



Interim Consolidated Financial Statements  
**September 30, 2010 and 2009**  
(expressed in US dollars)

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# Magma Energy Corp.

## Consolidated Balance Sheets

(expressed in thousands of United States dollars)

	Note	September 30, 2010 (Unaudited)	June 30, 2010 (audited)
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents		\$ 46,226	\$ 25,343
Accounts receivable		9,348	728
Bonds receivable	11	7,954	-
Embedded derivatives	12	2,212	-
Inventories		2,923	-
Prepaid expenses		546	483
		<u>69,209</u>	<u>26,554</u>
<b>Plant and equipment</b>	6	476,519	35,371
<b>Geothermal properties</b>	7	39,406	32,128
<b>Other intangible assets</b>	4	33,134	-
<b>Investments subject to significant influence</b>	17	15,222	103,828
<b>Bonds receivable</b>	11	4,266	-
<b>Embedded derivatives</b>	12	10,668	-
<b>Long-term receivable</b>		3,976	-
<b>Future income tax</b>	15	3,456	-
<b>Other assets</b>		150	822
		<u>\$ 656,006</u>	<u>\$ 198,703</u>
<b>Liabilities and Shareholders' Equity</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		\$ 44,694	\$ 5,105
Current portion of long-term debts and capital lease obligations	8	16,812	23
Currency and interest rate swaps		2,153	-
		<u>63,659</u>	<u>5,128</u>
<b>Long-term debts and capital lease obligations</b>	8	275,014	49,396
<b>Currency and interest rate swaps</b>		7,495	-
<b>Below market contracts - HS Orka</b>	4	39,306	-
<b>Future income tax</b>	15	27,846	-
<b>Deferred revenue</b>		2,222	2,109
		<u>415,542</u>	<u>56,633</u>
<b>Shareholders' Equity</b>			
<b>Share capital</b>		223,869	153,403
<b>Contributed surplus</b>		1,090	974
<b>Accumulated other comprehensive income</b>		27,424	10,110
<b>Deficit</b>		(21,645)	(22,417)
<b>Non-controlling Interest</b>		9,726	-
		<u>240,464</u>	<u>142,070</u>
		<u>\$ 656,006</u>	<u>\$ 198,703</u>

Commitments (14)

Approved on behalf of the Board of Directors

*"Ross Beaty"*  
Ross Beaty  
(Director)

*"Robert Pirooz"*  
Robert Pirooz  
(Director)

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

# Magma Energy Corp.

## Consolidated Statements of Operations

For the Three Months Ended September 30, 2010 and 2009 - (Unaudited)

(expressed in thousands of United States dollars, except per share amounts)

	Note	2010	2009
<b>Revenues</b>			
Energy sales		\$ 8,044	\$ 1,005
Total production and cost of sales		6,853	840
<b>Gross profit</b>		1,191	165
<b>Expenses</b>			
General and administrative		1,347	1,111
Professional fees		974	174
Amortization		428	259
Property investigations		329	352
Investor relations		129	107
Depletion and accretion		107	99
		3,314	2,102
Other income (expenses)			
Equity income		8,399	-
Change in fair value of long-term debt		(5,644)	-
Change in fair value of derivatives		13,282	-
Interest and other financing costs		(2,427)	-
Interest and other income		329	110
Foreign exchange gain (loss)		6,042	(839)
Loss on remeasurement of equity interest in HS Orka	4	(4,918)	-
Gain on bargain purchase	4	3,999	-
Geothermal property costs written-off		(170)	-
		18,892	(729)
<b>Income (loss) before income taxes</b>		16,769	(2,666)
Income taxes		(3,413)	-
<b>Income (loss) for the period</b>		\$ 13,356	\$ (2,666)
<b>Attributable to:</b>			
<b>Company</b>		\$ 13,042	\$ -
<b>Non-controlling interests</b>		314	-
		\$ 13,356	\$ -
<b>Weighted average shares outstanding</b> (thousands)			
Basic and diluted		277,574	231,112
<b>Earnings (loss) per common share</b>			
Basic and diluted earnings (loss) per share		0.05	(0.01)

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

# Magma Energy Corp.

## Consolidated Statements of Cash Flows

For the Three Months Ended September 30, 2010 and 2009 - (Unaudited)

(expressed in thousands of United States dollars)

	Note	2010	2009
<b>Operating activities</b>			
Income (loss) for the period		\$ 13,356	\$ (2,666)
Items not affecting cash			
Amortization, depletion and accretion		1,415	259
Equity income		(8,399)	-
Change in fair value of long-term debt		5,644	-
Change in fair value of derivatives		(13,282)	-
Unrealized foreign exchange		4,663	-
Future income taxes		3,413	-
Gain on bargain purchase		(3,999)	-
Loss on remeasurement of equity interest in HS Orka		4,918	-
Other		316	383
Increase (decrease) in non-cash working capital items		4,427	(229)
<b>Cash generated by (used in) operating activities</b>		<b>12,472</b>	<b>(2,253)</b>
<b>Financing activities</b>			
Proceeds on sale of bonds		3,101	-
New borrowings		9,624	-
Repayment of loans payable		(3,318)	-
Shares issued for cash, net of issue costs		41,260	89,272
<b>Cash generated by financing activities</b>		<b>50,667</b>	<b>89,272</b>
<b>Investing activities</b>			
Cash used to purchase HS Orka hf, net of cash acquired	4	(29,479)	-
Purchase of plant and equipment		(8,486)	(4,849)
Purchase of geothermal properties		(6,281)	(3,994)
Other		693	(494)
<b>Cash used in investing activities</b>		<b>(43,553)</b>	<b>(9,337)</b>
<b>Effect of foreign exchange on cash</b>		<b>1,297</b>	<b>7,602</b>
<b>Increase in cash and cash equivalents</b>		<b>20,883</b>	<b>85,284</b>
<b>Cash and cash equivalents - beginning of period</b>		<b>25,343</b>	<b>4,483</b>
<b>Cash and cash equivalents - end of period</b>		<b>\$ 46,226</b>	<b>\$ 89,767</b>
<b>Other cash flow information:</b>			
Interest received		\$ 70	\$ -
Interest paid		\$ 1,063	\$ -

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

## Magma Energy Corp.

Consolidated Statements of Comprehensive Income

For the Three Months Ended September 30, 2010 and 2009 - (Unaudited)

(expressed in thousands of United States dollars)

	<b>2010</b>	2009
Income (loss) for the period	<b>\$ 13,356</b>	\$ (2,666)
Other comprehensive income		
Translation adjustment on foreign operations	<b>17,314</b>	10,743
<b>Comprehensive income for the period</b>	<b>\$ 30,670</b>	\$ 8,077

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

# Magma Energy Corp.

## Consolidated Statements of Shareholders' Equity

For the Three Months Ended September 30, 2010 and 2009 - (Unaudited)

(expressed in thousands of United States dollars, except number of shares)

	Common Shares		Contributed Surplus	Accumulated other comprehensive income (loss)	Deficit	Non - controlling Interest	Total shareholders' equity
	Number of shares	Amount					
Balance, June 30, 2009	163,291,668	\$ 45,058	\$ -	\$ (739)	\$ (5,121)	\$ -	\$ 39,198
Initial public offering	73,600,334	95,153	-	-	-	-	95,153
Share issue costs	-	(6,726)	-	-	-	-	(6,726)
Stock-based compensation	-	-	449	-	-	-	449
Foreign exchange translation	-	-	-	10,743	-	-	10,743
Loss for the period	-	-	-	-	(2,666)	-	(2,666)
Balance, September 30, 2009	236,892,002	133,485	449	10,004	(7,787)	-	136,151
Issued for cash:							
Private placement	11,652,639	20,556	-	-	-	-	20,556
Share issue costs	-	(784)	-	-	-	-	(784)
Exercise of options	33,333	49	-	-	-	-	49
Value assigned to options granted	-	-	539	-	-	-	539
Value of options exercised	-	14	(14)	-	-	-	-
Stock-based compensation	60,000	83	-	-	-	-	83
Share of capital transaction of HS Orka	-	-	-	-	(850)	-	(850)
Foreign exchange translation	-	-	-	106	-	-	106
Loss for the period	-	-	-	-	(13,780)	-	(13,780)
Balance, June 30, 2010	248,637,974	153,403	974	10,110	(22,417)	-	142,070
Issued for cash:							
Equity offering (note 9)	40,334,628	43,597	-	-	-	-	43,597
Share issue costs (note 9)	-	(2,337)	-	-	-	-	(2,337)
Subscriptions receipts (note 4)	-	29,206	-	-	-	-	29,206
Value assigned to options granted	-	-	116	-	-	-	116
Foreign exchange translation	-	-	-	17,314	-	-	17,314
Income for the period	-	-	-	-	13,042	314	13,356
Acquisition of non-controlling interest (note 5)	-	-	-	-	(12,270)	-	(12,270)
Non-controlling interest	-	-	-	-	-	9,412	9,412
Balance, September 30, 2010	<b>288,972,602</b>	<b>\$ 223,869</b>	<b>\$ 1,090</b>	<b>\$ 27,424</b>	<b>\$ (21,645)</b>	<b>\$ 9,726</b>	<b>\$ 240,464</b>

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

# Magma Energy Corp.

Notes to Consolidated Financial Statements

September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

## 1 NATURE OF AND CONTINUANCE OF OPERATIONS

### a) Nature of Operations

Magma Energy Corp. was incorporated on January 22, 2008, pursuant to the Business Corporations Act of British Columbia.

Magma Energy Corp. and its subsidiary companies (collectively “the Company”) are engaged in the operation, development, exploration and acquisition of geothermal energy projects. The Company owns one operating plant, the Soda Lake Plant, in Nevada, USA, exploration properties in North and South America as disclosed in note 7, and two operating plants in Iceland.

### b) Continuance of Operations

Continuance of the Company’s operations is dependent upon continuing to achieve profitable operations. The recoverability of the carrying values of the Company’s geothermal properties is dependent upon the existence and discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete the development of these properties and future profitable production from or proceeds from disposition of geothermal properties. The carrying value of the Company’s geothermal properties represent net costs to date, less amounts amortized and/or written-off and does not represent current or future values.

The Company has entered into geothermal property acquisition agreements that, based on their terms, may require future outlays of cash in order to maintain the properties in good standing or in order to fulfil contractual obligations.

## 2 SIGNIFICANT ACCOUNTING POLICIES

### a) Basis of presentation

These consolidated financial statements are presented in United States dollars, have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) with respect to the preparation of interim financial statements. Accordingly, they do not include all of the information and disclosures required by Canadian GAAP in the preparation of annual consolidated financial statements. The accounting policies used in the preparation of the accompanying unaudited interim consolidated financial statements are the same as those described in the annual consolidated financial statements and the notes thereto for the fiscal year ended June 30, 2010, with the exception of those, as disclosed below. In the opinion of management, all adjustments considered necessary for fair presentation have been included in these financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements including the notes thereto for the fiscal year ended June 30, 2010.

The consolidated financial statements include the accounts of the Company and the following directly or indirectly wholly-owned subsidiaries:

Magma Energy (U.S.) Corp  
HS Orka hf (“HS Orka”)  
Magma Energy Chile Limitada  
Magma Energia Geotermica S.A.  
Isla Verde Energia S.A.  
Magma Energy Sweden A.B.  
Magma Energy Iceland EHF.

# Magma Energy Corp.

Notes to Consolidated Financial Statements  
September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

Magma Energy Italia S.R.L.  
Soda Lake Holdings I, LLC  
Soda Lake Holdings II, LLC  
Amor IX LLC  
Soda Lake Limited Partnership (“SLLP”)  
Soda Lake Resources Partnership (“SLRP”)  
Magma Energia Argentina S.A.  
Compania de Energia Limitada  
Magma Energy Servicios Ltda.

All inter-company transactions and balances have been eliminated on consolidation.

Certain reclassifications of prior year balances have been made to conform to the current period presentation. These reclassifications have had no impact on previously reported total current assets, total assets and working capital position, and do not affect previously reported cash flows from investing and financing activities.

## b) Use of 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.

## c) Business combinations

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. The Company has elected to early adopt these standards effective July 1, 2010.

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.

# Magma Energy Corp.

Notes to Consolidated Financial Statements  
September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

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.

## d) Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out principle, and includes expenditures incurred in acquiring the inventories and bringing them to their existing location and condition. Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and selling expenses.

## e) 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.

## f) Foreign currency translation

The functional currency of the Company and each of its subsidiaries, except HS Orka, is the Canadian dollar (“C\$”). As the operations of the foreign subsidiaries, other than HS Orka, 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 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 US dollars are reported as a separate component of shareholders’ equity within accumulated other comprehensive income (loss.)

# Magma Energy Corp.

Notes to Consolidated Financial Statements  
September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

## **g) Separable embedded derivatives**

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

## **h) Other derivative financial instruments**

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Derivatives are recognized initially at fair value; attributable transaction costs are recognized in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value in the balance sheet and changes in fair value are recognized through profit or loss.

## **3 SIGNIFICANT CHANGES IN ACCOUNTING POLICIES**

### ***Change in Accounting Policy and Future Accounting Pronouncements***

#### ***International Financial Reporting Standards***

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with International Financial Reporting Standards (“IFRS”) over an expected five year transitional period. In February 2008, the AcSB announced that publicly accountable enterprises must apply IFRS to interim and annual financial statements for fiscal periods beginning on or after January 1, 2011. As these requirements are required to be applied retrospectively, adoption of IFRS for the Company’s year ending June 30, 2012 will require the restatement for comparative purposes of amounts reported by the Company for interim periods ending September 30, 2010 and later and for its year ending June 30, 2011. While the Company has begun assessing the adoption of IFRS for fiscal 2012, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

Effective July 1, 2011, the Company’s primary basis of accounting will change to IFRS.

## **4 BUSINESS COMBINATION**

On August 17, 2010, the Company 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, the Company’s equity interest in HS Orka increased from 46.18% to 84.21%.

Obtaining control of HS Orka will advance the Company’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 primarily due to the gain on change in fair value of embedded derivatives. In determining these amounts management has assumed that the fair value

# Magma Energy Corp.

## Notes to Consolidated Financial Statements

September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

adjustments, determined provisionally, that arose on the acquisition date would have been the same if the acquisition had occurred on July 1, 2010.

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

(a) Consideration transferred:

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

The fair value of the subscription receipts was based on the listed closing share price of Magma Energy Corp on August 17, 2010 of C\$1.17.

Each subscription receipt will convert into one common share of Magma Energy Corp on December 18, 2010 for payment of no additional consideration. Magma 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. Alternative sources of funding are being evaluated for this November 30, 2010 payment.

(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>243,534</b>

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

# Magma Energy Corp.

## Notes to Consolidated Financial Statements

September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

(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.

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

Non-controlling interest has been measured at fair value.

## 5 ACQUISITION OF NON-CONTROLLING INTERESTS

On September 3, 2010 the Company 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) 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. The Company 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. The Company 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 the Company'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>

## Magma Energy Corp.

Notes to Consolidated Financial Statements

September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

### 6 PLANT AND EQUIPMENT

	September 30, 2010			June 30, 2010		
	Cost	Accum. Amort.	Net Book Value	Cost	Accum. Amort.	Net Book Value
Plant and plant equipment	\$ 40,734	\$ (1,891)	\$ 38,843	\$ 35,942	\$ (1,712)	\$ 34,230
Automotive	235	(143)	92	227	(132)	95
Furniture and equipment	1,442	(430)	1,012	1,261	(311)	950
	<b>42,411</b>	<b>(2,464)</b>	<b>39,947</b>	37,430	(2,155)	35,275
Plant and plant equipment - HS Orka (see note 4)	437,456	(976)	436,480	-	-	-
Assets held under capital leases						
Automotive	105	(13)	92	101	(5)	96
	<b>\$479,972</b>	<b>\$ (3,453)</b>	<b>\$ 476,519</b>	\$ 37,531	\$ (2,160)	\$ 35,371

Included in total plant and plant equipment is a total of \$53.4 million (June 30, 2010 - \$14.6 million) for assets presently under construction and on which no amortization has been recorded. These assets include drilling costs for new production wells and equipment that has not yet been put into service.

# Magma Energy Corp.

## Notes to Consolidated Financial Statements

September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

### 7 GEOTHERMAL PROPERTIES

As at September 30, 2010 the Company holds geothermal properties, or the rights to acquire geothermal properties, in the United States of America (USA), Argentina, Chile and Peru.

At September 30, 2010, the Company's expenditures on geothermal properties are as follows:

	Balance June 30, 2010	Acquisition Costs	Deferred Exploration Costs	Depletion	Effect of Reporting Currency Translation	Cost Written Off	Balance September 30, 2010
<b>Geothermal properties under development</b>							
<b>USA - Nevada</b>							
McCoy	\$ 7,714	\$ -	\$ 125	\$ -	\$ 268	\$ -	\$ 8,107
Desert Queen	3,093	-	31	-	107	-	3,231
Columbus Marsh	831	-	8	-	29	-	868
Beowawe	444	-	5	-	16	-	465
Panther Canyon	316	-	33	-	11	-	360
Baltazor Hot Springs	406	-	20	-	14	-	440
Buffalo Valley	642	-	40	-	22	-	704
Dixie Valley (White Rock Canyon)	1,081	-	8	-	38	-	1,127
Granite Springs	514	-	52	-	43	-	609
Hawthorne	797	-	-	-	30	-	827
<b>USA - Utah</b>							
Thermo	575	-	-	-	20	-	595
<b>USA - Oregon</b>							
Glass Buttes	185	-	-	-	-	(185)	-
<b>Chile</b>							
Maule*	11,582	-	(1,039)	-	2,396	-	12,939
Pellado*	457	-	3,885	-	68	-	4,410
El Medeno*	-	-	465	-	(13)	-	452
<b>Peru</b>							
Huaynaputina	94	-	8	-	6	-	108
Casiri	99	-	8	-	7	-	114
Sabancaya	95	-	8	-	6	-	109
Ccollo	98	-	11	-	4	-	113
Ticsani	100	-	11	-	4	-	115
San Pedro	12	-	11	-	-	-	23
Crucero	13	-	20	-	2	-	35
	29,148	-	3,710	-	3,078	(185)	35,751
<b>Geothermal property in production</b>							
Soda Lake - USA	2,980	-	550	(11)	136	-	3,655
	\$ 32,128	\$ -	\$ 4,260	\$ (11)	\$ 3,214	\$ (185)	\$ 39,406

\* - deferred exploration costs were reclassified in our Chile projects

# Magma Energy Corp.

## Notes to Consolidated Financial Statements

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### 8 LONG-TERM DEBT

At September 30, 2010, long term debt was comprised of the following:

Bonds	101,320
Credit agreement	9,718
Loans payable	180,703
Capital lease obligations	85
	<u>291,826</u>
Less current portion:	
Loans payable	16,805
Capital lease obligations	7
	<u>16,812</u>
Long-term portion	<u>275,014</u>

#### a) Bonds

On September 3, 2010 the Company acquired an additional 14.32 % interest in HS Orka by assuming a bond with a principal value of ISK 6.3 billion (approximately \$41.7 million) 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. The bonds are secured by the shares of HS Orka acquired in the transaction. The Company has the option on up to four occasions to repay up to 20% of the nominal principal and accrued interest outstanding. Up to two interest payments may be deferred over the term of the bond. Deferred interest payments will be added to the principal amount and interest will be accrued thereon.

The Company also has three bonds issued in fiscal 2010 with an aggregate principal amount of \$70.3 million. The principal amount of these 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. Up to three interest payments may be deferred over the term of the bond. 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 aluminum price for each month prior to the pre-payment.

The principal amounts of all the bonds outstanding at each anniversary date and any prepayments thereof made by the Company in the prior 12-month period are adjusted by a formula incorporating the average of the three-months forward 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. Interest is payable on each anniversary date of the bonds on the adjusted average principal amounts outstanding during the 12-month period prior to the anniversary date. 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 aluminum price for each month prior to the pre-payment.

## Magma Energy Corp.

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The indexation of the principal amount of the bonds to the price of aluminum described above, and the pre-payment option represent embedded derivatives. As the Company has chosen to classify the bonds as financial liabilities held for trading, the embedded derivatives have not been separated from the host financial instrument and the hybrid liability is being carried at fair value as follows:

Balance, June 30, 2010	\$	49,339
Additional bond assumed		43,240
Change in fair value		5,644
Foreign exchange loss		3,097
Balance, September 30, 2010	\$	<u>101,320</u>

The assumptions used in determining the fair values of the bonds are as follows:

Discount rates	7.83% - 13.65%
Aluminum prices (\$ per tonne)	\$2,180 - \$2,608

#### b) Credit agreement

During the quarter ended September 30, 2010, the Company entered into a credit agreement to borrow up to C\$10 million with interest at the rate of 8% per annum (see Note 10 Related Party Transactions).

#### c) Loans payable

Long-term borrowings assumed with the acquisition of HS Orka.

Amount in	Originating Currency	Currency	Interest	Year of Maturity	Balance
31,353	USD		2.53%	2019 - 2023	\$ 31,404
25,664	EUR		2.78%	2019 - 2021	35,131
54,268	SEK		3.38%	2021	8,119
371,459	CHF		2.22%	2019 - 2021	42,885
1,450,274	JPY		1.65%	2019 - 2023	17,436
2,476	GBP		1.12%	2017 - 2019	3,944
12,090	CAD		0.99%	2021 - 2023	11,747
3,494,077	ISK		3.87%	2016 - 2017	30,037
					<u>\$ 180,703</u>

# Magma Energy Corp.

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## 9 SHAREHOLDERS' EQUITY

### (a) Capital stock

At September 30, 2010, the Company had unlimited authorized common shares without par value and 288,972,602 common shares issued and outstanding (June 30, 2010 – 248,637,974).

On July 27, 2010, the Company completed a public share offering and issued 40.3 million common shares at a price of C\$ 1.12 per share for aggregate proceeds of approximately \$43.6 million.

### (b) Stock options

Under the Company's stock option plan, the board of directors may grant options for the purchase of up to a total of 10% of the total number of issued and outstanding common shares of the Company. Options granted under the plan vest over time at the discretion of the board of directors. Exercise prices on options granted under the plan are determined by reference to the market value on the date of the grant.

The changes in stock options issued are as follows:

	Three Months Ended September 30, 2010			Three Months Ended September 30, 2009	
	Number of options	Weighted average exercise price (C\$/option)		Number of options	Weighted average exercise price (C\$/option)
Outstanding, June 30, 2010	3,276,667	1.55	Outstanding, June 30, 2009	-	-
Granted	150,000	1.28	Granted	2,340,000	1.54
Exercised	-	-	Exercised	(33,333)	1.50
Forfeited	(116,667)	1.50	Forfeited	(30,000)	1.50
Outstanding, end of period	3,310,000	1.54	Outstanding, end of period	2,276,667	1.54
Exercisable, end of period	1,789,987	1.53	Exercisable, end of period	736,662	1.54

As of September 30, 2010, incentive stock options represent 1.1% (June 30, 2010 – 1.3%) of issued and outstanding common capital. The aggregate intrinsic value of vested share options (the market value less the exercise value) at both September 30, 2010 and June 30, 2010 was nil.

# Magma Energy Corp.

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The following table summarizes information about stock options outstanding and exercisable at September 30, 2010:

Options outstanding			Options exercisable		
Number of Shares	Expiry Date	Exercise Price (C\$/option)	Number of Shares	Exercise Price (C\$/option)	
1,960,000	July 7, 2014	1.50	1,339,990	1.50	
200,000	September 14, 2014	1.99	66,667	1.99	
100,000	December 18, 2014	1.83	33,332	1.83	
350,000	February 8, 2015	1.71	116,666	1.71	
50,000	February 15, 2015	1.66	16,666	1.66	
200,000	May 19, 2015	1.46	66,667	1.46	
300,000	June 22, 2015	1.40	99,999	1.40	
100,000	July 5, 2015	1.32	33,333	1.32	
50,000	September 28, 2015	1.21	16,667	1.21	
<b>3,310,000</b>		<b>1.54</b>	<b>1,789,987</b>	<b>1.53</b>	

During the quarter ended September 30, 2010, 150,000 options were granted at a weighted average strike price of C\$1.28. The average fair value of the options granted in the quarter was C\$0.31, based on the Black-Scholes option pricing model. The Company amortizes the fair value of stock options on a graded basis over the respective vesting period of the stock options. At September 30, 2010, the non-vested stock option expense not yet recognized was \$0.3 million (June 30, 2010 - \$0.5 million) and this expense is expected to be recognized over the next 2 years.

The allocation of the amortization of the fair value of the stock options is as follows:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009
<b>Consolidated Balance Sheets</b>		
Geothermal properties	\$ 15	\$ 24
<b>Consolidated Statements of Operations</b>		
Total production and cost of sales	7	-
General and administrative	70	314
Property investigations	3	69
Investor relations	22	42
	<b>102</b>	<b>425</b>
<b>Total amortization of stock option fair value</b>	<b>\$ 117</b>	<b>\$ 449</b>

The fair value of stock options for all options issued was estimated at the grant date based on the Black-Scholes option pricing model, using the following weighted average assumptions:

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	<u>Three Months Ended</u> <u>September 30, 2010</u>	<u>Three Months Ended</u> <u>September 30, 2009</u>
Expected dividend yield (%)	Nil	Nil
Average risk-free interest rate (%)	1.42% - 1.47%	1.23% - 1.29%
Expected life (years)	3	3
Expected volatility (%)	37% - 40%	46% - 52%
Expected rate of forfeiture	5%	5%

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the estimated fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

### 10 RELATED PARTY TRANSACTIONS

During the quarter, 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. 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 full principal amount has been advanced to the Company. During the quarter interest, standby and drawdown fees totalling \$0.3 million were paid.

### 11 BONDS RECEIVABLE

The bonds have stated interest rates of between 5 and 5.3% plus indexation to the Icelandic Consumer Price Index and mature between 2018 and 2019. A portion of the bonds have been classified as current as it is the Company's intention to sell them within 12 months.

### 12 EMBEDDED DERIVATIVES

The Company has entered into US dollar-based agreements expiring in 2011, 2019, and 2026 for the sale of power to two of its customers in Iceland. Under these agreements, power is to be sold at contractually determined amounts based in part on the future price of aluminum and are therefore considered to include embedded derivatives.

The fair values of the embedded derivatives are estimated using discounted cash flow models based in part on the forward price of aluminum over the next ten years as quoted by the London Metal Exchange and experts' expectations of future price changes.

### 13 MANAGEMENT OF FINANCIAL RISKS

The types of 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 is influenced mainly by the individual characteristics of each customer. Over 50% of the Company's revenue is attributable to sales transactions with three customers. The Company has set a credit policy where all new customers are evaluated. Payment history of new customers is checked and credit limits are set. The Company establishes

# Magma Energy Corp.

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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 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.

## **Market Risk**

The significant market risk exposures to which the Company 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 the Company's investments and debts 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

## **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.

## **Commodity Price Risk**

The Company's commodity consists of power produced. At the Company's Soda Lake facility, all power currently produced is sold to one customer under the terms of a 30-year power purchase agreement ("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.

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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.

As disclosed in note 8, 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.

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.

### 14 COMMITMENTS

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

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>

### 15 INCOME TAXES

Income tax expense comprises of current and future tax. Current tax and future tax are recognised in profit or loss except to the extent that it relates to a business combination, or items recognised directly in equity or in other comprehensive income.

Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Future income tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Future tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Future tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority.

A future tax asset is recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Future tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### 16 SEGMENTED DISCLOSURES

The Company has two business segments:

a) The exploration of geothermal properties; and

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## Notes to Consolidated Financial Statements September 30, 2010 – (Unaudited)

(tabular amounts expressed in thousands of United States dollars unless otherwise stated)

b) The production and sale of geothermal power.

All revenues were generated from our two producing plants in Iceland and one in the USA during the period ended September 30, 2010, and 100% of the revenues for the comparative period ended September 30, 2009 were derived from our plant in the USA.

	September 30, 2010			June 30, 2010		
	Geothermal Exploration	Production and Sales	Total	Geothermal Exploration	Production and Sales	Total
<b>CANADA</b>						
Current assets	\$ 36,706	\$ -	\$ 36,706	\$ 14,064	\$ -	\$ 14,064
Property, plant and equipment	282	-	282	256	-	256
	<b>36,988</b>	<b>-</b>	<b>36,988</b>	<b>14,320</b>	<b>-</b>	<b>14,320</b>
<b>USA</b>						
Current assets	919	1,003	1,922	317	1,056	1,373
Property, plant and equipment	153	38,928	39,081	172	34,307	34,479
Geothermal properties	18,931	2,059	20,990	17,615	1,963	19,578
Other assets	82	11	93	82	11	93
	<b>20,085</b>	<b>42,001</b>	<b>62,086</b>	<b>18,186</b>	<b>37,337</b>	<b>55,523</b>
<b>CHILE</b>						
Current assets	742	-	742	1,333	-	1,333
Property, plant and equipment	551	-	551	505	-	505
Geothermal properties	17,801	-	17,801	12,039	-	12,039
Other assets	57	-	57	50	-	50
	<b>19,151</b>	<b>-</b>	<b>19,151</b>	<b>13,927</b>	<b>-</b>	<b>13,927</b>
<b>PERU</b>						
Current assets	680	-	680	80	-	80
Geothermal properties	616	-	616	511	-	511
Other assets	2	-	2	682	-	682
	<b>1,298</b>	<b>-</b>	<b>1,298</b>	<b>1,273</b>	<b>-</b>	<b>1,273</b>
<b>ARGENTINA</b>						
Current assets	9	-	9	21	-	21
<b>ITALY</b>						
Current assets	16	-	16	16	-	16
<b>SWEDEN</b>						
Current assets	14	-	14	12	-	12
<b>ICELAND</b>						
Current assets	483	28,638	29,121	9,656	-	9,656
Property, plant and equipment	122	436,480	436,602	127	-	127
Intangibles	-	33,134	33,134	-	-	-
Other assets	-	37,587	37,587	-	103,828	103,828
	<b>605</b>	<b>535,839</b>	<b>536,444</b>	<b>9,783</b>	<b>103,828</b>	<b>113,611</b>
<b>Total Assets</b>	<b>\$ 78,166</b>	<b>\$ 577,840</b>	<b>\$ 656,005</b>	<b>\$ 57,538</b>	<b>\$ 141,165</b>	<b>\$ 198,703</b>

# Magma Energy Corp.

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### 16 SEGMENTED DISCLOSURE (Cont'd)

	For three months ended September 30, 2010			For three months ended September 30, 2009		
	Geothermal Exploration	Production and Sales	Total	Geothermal Exploration	Production and Sales	Total
<b>Revenue</b>						
Energy sales	\$ -	\$ 8,044	\$ 8,044	\$ -	\$ 1,005	\$ 1,005
<b>Direct cost of energy production</b>	-	(6,853)	(6,853)	-	(840)	(840)
<b>Gross profit</b>	-	1,191	1,191	-	165	165
<b>Other (income) and expenses</b>						
General and administrative	1,347	-	1,347	1,111	-	1,111
Professional fees	974	-	974	174	-	174
Amortization	47	381	428	37	222	259
Property investigations	329	-	329	352	-	352
Investor relations	129	-	129	107	-	107
Depletion and accretion	-	107	107	-	99	99
Equity income	-	(8,399)	(8,399)	-	-	-
Change in fair value of long-term debt	-	5,644	5,644	-	-	-
Change in fair value of derivatives	-	(13,282)	(13,282)	-	-	-
Interest and other financing costs	-	2,427	2,427	-	-	-
Interest and other income	(329)	-	(329)	(110)	-	(110)
Foreign exchange (gain) loss	(5,203)	(839)	(6,042)	839	-	839
Loss on remeasurement of equity interest in HS Orka	-	4,918	4,918	-	-	-
Gain on bargain purchase	-	(3,999)	(3,999)	-	-	-
Geothermal property costs written-off	170	-	170	-	-	-
Income taxes	-	3,413	3,413	-	-	-
	(2,536)	(9,629)	(12,165)	2,510	321	2,831
<b>Income (loss) for the period</b>	\$ 2,536	\$ 10,820	\$ 13,356	\$ (2,510)	\$ (156)	\$ (2,666)

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### 17 INVESTMENTS SUBJECT TO SIGNIFICANT INFLUENCE

	<b>September 30, 2010</b>	June 30, 2010
H.S. Orka	-	103,828
Blue Lagoon h.f.	<b>14,984</b>	-
Other	<b>238</b>	-
	<u><b>15,222</b></u>	<u>103,828</u>

During the current quarter the Company recorded equity income from HS Orka of \$8.1 million and equity income from Blue Lagoon h.f. of \$0.3 million.