were issued to IMG as consideration for the La Arena agreement. The La Arena agreement provides that the Company may earn-in and purchase 100% of all of the issued and outstanding shares of La Arena S.A. La Arena S.A., a wholly-owned subsidiary of IMG, owns 100% of the La Arena mineral project ("La Arena") in Peru. The exercise price of the option to acquire 100% of La Arena S.A. is US\$47,550,000, subject to adjustments, (the "Exercise Price") which is to be paid in cash by June 15, 2011.

**7. MINERAL PROPERTIES AND EVALUATION COSTS** (cont'd...)

*La Arena Option and Earn-in Right Purchase Agreement (cont'd...)*

If the Exercise Price is not paid by June 15, 2011 the Company may extend the option by two nine-month periods provided the Company has incurred the minimum expenditures of US\$10,000,000 in La Arena by June 15, 2011. The fee for the initial extension would be US\$2,500,000 multiplied by the remaining unpaid balance of the Exercise Price divided by the Exercise Price. The fee for the second extension of nine months would be US\$5,000,000 adjusted in the same manner as the fee for the first extension. In addition to the exercise price the Company has the right to convert up to US\$30,000,000 of expenditures incurred on La Arena by June 15, 2011 to earn up to a 38.7% interest in La Arena S.A. (the "Earn-in Right"). If the Company has not incurred minimum expenditures of US\$10,000,000 by June 15, 2012, IMG has the right, within six months of June 15, 2012, to purchase from the Company all of its purchased equity and earn-in-right equity for US\$500,000.

*Mineral property deposits*

The Company entered into agreements with contractors in Mexico, whereby the Company agreed to purchase drilling services and geophysical exploration services. In February 2008, the Company deposited 20 per cent of the total estimated cost for drilling certain mineral properties. The amount remaining on deposit of \$123,185 at May 31, 2010 (May 31, 2009 - \$123,185) was deemed to be uncollectible and was written off during the 2010 fiscal year.

**8. RELATED PARTY TRANSACTIONS**

During the year ended May 31, 2010, the Company entered into the following transactions with related parties:

- a) Paid or accrued \$268,000 (2009 - \$194,437) in management fees, office rent and administrative services to a company controlled by a director of the Company.
- b) Paid or accrued \$136,088 (2009 - \$195,406) in management fees to a director of the Company and a former director of the Company.
- c) Paid or accrued \$199,696 (2009 - \$104,809) in legal fees to a law firm in which the Company's corporate secretary and director is a partner of which \$31,213 (2009 - \$Nil) was included in share issue costs and \$73,240 (2009 - \$35,853) was included in transaction costs in relation to the Transaction outlined in Note 4.
- d) Paid directors' fees of \$95,088 (2009 - \$Nil) to directors of the Company.
- e) Charged rent of \$32,045 (2009 - \$43,133) to a public company and a private company with directors in common with the Company. The amounts receivable from these companies total \$49,054 (2009 - \$26,195) and are included in receivables.
- f) Due to related parties total \$75,392 (2009 - \$112,130) owing to officers and directors (or to persons related to them or companies controlled by them) for services as noted above and for reimbursable expenses.
- g) Paid or accrued \$105,300 (2009 - \$Nil) to two officers of the Company in bonuses as part of the Rio Alto transaction as described in Note 4 above. In addition the Company paid \$349,602 (2009 - \$Nil) in management fees to the two officers.

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**8. RELATED PARTY TRANSACTIONS (cont'd...)**

- h) Paid or accrued \$2,500 (2009 - \$30,000) in management fees to a former officer.
- i) Paid or accrued \$Nil (2009 - \$66,900) in investor relations and promotion fees to a company where a former director is a principal.
- j) As outlined in Note 10, included in subscriptions receivable was \$42,055 due from a director for the exercise of 84,110 warrants at \$0.50 per share and \$75,000 due from a director for 100,000 common shares at \$0.75 per share.
- k) As outlined in Note 7, Materias was sold to a former director of the Company, who issued a promissory note receivable.

These transactions were conducted in the normal course of business and were measured at the exchange value which represented the amount of consideration established and agreed to by the related parties.

**9. CAPITAL MANAGEMENT**

The Company has no externally imposed capital requirements. The objectives of capital risk management are to safeguard the Company's ability to continue as a going-concern, to provide adequate returns to shareholders and protect shareholder value, provide benefits for other stakeholders, and ensure the growth of the business. The Company considers the items in shareholders' equity as capital and manages the capital structure by issuing treasury shares, engaging in commodity-backed transactions, the potential sale of assets, the incurrence of debt or the return of capital to shareholders in light of economic conditions and the characteristics of the Company's assets.

The Company's capital structure reflects the Company's focus on growth in a capital intensive industry with lengthy development times as well as the risks associated with exploration and development activities due to factors that are beyond the Company's control including, without limitation, the receipt of necessary permits, the availability of financial and human resources and the volatility of commodity prices. The adequacy of the Company's capital structure is assessed on an ongoing basis and is adjusted as necessary and as financial markets permit in order to fund exploration and development programs. Exploration and development activities may be delayed or accelerated as circumstances or events change.

**10. CAPITAL STOCK AND CONTRIBUTED SURPLUS**

During the year ended May 31, 2010:

- a) The Company issued 35,143,411 shares with a value of \$7,028,682 and 4,329,000 warrants with a value of \$492,987 to acquire RAML as described in Note 4;
- b) The Company issued 28,399,566 shares for \$14,589,281 in two private placement financings as described below;

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**10. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)**

- c) The Company issued 3,582,585 shares for \$1,747,498 relating to the conversion of warrants.
- d) The Company issued 503,000 shares for \$123,750 relating to the exercise of stock options.

Shares issued and outstanding at May 31, 2010 were 108,035,575.

On November 30, 2009 the Company completed a private placement by issuing 17,044,927 common shares at \$0.36 per share for gross proceeds of \$6,136,173. The agent for the private placement was paid a cash fee of \$398,851. Other costs related to the private placement amounted to \$62,934.

On May 20, 2010 the Company completed the first of two tranches of a private placement by issuing 10,097,162 common shares at \$0.75 per share for gross proceeds of \$7,510,000. The agent for the private placement was paid a cash fee of US\$510,000.

On May 28, 2010 the Company completed the second tranche of the \$0.75 private placement by issuing 1,257,477 common shares for gross proceeds of \$943,108. A total of 11,354,639 common shares were issued pursuant to this \$0.75 private placement for aggregate gross proceeds of \$8,453,108 of which \$165,005 was received after the year end and was recorded as Subscriptions Receivable.

There were no capital stock transactions during the year ended May 31, 2009.

*Shares held in escrow*

Certain former shareholders of RAML agreed, as a condition of the acquisition of RAML by MSM, to place 8,537,990 common shares of the Company in escrow. These shares will be released from escrow as follows:

June 25, 2010	2,134,497	(subsequently released)
October 25, 2010	2,134,497	
February 25, 2011	2,134,497	
June 25, 2011	2,134,499	
	<u>8,537,990</u>	

**Stock options**

The Company has a shareholder approved stock option plan under which it is authorized to grant options to executive officers and directors, employees and consultants enabling them to acquire up to 10% of the issued and outstanding common shares of the Company. Under the plan, the exercise price of each option is determined by the directors, subject to regulatory approval, if required, and generally equals or exceeds the market price of the Company's stock on the date of grant. The options can be granted for a maximum term of 10 years and vest as determined by the board of directors.

On July 24, 2009, the Company granted options to acquire 2,500,000 common shares in the capital of the Company. The options vested immediately, are exercisable at \$0.30 per common share and expire on July 16, 2014. Concurrent with the grant of options, the Company made application to change the exercise price of options to acquire 400,000 of the Company's common shares from \$0.45 to \$0.30 per common share. The fair value of the options granted and re-pricing of options was calculated as follows using a Black-Scholes option pricing model:

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**10. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)**

**Stock options (cont'd...)**

	<u>Options Granted</u>	<u>Options Re-priced</u>
Number of Options	2,500,000	400,000
Grant Date	July 24, 2009	July 24, 2009
Exercise Price	\$0.30	\$0.30
Expected Life	5 year	3 years
Volatility	100.00%	100.00%
Risk-free rate	0.24%	0.24%
<b>Fair Value</b>	<b>\$ 340,961</b>	<b>\$ 6,647</b>

On September 18, 2009 the Company entered into an agreement with an investor relations services for a one-year period. Compensation for these services included a fee, paid in advance, of €22,500 and the grant of 200,000 stock options. The Company also engaged a financial consultant for a one-year period with an advance payment of \$50,000 and the grant of 200,000 stock options. These stock options have an exercise price of \$0.35, a life of 5 years and vest as to 25% in three months, 25% in six months, 25% in nine months and 25% in twelve months. The fair values of the options were determined by a Black-Scholes option pricing model using the following assumptions:

Number of Options	400,000
Exercise Price	\$0.35
Expected Life	5 years
Volatility	100.00%
Risk-free rate	0.23%
<b>Fair Value</b>	<b>\$ 86,074</b>

On March 15, 2010, the Company appointed a new director and granted options to acquire 180,000 common shares in the capital of the Company to him. The options vested immediately, are exercisable at \$0.70 per common share and expire on March 15, 2015. The fair value of the options granted was calculated as follows using a Black-Scholes option pricing model:

Number of Options	180,000
Exercise Price	\$0.70
Expected Life	5 years
Volatility	79.23%
Risk-free rate	1.44%
<b>Fair Value</b>	<b>\$ 78,868</b>

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**10. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)**

**Stock options (cont'd...)**

Stock option transactions are summarized as follows:

	Number of Options	Weighted Average Exercise Price
Outstanding, May 31, 2008	3,283,000	\$ 0.32
Granted	100,000	0.23
Exercised	-	-
Expired/ cancelled	(415,000)	0.31
Outstanding, May 31, 2009	2,968,000	0.32
Granted	3,080,000	0.33
Exercised	(503,000)	0.25
Cancelled	(400,000)	0.45
Repriced	400,000	0.30
Outstanding, May 31, 2010	5,545,000	\$ 0.32
Options exercisable – May 31, 2010	5,345,000	\$ 0.32

The weighted average fair value per option granted and re-priced for May 31, 2010 was \$0.15 and May 31, 2009 was \$0.07

Stock options outstanding at May 31, 2010 are as follows:

Number of Options	Number of Underlying Shares	Number of Options Exercisable	Weighted Average Exercise Price	Date of Expiry	Remaining Contractual Life (months)
400,000	400,000	400,000	\$ 0.30	May 7, 2012	24
1,593,000	1,593,000	1,593,000	\$ 0.25	May 7, 2012	24
97,000	97,000	97,000	\$ 0.25	May 11, 2012	24
125,000	125,000	125,000	\$ 0.45	July 4, 2012	26
50,000	50,000	50,000	\$ 1.25	July 4, 2012	26
200,000	200,000	200,000	\$ 0.45	August 2, 2012	26
2,500,000	2,500,000	2,500,000	\$ 0.30	July 16, 2014	50
400,000	400,000	200,000	\$ 0.35	September 18, 2014	52
180,000	180,000	180,000	\$ 0.70	March 15, 2015	58
5,545,000	5,545,000	5,345,000	\$ 0.32		39

**Stock-based compensation**

The fair value of stock options granted during the year ended May 31, 2010 was \$505,903 (May 31, 2009 - \$7,025). The Company recognized \$474,782 (May 31, 2009 - \$64,084) of stock-based compensation expense. The following weighted average assumptions were used for a Black-Scholes valuation of stock options granted and repriced during the year:

	May 31, 2010	May 31, 2009
Estimated life	4.76 years	1 year
Risk free interest rate	0.30%	0.92%
Estimated volatility	98.93%	131.21%
Dividend rate	0.00%	0.00%

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**10. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)**

**Agent's Options**

During the year ended May 31, 2010, 884,905 agent's options with an exercise price of \$1.00 per share expired on June 29, 2009. There were no agent's options outstanding as of May 31, 2010.

**Warrants**

During the year ended May 31, 2010, the Company issued:

- a) 145,994 common shares on the conversion of 145,985 warrants at \$0.20 for proceeds of \$29,197;
- b) 2,550,490 common shares on the conversion of 2,550,490 warrants at \$0.50 for proceeds of \$1,275,245.
- c) 886,110 common shares on the conversion of 886,110 warrants at \$0.50 for proceeds of \$443,055. These warrants were converted on May 31, 2010 and funds were deposited subsequent to May 31, 2010 and as such the amounts are recorded in Subscriptions Receivable.

Warrant transactions are summarized as follows:

	Number of Warrants	Weighted Average Conversion Price per Warrant
Outstanding, May 31, 2008	11,560,345	\$ 0.94
Granted	-	-
Converted	-	-
Expired	(414,595)	0.50
Outstanding, May 31, 2009	11,145,750	0.96
Granted	4,329,000	0.23
Converted	(3,582,585)	0.49
Expired	(1,288,400)	0.50
Outstanding, May 31, 2010	10,603,765	\$ 0.88

Warrants outstanding at May 31, 2010 were as follows:

Number of Warrants	Conversion Price	Expiry Date
6,420,750	\$1.30	December 31, 2010
183,015	\$0.20	June 25, 2010 (Note 16)
1,500,000	\$0.30	June 25, 2012
2,500,000	\$0.20	June 25, 2012
10,603,765	\$0.88	

**11. FINANCIAL INSTRUMENTS**

**Fair values**

As at May 31, 2010, the carrying values of receivables, promissory note, accounts payable and accrued liabilities and due to related parties approximate their fair values due to their short term to maturity. Cash is measured at fair value based on Level 1 of the fair value hierarchy.

**11. FINANCIAL INSTRUMENTS** (cont'd...)

**Liquidity risk**

Liquidity risk is managed by the Company by maintaining sufficient cash balances to meet current working capital requirements. The Company is considered to be in the development stage and is dependent on obtaining regular funding in order to continue its development programs.

Despite previous success in acquiring such funding, there is no guarantee that additional funding will be obtained.

**Credit risk**

The Company's credit risk is primarily attributable to its liquid financial assets and would arise from the non-performance by counterparties of contractual financial obligations. The Company limits its exposure to credit risk on liquid assets by maintaining its cash with high-credit quality financial institutions, for which management believes the risk of loss to be minimal. Management believes that the credit risk concentration with respect to receivables is minimal.

**Currency risk**

The Company operates in Canada, Guernsey and Peru and is therefore exposed to foreign exchange risk arising from transactions denominated in foreign currencies.

The operating results and the financial position of the Company are reported in Canadian dollars. The fluctuations of the operating currencies in relation to the Canadian dollar will, consequently, have an impact upon the reported results of the Company and may also affect the value of the Company's assets and liabilities. A 5% movement in the Canadian dollar against the US dollar at May 31, 2010 would have affected net earnings by approximately \$151,000. In addition, the Company is exposed to currency risk in relation to the US\$47,550,000 cash payment required to exercise the option pursuant to the La Arena agreement outlined in Note 7. A 5% movement in the Canadian dollar against the US dollar would result in additional payment of approximately CDN\$2,500,000.

The Company has not entered into any agreements or purchased any instruments to hedge possible currency risk.

**Interest risk**

The Company invests its cash in instruments that are redeemable at any time without penalty, thereby reducing its exposure to interest rate fluctuations. Other interest rate risks arising from the Company's operations are not considered material.

**Price risk**

The Company is exposed to price risk with respect to commodity and equity prices. The ability of the Company to develop its mineral properties and future profitability of the Company are directly related to the market price of gold and copper. The Company monitors commodity prices to determine appropriate actions to be undertaken.

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**12. INCOME TAXES**

Income taxes differ from the amount that would have been computed by applying the combined federal and provincial statutory income tax rate of 29% in 2009 (33% in 2008) to earnings before income taxes. The reasons for the differences are as follows:

	2010	2009
Loss before income taxes	\$ 13,565,500	\$ 1,450,870
Income tax (recovery) provision using statutory tax rates	(3,877,427)	(420,752)
Increase (reduction) in income taxes resulting from:		
Difference in foreign tax rates	2,964,132	14,618
Non-deductible items	256,409	27,031
Deductible items	(130,294)	(65,643)
Unrecognized benefit of non-capital losses	636,757	444,746
Income tax recovery	<u>\$ (150,423)</u>	<u>\$ -</u>

The significant components of the Company's future income tax assets and liabilities are as follows:

	2010	2009
Future income tax assets:		
Share issue costs	\$ 332,585	\$ 160,000
Non-capital losses carried forward	1,508,160	768,000
Mineral properties	412,661	413,000
Other	14,400	10,000
Future income tax assets	2,267,806	1,351,000
Less: valuation allowance	<u>(2,119,266)</u>	<u>(1,351,000)</u>
	148,540	-
Future income tax liabilities:		
Equipment	(79,534)	-
Mineral properties	<u>(2,711,332)</u>	<u>-</u>
Net future income tax liability	<u>\$ (2,642,326)</u>	<u>\$ -</u>

The Company has non-capital losses for Canadian income tax purposes of approximately \$5,400,000, which can be carried forward to reduce taxable income in future years. Unless utilized, these losses will expire at various times through 2030. In addition, the Company has Canadian exploration and development expenditures of approximately \$1,650,000 to reduce taxable income of future years. Future tax benefits that may arise as a result of these losses and resource expenditures have not been recognized in these consolidated financial statements and have been offset by a valuation allowance.

**13. SEGMENTED INFORMATION**

The Company operates in one business segment, being the acquisition and development of mineral properties, in Peru.

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**13. SEGMENTED INFORMATION (cont'd...)**

Segmented disclosure and company-wide information is as follows:

	<b>As at and for the year ended May 31, 2010</b>			
	Canada	Mexico	Peru	Total
Operating expenses	\$ (2,913,344)	\$ (243,623)	\$ (1,248,403)	\$ (4,405,370)
Other income and expenses	327,214	(9,336,921)	-	(9,009,707)
Loss	<u>\$ (2,586,130)</u>	<u>\$ (9,580,544)</u>	<u>\$ (1,248,403)</u>	<u>\$ (13,415,077)</u>
Mineral properties	\$ -	\$ -	\$ 20,795,584	\$ 20,795,584
Equipment, net	6,188	-	265,114	271,302
Other assets	6,207,535	-	476,689	6,684,224
	<u>\$ 6,213,723</u>	<u>\$ -</u>	<u>\$ 21,537,387</u>	<u>\$ 27,751,110</u>

	<b>As at and for the year ended May 31, 2009</b>		
	Canada	Mexico	Total
Operating expenses	\$ (1,014,919)	\$ (574,496)	\$ (1,589,415)
Other income	138,081	464	138,545
Loss	<u>\$ (876,838)</u>	<u>\$ (574,032)</u>	<u>\$ (1,450,870)</u>
Mineral properties	\$ -	\$ 8,022,067	\$ 8,022,067
Equipment, net	5,528	351,195	356,723
Other assets	6,042,500	629,950	6,672,450
	<u>\$ 6,048,028</u>	<u>\$ 9,003,212</u>	<u>\$ 15,051,240</u>

**14. COMMITMENTS**

The Company entered into an operating lease agreement for its corporate and Lima office premises. The annual lease commitments under the lease are as follows:

	Corporate	Lima	Total
2011	\$ 45,779	\$ 72,314	\$ 118,093
2012	7,630	72,314	79,944
	<u>\$ 53,409</u>	<u>\$ 144,628</u>	<u>\$ 198,037</u>

**15. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS**

Significant non-cash transactions for the period ended May 31, 2010 were:

- a) Mineral property and deferred exploration costs include amounts of \$121,720 in accounts payable and accrued liabilities.
- b) Included in share issue costs are \$52,500 which relate to accounts payable and accrued liabilities.
- c) Included in the loss on sale of mineral property interests are \$56,793 which relate to amortization of equipment.
- d) Included in the mineral property costs are the net assets acquired from RAML as outlined in Note 4. The Company also applied \$48,978 of deferred costs paid in a prior year to transaction costs included in the purchase price allocation.
- e) Included in the loss on sale of mineral property interests is the disposal of Materias net assets as outlined in Note 7.

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**15. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS (cont'd...)**

Significant non-cash transactions for the year ended May 31, 2009 were:

- a) Included in mineral property costs were \$69,420 which relates to accounts payable and accrued liabilities, \$78,512 which relate to amortization of equipment and \$57,213 which relate to reclassification of mineral property deposits.
- b) The Company reclassified value added tax receivable of \$314,793 from current assets to long-term assets.

**16. SUBSEQUENT EVENTS**

- a) Subsequent to May 31, 2010, the Company closed a private placement of 10,200,000 common shares for gross proceeds of \$7,752,000. The Company paid a cash finder's fee of \$542,640.
- b) The Company granted 150,000 options to a company to provide financial advisory services. These options have an exercise price of \$0.75, will expire on June 30, 2011 and vest as to 25% in three months, 25% in six months, 25% in nine months and 25% in twelve months. The fair values of the options were determined by a Black-Scholes option pricing model using the following assumptions:

Number of Options	150,000
Exercise Price	\$0.75
Expected Life	1 year
Volatility	82.13%
Risk-free rate	0.53%
<b>Fair Value</b>	<b>\$ 29,334</b>

- c) The Company entered into an agreement with an investor relations consultant for a one-year period with a 30-day termination clause after the initial 6 months. Compensation for these services includes a fee of US\$4,000 per month, reimbursement for related expenses and an aggregate of 100,000 stock options with an exercise price of \$0.80. The fair values of the options were determined by a Black-Scholes options pricing model using the following assumptions:

Number of Options	100,000
Exercise Price	\$0.80
Expected Life	1 year
Volatility	84.85%
Risk-free rate	0.68%
<b>Fair Value</b>	<b>\$ 26,473</b>

- d) The Company issued 150,000 common shares for gross proceeds of \$50,000 for the exercise of stock options at \$0.35 and \$0.30 per share and 157,500 common shares for gross proceeds of \$31,500 for the exercise of warrants at \$0.20 per warrant; 25,515 warrants expired unexercised at \$0.20 per warrant.