
Magma Energy Corp. ("Magma" or the "Company") was incorporated on January 22, 2008, pursuant to the *Business Corporations Act* (British Columbia), and effectively commenced operations in February 2008. On July 7, 2009 Magma completed an initial public offering ("IPO") and listed its common shares on the facilities of the Toronto Stock Exchange ("TSX") under the symbol "MXY".

Magma's mission is to become one of the pre-eminent primary geothermal power companies in the world. Magma intends to achieve this by increasing its production of geothermal electricity and enhancing its defined geothermal power generating capacity through the advancement of its existing projects, by acquiring new geothermal energy projects and by acquiring interests in companies which own existing projects.

The Company is actively engaged in operating, developing, exploring and acquiring geothermal energy projects in North, South and Central America. Magma's head office is located in Vancouver, Canada.

This management's discussion and analysis ("MD&A") focuses on significant factors that affected Magma and its subsidiaries (collectively "Magma" or the "Company") during the relevant reporting period and to the date of this report. The MD&A supplements, but does not form part of, the unaudited interim consolidated financial statements of the Company and the notes thereto for the three months ended September 30, 2009 and 2008 and, consequently, should be read in conjunction with the afore-mentioned financial statements and notes thereto. In addition, this MD&A should be read in conjunction with the audited consolidated financial statements of the Company for the year ended June 30, 2009, the related MD&A for that period and Magma's Annual Information Form ("AIF"), which are available on SEDAR at www.sedar.com.

All amounts in this MD&A are expressed in United States dollars unless otherwise indicated. References to C\$ are to Canadian dollars.

Forward Looking Information

This MD&A contains certain "forward-looking information" which may include, but is not limited to, statements with respect to future events or future performance, management's expectations regarding the Company's growth, results of operations, estimated future revenues, requirements for additional capital, production costs and revenue, future demand for and prices of electricity, business prospects and opportunities. In addition, statements relating to estimates of recoverable geothermal energy "reserves" or "resources" or energy generation capacities (at either ninety percent probability ("P₉₀") or fifty percent probability ("P₅₀")) are forward-looking information, as they involve implied assessment, based on certain estimates and assumptions, that the geothermal resources and reserves described can be profitably produced in the future. Such forward-looking information reflect management's current beliefs and is based on information currently available to management. Often, but not always, forward-looking statements can be identified by the use of words such as "plans", "expects", "is expected", "budget", "scheduled", "estimates", "forecasts", "predicts", "intends", "targets", "aims", "anticipates" or "believes" or variations (including negative variations) of such words and phrases or may be identified by statements to the effect that certain actions "may", "could", "should", "would", "might" or "will" be taken, occur or be achieved. A number of known and unknown risks, uncertainties and other factors, may cause the actual results or performance to materially differ from any future results or performance expressed or implied by the forward-looking information. Such factors include, among others, general business, economic, competitive, political and social uncertainties; the actual results of current geothermal energy production, development and/or exploration activities and the accuracy of probability simulations prepared to predict prospective geothermal resources; changes in project parameters as plans continue to be refined; possible variations of production rates; failure of plant, equipment or processes to operate as anticipated; accidents, labour disputes and other risks of the geothermal industry; political instability or insurrection or war; labour force availability and turnover; delays in obtaining governmental approvals or in the completion of development or construction activities or in the commencement of operations; as well as

those factors discussed in the section entitled "Risk Factors" in this MD&A and in Magma's AIF for its fiscal year ended June 30, 2009. These factors should be considered carefully and readers of this MD&A should not place undue reliance on forward-looking information.

Although the forward-looking information contained in this MD&A is based upon what management believes to be reasonable assumptions, there can be no assurance that such forward-looking information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such information. Accordingly, readers should not place undue reliance on forward-looking information. Such forward-looking information is made as of the date of this MD&A and, other than as required by applicable securities laws, Magma assumes no obligation to update or revise such forward-looking information to reflect new events or circumstances.

Highlights of the Quarter Ended September 30, 2009

- ☺ On July 7, 2009 Magma completed its IPO, issued 73,600,334 common shares for net proceeds of \$88.4 million and listed its common shares on the TSX under the symbol "MXY".
- ☺ In July and August 2009, Magma entered into agreements to acquire an aggregate 43.1% interest in HS Orka, a producing geothermal company located in Iceland. The acquisition is expected to close in November.
- ☺ In July 2009, Magma expanded its US property portfolio by acquiring 7 new geothermal properties in Nevada.
- ☺ In September, 2009 the Company entered into an agreement to acquire 369 acres of land located in Mineral County, Nevada, in consideration of \$800,000, of which \$500,000 is payable upon closing of the transaction and the remaining \$300,000 payable in one year. The transaction closed on October 20, 2009.

Geothermal Energy Projects

Significant events, transactions and activities on Magma's geothermal properties which occurred during the quarter ended September 30, 2009 and to the date of this MD&A are disclosed below. The reader is cautioned that geothermal resources and probabilistic estimates of gross megawatt ("MW") capacity, as disclosed in this MD&A, have a great amount of uncertainty as to their existence and as to whether they can be accessed in an economically viable manner. It cannot be assumed that all of, or any part of, a geothermal resource will be commercially extracted or that estimates of MW capacity will be achieved.

Potential Acquisition of HS Orka

In July 2009, the Company entered into an agreement to acquire a 10.78% interest in HS Orka hf ("HS Orka"), a producing geothermal company located in Iceland. The Company will acquire an 8.62% interest in HS Orka in consideration of 2.5 billion Icelandic Krona ("ISK") (approximately \$20.2 million) payable upon closing of the transaction and a further 2.16% interest in consideration of 625 million ISK (approximately \$5.0 million) payable by March 31, 2010. An option will also be granted to the Company to acquire approximately an additional 5% interest in HS Orka in consideration of making a capital infusion of \$15 million into HS Orka.

On August 31, 2009, the Company entered into three share purchase agreements to acquire an additional 32.32% interest in HS Orka. Consideration for the acquisition will be 12.4 billion ISK (approximately \$100.8 million), of which 3.7 billion ISK (approximately \$30.2 million) will be paid in cash and the remainder of 8.7 billion ISK (approximately \$70.6 million) with the issuance of a bond. The bond

is repayable in a single installment in seven years and bears interest at an effective rate of 1.52% per annum. The bond will be secured by the shares acquired by the Company in this transaction.

The closing of both these transactions are subject to several closing conditions, including obtaining the approval of Canadian regulatory authorities.

HS Orka is the largest privately owned energy company in Iceland with installed net geothermal power capacity of 175 MW. In addition, HS Orka generates 150 MW of thermal energy for district heating. Expansions have been planned that will increase HS Orka's geothermal power production to 425 MW by 2015. The acquisition of a 43.1% stake in HS Orka will add 75.43 MW of net geothermal production to Magma's net total production.

The acquisition of the interest in HS Orka will be financed by additional equity financings, debt or other sources of financing available to the Company. In October 2009, Magma completed a private placement for net proceeds of approximately \$19.8 million to finance the acquisition of the initial 8.62% interest.

Operating Project

Soda Lake Operation, Nevada, USA

Magma owns a 100% interest in the Soda Lake Operation located 11 kilometers northwest of the City of Fallon, Nevada.

Shortly after acquiring the Operation in October 2008, Magma designed a two phased expansion approach of the Soda Lake Operation as follows:

- Phase 1 - an initial \$18.2 million drilling/exploration and plant upgrade program to restore the generating capacity back to the original nameplate of 23 MW gross (16 MW net) by drilling new production wells and upgrading and refurbishing the existing power plant equipment; and
- Phase 2 - conditional upon the successful completion of the Phase 1 drilling/exploration program and additional reservoir definition, a further expansion program to increase nameplate capacity to the P₉₀ estimate of the geothermal reservoir's gross generation capacity of 28.8 MW, and potentially up to the P₅₀ estimate of 54.8 MW, by drilling new production and injection wells and adding new surface generation facilities.

The Phase 1 expansion and refurbishment program to 16 MW net is being funded from the net proceeds of the IPO. Any further expansion program will be partially funded from operating revenues, working capital and Magma's existing credit agreement. Additional financing will be obtained through a combination of additional equity financing, debt financing on either a corporate or a project basis, and the utilization of available tax credits and/or energy grants.

Progress on the Phase 1 program to the date of this MD&A includes the completion of two drill holes to depths of 4,468 feet and 8,995 feet respectively. The wells were drilled to provide further information regarding the distribution of heat and permeability of the Soda Lake reservoir. Magma is currently analyzing data from all wells drilled to date at Soda Lake. This work includes an optimization review of the current and reinjection strategy. In addition to drilling activities, Magma has completed a detailed engineering assessment of power plant upgrades and refurbishments that are required in anticipation of the new production wells. Construction awards have been issued for improvements to the existing cooling tower, well-field piping and electrical system upgrades as well as the refurbishment of existing power generating equipment. All plant refurbishment activities are on track for completion by the end of March 2010. A portion of the upgrades were completed in September and October when the plant was partially shut down for annual maintenance.

Exploration Projects

Since commencement of operations, Magma has acquired a portfolio of geothermal exploration properties from a variety of sources, including through U.S. Bureau of Land Management ("BLM") lease auctions and sales, a purchase from the University of Chile, applications for new geothermal exploration authorizations from the Government of Peru and purchases from third party leaseholders and landowners.

In July 2009, Magma added to its portfolio by acquiring 7 new properties in Nevada as well as additional concessions for its McCoy Property from the BLM for cash consideration of \$2,559,227. The 7 new properties acquired are early-stage properties and comprise a total of 63,622 acres as follows:

Baltazor Hot Springs	6,662 acres
Buffalo Valley	13,183 acres
Granite Springs	24,973 acres
Mopung Hills	3,840 acres
White Rock Canyon	2,799 acres
Soda Lake East	3,771 acres
Upsal Hogback	8,394 acres.

The Soda Lake East and Upsal Hogback properties are adjacent to the existing property containing the Soda Lake Operation.

On September 21, 2009 the Company entered into an agreement to acquire 369 acres of land located in Mineral County, Nevada, in consideration of \$800,000. Of this amount, \$500,000 was paid upon the closing of the transaction on October 20, 2009. The remaining \$300,000 is payable in one year.

Magma's five advanced-stage properties are the Maule Property located in Chile, the McCoy, Panther Canyon and Desert Queen Properties located in Nevada and the Thermo Property located in Utah. Exploration programs have been planned for each of the five advanced-stage exploration properties, including permitting, magnetotelluric, resistivity, gravity and magnetic surveys, reflection seismology and drilling slim holes, having an estimated total cost of up to \$30,000,000.

All of the currently planned exploration program expenditures are discretionary and there are no expenditure commitments on any of Magma's properties.

Exploration work on Magma's US properties during the quarter consisted primarily of reflection seismology and other geophysical work conducted on McCoy, Panther Canyon, Desert Queen and Upsal Hogback.

On October 30, 2009 the Company was awarded \$10 million in grants by the US Department of Energy under the American Recovery and Reinvestment Act for its Soda Lake and McCoy properties. The grants are expected to reimburse a portion of Magma's planned innovative exploration expenditures on these properties over the next 24 months.

Maule, Chile

Magma owns a 100% interest in the Maule exploration concessions, which were acquired from the University of Chile in 2008.

Magma completed an initial drill program on Maule in June 2009. Results from the successful completion of this first slim hole saw temperatures exceeding 200°C at a depth of 650 metres below surface. The encouraging results enabled Magma's consultants, Sinclair Knight Mertz ("SKM") to estimate an Inferred

Resource of 7,000 petajoules of thermal energy in place, relative to 40°C, that is estimated to be capable of producing 140 MW of electrical generation for 30 years. The resource estimate was prepared in accordance with the Code for Geothermal Resources and Reserves Reporting ("the Code") 1st Edition: 2008, published by the Australian Geothermal Energy Association. The report was prepared by Dr. Philip James White, who is responsible for its content. Dr. White, a senior geologist with SKM, is a "Competent Person" as defined under the Code, a member of the Society of Economic Geologists and is independent of Magma. The resource estimate report, titled "*Laguna Del Maule Resource Estimate*", dated August 14, 2009 may be obtained from www.sedar.com.

Based on the slim hole results and the resource estimate, in July 2009, Magma submitted a geothermal development plan to the Chilean government for a 50 MW power project on the Maule property. Approval by the Chilean government will enable additional drilling and infrastructure development to begin later in 2009. The approval process is currently on-going and is expected to take several months.

In September 2009, planning for an access road commenced and the first stage of road construction was initiated in October 2009.

Financial Results From Operations

The information provided below highlights the Company's quarterly results for the past 7 quarters since inception on January 22, 2008 to September 30, 2009. The financial information referenced below has been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The significant accounting policies are outlined within Note 2 to the audited consolidated financial statements of the Company for the fiscal year ended June 30, 2009. These accounting policies have been followed consistently through the current period.

Summary of Unaudited Quarterly Results

Three months ended:	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008
Revenue	\$ 1,005,021	\$ 1,256,612	\$ 1,925,999	\$ 1,302,519
Direct cost of energy production	840,205	612,391	1,444,467	946,427
Gross profit	164,816	644,221	481,532	356,092
Expenses	2,101,457	1,261,567	1,175,455	1,359,255
Other income (expenses)	(728,948)	(1,259,422)	10,664	(66,506)
Net loss for the period	(2,665,589)	(1,876,768)	(683,259)	(1,069,669)
Loss per share (basic and diluted)	(0.01)	(0.01)	-	(0.01)

Three months ended:	September 30, 2008	June 30, 2008	March 31, 2008
Revenue	\$ -	\$ -	\$ -
Direct cost of energy production	-	-	-
Gross profit	-	-	-
Expenses	1,169,392	633,433	50,622
Other income (expenses)	339,532	4,207	18,508
Net loss for the period	(829,860)	(629,226)	(32,114)
Loss per share (basic and diluted)	(0.01)	(0.01)	-

Selected Financial Information

	For the Three Months Ended September 30, 2009	For the Year Ended June 30, 2009	For the Period from Inception (January 22, 2008) to June 30, 2008
Total revenues	\$ 1,005,021	\$ 4,485,130	\$ -
Net loss	(2,665,589)	(4,459,556)	(661,340)
Loss per share (basic and diluted)	(0.01)	(0.03)	(0.01)
Total assets	140,761,766	43,779,529	12,908,970
Total current liabilities	2,536,747	2,600,018	721,001
Total long-term liabilities *	2,073,829	1,981,836	-
Total shareholders' equity	136,151,190	39,197,675	12,187,969

* Total long-term liabilities consists of deferred revenue relating to the Soda Lake Operation.

Results of Operations

The Company effectively commenced operations in February 2008 and, therefore, has completed only 7 full quarters of operations. As a result, the expenses incurred during the respective quarters are not reflective of expenses that will be incurred in the future given the relative start-up nature of the Company's operations to date. In addition, Magma had no revenues from operations prior to the acquisition of the Soda Lake Operation on October 3, 2008. Therefore, comparisons of revenues and expenses between quarters are not meaningful due to the timing and nature of the Company's activities from quarter to quarter.

For the quarter ended September 30, 2009, the Company incurred a loss of \$2,665,589 (\$0.01 per share).

The Soda Lake Operation generated revenues from energy sales of \$1,005,021 and gross profit of \$164,816. A total of 12,263 MWh was sold during the quarter. Net loss from plant operations, after deducting amortization, accretion and depletion expenses, was \$155,837 (refer to Note 10 of the unaudited interim consolidated financial statements for September 30, 2009) compared to net income from plant operations of \$288,415 for the quarter ended June 30, 2009. Revenues were lower during the current quarter due to planned outages for the on-going plant refurbishment and for annual maintenance. Operating expenses were also higher due to the annual maintenance.

Net loss from the Company's geothermal exploration and corporate activities during the current quarter was \$2,509,752 (refer to Note 10 of the unaudited interim consolidated financial statements for September 30, 2009). Significant items included general and administrative expenses of \$1,093,323, property investigations expenses of \$351,432, professional fees of \$174,013, foreign exchange losses of \$839,076 and interest income of \$110,128.

Corporate activities during the quarter were focused on completing the agreements for the acquisition of HS Orka and completing the IPO, which closed on July 7, 2009. Legal, accounting and regulatory fees were incurred in connection with these activities.

Property investigations activities consisted of evaluating various properties in Central and South America and in the USA for potential acquisition.

During the current quarter, the Company granted stock options to directors, employees and consultants for the acquisition of up to 2,340,000 common shares. Option compensation of \$408,504 was expensed and \$23,656 was capitalized to geothermal property costs during the quarter in connection with these option grants. No options had previously been granted by the Company.

Foreign exchange losses of \$839,076 were primarily the result of the impact of the fluctuations in the US dollar versus the Canadian dollar.

Interest income of \$110,128 was earned on the Company's cash balances.

Liquidity and Capital Resources

At September 30, 2009 the Company had cash and cash equivalents of \$89,766,570 compared to \$4,482,693 at June 30, 2009. The increase was due to the successful completion of the IPO for net proceeds of \$88,427,047. Magma ended the quarter with working capital of \$88,116,120 compared to \$2,747,685 at June 30, 2009. Working capital items at September 30, 2009, other than cash and cash equivalents, consisted of receivables of \$344,481, prepaid expenses of \$541,816 and accounts payable and accrued liabilities of \$2,536,747.

Working capital is defined as current assets minus current liabilities. Working capital calculations or changes are not measures of financial performance, nor do they have standardized meanings, under Canadian GAAP. Readers are cautioned that this calculation may differ among companies and analysts and therefore may not be directly comparable.

Cash and cash equivalents consist of cash and term deposits that are redeemable prior to maturity on demand and without economic penalty to the Company. The Company's exposure to credit risk on its C\$ and US\$ cash and term deposits is limited by maintaining such cash and term deposits with a major Canadian bank that has a high-credit quality. A minimal amount of cash is held by banks in the USA and in South America to fund the immediate needs of subsidiaries in those locations.

The Company currently has no long-term debt obligations or off-balance sheet arrangements.

The Company has a credit facility of up to C\$20 million, all of which is available for use at the date of this MD&A (refer to Note 6 of the unaudited interim consolidated financial statements for September 30, 2009).

To date, the capital requirements of the Company have been met by equity proceeds and short term loans. The Company's continuing operations as intended are dependent on management's ability to raise required funding through future equity issuances, debt financing, asset sales or a combination thereof (refer to "Risks and Uncertainties" in this MD&A and in Magma's AIF for the year ended June 30, 2009).

Management is of the opinion that the Company has sufficient working capital to meet its administrative overhead for the ensuing twelve months as well as to fund the planned exploration programs on its exploration properties. Working capital will also be used to fund Phase 1 of the planned Soda Lake Operation expansion. Funding for the Soda Lake Operation Phase 2 expansion and further exploration and development of the Company's exploration properties will be financed via a combination of additional equity financing, debt or tax and other incentives.

Subsequent to the quarter end, in October 2009, Magma completed a private placement and raised net proceeds of approximately \$19,778,000. These proceeds will be used to fund the initial acquisition of an 8.62% interest in HS Orka. The purchase of the remaining 34.48% interest in HS Orka will be financed by additional equity financings, debt or other sources of financing available to the Company. Management is currently reviewing all of the alternatives available to the Company.

Magma will require substantial additional capital to continue the exploration and development of its geothermal properties beyond the currently planned exploration programs and to fund Phase 2 of the Soda Lake Operation expansion. While the Company has been successful in obtaining financing in the past, there is no assurance that such financing will continue to be available or be available on favourable terms

in the future. An inability to raise additional financing may impact the future assessment of the Company as a going concern.

Management of Financial Risks

The Company's financial instruments consist of cash and cash equivalents, receivables and accounts payable and accrued liabilities. Fair value estimates are made at the balance sheet date based on relevant market information and information about the financial instrument. These estimates are subjective in nature and may involve significant uncertainties in matters of judgment and, therefore, cannot be determined with precision. The fair values of the Company's financial instruments approximate their carrying values due to their short term to maturity or capacity for prompt liquidation.

The reader is referred to Note 11 of the unaudited interim consolidated financial statements for September 30, 2009 for additional disclosure regarding the management of risks. Significant financial risk exposure and the way in which such exposure is managed by the Company is as follows:

Credit Risk

The Company's exposure to credit risk on its C\$ and US\$ cash is limited by maintaining these assets with high-credit quality financial institutions. The Company may be exposed to the credit risk of South American banks which hold cash for the Company's South American operations. The Company limits its exposure to this risk by maintaining minimal cash balances in those countries to fund the immediate needs of its South American subsidiaries.

Liquidity Risk

Liquidity risk is the risk that the Company will be unable to meet its financial obligations as they become due. The Company manages liquidity risk by ensuring that it has sufficient cash, credit facilities and other financial resources available to meet its obligations. The Company forecasts cash flows for a period of 12 months to identify financial requirements. These requirements are met through a combination of cash flows from operations, credit facilities and accessing capital markets.

At September 30, 2009, the Company's liabilities consisted of trade and other payables which are due primarily within the next quarter. The Company's cash and cash equivalents of \$89,766,570 at September 30, 2009 were more than sufficient to pay these current liabilities.

Interest Rate Risk

Interest rate risk is the risk that the future cash flows and fair values of the Company will fluctuate because of changes in market interest rates. Generally, the Company's interest income will be reduced during sustained periods of lower interest rates as higher yielding cash equivalents and short-term investments mature and the proceeds are invested at lower interest rates.

Based on the above net exposures as at September 30, 2009, and assuming that all other variables remain constant, a 1% increase or decrease in interest rates would result in an increase or decrease of approximately \$221,750, in the Company's interest income for the quarter.

Currency Risk

The functional currency of the Company and its subsidiaries is the Canadian dollar. The carrying amounts of monetary assets and liabilities denominated in currencies other than the Canadian dollar are subject to fluctuations in the underlying foreign currency exchange rates. Gains and losses on such items are included as a component of net loss for the period.

The reporting currency selected for the presentation of these consolidated financial statements is the U.S. dollar. For presentation purposes, all assets and liabilities are translated into U.S. dollars at the exchange rate in effect at the balance sheet date. As a result, reported amounts of all assets and liabilities will fluctuate with changes in the underlying Canadian dollar – U.S. dollar exchange rate. Gains and losses arising upon translation into U.S. dollars are reported as a component of accumulated other comprehensive income or loss.

Share Capital and Financings

As at September 30, 2009, the Company had 236,892,002 issued and outstanding common shares. Subsequent to the quarter end, in October 2009, Magma issued 11,652,639 common shares in a private placement for net proceeds of \$19,778,000. Magma's Chief Executive Officer purchased 25% of this placement. As at the date of this MD&A, a total of 248,544,641 common shares are issued and outstanding.

As at September 30, 2009, the Company had options outstanding for the acquisition of up to 2,340,000 common shares exercisable at a price of C\$1.50 to July 7, 2014 as to 2,140,000 shares and at a price of C\$1.99 to September 14, 2014 as to 200,000 shares. The options vest over a two year period commencing with one-third upon the date of grant.

Commitments and Contingencies

- (a) The Company has entered into lease agreements for the rental of office facilities that require minimum payments in the aggregate as follows:

Fiscal 2010	\$	126,533
Fiscal 2011		124,015
Fiscal 2012		106,030
Fiscal 2013		33,236
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Total lease commitments	\$	389,314

- (b) In January 2009, the Company entered into an agreement to acquire a 100% interest in two geothermal leases consisting of 944 acres located near the Soda Lake geothermal plant in Nevada in consideration of \$184,842. Payment for the acquisition is contingent upon the receipt of clear title to the leases. The leases are subject to a royalty of 1% of the proceeds from the sale by the Company of any electrical power generated from geothermal resources located on the leased properties.
- (c) On August 7, 2003, a lawsuit entitled Emma Wagner v. Chevron Oil, et. al., including Amor IX LLC, Soda Lake Limited Partnership and Soda Lake Resource Partnership ("SLRP"), the three entities which collectively own the Soda Lake Operation, was filed in the Third Judicial District Court of the State of Nevada. The Plaintiff alleged that she was improperly excluded from a geothermal unit agreement, which allegedly resulted in the Plaintiff not being paid certain royalty payments. The Defendant filed a motion for summary judgment, which the court granted via an order issued on January 9, 2008. The Plaintiff then filed a notice of appeal on February 8, 2008. On September 25, 2009 the Supreme Court of the State of Nevada affirmed the judgment of the District Court in favor of the Defendant.
- (d) On May 14, 2008, a complaint entitled Katherine Arai, et al v. CD Soda SLR, Inc. et al, including SLRP, was filed in the Third Judicial District of the State of Nevada. The Plaintiffs alleged that they were not being paid the correct amount of royalty payments. The amounts allegedly not paid are not known but the Plaintiffs claim that such amounts exceed \$10,000. Management of SLRP

is unable to conclude that an unfavorable outcome in this matter is either probable or remote, and management is unable to estimate the amount or range of a potential loss, if any. Accordingly, no amount has been accrued in these financial statements in connection with this claim.

Subsequent events

Events occurring subsequent to September 30, 2009 include the closing of a private placement for net proceeds of \$19,778,000, and the award of two grants totalling \$10 million under the American Recovery and Reinvestment Act for partial funding of exploration activities planned on its Soda Lake and McCoy properties, details of which are disclosed elsewhere in this MD&A.

In addition, in October 2009, Magma and Ram Power Corp.'s wholly owned subsidiary, Polaris Geothermal Inc. ("Polaris"), were jointly awarded two geothermal concessions known as Volcán Mombacho and Caldera de Apoyo in Nicaragua. Magma and Polaris will enter into a joint venture agreement for the future exploration of these concessions with Polaris as the operator and each company contributing equally to project costs.

Outlook

With the closing of the IPO in July 2009, Magma has sufficient funds to carry out its currently planned programs to double its electricity production at Soda Lake and advance its exploration properties. In addition, Magma expects to close its purchase of a 43.1% interest in HS Orka in late November 2009, which will add 75 MW of net geothermal production to Magma's total production. Given the acquisition opportunities available in the industry and Magma's own portfolio of projects, management is optimistic that it will be able to grow the Company significantly and achieve its mission of becoming one of the pre-eminent geothermal power companies in the world in the near future.

Critical Accounting Policies and Management's Estimates

The preparation of financial statements in conformity with Canadian GAAP 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 amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are used in determining the valuation of deferred geothermal property acquisition and exploration costs, the fair values of business acquisitions, stock options, financial instruments, asset retirement obligations and future income tax assets. The Company evaluates its estimates on an on-going basis and bases them on various assumptions that are believed to be reasonable under the circumstances. The Company's estimates form the basis for making judgments about the carrying value for assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. Should the Company be unable to meet its ongoing obligations, the realizable value of its assets may decline materially from current estimates.

The accounting policies described below are considered by management to be essential to the understanding and reasoning used in the preparation of the Company's financial statements and the uncertainties that could have a bearing on its financial results.

Geothermal property costs

The Company capitalizes all costs related to investments in geothermal property interests on a property by property basis. Such costs include acquisition costs and exploration and development expenditures, net of any recoveries. Costs are deferred until such time as the extent of resources has been determined and property interests are either developed, the property sold or the resource rights are allowed to lapse.

During the period, the capitalized costs are reviewed on a property by property basis to consider whether there are any conditions that may indicate impairment. When the carrying value of a property exceeds its net recoverable amount estimated by quantifiable evidence of an economic geological resource or reserve, joint venture expenditure commitments or the Company's assessment of its ability to sell the property for an amount less than the deferred costs, the property is written down to its fair value to recognize the impairment.

From time to time the Company may acquire or dispose of a geothermal property interest pursuant to the terms of an option agreement. Where the options are exercisable entirely at the discretion of the Company or the optionee, the amounts payable or receivable are recorded as property costs or recoveries when the payments are made or received.

Capitalized costs will be depleted over the useful lives of the properties upon commencement of commercial production or written off if the properties are abandoned or the claims allowed to lapse.

Foreign Currency Translation

The functional currency of the Company and each of its subsidiaries is the Canadian dollar. As the operations of foreign subsidiaries are regarded as being integrated with the parent company, the temporal method of translation has been applied. Under this method, monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect on the balance sheet date while non-monetary assets and liabilities, revenues and expenses are translated using exchange rates in effect at the time of each transaction. Gains and losses from these translations are included in the results from operations.

The reporting currency selected for the presentation of these consolidated financial statements is the U.S. dollar. For presentation purposes, consolidated assets and liabilities are translated into U.S. dollars at the exchange rate in effect at the balance sheet date. Consolidated revenues and expenses are translated into U.S. dollars at rates in effect at the time of the underlying transactions. Gains and losses arising from translation of the consolidated financial statements into U.S. dollars are reported as a separate component of shareholders' equity within accumulated other comprehensive loss.

Financial Instruments

The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855, "Financial Instruments – Recognition and Measurement", requires that all financial assets (except those classified as loans and receivables or held-to-maturity), and derivative financial instruments must be measured at fair value. All financial liabilities must be measured at fair value when they are classified as held for trading; otherwise, they are measured at amortized cost. Investments classified as held-for-trading are reported at fair market value (or marked to market) based on quoted market prices with unrealized gains or losses included in earnings for the period. Investments classified as available-for-sale are reported at fair market value (or marked to market) based on quoted market prices with unrealized gains or losses excluded from earnings and reported as other comprehensive income or loss.

The Company has classified cash and cash equivalents as held-for-trading, receivables as loans and receivables, and accounts payable and accrued liabilities as other financial liabilities.

Future accounting changes

Business Combinations (Section 1582)

CICA Handbook Section 1582 was issued in January 2009 to replace Section 1581, "Business Combinations". Section 1582 establishes standards for accounting for business combinations and will apply prospectively to business combinations for acquisitions completed on or after January 1, 2011. The

Company has not yet determined the impact of the adoption of this standard on its unaudited interim consolidated financial statements.

Consolidated Financial Statements (Section 1601) and Non-Controlling Interest (Section 1602)

CICA handbook Sections 1601 and 1602 were issued in January 2009 and will replace Section 1600, "Consolidated Financial Statements", effective for fiscal years beginning on or after January 1, 2011. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for non-controlling interests in consolidated financial statements. The Company has not yet determined the impact of the adoption of these standards on its unaudited interim consolidated financial statements.

International Financial Reporting Standards ("IFRS")

Magma is required to prepare its financial statements in accordance with IFRS commencing with its interim consolidated financial statements for the three-month period ending September 30, 2011 with the restatement for comparative purposes of amounts reported by the Company for its interim consolidated financial statements for the three-month period ending September 30, 2010. The Company has begun assessing the adoption of IFRS for fiscal 2012 and will implement a comprehensive program to manage the transition to IFRS. The program will focus on the key areas impacted by IFRS, including financial reporting, systems and processes, communications and staff training. As the Company has only just begun its assessment, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

Internal Control over Financial Reporting

Management has designed, established and is maintaining a system of internal control over financial reporting to provide reasonable assurance that the financial information prepared by the Company for external purposes is reliable and has been recorded, processed and reported in an accurate and timely manner and in accordance with Canadian GAAP. The Company's system of internal control is designed to address identified risks that threaten the reliability of its external financial reporting. However, due to the inherent limitations in any system of internal control, material misstatements may not be prevented or detected on a timely basis.

During the three months ended September 30, 2009 and to the date of this MD&A, there were no significant changes in the Company's internal control over financial reporting that occurred that had materially affected or is reasonably likely to materially affect its internal control over financial reporting.

Risks and Uncertainties

The risks and uncertainties described in this section are considered by management to be the most important in the context of the Company's business. The risks and uncertainties below are not inclusive of all the risks and uncertainties the Company may be subject to and other risks may apply.

These risks and uncertainties should be read in conjunction with the risks and uncertainties as described more fully in Magma's Annual Information Form, which is available on SEDAR at www.sedar.com.

Geothermal exploration and development programs are highly speculative, are characterized by significant inherent risks and costs, and may not be successful.

Magma's future performance depends on its ability to discover and establish economically recoverable and sustainable geothermal resources on its properties through its exploration and development

programs. Geothermal exploration and development involves a high degree of risk and few properties that are explored are ultimately developed into generating power plants. There is no assurance that Magma's exploration and development programs will be successful. Despite historical exploration work, Magma's properties, other than the Soda Lake Operation, are without a known geothermal resource. Substantial exploration and development work is required in order to determine if any economically recoverable and sustainable geothermal resources are located on these exploration properties. Successfully discovering geothermal resources is dependent on a number of factors, including the technical skill of exploration personnel involved. Even in the event commercial quantities of geothermal resources are discovered, it may not be commercially feasible to bring power generation facilities into a state of commercial production from such geothermal resources. The commercial viability of a geothermal resource once discovered is dependent on a number of factors, some of which are particular attributes of the resource, such as heat content (the relevant composition of temperature and pressure), useful life, operational factors relating to the extraction of fluids from the geothermal resource, proximity to infrastructure, capital costs to construct a power plant and related infrastructure and energy prices. Many of these factors are beyond Magma's control.

Geothermal exploration and development costs are high and are not fixed. A geothermal resource cannot be relied upon until substantial development, including drilling, has taken place. The costs of development drilling are subject to numerous variables such as unforeseen geologic conditions underground that could result in substantial cost overruns. Drilling at Magma's properties may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs.

Drilling operations may be curtailed, delayed or cancelled as a result of numerous factors, many of which are beyond the Company's control, including economic conditions, mechanical problems, title problems, weather conditions, compliance with governmental requirements and shortages or delays of equipment and services. If Magma's drilling activities at the Soda Lake Operation and on its exploration properties are not successful, it could materially adversely affect Magma's business, financial condition, future results and cashflow.

The Company has a limited operating history.

Magma has a very limited history of operations. The Company is subject to many of the risks common to start up enterprises, including under-capitalization, cash shortages, limitations with respect to personnel, financial, and other resources and lack of revenues. There is no assurance that Magma will be successful in achieving a return on shareholders' investment and the likelihood of success must be considered in light of Magma's early stage of operations.

From inception the Company has incurred net losses. As a result of its planned exploration and plant expansion projects, over the near term Magma does not expect that its operating revenues will be sufficient to cover its expenses. As a result, Magma expects to continue to incur net losses until it is able to generate significant revenues. Magma's ability to generate significant revenues and become profitable will depend on a number of factors, including its ability to:

- successfully complete its planned expansion programs to its Soda Lake Operation;
- acquire interests in producing geothermal power companies or producing geothermal power plants that contribute to its profitability;
- acquire additional prospective exploration and development properties;
- advance planned and future exploration programs on its exploration properties;
- verify geothermal resources on its exploration properties that are sufficient to generate a favourable economic return from electricity sales;

- acquire electrical transmission and interconnection rights for its geothermal power plant development projects;
- enter into power purchase agreements for the sale of electricity from its geothermal power plant development projects at prices that support its operating and financing costs;
- finance and complete the development and construction of geothermal power plants on its properties;
- operate producing geothermal power plants on a profitable basis;
- secure adequate capital to support its expansion, exploration and development programs and finance its acquisitions; and
- attract and retain qualified personnel.

Magma's financial performance depends on its successful operation of geothermal power plants, which is subject to various operational risks.

Magma's financial performance depends on its successful operation of geothermal power plants. At present Magma operates a single power plant at its Soda Lake Operation. The cost of operation and maintenance and the operating performance of a geothermal power plant may be adversely affected by a variety of factors, including some that are discussed elsewhere in these risk factors and the following:

- regular and unexpected maintenance and replacement expenditures;
- shutdowns due to the breakdown or failure of the plant's equipment or the equipment of the transmission serving utility;
- labour disputes;
- catastrophic events such as fires, explosions, earthquakes, landslides, floods, releases of hazardous materials, severe storms or similar occurrences affecting a power plant, any of the power purchasers from a power plant or third parties providing services to a power plant; and
- the aging of power plants, which may reduce their operating performance and increase the cost of their maintenance.

Any of these events could significantly increase the expenses incurred by a power plant or reduce the overall generating capacity of a power plant and could significantly reduce or entirely eliminate the revenues generated by a power plant, which in turn would reduce our net income and could materially and adversely affect our business, financial condition, future results and cashflow.

Magma may be unable to obtain the financing it needs to pursue its growth strategy.

When Magma identifies a geothermal property that it may seek to acquire or to develop, a substantial capital investment often will be required. The continued access to capital, through project financing or through credit facilities or other arrangements with acceptable terms is necessary for the success of Magma's growth strategy. The Company's attempts to secure the necessary capital may not be on favourable terms, or successful at all. Market conditions and other factors may not permit future project and acquisition financings on terms favourable to Magma. The Company's ability to arrange for financing on favourable terms, and the costs of such financing, are dependent on numerous factors, including general economic and capital market conditions, investor confidence, the continued success of current projects, the credit quality of the project being financed, the political situation in the jurisdiction in which the project is located and the continued existence of tax laws which are conducive to raising capital. If Magma is unable to secure capital through credit facilities or other arrangements, it may have to finance its projects using equity financing which will have a dilutive effect on its common shares. Also, in the absence of favourable financing or other capital raising options, Magma may decide not to build new

plants or acquire properties from third parties. Any of these alternatives could have a material adverse effect on Magma's growth prospects and financial condition.

The success of Magma's business relies on attracting and retaining key personnel.

Magma is dependent upon the services of its senior management team. The loss of any of their services could have a material adverse effect upon it.

Employee recruitment, retention and human error.

Recruiting and retaining qualified personnel is critical to Magma's success. Magma is dependent on the services of key executives, including its Chief Executive Officer and other highly skilled and experienced executives and personnel focused on managing the Company's interests. The number of persons skilled in acquisition, exploration, development and operation of geothermal properties is limited and competition for such persons is intense. As its business activities grow, Magma will require additional key financial, administrative and technical personnel as well as additional operations staff. There can be no assurance that Magma will be successful in attracting, training and retaining qualified personnel as competition for persons with these skill sets increase. If Magma is not successful in attracting, training and retaining qualified personnel, the efficiency of its operations could be impaired, which could have an adverse impact on its future cash flows, earnings, results of operations and financial condition.

Despite efforts to attract and retain qualified personnel, as well as the retention of qualified consultants, to manage Magma's interests, even when those efforts are successful, people are fallible and human error could result in significant uninsured losses to Magma. These could include loss or forfeiture of geothermal claims or other assets for non-payment of fees or taxes, significant tax liabilities in connection with any tax planning effort Magma might undertake and legal claims for errors or mistakes by Magma's personnel.

Magma may not be able to successfully integrate businesses or projects that it acquires in the future.

Magma's business strategy is to expand in the future, including through acquisitions. Integrating acquisition targets is often costly, and Magma may not be able to successfully integrate acquired companies with its existing operations without substantial costs, delays or other adverse operational or financial consequences. Integrating the acquired companies involves a number of risks that could materially and adversely affect Magma's business, including:

- the failure of the acquired companies to achieve expected results;
- inability to retain key personnel of acquired companies;
- risks associated with unanticipated events or liabilities; and
- difficulties associated with establishing and maintaining uniform standards, controls, procedures and policies, including accounting and other financial controls and procedures.

Additional information about the Company is available on SEDAR at www.sedar.com and on the Company's website at www.magmaenergycorp.com.