
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, 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 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 six months ended December, 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 December 31, 2009

- ✔ Acquisition of a 40.94% interest in HS Orka HF, a producing geothermal company in Iceland.
- ✔ Completion of a private placement and issuance of 11,652 million common shares at a price of C\$1.85 per share for net proceeds of \$19.774 million.
- ✔ Award of \$10 million in grants from the US Department of Energy under the American Recovery and Reinvestment Act for Magma's Soda Lake and McCoy properties.

Geothermal Energy Projects

Significant events, transactions and activities on Magma's geothermal properties which occurred during the quarter ended December 31, 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.

Acquisition of HS Orka HF

In July 2009, the Company entered into an agreement to acquire a 10.78% interest in HS Orka hf ("HS Orka"), an Icelandic company with two geothermal energy producing plants. On November 17, 2009 the Company acquired an 8.62% interest in HS Orka in consideration of 2.5 billion Icelandic Krona ("ISK") (\$16.981 million). A further 2.16% interest is to be acquired by March 31, 2010 for consideration of 625 million ISK (approximately \$5.0 million).

Pursuant to an agreement with the majority shareholder of HS Orka, the Company has the right 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. These transactions closed on December 14, 2009. Consideration for the acquisition included an aggregate cash payment of 3.7 billion ISK (\$29.793 million) and the issuance of bonds to the vendors with an aggregate principal amount of \$70.270 million. The bonds are secured by the shares acquired by the Company in this transaction.

HS Orka is the largest privately owned energy company in Iceland with installed net geothermal power capacity of 175 MW from its two power plants, Svartsengi and Reykjanes. In addition, HS Orka generates 150 MW of thermal energy for district heating. Expansions for an additional 230 MW have

been planned which will increase HS Orka's geothermal power production to a total of 405 MW by 2015. The acquisition of a 43.1% stake in HS Orka will add 75 MW of net geothermal production to Magma's net total production.

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 23% of Iceland's electricity demand and powers many of Iceland's homes and businesses, including Iceland's large aluminum industry. Iceland's geographical and geological peculiarities have endowed it 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 the growth of the Company.

The acquisition of the 40.94% interest in HS Orka was financed with the proceeds of the private placement that closed in October 2009, from cash on hand and by the issuance of the bonds. Additional acquisitions of HS Orka shares will be financed by additional equity financing, cash on hand, debt or other sources of financing available to the Company.

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.

Progress on the Phase 1 program includes the completion of two drill holes to depths of 4,468 feet and 8,995 feet respectively. Following a field optimization program on the initial well, 45A-33, a flow test was successfully completed in late December 2009. The test demonstrated the well to be capable of 1,200 gallons per minute of sustained flow at a temperature of 385°F, sufficient to provide 3 MW of net power. The well is in the process of being connected to the existing Soda Lake facility.

The field optimization program incorporated an established oil and gas stimulation technique known as deflagration, which, to the best of Magma's knowledge, has never previously been used in the geothermal industry.

In addition to drilling activities, Magma completed a detailed engineering assessment of power plant upgrades and refurbishments that would be required in anticipation of the new production wells. A significant portion of the refurbishment program was completed in September and October 2009 when the plant was partially shut down for annual maintenance. The refurbishments completed to date have contributed an additional 1 MW of net output commencing in December 2009.

The expansion work completed to date confirms half of Magma's planned Phase 1 program to increase the gross power capacity of the Soda Lake Operation from 11 MW to 23 MW. Magma expects to confirm the remaining capacity increase by the end of March 2010.

Exploration Projects

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. The approval process is currently on-going.

Road construction to the drill site was initiated in October 2009 and 13.5 km have been completed to date. Concurrent with the road building, additional geological studies focusing on stratigraphy and structure are being carried out.

Pellado, Chile

Subsequent to the period end, in January 2010, Magma was awarded the 100,000 hectare Pellado property, which adjoins the Maule property. The drilling and magnetotelluric geophysical program carried out by Magma in 2009 at Maule resulted in the discovery of a large heat anomaly, the Mariposa Geothermal Resource ("Mariposa"). This resource straddles the Pellado and Maule properties. SKM estimates that Mariposa contains an inferred resource of 320 MW of electrical generation capacity, including the 140 MW estimate located within the Maule property.

The award of Pellado allows Magma to explore and develop the entire Mariposa resource. Management of Magma has planned a \$15 million exploration program which currently anticipates two wells being drilled on each of the Pellado and, when granted, the Maule properties, along with other work.

Other Properties

Exploration work on Magma's US properties during the quarter consisted primarily of environmental assessments, reflection seismology and other geophysical work conducted on McCoy 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.

In December 2009, upon completing an assessment of the potential of the Whitehorse property in Nevada, management returned the property to its former owners. Costs incurred on the property of approximately \$527,000, net of the remaining purchase price payable, were written off at December 31, 2009.

Magma continues to evaluate the potential of all of its remaining exploration properties before commencing on 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 properties.

Financial Results From Operations

The information provided below highlights the Company's quarterly results for the past 8 quarters since inception on January 22, 2008 to December 31, 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 and within Note 2 to the unaudited interim consolidated financial statements for the six months ended December 31, 2009. These accounting policies have been followed consistently through the current period.

Summary of Unaudited Quarterly Results

(expressed in thousands of US dollars, except for per share amounts)

Three months ended:	December 31, 2009	September 30, 2009	June 30, 2009	March 31, 2009
Revenue	\$ 1,409	\$ 1,005	\$ 1,256	\$ 1,926
Direct cost of energy production	820	840	612	1,444
Gross profit	589	165	644	482
Expenses	2,025	2,101	1,262	1,176
Other income (expenses)	(3,527)	(729)	(1,259)	11
Income tax expense	(286)	-	-	-
Net loss for the period	(5,249)	(2,665)	(1,877)	(683)
Loss per share (basic and diluted)	(0.02)	(0.01)	(0.01)	-

Three months ended:	December 31, 2008	September 30, 2008	June 30, 2008	March 31, 2008
Revenue	\$ 1,302	\$ -	\$ -	\$ -
Direct cost of energy production	946	-	-	-
Gross profit	356	-	-	-
Expenses	1,359	1,169	633	51
Other income (expenses)	(67)	339	4	19
Net loss for the period	(1,070)	(830)	(629)	(32)
Loss per share (basic and diluted)	(0.01)	(0.01)	(0.01)	-

Selected Financial Information

	For the Six Months Ended December, 2009	For the Year Ended June 30, 2009	For the Period from Inception (January 22, 2008) to June 30, 2008
Total revenues	\$ 2,414	\$ 4,485	\$ -
Net loss	(7,915)	(4,460)	(661,340)
Loss per share (basic and diluted)	(0.03)	(0.03)	(0.01)
Total assets	206,454	43,780	12,908,970
Total current liabilities	2,475	2,600	721,001
Total long-term liabilities	48,602	-	-
Total shareholders' equity	153,359	39,198	12,187,969

Results of Operations

For the Three Months Ended December 31, 2009

The Company effectively commenced operations in February 2008 and, therefore, has completed only 8 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. In December 2009, Magma acquired a 40.94% interest in HS Orka and has accounted for its proportionate share of income from Hs Orka using the equity basis of accounting. 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 December 31, 2009, the Company incurred a loss of \$5.249 million (\$0.02 per share) from its operational segments as follows:

<i>(expressed in thousands of US dollars)</i>	
Geothermal exploration	\$ (4,493)
Production and sales:	
Soda Lake Operation	203
Equity loss from HS Orka	(1,926)
Change in valuation of long-term debt	1,087
Interest on long-term debt	(50)
Foreign exchange gain	216
Income tax expense	(286)
Loss for the three months ended December 31, 2009	\$ (5,249)

Net loss from the Company's geothermal exploration and corporate activities during the current quarter was \$4,493,000 (refer to Note 11 of the unaudited interim consolidated financial statements for December 31, 2009). Significant items included general and administrative expenses of \$752,000, property investigations expenses of \$451,000, professional fees of \$210,000, investor relations expenses of \$153,000, foreign exchange losses of \$2,471,000 and interest income of \$144,000. In addition, the Company wrote-off \$527,000 of costs incurred on the Whitehorse property.

Corporate activities during the quarter were focused on closing the two transactions to acquire a 40.94% interest in HS Orka. Property investigations activities consisted of evaluating various properties in Central and South America and other areas for potential acquisition. Professional fees included legal, audit and consulting fees incurred in connection with the acquisition of HS Orka as well as various corporate matters. Investor relations activities consisted of attendance at conferences and trade shows and meetings with investors and analysts to raise the Company's profile. Foreign exchange losses were due

to rate fluctuations between the Canadian and US dollars. In addition, the Company had acquired Icelandic kroner ("ISK") and euros to purchase ISK for the HS Orka acquisition and incurred holding losses from the time of acquiring the currencies to the time of payment. Interest income of \$144,000 was earned on the Company's cash balances.

The Soda Lake Operation generated revenues from energy sales of \$1,409,000 and gross profit of \$589,000. A total of 15,406 MWh was sold during the quarter. Net income from plant operations, after deducting amortization, accretion and depletion expenses, was \$203,000 (refer to Note 11 of the unaudited interim consolidated financial statements for December 31, 2009) compared to net income from plant operations of \$156,000 for the quarter ended September 30, 2009. The increase was due to the increased revenue from the plant refurbishments as well from cooler ambient temperatures during the quarter.

The equity loss from HS Orka for the period December 14 to December 31, 2009 was \$1,926,000. Net loss consisted of the following:

(expressed in thousands of US dollars)

Equity loss for the period December 14 to December 31, 2009:	
Loss for the period before taxes	\$ (2,422)
Income tax recovery	442
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Loss for the period	(1,980)
Amortization of fair value allocations	(44)
Future income tax recovery	98
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	\$ (1,926)

HS Orka has four power purchase agreements 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. While the price of aluminum increased significantly throughout most of 2009, it declined during the month of December, resulting in a loss in the value of the embedded derivatives for that period. The loss for the period of \$1.980 million was due primarily to the decrease in the value of the embedded derivatives. Magma's portion of the decrease in the value of the embedded derivatives for the period was approximately \$2.540 million.

The London Metal Exchange ("LME") has projected aluminum prices to increase steadily over the next 11 years from \$2,226 per tonne for 2010 to \$2,731 per tonne for 2020, as disclosed in the table below. As a significant portion of HS Orka's revenues and income are indexed to aluminum prices, the profitability of its future operations should benefit from this rise in aluminum prices.

Aluminum Price Projection	2010	2011	2012	2013	2014	2015	2020
LME Forward Curve - USD/Tonne	2,226	2,304	2,375	2,428	2,477	2,521	2,731

(source: London Metal Exchange)

Management of Magma has concluded that the Company has significant influence over HS Orka since December 14, 2009 due to its ownership of a 40.94% interest and the continuing right to appoint two members to HS Orka's five-member board of directors. The equity method of accounting for its investment was therefore adopted.

Summary financial information with respect to HS Orka as at December 31, 2009 and for the year then ended is included in Note 3 of the unaudited interim consolidation financial statements for December 31, 2009.

As partial consideration for the acquisition of HS Orka, Magma issued three bonds with an aggregate principal amount of \$70.270 million. As explained in Note 7 of the unaudited interim consolidated financial statements for December 31, 2009, 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. The fair value of the bonds at the date of issuance was determined to be \$49.403 million. At December 31, 2009 the fair value of the bonds were estimated to be \$48.316 million. The decrease in fair value of \$1.087 million is due primarily to the decrease in aluminum prices between December 14 and December 31, 2009. Annual interest payments are based on the adjusted principal amounts owing.

The Company has recorded a future income tax liability of \$285,919 with respect to the change in the fair value of the bonds.

For the Six Months Ended December 31, 2009

For the six months ended December 31, 2009, the Company incurred a loss of \$7.915 million (\$0.03 per share) from its operational segments as follows:

<i>(expressed in thousands of US dollars)</i>		
Geothermal exploration	\$	(7,442)
Production and sales:		
Soda Lake Operation		47
Equity losses from HS Orka		(1,926)
Change in valuation of long-term debt		1,087
Interest on long-term debt		(50)
Foreign exchange gain		655
Income tax expense		(286)
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Loss for the six months ended December 31, 2009	\$	(7,915)

Net loss from the Company's geothermal exploration and corporate activities during the current quarter was \$7,442,000 (refer to Note 11 of the unaudited interim consolidated financial statements for December 31, 2009). Significant items included general and administrative expenses of \$1,846,000, property investigations expenses of \$801,000, professional fees of \$384,000, investor relations expenses of \$260,000, foreign exchange losses of \$3,750,000, the write-off of the Whitehorse property of \$527,000 and interest income of \$254,000.

The Soda Lake Operation generated revenues from energy sales of \$2,414,000 and gross profit of \$754,000. A total of 27,669 MWh was sold during the six month period. Net income from plant operations, after deducting amortization, accretion and depletion expenses, was \$47,000 (refer to Note 11 of the unaudited interim consolidated financial statements for December 31, 2009). The plant refurbishments increased the output capacity of the Soda Lake Operation by 1 MW commencing in December 2009. The Operation will continue to increase its revenues and consequently, its profitability, in the future due to the plant refurbishments.

Liquidity and Capital Resources

At December 31, 2009 the Company had cash and cash equivalents of \$53.681 million compared to \$4.483 million at June 30, 2009. The increase was due to the successful completion of the IPO for net proceeds of \$88.426 million. Significant cash expenditures during the six months included the cash payments for the acquisition of HS Orka of \$46.774 million. Magma ended the quarter with working capital of \$52.337 million compared to \$2,748 million at June 30, 2009.

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 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 countries in which the Company's subsidiaries operate to fund their immediate needs.

The Company has no off-balance sheet arrangements.

Long-term debt consists of three bonds with an aggregate principal amount of \$70.270 million issued as partial consideration for the acquisition of HS Orka, as disclosed in Notes 3 and 7 of the unaudited interim consolidated financial statements for December 31, 2009. The principal amount of the bonds will mature and become due on December 14, 2016. The bonds are secured by the shares of HS Orka acquired in the transaction. The Company has the option to repay the principal amount at any time, in whole or in part, without penalty. The principal amounts outstanding at each anniversary date and any prepayments thereof made by the Company in the prior 12-month period are adjusted based on the average of the three-months selling price of aluminum, as posted by the London Metal Exchange for the first business day of each month, for the prior 12-month period. The aluminum price used in the adjustment calculation may not be less than \$1,750 per tonne and may not exceed \$3,250 per tonne. Interest is payable on each anniversary date of the bonds at the rate of 1.5% per annum on the adjusted average principal amounts outstanding during the 12-month period prior to the anniversary date. Interest payments may be deferred for up to three years. Deferred interest payments will be added to the principal amount and interest will be accrued thereon. For the purposes of calculating interest payable at the end of each year, any pre-payments of the principal amounts during the preceding twelve month period shall also be adjusted based on the average monthly aluminium price for each month prior to the pre-payment. The Company currently expects to make the first interest payment from cash on hand. The bonds are classified as financial liabilities held for trading and have been carried at fair value.

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 is being 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.

In October 2009, Magma completed a private placement and raised net proceeds of approximately \$19.773 million. These proceeds were used to partially fund the acquisition of HS Orka. The remainder of the cash payments were made from cash on hand. The purchase of the remaining 2.16% interest in HS Orka, and the acquisition of any future interests, will be financed by additional equity financings, debt or other sources of financing available to the Company. Management is currently reviewing all available alternatives.

Magma will require substantial additional capital to continue the exploration and development of its geothermal properties beyond the currently planned exploration programs, to fund Phase 2 of the Soda Lake

Operation expansion and to acquire further interests in HS Orka beyond the 43.1% interest. 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, accounts payable and accrued liabilities and long-term debt. 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. Other than long-term debt, 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 12 of the unaudited interim consolidated financial statements for December 31, 2009 and 2008 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 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 December 31, 2009, the Company's current liabilities consisted primarily of trade and other payables which are due within the next quarter. The Company's cash and cash equivalents of \$53.681 million at December 31, 2009 was more than sufficient to pay these current liabilities.

Interest on long-term debt is due on December 14 of each year, commencing in 2010 until 2016 inclusive. The amount of interest payable on each due date is estimated to be approximately \$1,070,000, subject to adjustments to the principal amounts outstanding as described in note 7 and assuming no prepayments of any portion of the principal amounts outstanding or deferral of annual interest payments. The Company has the right to defer up to three interest payments but currently expects that the payment due in 2010 will be paid from cash on hand.

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 December 31, 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 \$234,000, in the Company's interest income for the period.

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 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 a 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.

Commodity Price Risk

HS Orka has entered into long-term agreements for the sale of electrical power whereby the sales price of the power is 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. A 10% increase or decrease in the price of aluminum would have increased or decreased the net income of HS Orka by \$23.114 million in 2009. HS Orka does not hedge against aluminum price changes.

The bonds issued as partial consideration for the purchase 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.

Share Capital and Financings

As at December 31, 2009, the Company had 248,544,641 issued and outstanding common shares.

As at December 31, 2009, the Company had options outstanding for the acquisition of up to 2,410,000 common shares exercisable at a price of C\$1.50 to July 7, 2014 as to 2,110,000 shares, at a price of C\$1.99 to September 14, 2014 as to 200,000 shares and at a price of C\$1.81 to December 18, 2014 as to 100,000 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:

(expressed in thousands of US dollars)

Fiscal 2010	\$	106
Fiscal 2011		178
Fiscal 2012		165
Fiscal 2013		93
Fiscal 2014		60
Fiscal 2015		31
Total lease commitments	\$	633

- (b) 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

In January 2010, Magma was awarded the 100,000 hectare Pellado property, as discussed under Exploration Projects. There are no financial commitments associated with the award of this property.

Outlook

The quarter ended December 31, 2009 confirmed Magma's ability to increase its current and future total production with the acquisition of the 40.94% interest in HS Orka and positive progress on its Phase 1 program at Soda Lake. The award of the Pellado property, which adjoins the Maule property, in January 2010 significantly increased Magma's resources in Chile. Magma expects to acquire an additional 2.16% interest in HS Orka in March 2010, bringing its interest in HS Orka to 43.1%. These significant events and transactions increase Magma's attributable geothermal resources to 784 MW, in addition to Magma's producing reserves of 86 MW.

Given the acquisition opportunities available in the industry and Magma's own portfolio of projects, management is optimistic that it will continue 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.

Equity Investments

The Company accounts for investments subject to significant influence by the equity method. Investments subject to significant influence are initially recorded at the consideration amount on the date the equity interest is acquired. Thereafter, the Company records its equity share of the equity investee's income or loss for the period as an increase or decrease to the carrying amount of the investment. Dividends received would be recorded as a decrease to the carrying amount of the investment.

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 and long-term debt 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 December 31, 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 listed in order of importance nor are they inclusive of all the risks and uncertainties the Company may be subject to as 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. Magma operates a single power plant at its Soda Lake Operation and has a 40.94% interest in HS Orka which operates two power plants in Iceland. 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;

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- 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;
 - the aging of power plants, which may reduce their operating performance and increase the cost of their maintenance; and
 - with respect to the operations of HS Orka, the risk associated with a decrease in the price of aluminum.

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.