



## **Management's Discussion and Analysis Of Financial Condition and Results of Operations**

**For the Quarter Ended September 30, 2010**

**November 15, 2010**

Magma Energy Corp. (the "Company" and, together with its subsidiaries, "Magma") 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 the Company 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 leading primary geothermal power companies in the world. Magma intends to achieve this by increasing its production of geothermal electricity through the advancement of its existing projects, discovering new geothermal resources and by acquiring new geothermal energy projects.

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

This management's discussion and analysis ("MD&A") focuses on significant factors that affected Magma during the relevant reporting period and to the date of this report. The MD&A supplements, but does not form part of, the unaudited consolidated financial statements of Magma and the notes thereto for the three months ended September 30, 2010 and 2009 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 Magma's audited consolidated financial statements for the year ended June 30, 2010, the related MD&A for that period and Magma's Annual Information Form ("AIF") for the year ended June 30, 2010, which are available on System for Electronic Disclosure and Retrieval ("SEDAR") at [www.sedar.com](http://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. References to ISK are to Icelandic kroner

All financial information has been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").

Unless otherwise indicated, all references to power generation or capacity in megawatts ("MW") in this MD&A are to gross power generation or capacity.

### **Forward Looking Information**

Except for historical information contained in this MD&A, the following disclosures are forward-looking information or future oriented financial information and as such are based on an assumed set of economic conditions and courses of action. Please refer to the cautionary note regarding the risks associated with the forward-looking information at the back of this MD&A and the risk factors set out under the headings "Management of Financial Risks" in this MD&A and "Risk Factors" in Magma's AIF for the year ended June 30, 2010 available on SEDAR.

### **Highlights of the Quarter Ended September 30, 2010**

- ✔ On July 5, 2010, the Company entered into a credit agreement with the Company's Chairman and Chief Executive Officer, pursuant to which the Company is able to borrow up to C\$10 million. The principal amount has been advanced to the Company and was used in connection with the acquisition of shares of HS Orka h.f. ("HS Orka").
- ✔ On July 27, 2010, the Company closed a public share offering of 40,334,628 common shares at a price of C\$1.12 per common share, including 4,620,342 common shares issued upon partial exercise of the underwriters' over-allotment option, for aggregate gross proceeds of \$43.6 million.



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- ☺ On August 17, 2010, Magma acquired additional shares in HS Orka resulting in Magma's ownership of HS Orka increasing to 84.21%. Consideration for this acquisition was 4.2 billion Icelandic Króner ("ISK") (approximately \$34.8 million), issuing 24,808,569 subscription receipts of the Company, and payment of 3.1 billion ISK (approximately \$25.3 million), subject to certain interest adjustments on November 30, 2010.
- ☺ On September 3, 2010, Magma announced that it closed the final portion of the agreement to acquire further shares of HS Orka. Magma acquired 14.32% of HS Orka's outstanding shares by assuming a bond with the municipality of Reykjanesbaer with a principal value of 6.3 billion ISK (approximately \$43.2 million fair value). Magma now holds a 98.53% interest in HS Orka.

### Geothermal Energy Projects

Significant events, transactions and activities on Magma's geothermal properties which occurred during the three months ended September 30, 2010 and to the date of this MD&A are disclosed below. The reader is cautioned that geothermal resources and probabilistic estimates of 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.

### Acquisition of HS Orka

HS Orka is the largest privately owned energy company in Iceland, producing approximately 9% of the country's power needs. Installed geothermal power capacity is 175 MW from the Svartsengi and Reykjanes power plants. In addition, HS Orka generates 150 MW of thermal energy for district heating. HS Orka's 75 MW Svartsengi plant began production in 1977 and its 100 MW Reykjanes plant began production in 2006. Iceland has one of the world's largest and best developed geothermal industries, supported by substantial geothermal resources and a highly skilled workforce. Geothermal energy accounts for 25% of Iceland's electricity demand and powers many of Iceland's homes and businesses, including part of Iceland's large aluminum industry. Iceland is endowed with an abundant supply of geothermal resources. Magma's investment in HS Orka and, consequently, in Iceland's energy industry, is a significant part of management's strategic plans for Magma's growth.

On August 17, 2010, Magma obtained control of HS Orka, the largest privately owned energy company in Iceland, by acquiring an additional 38.03 % of the shares and voting interests in HS Orka. As a result, Magma's equity interest in HS Orka increased from 46.18 % to 84.21 %.

Taking control of HS Orka will advance Magma's objective of becoming one of the leading primary geothermal power companies in the world.

In the three months ended September 30, 2010 HS Orka contributed revenue of \$7.0 million and net profit of \$16.2 million. If the acquisition had occurred on July 1, 2010, management estimates that consolidated revenue would have been \$15.0 million, and consolidated net profit for the period would have been \$22.6 million. In determining these amounts management has assumed that the fair value adjustments, determined provisionally, that arose on the acquisition date would have been the same if the acquisition had occurred on July 1, 2010.



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The following summarizes the consideration transferred and the recognized amounts of assets acquired and liabilities assumed at the acquisition date:

*(all tables below expressed in thousands)*

(a) Consideration transferred:

Cash and cash payable	\$	60,469
Equity instruments (24,808,569 subscription receipts)		28,148
	<b>\$</b>	<b>88,617</b>

The fair value of the subscription receipts was based on the listed closing share price of the Company on August 17, 2010, the date the subscription receipts were issued, of C\$1.17 per share.

Each subscription receipt will convert into one common share of the Company on December 18, 2010 for payment of no additional consideration. The Company has the right at its sole option to repurchase the subscription receipts, in whole or in part, at prices ranging from ISK 135.90 to ISK 142.24 per subscription receipt at certain times between September 4 and December 11, 2010.

Of the cash consideration, \$25.3 million is payable on November 30, 2010. The amount owing is included in accounts payable and accrued liabilities.

(b) Identifiable assets acquired and liabilities assumed:

Cash	\$	5,275
Receivables		7,596
Inventory		2,873
Plant and equipment		414,751
Other intangible assets (incl: geothermal properties, development costs, etc.)		31,630
Bonds		17,936
Investments		14,286
Other assets		3,786
Net future income tax liabilities		(19,793)
Accounts payable and accrued liabilities		(10,155)
Long-term debt		(177,145)
Below market contracts - HS Orka		(37,449)
Derivatives		(10,057)
	<b>\$</b>	<b>243,534</b>

The fair values have been determined on a provisional basis pending completion of the valuations.

(c) A bargain purchase was recognized as a result of the acquisition as follows:

Total consideration transferred	88,617
Non-controlling interests, based on their proportionate interest in the fair value of the assets and liabilities of the acquiree	38,454
Fair value of previously held interest in the acquiree	112,464
Less fair value of net identifiable assets of the acquiree	(243,534)
<b>Bargain purchase</b>	<b>\$ (3,999)</b>

The bargain purchase resulted due to a portion of the shares being acquired at a price of ISK 3.00 per share which was significantly lower than the average price paid for the other shares.



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The remeasurement to fair value of Magma's existing 46.18 % interest in HS Orka resulted in a loss of \$4.9 million, which has been recognized in other income (expenses) in the consolidated statement of operations.

Non-controlling interest has been measured at fair value.

On September 3, 2010, Magma acquired an additional 14.32 % interest in HS Orka by assuming a bond with a principal value of ISK 6.3 billion (approximately \$43.2 million fair value) repayable in 2016 with interest at 3.5% per annum. The principal amount is indexed based on movement in aluminum prices on the London Metal Exchange. Magma now holds a 98.53 % interest in HS Orka. The fair value of the bond has been determined on a provisional basis pending completion of the valuations.

The carrying amount of HS Orka's net assets in the consolidated financial statements on the date of acquisition was \$243.5 million. Magma recognized a decrease in the non-controlling interest of \$35.4 million and a decrease in retained earnings of \$12.3 million.

The following summarizes the effect of the changes in Magma's ownership interest in HS Orka.

Ownership interest at September 2, 2010 (84.21% ownership interest)	\$	204,205
Effect of increase in ownership interest (14.32% increase)		35,416
Share of comprehensive income		(4,828)
<b>Ownership interest at end of period (98.53% ownership interest)</b>	<b>\$</b>	<b>234,793</b>

### Operating Projects

#### *HS Orka Operations, Iceland*

In June 2010, HS Orka took possession of a 50 MW Fuji Electric turbine generator for its Reykjanes power plant which currently produces 100 MW from twin Fuji units. HS Orka plans to expand the Reykjanes plant's output to 180 MW in two phases pending permitting and new power purchase agreements ("PPA") with one or more power purchasers. A 50 MW (phase 1) expansion is planned for 2012 (pending PPA negotiations). An additional 30 MW (phase 2) expansion is scheduled to commence following the phase 1 expansion and requires no additional drilling as the source is low pressure steam generated from current operations. In addition to the Reykjanes expansion projects, HS Orka has the capability to develop existing inferred and indicated resources on its current exploration properties Eldvorp and Krysuvik thus increasing total production up to 405 MW.

Drilling for additional power plant expansion capacity at Reykjanes is ongoing. The current budget for the 50 MW (phase 1) expansion is \$116.0 million, of which approximately \$41.7 million has already been spent. The remaining cost for the expansion is expected to be funded mainly from HS Orka's cash on hand and by debt financing.

To proceed with the expansion of the Reykjanes plant, HS Orka has applied for and will require an expansion to its operating permit from the National Energy Authority ("Orkustofnun"). Orkustofnun has indicated that it is waiting for the results from recent production drilling efforts and further details on HS Orka's reinjection strategy prior to granting the permit.

HS Orka previously entered into a conditional PPA with Nordural Helguvik sf ("Nordural") to sell power from HS Orka's expansion program to a new aluminum smelter to be constructed and located in Reykjanesbaer. The PPA was executed on April 23, 2007 and contained a number of conditions which were not fulfilled by the requirements in the PPA. Accordingly, Magma holds the view that the PPA has lapsed in accordance with its terms. Nordural disputes this interpretation and maintains that the PPA is a valid agreement. The PPA provides that disputes relating to the PPA shall be resolved by arbitration. Nordural has initiated arbitration proceedings to determine the validity of the PPA. The arbitration proceedings were initiated on July 19, 2010 and no hearing date has been set.



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### ***Soda Lake Operation, Nevada, USA***

Magma's Soda Lake operation consists of two geothermal, binary power producing facilities currently operating at 15MW gross capacity.

#### **Soda Lake Phase 1 Expansion**

The Soda Lake Phase 1 expansion and refurbishment program to 16 MW net has been funded to date from cash on hand. Additional financing will be obtained from operating cash flows, 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.

The Soda Lake Phase 1 expansion highlights include the following key activities in order to achieve nameplate capacity:

- Addition of new production well 45A-33
- Addition of new production well 41B-33
- Addition of steam/mixing system well 41-33
- Plant refurbishments
- Drilling new well 25A-33

Magma expects to complete the Phase 1 expansion by the end of 2010. With the commencement of drilling of a third production well, the original budget of \$18.2 million has increased to \$25.0 million with approximately \$20.0 million committed to date.

The Soda Lake operation sells all of its current electricity output to NV Energy Company ("NV Energy") under two 30-year PPAs that terminate in 2020. Magma has commenced discussions with NV Energy and one other party to negotiate an improvement in the pricing under the current PPAs and for the planned increase in electricity output from the plant expansion. There is no guarantee that these negotiations will prove successful. However, given Magma's plans to expand and increase the output of the Soda Lake operation, management is of the opinion that a successful re-negotiation of the existing agreements and/or a new agreement on more favourable terms may be achieved.

#### **Soda Lake Phase 2 Expansion**

The Soda Lake Phase 2 expansion commenced in June 2010 with the receipt of the necessary environment permits from the US Bureau of Land Management ("BLM") to conduct a 3D/3C Seismic survey on the Soda Lake property as part of a \$5.0 million US Department of Energy ("DOE") grant received by Magma. The survey commenced in July 2010 and it is currently anticipated that, should a successful target be recognized through the efforts of this geo-physical survey, production drilling will commence in late 2010. In addition to the seismic survey Magma intends to commence a thermal gradient drilling program following receipt of permits from the BLM which are currently under review. These two activities combined with the updated resource assessment received by GeothermEx Inc. will define the overall size and drilling and development strategy for the Soda Lake Phase 2 expansion.



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### **Exploration Projects**

Since commencement of operations, Magma has acquired a portfolio of geothermal exploration properties from a variety of sources, including through 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.

#### **USA**

Magma's advanced-stage property in the United States is McCoy. In addition, Magma has invested in a number of early stage properties in the USA. Magma continues to evaluate the potential of all of its remaining exploration properties before commencing exploration programs on any of the properties. All of the currently planned exploration program expenditures are discretionary and there are no expenditure commitments on any of Magma's exploration stage properties in the USA.

#### **Chile**

In Chile, at Magma's Mariposa reservoir, a third slim hole was spudded in the quarter and has since been drilled to a depth of over 1,000 meters. More slim holes are planned and all data will be used in a reservoir model to update the current 320 MW Inferred Resource estimate before production well drilling begins in late 2011. Transmission routes were also evaluated during the quarter.

#### **Peru**

Southern Peru is a region of volcanoes and geothermal systems of significant size. Magma has been actively pursuing additional concessions in Peru to add to its existing portfolio of Sabancaya, Huaynaputina, Ticsani, Ccollo, and Casiri. New geothermal concession areas were applied for in January, 2010. Mining rights have been obtained for Sabancaya, Huaynaputina, Ticsani, Ccollo, Casiri Crucero, and San Pedro in addition to the geothermal applications in progress. Additional concession applications are in preparation following successful field work in the last quarter of fiscal 2010. Magma is now awaiting the award of the concessions, and as part of the process has published its first concession area "Crucero" with title expected to be awarded before the end of the calendar year.

### **Financial Review**

For the quarter ended September 30, 2010, Magma recorded a net profit of \$13.4 million (\$0.05 per share), compared to a loss of \$2.7 million (\$0.01 per share) in for the same quarter last year. The financial results for the quarter include the consolidation of the results of HS Orka since August 17, 2010, the date on which Magma acquired control. Therefore, the results for this quarter are not comparable with prior periods.

#### **Gross Profit from Operations**

Total gross profit from operations was \$1.2 million for the three months ended September 30, 2010 compared to \$0.2 million for the same quarter last year.

Revenues in the current quarter from energy sales totalled \$8.0 million compared to \$1.0 million in the same period last year. Our Soda Lake operation contributed revenues of \$1.0 million for the current quarter (\$1.0 million in Q1, 2010) while HS Orka contributed \$7.0 million of revenues for the current quarter. If HS Orka had been consolidated for the entire quarter it is estimated that consolidated revenue would have been approximately \$15 million for the quarter. HS Orka's revenues are approximately 7% higher than in the same period of last year. Approximately 46% of HS Orka's revenues are sold under PPAs with prices indexed to the price of aluminum, resulting in higher revenues as aluminum prices increase. The average aluminum price for the three months ended September 30, 2010 was \$2,107 per tonne versus \$1,842 per tonne for the same period last year, according to the London Metal Exchange.



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Total costs of production for the quarter totalled \$6.9 million compared to \$0.8 million in the first quarter of the prior year. This included costs for labour, repairs and maintenance, supplies, and all other operating costs, including plant general and administrative expenses. The Soda Lake operation accounted for \$1.2 million of total production costs in the current quarter while HS Orka accounted for the remaining \$5.7 million.

### **Expenses**

Total expenses for the current quarter were \$3.3 million compared to \$2.1 million in the same quarter last year. This increase of \$1.2 million is primarily due to:

- an increase of \$0.2 million in general and administrative expenses for the quarter compared to the same quarter of last year. General and administrative expenses included the costs of all administrative and certain management personnel as well as the overhead and administrative costs necessary to operate five offices in Canada, USA, Chile, Sweden and Iceland. The increase represents additional costs as Magma grew and extended its operations into Sweden and Iceland. Also included in this amount is \$0.1 million (Q1, 2010 – \$0.3 million) in relation to stock-based compensation. Stock based compensation expense is recognized over the vesting period of options granted.
- an increase in professional fees of \$0.8 million compared to the same quarter last year is attributable to additional work done in the current fiscal year the acquisition of HS Orka, increased regulatory requirements required for a publicly listed company and activities related to Magma's growth.

### **Other Income and Expenses**

Total other income for the quarter ended September 30, 2010 was \$18.9 million compared to other expenses of \$0.7 million in the same quarter last year. The increase of \$19.6 million is due primarily to:

- equity income of \$8.4 million from Magma's investment in HS Orka. Magma accounted for its investment in HS Orka from December 14, 2009 to August 16, 2010 under the equity method. The equity income for the current quarter was primarily the result of the change in the fair value of embedded derivatives. HS Orka has three PPAs under which the sales price of the power sold is partially based on the market price of aluminum. The indexing of the sales price to the price of aluminum gives rise to embedded derivatives which are fair valued at each reporting date. Due to the increase in aluminum forward prices between July 1, 2010 and August 16, 2010, HS Orka recorded income of \$13.8 million relating to the change in fair value of the embedded derivatives. Magma's portion of this income on the change in the fair value of embedded derivatives was approximately \$6.4 million. Magma's portion of HS Orka's gross profit from operations included in equity income was \$1.2 million.
- loss in the change in the fair value of long term debt of \$5.6 million. As partial consideration for its acquisition of shares of HS Orka, Magma has a long term bond liability of \$101.3 million. The bonds bear interest at below market rates and contain certain embedded derivatives. The bonds have been accounted for as hybrid instruments designated as held-for-trading and are revalued at each balance sheet date.
- change in the fair value of derivatives of \$13.3 million. On August 17, 2010, Magma acquired control of HS Orka and the results of HS Orka are consolidated with the financial results of Magma from August 17, 2010. For the period from August 17 to September 30, 2010, Magma recorded income from change in the fair value of derivatives and embedded derivatives in HS Orka described above.
- interest and other financing costs of \$2.4 million. This includes both the interest on the long-term bond liability, the credit agreement and the debt assumed with the acquisition of HS Orka. The Company had no debt in the first quarter of the prior year.
- foreign exchange gains of \$6.0 million compared to a foreign exchange loss of \$0.8 million for the same period last year.



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- loss on the remeasurement of equity interest in HS Orka of \$4.9 million. In accounting for the acquisition of control of HS Orka 100% of the acquired assets and liabilities are revalued to fair value on August 17, 2010 resulting in a revaluation of the ownership interest prior to attaining control. This remeasurement of the equity interest of 46.18% ownership in HS Orka resulted in a loss of \$4.9 million.
  - A bargain purchase of \$4.0 million resulted due to a portion of shares acquired at a price of ISK 3.00 per share which was lower than the average price paid for the other shares.

**Summary of Unaudited Quarterly Results and Selected Annual Information**

Magma effectively commenced operations in February 2008. 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 Magma's operations and aggressive growth to date. In addition, Magma had no revenues from operations prior to the acquisition of the Soda Lake operation on October 3, 2008. Magma accounted for its proportionate share of income from HS Orka using the equity method of accounting in the third and fourth quarter of fiscal 2010. With the further acquisition of another 52.35% of HS Orka during the three months ended September 30, 2010, Magma's results include the consolidation of HS Orka into its financial statements from August 17, 2010. Therefore, comparisons of revenues and expenses between quarters are not meaningful due to the timing and nature of Magma's activities from quarter to quarter. Seasonality has an impact on the Soda Lake operation, as production is lower in the summer months due to hotter ambient temperatures. HS Orka is also impacted by lower demand in the summer months.



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*(expressed in thousands, except for per share amounts)*

<b>Three months ended:</b>	<b>September 30, 2010</b>	<b>June 30, 2010</b>	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Revenue	8,044	1,347	1,295	1,409
Gross profit	1,191	488	417	589
Expenses (and other income)	15,578	(8,750)	(973)	(5,552)
Taxes	(3,413)	(412)	698	(286)
Net income (loss)	13,356	(8,674)	142	(5,249)
Earnings per share (basic and diluted)	0.05	(0.04)	-	(0.02)

  

<b>Three months ended:</b>	<b>September 30, 2009</b>	<b>June 30, 2009</b>	<b>March 31, 2009</b>	<b>December 31, 2008</b>
Revenue	1,005	1,256	1,926	1,303
Gross profit	165	644	482	356
Expenses (and other income)	(2,830)	(2,521)	(1,165)	(1,426)
Taxes	-	-	-	-
Net income (loss)	(2,666)	(1,877)	(683)	(1,070)
Earnings per share (basic and diluted)	(0.01)	(0.01)	-	(0.01)

**Selected Financial Information**

	<b>For the Three Months Ended September 30, 2010</b>	For the Year Ended June 30, 2010	For the Year Ended June 30, 2009
Total revenues	<b>8,044</b>	5,056	4,485
Income (loss) for the period	<b>13,356</b>	(16,446)	(4,460)
Earnings (loss) per share (basic and diluted)	<b>0.05</b>	(0.07)	(0.03)
Total assets	<b>656,006</b>	198,703	43,780
Total current liabilities	<b>63,659</b>	5,128	2,600
Total long-term liabilities	<b>351,883</b>	51,505	1,982
Total shareholders' equity	<b>240,464</b>	142,070	39,198

**Liquidity and Capital Resources**

At September 30, 2010, Magma had cash and cash equivalents of \$46.2 million compared to \$25.3 million at June 30, 2010. The increase was due primarily to the completion of the public offering for net proceeds of \$41.3 million, proceeds from the credit facility of C\$ 10.0 million, cash from operating activities of \$12.5 million and the effect of foreign exchange on cash of \$1.3 million offset by cash payments for the acquisition of HS Orka of \$29.5 million (net of cash acquired from HS Orka), exploration expenditures of \$6.3 million and expansion work at the Soda Lake operation, HS Orka and other plant and equipment purchases of \$8.5 million. Magma ended the quarter with working capital of \$5.6 million compared to \$21.4 million at June 30, 2010.

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.



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Cash and cash equivalents consist of cash and term deposits that are redeemable prior to maturity on demand and without economic penalty to Magma. Magma's exposure to credit risk on its cash and term deposits is limited by maintaining the majority of its 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 countries in which the Company's subsidiaries operate to fund their immediate needs.

Magma has no off-balance sheet arrangements.

Long-term debt consists primarily of long-term bonds and other long-term debt assumed with the acquisition of HS Orka. The principal amount of the bonds and other long-term debt has maturity dates that range from 2016 to 2023.

Management is of the opinion that Magma has sufficient working capital to meet its administrative overhead for the ensuing year. Working capital is being used to fund the Soda Lake Phase 1 expansion. Funding for the Soda Lake Phase 2 expansion and further exploration and development of Magma's exploration properties will be financed via a combination of additional equity financing, debt or tax and other incentives.

In July 2010, the Company completed a public offering of common shares. The net proceeds of this offering were \$41.3 million. Also in July 2010, the Company entered into a credit agreement with Mr. Ross Beaty, the Company's Chairman and Chief Executive Officer, pursuant to which the Company borrowed C\$10.0 million.

Alternative sources of funding are being evaluated for the final payment of approximately \$25.3 million, payable November 30, 2010, for the acquisition of HS Orka.

Until Magma is able to access cash from its production operations, Magma will require additional capital to continue the exploration and development of its geothermal properties beyond the currently planned exploration programs, to fund Soda Lake Phase 2 of the Soda Lake operation expansion and to develop its other properties. While Magma 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.

### **Related Party Transactions**

During the current quarter, the Company entered into a credit agreement with Mr. Ross Beaty, the Company's Chairman and Chief Executive Officer, pursuant to which the Company is able to borrow up to C\$10.0 million. Interest at the rate of 8% per annum, compounded daily, is payable monthly commencing on July 30, 2010. In addition, a standby fee in the amount of 1% of the credit facility and a drawdown fee in the amount of 1.5% of the amount advanced is payable in cash. The principal amount has been advanced to the Company to be used in connection with Magma's acquisition of shares of HS Orka.

### **Management of Financial Risks**

Magma's financial instruments consist of cash and cash equivalents, receivables, other assets, accounts payable and accrued liabilities and long-term debt. All financial assets, except those classified as loans and receivables or held-to-maturity, and derivative financial instruments must be measured at fair value. Loans and receivables are measured at amortized cost. 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 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.



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Magma has classified cash and cash equivalents and other assets as held-for-trading, receivables as loans and receivables, accounts payable and accrued liabilities as other financial liabilities and long-term debt as held-for-trading.

Significant financial risk exposure and the way in which such exposure is managed by Magma are as follows:

### ***Credit Risk***

Magma's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Over 50% of the Magma's revenue is attributable to sales transaction with three customers. Magma has set a credit policy where all new customers are evaluated. Payment history of new customers is checked and credit limits are set. Magma establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables.

### ***Liquidity Risk***

Liquidity risk is the risk that Magma will be unable to meet its financial obligations as they become due. Magma manages liquidity risk by ensuring that it has sufficient cash, credit facilities and other financial resources available to meet its obligations. Magma 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.

### ***Market Risk***

The significant market risk exposures to which Magma is exposed are interest rate risk, currency risk and commodity price risk.

### ***Interest Rate Risk***

Interest rate risk is the risk that the future cash flows and fair values of Magma's investments and debts will fluctuate because of changes in market interest rates. Generally, Magma'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

### ***Currency Risk***

The functional currency of the Company and its subsidiaries, except HS Orka, 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 year.

The functional currency of HS Orka is the ISK and, therefore, HS Orka is exposed to currency risk on its sales, purchases and borrowings that are denominated in currencies other than ISK. The currencies in which these transactions are primarily denominated are the US dollar, Swiss franc, Euro and Japanese yen. HS Orka does not in general hedge against foreign exchange rate risk, but may hedge single, large transactions with forward foreign exchange agreements for shorter periods. HS Orka does not hedge its currency risk on its long-term debt denominated in foreign currencies.

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.



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### Commodity Price Risk

Magma's commodity consists of power produced. At the Magma's Soda Lake facility, all power currently produced is sold to one customer under the terms of a 30-year PPA which consists of a fixed price component and an escalating price component. Because all power produced will be sold at rates specified by the PPA until 2020, revenue from the Soda Lake facility is not exposed to significant commodity price risk.

HS Orka has entered into PPAs for the sale of electrical power whereby the sales price of the power is partially based on the market price of aluminum. Therefore, its revenues and profitability of its operations are significantly exposed to fluctuations in the price of aluminum.

The bonds issued as partial consideration for the purchase of share of HS Orka are subject to adjustment based on the price of aluminum. Therefore, the principal amounts owed on the due date, and the annual interest payments thereon, will fluctuate with the price of aluminum.

A 10% increase or decrease in the price of aluminum at September 30, 2010 would have increased or decreased net income by \$22.2 million.

### Share Capital and Financings

As at September 30, 2010, the Company had 288,972,602 issued and outstanding common shares.

As at September 30, 2010, the Company had options outstanding for the acquisition of up to 3,310,000 common shares. The options vest over a two-year period commencing with one-third upon the date of grant.

Issued and outstanding shares of the Company, at November 15, 2010 are 288,972,602.

### Commitments and Contingencies

Magma has entered into lease agreements for the rental of office facilities that require minimum payments in the aggregate as follows:

*(expressed in thousands of dollars)*

Fiscal 2011	\$	140
Fiscal 2012		165
Fiscal 2013		94
Fiscal 2014		61
Fiscal 2015		31
<b>Total lease commitments</b>	<b>\$</b>	<b>491</b>

### Outlook

The quarter ended September 30, 2010 was very positive for the continued growth of Magma's operations and increase in its current and future total production. The acquisition of the additional 52.35% interest in HS Orka during the quarter brought Magma's total interest to 98.53%. Progress on the Soda Lake Phase 1 expansion continues to advance with increases in revenue currently being realized.

As Magma now has majority ownership in HS Orka, Magma's future consolidated financial statements will incorporate HS Orka's financial results for the full period. Therefore, Magma's consolidated revenues will be impacted by the indexation of HS Orka's revenues to changes in aluminum prices. As aluminum prices increase so will revenues and the change in the fair value of the embedded derivatives in sales



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contracts. This will be somewhat offset by the change in the fair value of long term debt as both Magma's existing long-term debt and the debt assumed on the final acquisition of HS Orka will increase as aluminum prices increase.

Given the acquisition opportunities available in the industry and Magma's own portfolio of projects, management is optimistic that it will continue to grow Magma significantly and achieve its mission of becoming one of the leading primary geothermal power companies in the world.

### **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 amounts reported in the consolidated financial statements and related notes. Significant areas where management's judgment is applied are depreciation, the assessment of asset impairment, stock-based compensation, the future price of aluminum, financial instruments, future income tax assets and liabilities and associated reserves, tax positions, geothermal properties and asset retirement obligations. Actual results could differ from those estimates.

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

#### ***Business combinations and related sections***

CICA Handbook Sections 1582, "Business Combinations", 1601, "Consolidated Financial Statements", and 1602 "Non-Controlling Interests", replace CICA Handbook Sections 1581 and 1600. The new standards revise guidance on the determination of the carrying amount of assets acquired and liabilities assumed, goodwill and accounting for non-controlling interests at the time of a business combination. These standards are effective for any business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011, with early adoption permitted. Magma has elected to early adopt this standard and has applied this to the HS Orka acquisition.

Acquisitions of subsidiaries and businesses (other than entities which were under the control of the parent) are accounted for using the acquisition method. The cost of the business combination is measured as the aggregate of the fair value (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree. The acquiree's identifiable assets and liabilities that meet the conditions for recognition under Section 1582 are recognized at their fair value at the acquisition date except for non-current assets (or disposal groups) that are classified as held for sale in accordance with Section 3475 "Disposal of Long-lived Assets and Discontinued Operations", which are recognized and measured at fair value less cost to sell.

Goodwill arising on acquisition is recognized as an asset and initially measured at cost, being the excess of the cost of the business combination over the Company's interest in the net fair value of the identifiable assets and liabilities recognized. If, after reassessment, the Company's interest in the net fair value of the acquiree's identifiable assets and liabilities exceeds the cost of the business combination, the excess is recognized immediately in profit or loss as a bargain purchase.

Under Section 1602 "Non-controlling Interest", transactions that result in changes in ownership interests while retaining control are accounted for as transactions with equity holders in their capacity as equity holders. As a result no gain or loss on such changes is recognized. Also, no change in the carrying amounts of assets (including goodwill) or liabilities is recognised as a result of such transaction.

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***Equity investments***

Magma accounts for investments subject to significant influence by the equity method. Investments subject to significant influence are initially recorded at the fair value of the consideration given up to the date of equity interest is acquired. Thereafter, Magma records its prorata share of the equity investee's income or loss for the year as an increase or decrease in the carrying amount of the investment. Dividends received would be recorded as a decrease to the carrying amount of the investment. At each balance sheet date we assess whether there are any indications that the investment may be impaired.

***Financial Instruments***

Magma's financial instruments consist of cash and cash equivalents, receivables, other assets, accounts payable and accrued liabilities, and long-term debt.

Financial assets are designated into one of the following four categories at initial recognition:

- Held for trading – recorded at fair value with resultant gain or loss recognized in profit and loss
- Held to maturity – recorded at amortized cost with resultant gain or loss recognized in profit and loss
- Available for sale – recorded at fair value with resultant gain or loss recognized in other comprehensive income
- Loans and receivables – recorded at amortized cost with resultant gain or loss recognized in profit and loss

Financial liabilities are designated into one of the following categories at initial recognition:

- Held for trading – recorded at fair value with resultant gain or loss recognized in profit and loss
- Other financial liabilities – recorded at amortized cost with resultant gain or loss recognized in profit and loss

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.

***Plant and equipment***

Operating assets are stated at cost, net of accumulated amortization and accumulated impairment losses. The major categories include power plants, boreholes, electrical systems, hot water and cold water distribution systems, housing and other operating assets. Major additions to operating assets including betterments, are capitalized and repairs and maintenance are expensed. Amortization is provided on a straight-line basis over the estimated useful lives of the plant assets. Power plants are 20 - 40 years, boreholes are 20 years, electrical systems are 50 years, hot water and cold water distribution systems are 50 years, housing is at 50 years, and other operating assets vary from 5 to 20 years. Costs include expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use and capitalized borrowing costs.

***Geothermal properties***

Magma 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 the resources has been determined and geothermal property interests are either developed, the property sold or the rights are allowed to



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lapse. Costs that are incurred but not for a specific identifiable property are classified as general and are expensed in the period incurred.

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 resource or reserve, joint venture expenditure commitments or Magma'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, Magma 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 Magma or the optionee, the amounts payable or receivable are recorded as property costs or recoveries when the payments are made or received.

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

Depletion on geothermal properties in production is provided on a straight-line basis over 40 years.

Although Magma has taken steps to verify the title to geothermal properties in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee Magma's title. Property title may be subject to unregistered prior agreements or transfers and title may be affected by undetected defects.

### ***Environmental protection practices and asset retirement obligations***

Magma is subject to the laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. Magma may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest.

Magma conducts its geothermal exploration and development activities in compliance with applicable environmental protection legislation. Magma is not aware of any existing environmental problems related to any of its current or former properties that may result in material liability to Magma.

Magma recognizes the fair value of liabilities for asset retirement obligations in the period in which a reasonable estimate of such costs can be made. The asset retirement obligation is recognized at fair value and recorded as a liability with a corresponding increase to the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost is allocated to expenses using a systematic and rational method and is also adjusted to reflect period-to-period changes in the liability resulting from passage of time and revisions to either timing or the amount of the original estimate of the undiscounted cash flow. The fair value of the legal obligation for asset retirement is assessed each reporting period.

Magma's obligation to restore the site underlying its geothermal power plant at the Soda Lake operation is contingent upon the cessation of operations at that location. Magma intends to continue operating this site indefinitely and has the unilateral right to renew all underlying land leases necessary to allow it to do so.

It is reasonably possible that our estimates of any reclamation and site restoration liabilities could change as a result of changes in regulations or cost estimates. The effect of changes in estimated costs is recognized on a prospective basis.

As at September 30, 2010, Magma has not recognized any amounts in connection with asset retirement obligations.

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***Foreign currency translation***

The functional currency of the Company and each of its subsidiaries, except HS Orka, 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 functional currency of HS Orka is the Icelandic Kroner ("ISK") and HS Orka is regarded as being self-sustaining. As a result, the current rate method of translation has been applied. Under this method, assets and liabilities are translated into Canadian dollars at the exchange rate in effect on the balance sheet, revenues and expenses are translated using exchange rates in effect at the time of each transaction. Gains and losses from these translations are recognized in other comprehensive income.

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

***Goodwill and goodwill impairment***

Business acquisitions are accounted for using the purchase method whereby assets acquired and liabilities assumed are recorded at fair value as of the date of the acquisition with the excess of the purchase price over such fair value recorded as goodwill. Goodwill is assigned to the reporting unit and is not amortized.

Goodwill of a reporting unit is tested for impairment on an annual basis or more frequently when an event or circumstance occurs that more likely than not reduces the fair value of a reporting unit below its carrying amount. Magma compares the estimated fair value of the reporting unit to which goodwill was assigned with the carrying amount of the reporting unit. When the carrying amount of a reporting unit exceeds its estimated fair value, Magma measures the goodwill impairment loss, if any, as the excess of the carrying amount of the reporting unit's goodwill over its estimated fair value. A goodwill impairment loss is not reversed if the fair value of the reporting unit's goodwill subsequently increases.

***Recent accounting pronouncements***

Recent accounting pronouncements issued which may impact us in the future are as follows:

***International Financial Reporting Standards ("IFRS") Changeover Plan***

Effective January 1, 2011, Canadian publicly listed entities will be required to prepare their financial statements in accordance with IFRS, instead of current Canadian GAAP. First-time adoption is mandatory for interim and annual financial statements relating to annual periods beginning on or after January 1, 2011. Accordingly, although Magma will first report its results under IFRS in the year ending June 30, 2012, the underlying conversion will be based on an effective transition date of July 1, 2011.

Magma is currently establishing an IFRS conversion team to lead the significant undertaking of transition from Canadian GAAP to IFRS. Magma is currently preparing a detailed IFRS conversion plan, which will continue to evolve to accommodate the expected development of IFRS accounting standards past 2012.

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Magma has identified four phases to its IFRS conversion: scoping and planning, detailed assessment, implementation and post implementation. The scoping and planning phase involves establishing a project team and organizational structure, including oversight of the process; this includes a project charter, project management plan, stakeholder analysis and communication strategy. This phase also entails an initial assessment of the key areas where IFRS transition may have a significant impact and present significant challenges. Magma is currently working through the scoping and planning phase. The second phase, detailed assessment, involves in-depth technical analysis that will result in understanding potential impacts, decisions on accounting policy choices and the drafting of accounting policies. Magma has not yet commenced this phase but expects to commence this detailed technical analysis in late 2010. As Magma has not yet started its detailed assessment, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time. In addition this will result in identifying resource and training requirements, processes for preparing financial statements, establishing IT system requirements and preparing detailed transition plans. During the implementation phase, Magma will identify and carry out the implementation requirements to effect management's accounting choices, develop sample financial statements, implement business and internal control requirements, calculate the opening balance sheet at July 1, 2011 and other transitional reconciliations and disclosure requirements. The last phase of post implementation will involve continuous monitoring of changes in IFRS throughout the implementation process (through to 2012).

Magma is developing and maintaining our IFRS competencies by addressing training requirements at various levels of the organization. These sessions are ongoing and are provided by external advisors. Magma will continually assess training and resource requirements as the project progresses.

HS Orka currently reports under IFRS. In order to accurately reflect Magma's equity earnings from HS Orka, Magma has reconciled the financial statements of HS Orka under IFRS to Canadian GAAP. The differences identified in HS Orka's financial statements under IFRS compared to Canadian GAAP are as follows:

- In accordance with IAS 16, HS Orka revalued certain of its operating assets on December 31, 2009 and January 1, 2008. Revaluation of long-lived assets is not permitted under Canadian GAAP.
- HS Orka has recognized a pension fund commitment with respect to pension plan arrangements it maintains for its current and former employees. These pension plans include defined benefit and defined contribution plans and are multi-employer plans. Obligations for contributions to defined contribution plans are recognized as an expense in profit or loss as incurred. With respect to defined benefit plans, HS Orka's net obligation or pension fund commitment is calculated separately for each plan by estimating the amount of future benefit that current and former employees have earned in return for their service in the current and future periods. The calculation is performed annually by qualified actuaries with the changes in pension fund commitment recognized in profit or loss for the period.

The provision is recognized if, as a result of a past event, HS Orka has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Under Canadian GAAP, HB Section 3461, "*Employee Future Benefits*", defines a defined benefit plan as a benefit plan that specifies either the benefits to be received by an employee, or the method of determining those benefits. A multi-employer plan is a defined benefit plan to which two or more unrelated entities contribute, usually pursuant to one or more collective bargaining agreements. Although a multiemployer plan may have the characteristics of a defined benefit plan, sufficient information to follow the standards on defined benefit plans, as stated in HB 3461.024 –

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3461.134, is normally not available. In such circumstances, a multiemployer plan is accounted for following the standards on defined contribution plans.

HS Orka has accounted for its pension arrangements as a defined benefit plan under IFRS; however, there is not sufficient information to present all the required disclosures for a defined benefit plan. As such, the accounting would be as for a defined contribution plan in accordance with Canadian GAAP.

- In July 2009, HS Orka sold certain land to a third party and has leased the land back from the purchaser. The gain on the sale of the property was recorded in the income statement and included within the financial results as at December 31, 2009 in accordance with IFRS. Under both IFRS and Canadian GAAP, the leaseback has been classified as an operating lease. Under HB Section 3065, "Leases", a sale-leaseback transaction involves the sale of property with the purchaser concurrently leasing the same property back to the seller. This definition is consistent with the definition under IAS 17. Under Canadian GAAP, any gain or loss arising from a sale-leaseback transaction is accounted for based on the nature of the resulting leaseback. Where the leaseback is classified as an operating lease, any gain or loss is deferred and amortized over the lease term. In accordance with IAS 17, any gain or loss arising from the sale-leaseback transaction is recognized in profit or loss for the period if the transaction takes place at fair value and the leaseback is classified as operating.

**Disclosure Controls and Procedures and Internal Control Over Financial Reporting**

***Disclosure Controls and Procedures***

The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures. Based on the results of that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as at September 30, 2010, the Company's disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by Magma in reports it files is recorded, processed, summarized and reported within the appropriate time periods and forms.

***Internal Control Over Financial Reporting***

The Company's management, under the supervision of the Audit Committee and its Chief Executive Officer and Chief Financial Officer, are responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles the Company's controls include policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of Magma;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and receipts and expenditures of Magma are made only in accordance with authorizations of management and the directors of Magma; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Magma's assets that could have a material effect on the annual financial statements or interim financial statements.



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Management has evaluated the effectiveness of our internal control over financial reporting. Based on this assessment, Management has concluded that, as at September 30, 2010, Magma's internal control over financial reporting was effective.

There have been no significant changes to the Company's internal controls over financial reporting during the most recent fiscal period that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### ***Limitations of Controls and Procedures***

The Company's management, including the Chief Executive Officer and Chief Financial Officer, believe that any disclosure controls and procedures or internal controls over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgements in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

### **Cautionary Statement Regarding 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 our growth; results of operations; business prospects and opportunities; expansion programs at HS Orka's Svartsengi and Reykjanes power plants and the Soda Lake operation; the negotiation of an improvement in pricing under the current Soda Lake PPAs; programs to upgrade and develop inferred and indicated resources at HS Orka's properties and the Soda Lake operation; permitting for Magma's expansion and exploration programs; negotiation of a PPA for expansion to HS Orka's Svartsengi and Reykjanes power plants; estimates of recoverable geothermal energy "resources" or energy generation capacities; estimates or predictions of gas content, porosity, permeability, fractures, reservoir temperature, reservoir pressure, steam cap temperature, well-head pressure and scaling; and data collection, expansion, upgrade, development, reinjection, rework or inhibition plans for any of Magma's properties. Such forward-looking information reflects 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 "plan", "expect", "is expected", "budget", "estimates", "goals", "intend", "targets", "aims", "appears", "likely", "typically", "potential", "probable", "continue", "strategy", "proposed", 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" or "shall" be taken, occur or be achieved.

A number of known and unknown risks, uncertainties and other factors, may cause our actual results or performance to materially differ from any future results or performance expressed or implied by the forward-looking information. Such factors include, but are not limited to: new production wells at our Soda Lake operation may not define sufficient additional and commercially viable geothermal resources to support our planned expansion programs; failure to discover and establish economically recoverable and sustainable geothermal resources through our exploration and development programs; geothermal exploration and development programs are highly speculative, are characterized by significant inherent



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risk and costs, and may not be successful; we have a limited operating history; our financial performance depends on our successful operation of geothermal power plants, which is subject to various operational risks; our geothermal resources may decline over time and may not remain adequate to support the life of our power plants; imprecise estimation of probability simulations prepared to predict prospective geothermal resources or energy generation capacities; imprecise estimation of resources and reserves of geothermal energy; variations in project parameters and production rates; geological occurrences beyond our control may compromise our operations and their capacity to generate power; inability to obtain the financing we need to pursue our growth strategy; it is very costly to place geothermal resources into commercial production; we may continue to incur negative operating cash flow for the foreseeable future; energy prices are subject to dramatic and unpredictable fluctuations; industry competition may impede our ability to access suitable geothermal resources; we may be unable to enter into PPAs on terms favourable to us, or at all; the cancellation or expiry of government initiatives to support renewable energy generation may adversely affect our business; impact of significant capital cost increases; unexpected or challenging geological conditions; changes to regulatory requirements, both regionally and internationally, governing development, geothermal resources, production, exports, taxes, labour standards, occupational health, waste disposal, toxic substances, land use, environmental protection, project safety and other matters; failure to obtain or maintain necessary licenses, permits and approvals from government authorities; the success of our business relies on attracting and retaining key personnel; the risk of human error; our officers and directors may have conflicts of interests arising out of their relationships with other companies; we may face adverse claims to our title; developments regarding Aboriginal, First Nations and Indigenous peoples; a significant portion of our revenue is attributed to payments made by a single power purchaser under the Soda Lake PPAs; fluctuations in foreign currency exchange and interest rates may affect our financial results; we may not be able to successfully integrate businesses or projects that we acquire in the future; our insurance policies may be insufficient to cover losses; the government of Iceland may take action which results in fines or other penalties levied against Magma or HS Orka; the government of Iceland may invalidate or wind-down Magma's acquisition of shares of HS Orka; the government of Iceland may invalidate or wind-down the prior privatization of Hitaveita Sudurnesja (now HS Orka); the government of Iceland may pass legislation or constitutional amendments to nationalize or restrict private or foreign ownership in Iceland's energy sector or to reduce the term of utilization rights for water or geothermal resources owned by municipalities or the state, increase levies for such utilization rights or restrict transfers of such utilization rights; Magma may not be compensated for certain government action relating to Magma's interest in HS Orka; aluminum price risk; the results of operations of the companies in which we hold a significant interest; risks associated with inter regional transmission grids; host country economic, social and political conditions can negatively affect our operations; economic, social and political risks arising from potential inability of end-users to support our properties; the fluctuation of our common share price could result in investors losing a significant part of their investment; we have no dividend payment policy and do not intend to pay any cash dividends in the foreseeable future; the issuance of additional equity securities may negatively impact the trading price of our common shares; the risk of volatility in global financial conditions, as well as significant decline in general economic conditions; and other development and operating risks. There may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. These factors are not intended to represent a complete list of the risk factors that could affect us. Additional risk factors are discussed in the section entitled "Management of Financial Risks" in this MD&A and in the section entitled "Risk Factors" in the Company's AIF for the year ended June 30, 2010, available on the SEDAR website at [www.sedar.com](http://www.sedar.com). These factors should be considered carefully and investors should not place undue reliance on forward-looking information.

The forward-looking information contained in this MD&A is based upon what management believes to be reasonable assumptions, including, but not limited to: the government of Iceland not invalidating or winding-down the Final Acquisition; the government of Iceland not winding-down the prior privatization of Hitaveita Sudurnesja (now HS Orka); the government of Iceland not passing legislation or constitutional amendments to nationalize or restrict private or foreign ownership in Iceland's energy sector or to reduce



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the term of utilization rights for water or geothermal resources owned by the municipalities or the state, increase levies for such utilization rights or restrict transfers of such utilization rights; the effects of any increase in power production from HS Orka or our Soda Lake Operation; the success and timely completion of planned exploration and expansion programs, including improvements to facilities at HS Orka's Svartsengi and Reykjanes power plants or our Soda Lake Operation; our ability to comply with local, state and federal regulations dealing with operational standards and environmental protection measures; our ability to negotiate and obtain PPAs on favourable terms; our ability to obtain necessary regulatory approvals, permits and licences in a timely manner; the availability of materials, components or supplies; our ability to solicit competitive bids for drilling operations and obtain access to critical resources; the growth rate in net electricity consumption; support and demand for non-hydroelectric renewables; government initiatives to support the development of renewable energy generation; the accuracy of volumetric reserve estimation methodology and probabilistic analysis used to estimate the quantity of potentially recoverable energy; the accuracy of the analysis used to estimate resources and reserves of geothermal energy; environmental, administrative or regulatory barriers to the exploration and development of geothermal resources on our properties; geological, geophysical, geochemical and other conditions at our properties; the reliability of technical data, including extrapolated temperature gradient, geophysical and geochemical surveys and geothermometer calculations; capital expenditure estimates; availability of capital to fund exploration, development and expansion programs; our competitive position; and general economic conditions. Forward-looking information is also based upon the assumption that none of the identified risk factors that could cause actual results to differ materially from the forward-looking information will occur.

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.

*Additional information about Magma, including Magma's's Annual Information Form is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on Magma's's website at [www.magmaenergycorp.com](http://www.magmaenergycorp.com).*