



Audited Financial Statements
As at December 31, 2009 and 2008 and for the years then ended

Management's Report

The accompanying financial statements of MGM Energy Corp. (the "Company") are the responsibility of Management and have been approved by the Board of Directors. The financial statements have been prepared by Management in Canadian dollars and in accordance with Canadian Generally Accepted Accounting Principles and include certain estimates that reflect Management's best judgments. When alternative accounting methods exist, Management has chosen those it considers most appropriate in the circumstances.

Management is also responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The Company's internal control system was designed to provide reasonable assurance that all transactions are accurately recorded to permit preparation of financial statements in accordance with Generally Accepted Accounting Principles, and that the Company's assets are safeguarded.

The Board of Directors is responsible for ensuring that Management fulfills its responsibilities for financial reporting and internal control. The Board of Directors exercises this responsibility through the Audit Committee. The Audit Committee meets regularly with Management and the independent auditors to ensure that Management's responsibilities are properly discharged and to review the financial statements. The Audit Committee reports its findings to the Board of Directors for consideration when approving the financial statements for issuance to the shareholders. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors. The Audit Committee of the Board of Directors is comprised entirely of independent directors.

Ernst & Young LLP, independent auditors appointed by the shareholders of the Company, conducts an examination of the financial statements in accordance with Canadian generally accepted auditing standards. Ernst & Young LLP has full and free access to the Audit Committee and Management.

/s/ Clayton H. Riddell
Clayton H. Riddell
Chief Executive Officer

/s/ Richard N. Miller
Richard N. Miller
Chief Financial Officer

March 15, 2010

Auditors' Report

To the Shareholders of **MGM Energy Corp.**

We have audited the balance sheets of **MGM Energy Corp.** (the "Company") as at December 31, 2009 and 2008 and the statements of loss and other comprehensive loss, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
March 15, 2010

/s/ Ernst & Young LLP
Chartered Accountants

MGM Energy Corp.
Balance Sheets
(\$000s)

| As at December 31 | 2009 | 2008 |
|--|-------------------|-------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 4,486 | \$ 82,001 |
| Restricted cash | 10,000 | - |
| Accounts receivable and other current assets | 1,650 | 1,850 |
| | 16,136 | 83,851 |
| Property, plant and equipment (Note 4) | 233,127 | 220,725 |
| Future income taxes (Note 9) | 258 | 9,014 |
| | \$ 249,521 | \$ 313,590 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | \$ 2,601 | \$ 12,628 |
| Due to related parties (Note 12) | 70 | 108 |
| | 2,671 | 12,736 |
| Asset retirement obligations (Note 6) | 2,159 | 1,996 |
| | 4,830 | 14,732 |
| Contingencies and Commitments (Notes 5, 7 and 13) | | |
| Shareholders' Equity | | |
| Share capital (Note 7) | 449,735 | 455,336 |
| Contributed surplus (Note 8) | 6,420 | 4,664 |
| Deficit | (211,464) | (161,142) |
| | 244,691 | 298,858 |
| | \$ 249,521 | \$ 313,590 |

See the accompanying notes to the financial statements.

On behalf of the Board of Directors

/s/ H. W. Sykes
H. W. Sykes
Director

/s/ R. B. Hodgins
R. B. Hodgins
Director

MGM Energy Corp.
Statements of Loss and Other Comprehensive Loss
(\$000s, except as noted)

| Years Ended December 31 | 2009 | 2008 |
|---|--------------------|---------------------|
| Revenue | | |
| Interest income | \$ 236 | \$ 2,763 |
| Expenses | | |
| General and administrative | 4,882 | 5,513 |
| Stock-based compensation (Note 8) | 1,756 | 2,357 |
| Pipeline regulatory and access | - | 55 |
| Exploration | 2,404 | 28,827 |
| Lease rental and land costs | 1,286 | 3,273 |
| Dry hole (Note 4) | 39,147 | 73,942 |
| Write-down of petroleum and natural gas properties (Note 4) | - | 10,000 |
| Interest and financing charges | 783 | 336 |
| Accretion of asset retirement obligations (Note 6) | 206 | 128 |
| Gain on settlement of asset retirement obligations (Note 6) | (114) | - |
| Depreciation | 466 | 382 |
| | 50,816 | 124,813 |
| Loss before income tax | (50,580) | (122,050) |
| Future income tax recovery (Note 9) | (258) | (21,889) |
| Net loss and other comprehensive loss | \$ (50,322) | \$ (100,161) |
| Net loss per Common Share (\$/share) | | |
| Basic | \$ (0.19) | \$ (0.52) |
| Diluted | \$ (0.19) | \$ (0.52) |
| Weighted average Common Shares outstanding (000s) | | |
| Basic | 268,383 | 190,935 |
| Diluted | 268,383 | 190,935 |

Statements of Deficit
(\$000s)

| Years Ended December 31 | 2009 | 2008 |
|-----------------------------|---------------------|---------------------|
| Deficit, beginning of year | \$ (161,142) | \$ (60,981) |
| Net loss | (50,322) | (100,161) |
| Deficit, end of year | \$ (211,464) | \$ (161,142) |

See the accompanying notes to the Financial Statements.

MGM Energy Corp.
Statements of Cash Flows

(\$000s)

| Years Ended December 31 | 2009 | 2008 |
|--|-----------------|------------------|
| Operating activities | | |
| Net loss and other comprehensive loss | \$ (50,322) | \$ (100,161) |
| Add (deduct): | | |
| Stock-based compensation | 1,756 | 2,357 |
| Exploration | 2,404 | 28,827 |
| Dry hole | 39,147 | 73,942 |
| Accretion of asset retirement obligations | 206 | 128 |
| Non-cash general and administrative expense | (32) | - |
| Gain on settlement of asset retirement obligations | (114) | - |
| Write-down of petroleum and natural gas properties | - | 10,000 |
| Depreciation | 466 | 382 |
| Future income tax recovery | (258) | (21,889) |
| | (6,747) | (6,414) |
| Change in non-cash working capital (Note 11) | (3,376) | 2,792 |
| | (10,123) | (3,622) |
| Financing activities | | |
| Common shares issued, net of issuance costs | 3,413 | 77,237 |
| | 3,413 | 77,237 |
| Investing activities | | |
| Restricted cash contributions | (10,000) | - |
| Capital expenditures | (54,316) | (95,859) |
| Change in non-cash working capital (Note 11) | (6,489) | (7,056) |
| | (70,805) | (102,915) |
| Decrease in cash and cash equivalents | (77,515) | (29,300) |
| Cash and cash equivalents, beginning of year | 82,001 | 111,301 |
| Cash and cash equivalents, end of year | \$ 4,486 | \$ 82,001 |

Supplemental cash flow information (Note 11)

See the accompanying notes to the Financial Statements.

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

1. Structure and Formation of the Company

MGM Energy Corp. (“MGM Energy” or the “Company”) is an independent Canadian public company, the principal business of which is to acquire, develop, exploit and produce oil and natural gas in Northern Canada. The Company was incorporated under the *Business Corporations Act* (Alberta) (the “ABCA”) as 1278517 Alberta Ltd. on October 31, 2006. On December 4, 2006, the Company’s articles were amended to change its name to “MGM Energy Corporation” and subsequently on January 9, 2007 the articles were further amended to change its name to “MGM Energy Corp.” On January 12, 2007, the Company was spun out of Paramount Resources Ltd. (“Paramount”) pursuant to a plan of arrangement under the ABCA involving Paramount, its shareholders and MGM Energy.

2. Basis of Presentation

MGM Energy is considered to be a development stage enterprise, as it has yet to generate revenue from its planned principal operations. Similar to other development stage enterprises, the recoverability of amounts shown for property, plant and equipment are dependent upon the ability of the Company to obtain necessary financing for its planned exploration and development activities and to discover, develop, transport and market economically recoverable quantities of petroleum and natural gas. There can be no assurance, however, that the Company’s efforts to obtain additional financing will ultimately be successful. As at the date of these financial statements, management is uncertain whether MGM Energy will continue to have access to equity from sources other than related parties or other sources of funding such as asset sales, given the current risk profile of the Company and the significant decline in its share price over the past two years. The going-concern assumption for MGM Energy is appropriate as at the date of these financial statements as the Company has sufficient working capital at December 31, 2009 plus committed funding sources to fully fund the Company’s expected costs and commitments in 2010.

These financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”).

3. Summary of Significant Accounting Policies

(a) *Joint Operations*

A portion of MGM Energy’s activities are conducted jointly with others and accordingly, these financial statements reflect only the Company’s proportionate share of any revenues, expenses, assets and liabilities.

(b) *Measurement Uncertainty and Use of Estimates*

The timely preparation of these financial statements in conformity with Canadian GAAP requires that management make estimates and assumptions and use judgment that affects: (i) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and (ii) the reported amounts of expenses during the reported periods. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Actual results could differ materially from these estimates.

The amounts recorded for accretion and asset retirement obligations are based on estimates of future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact of changes in these estimates and assumptions on the financial statements of future periods could be material.

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash and short-term investments with original maturities of three months or less. The short-term investments are classified as held-to-maturity and measured at amortized cost using the effective interest method. As at December 31, 2009, cash equivalents included \$2.5 million (2008 - \$80 million) of investment in short-term instruments with maturity of three months or less and which bore interest at a rate of 0.27%. As at December 31, 2009, restricted cash of \$10.0 million was held in trust for payment of a land penalty due in July 2010.

(d) Property, Plant and Equipment

Property, plant and equipment are recorded at cost. MGM Energy follows the successful efforts method of accounting for petroleum and natural gas operations. Under this method, acquisition costs of oil and gas properties and costs of drilling and equipping development wells are capitalized. Costs of drilling exploratory wells are initially capitalized. If economically recoverable reserves are not found, such costs are charged to earnings as dry hole expense. Exploration wells are assessed annually, or more frequently as economic conditions dictate, for determination of reserves and, as such, success. Costs of drilling exploratory wells remain capitalized when a well has found a sufficient quantity of reserves to justify completion as a producing well and sufficient progress is being made to assess the reserves and the economic and operating viability of the well. All other exploration costs, including geological and geophysical costs and annual lease rentals, are charged to earnings when incurred. Producing areas and significant unproved properties are assessed annually, or more frequently as economic events dictate, for potential impairment. Any impairment loss is the difference between the carrying value of the asset and its fair value.

(e) Depletion and Depreciation

Capitalized costs of proved oil and gas properties are depleted using the unit of production method. For purposes of these calculations, natural gas volumes are converted to barrels on an energy equivalent basis.

The costs of successful exploratory wells and development wells are depleted over proved developed reserves while acquired resource properties with proved reserves are depleted over proved reserves. Acquisition costs of probable reserves are not depleted or amortized while under active evaluation for commercial reserves. Costs become subject to depletion as proved reserves are recognized. Other property, plant and equipment are depreciated over their estimated useful lives.

Costs associated with significant development projects are not depleted until commercial production commences.

(f) Asset Retirement Obligations

MGM Energy recognizes the fair value of an asset retirement obligation in the period in which it is incurred and when a reasonable estimate of the fair value can be made. The fair value of asset retirement obligations is initially capitalized as part of the cost of the related long-lived asset and either depleted on the same basis as the underlying asset if the cost of the well is capitalized pursuant to the successful efforts method of accounting or expensed as a dry hole cost if the costs of the well were charged to dry hole expense. The accumulated asset retirement obligation is adjusted for the passage of time, which is recognized as accretion expense in the statements of loss and other comprehensive loss, and for revisions in either the timing or the amount of the original estimated cash flows associated with the liability. Actual costs incurred upon settlement of the asset retirement obligation reduce the asset retirement obligation to the extent of the liability recorded. Differences between the actual costs incurred upon

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

settlement of the asset retirement obligation and the liability recorded are recognized in the period in which the settlement occurs.

(g) Future Income Taxes

MGM Energy follows the liability method of accounting for income taxes. Under this method, future income taxes are recognized for the effect of any difference between the carrying amount of an asset or liability reported in the financial statements and its respective tax basis, using substantively enacted income tax rates. Accumulated future income tax balances are adjusted to reflect changes in substantively enacted income tax rates, with adjustments being recognized in the results of operations in the period in which the change occurs.

(h) Flow-Through Shares

MGM Energy has financed a portion of its exploration activities through the issue of flow-through shares. As permitted under the *Income Tax Act* (Canada), the tax attributes of eligible expenditures incurred with the proceeds of flow-through share issuances are renounced to subscribers. On the date that MGM Energy files the renouncement documents with the tax authorities, a future income tax liability is recognized and shareholders' equity is reduced, for the tax effect of expenditures renounced to subscribers.

(i) Stock-Based Compensation

MGM Energy has granted stock options to employees and directors, the details of which are described in Note 8 (Stock-Based Compensation).

MGM Energy uses the fair value method to recognize compensation expense associated with the MGM Energy options. Fair values are determined using the Black-Scholes-Merton option pricing model and relevant assumptions on the date options are granted. Compensation costs are recognized over the vesting period of the stock options.

(j) Other Comprehensive Income, Financial Instruments and Hedging

MGM Energy classifies all financial instruments into one of the following categories: loans and receivables, assets held-to-maturity, assets available-for-sale, other financial liabilities, and held-for-trading assets and liabilities.

Financial instruments that are classified as held-for-trading or available-for-sale are re-measured each reporting period at fair value with the resulting gain or loss recognized immediately in net income and other comprehensive income, respectively. All other financial instruments are initially accounted for at fair value and subsequently at amortized cost using the effective interest method with foreign exchange gains and losses recognized immediately in net income.

MGM Energy currently does not utilize hedges or other derivative financial instruments in its operations.

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

(k) Recent Accounting Pronouncements

International Financial Reporting Standards (“IFRS”)

In February 2008, the Accounting Standards Board (“AcSB”) of the Canadian Institute of Chartered Accountants (“CICA”) confirmed that the use of IFRS will be required in 2011 for publicly accountable enterprises. In April 2008, the AcSB issued an IFRS Omnibus Exposure Draft proposing that publicly accountable enterprises be required to apply IFRS, in full and without modification, on January 1, 2011. The transition date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010. The AcSB proposes that CICA Handbook Section - Accounting Changes, paragraph 1506.30 (which would require an entity to disclose information relating to a new primary source of GAAP that has been issued but is not yet effective and that the entity has not applied) not be applied with respect to this Exposure Draft. The Company has developed a changeover plan to complete the transition to IFRS by January 1, 2011 including the preparation of required comparative information. The Company is continuing to assess the financial reporting impacts of the adoption of IFRS and, at this time, the impact on future financial position and results of operations is not reasonably determinable or estimable. Further, the Company anticipates a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the level of this disclosure required and any necessary systems changes to gather and process the information.

4. Property, Plant and Equipment

| | December 31, 2009 | | | December 31, 2008 |
|--------------------------------------|-------------------|--|-------------------|----------------------|
| | Cost | Accumulated Depletion and Depreciation | Net Book Value | Net Book Value |
| Petroleum and natural gas properties | \$ 232,636 | \$ - | \$ 232,636 | \$ 219,627 |
| Other | 1,256 | 765 | 491 | 1,098 |
| | <u>\$ 233,892</u> | <u>\$ 765</u> | <u>\$ 233,127</u> | <u>\$ 220,725</u> |

As the Company is in the development stage and has no production, all capitalized costs associated with non-producing petroleum and natural gas properties are currently not subject to depletion.

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

Continuity of Suspended Exploratory Well Costs

| | Year Ended December 31 | |
|--|------------------------|-----------|
| | 2009 | 2008 |
| Balance, beginning of year | \$ 42,939 | \$ 52,778 |
| Additions pending the determination of proved reserves | 17,606 | 15,197 |
| Well costs charged to dry hole expense | (4,292) | (25,036) |
| Balance, end of year | \$ 56,253 | \$ 42,939 |

Aging of Capitalized Exploratory Well Costs

| | Year Ended December 31 | |
|--|------------------------|-----------|
| | 2009 | 2008 |
| Exploratory well costs capitalized for a period of one year or less | \$ 17,606 | \$ 15,197 |
| Exploratory well costs capitalized for a period of greater than one year | 38,647 | 27,742 |
| Balance, end of year | \$ 56,253 | \$ 42,939 |
| Number of projects that have exploratory well costs that have been capitalized for a period of greater than one year | 4 | 3 |

At December 31, 2009, \$56.3 million of capitalized exploratory well costs relate to three wells located in the Central Mackenzie Valley and one well in the Mackenzie Delta. The commerciality of the gas related to such properties is being assessed in conjunction with the evaluation of the Mackenzie Valley pipeline.

The dry hole expense of \$39.1 million for the year ended December 31, 2009 relates to two wells drilled during the 2008/09 winter program. The dry hole expense of \$73.9 million for the year ended December 31, 2008 relates to one well drilled in the 2008/2009 winter program, three wells drilled in the 2007/08 winter program, and three wells drilled in 2004 and 2005. The dry hole expense results from the determination by MGM Energy that there are no economically recoverable reserves related to these wells.

The writedown of petroleum and natural gas properties of \$10.0 million for the year ended December 31, 2008 was the result of reducing the book value of a \$10.0 million land deposit, previously capitalized to property, plant and equipment, to zero.

5. Demand Facility

At December 31, 2008, MGM Energy had a \$30 million senior secured revolving demand facility bearing interest at the lender's prime rate or banker's acceptance rate, at the discretion of the Company. In October 2009, the amount of the facility was reduced from \$30 million to \$25 million and will further reduce to \$20 million as certain letters of credit expire or reduce. Concurrent with the reduction in the amount of the facility, the amount available for direct borrowings was reduced from \$10 million to \$1 million, although the entire amount of the facility remains available for letters of credit. In addition to the amendment to the facility amount, an officer and director of the Company provided a \$14 million guarantee as additional security for the facility. A fee is paid for the provision of the guarantee which fee is equivalent to the fees paid to the Bank under the Company's demand facility. The amount of the guarantee fee will fluctuate based on the amount and types of letters of credit outstanding. Based on letters of credit outstanding at December 31, 2009, the fee payable for the guarantee will be approximately \$0.1 million per quarter. MGM Energy is required to repay the facility or to have funds available in cash or short-term investments

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

at least equal to the borrowings under the facility, excluding letters of credit, for a period of three consecutive business days each quarter.

At December 31, 2009, the amount of the facility had been reduced to \$22.9 million as a result of the cancellation of a \$2.1 million letter of credit in the fourth quarter of 2009. There was no debt outstanding on the facility; however, there were undrawn letters of credit outstanding of \$20.5 million. All letters of credit have a term of one year or less but are automatically renewable on an annual basis for an additional year if the letter of credit is not cancelled prior to its expiry date.

6. Asset Retirement Obligations

| | Year Ended December 31 | |
|---|------------------------|----------|
| | 2009 | 2008 |
| Asset retirement obligations, beginning of year | \$ 1,996 | \$ 1,172 |
| Liabilities incurred | 656 | 523 |
| Revisions in estimated cost of abandonment | (585) | 173 |
| Liabilities settled | (114) | - |
| Accretion expense | 206 | 128 |
| Asset retirement obligations, end of year | \$ 2,159 | \$ 1,996 |

The total future asset retirement obligations were estimated by management based on MGM Energy's net ownership in all wells, the estimated work to reclaim and abandon the wells, and the estimated timing of the costs to be incurred in future periods. The undiscounted cash flows estimated to settle the asset retirement obligations associated with MGM Energy's oil and gas properties at December 31, 2009 are \$16.6 million (2008 - \$16.1 million). The majority of these obligations are not expected to be settled for several years, or decades, and have been discounted using credit-adjusted risk-free rates between 7 7/8 percent and 10 percent, and assuming an inflation rate of 3 percent.

In 2009, MGM Energy abandoned two wells in the Central Mackenzie area, which reduced asset retirement obligations by \$0.1 million. The cost of the abandonment is recoverable from rentals previously paid on the property; therefore there was no net cost to the Company to complete the abandonment. As a result, the Company recognized a gain on settlement of the asset retirement obligation of \$0.1 million.

7. Share Capital

Authorized

MGM Energy's authorized capital is comprised of an unlimited number of Common Shares, 18.2 million voting Class A Preferred Shares convertible to Common Shares on a one-for-one basis without any further consideration, an unlimited number of preferred shares, issuable in series ("Preferred Shares") and an unlimited number of Non-Voting Common Shares. There were no Class A Preferred Shares, Preferred Shares or Non-Voting Common Shares outstanding at December 31, 2009.

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

Issued and Outstanding

| Common Shares | Shares | Amount |
|---|---------------|---------------|
| Balance, December 31, 2006 | 1 | \$ - |
| Issued on MGM Spinout | 2,832,673 | 3,508 |
| Cancelled on MGM Spinout | (1) | - |
| Issued on exercise of Short Term and Longer Term Warrants | 13,824,021 | 76,504 |
| Conversion of Class A Preferred Shares | 18,200,000 | 41,706 |
| Issued for cash | 94,088,150 | 292,120 |
| Share issuance costs, net of tax benefit | - | (9,563) |
| Balance, December 31, 2007 | 128,944,844 | \$ 404,275 |
| Tax adjustment on flow-through share renunciations | - | (26,982) |
| Issued for cash | 134,250,000 | 80,108 |
| Share issuance costs, net of tax benefit | - | (2,065) |
| Balance, December 31, 2008 | 263,194,844 | \$ 455,336 |
| Tax adjustment on flow-through share renunciations | - | (9,014) |
| Issued for cash | 26,300,000 | 3,454 |
| Share issuance costs, net of tax benefit | - | (41) |
| Balance, December 31, 2009 | 289,494,844 | \$ 449,735 |

In July 2008, MGM Energy issued 82,000,000 Common Shares at \$0.55 per share and 52,250,000 Common Shares issued on a flow-through basis at \$0.67 per share, for gross proceeds of \$80.1 million.

In October 2009, MGM Energy issued 19,633,333 Common Shares at \$0.125 per share and 6,666,667 Common Shares issued on a flow-through basis at \$0.15 per share, for gross proceeds of \$3.5 million.

Flow-Through Shares

In October 2009, MGM Energy issued a total of \$1.0 million of Common Shares on a flow-through basis. The proceeds will be utilized to fund seismic expenditures in the winter of 2009/10.

Capital Disclosure

MGM Energy manages shareholders' equity as capital. Shareholders' equity had a book value of \$244.7 million as at December 31, 2009. MGM Energy does not manage its revolving demand facility as capital as it is not the intent of MGM Energy at this time to use the facility to finance operations. MGM Energy's near-term objectives regarding capital are to ensure that it has sufficient cash resources to fund its near-term ongoing operations and to fund any planned winter drilling and seismic programs prior to making financial commitments relating to the programs. As all of MGM Energy's operations are located in the Northwest Territories, almost all capital expenditures will be incurred during the winter months, although the capital expenditures have to be committed to during the preceding summer to ensure that equipment and services will be available. Given MGM Energy's stage of development and that there is currently no certainty regarding the completion of the Mackenzie Valley Pipeline, management is of the view that debt financing is not an option for MGM Energy at this time. Therefore, it is likely that all capital requirements will be funded from issuance of equity until such time as there is more certainty regarding the Mackenzie Valley Pipeline. On an annual basis, MGM Energy will determine the potential winter drilling and seismic programs and will proceed with those programs only to the extent that equity capital is available to MGM Energy. MGM Energy is not subject to any externally imposed capital requirements.

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

8. Stock-Based Compensation

MGM Energy Options

MGM Energy has a stock option plan (the “Plan”) that enables the Board of Directors or its Compensation Committee to grant to MGM Energy employees and directors options to acquire Common Shares of the Company. The exercise price of an option is no lower than the closing market price of the Common Shares on the day preceding the date of grant. Upon exercise of options under the Plan, optionholders receive either (i) a share certificate for the Common Shares; or (ii) a cash payment in an amount equal to the positive difference, if any, between the market price and the exercise price of the number of Common Shares in respect of which the option is exercised (a “Cash Surrender”). MGM Energy, however, can refuse to accept a Cash Surrender and therefore require that the holder exercise their vested options for cash and acquire Common Shares.

| MGM Energy Options | 2009 | | 2008 | |
|----------------------------------|---|------------|---|------------|
| | Weighted Average Exercise Price (\$ / share) | Options | Weighted Average Exercise Price (\$ / share) | Options |
| Balance, beginning of year | 1.30 | 11,233,000 | 3.50 | 3,146,000 |
| Granted | 0.14 | 10,835,500 | 0.46 | 8,651,000 |
| Forfeited | 0.75 | (586,000) | 1.56 | (564,000) |
| Balance, end of year | 0.72 | 21,482,500 | 1.30 | 11,233,000 |
| Options exercisable, end of year | 2.02 | 3,647,750 | 3.99 | 1,040,000 |

Additional information about MGM Energy’s stock options outstanding at December 31, 2009 is as follows:

| Range of Exercise Prices (\$ / share) | Number | Outstanding | | Exercisable | | |
|--|-------------------|--|---|------------------|--|---|
| | | Weighted Average Contractual Life (years) | Weighted Average Exercise Price (\$ / share) | Number | Weighted Average Contractual Life (years) | Weighted Average Exercise Price (\$ / share) |
| 0.14 – 1.00 | 18,606,500 | 9.24 | 0.28 | 1,942,750 | 8.61 | 0.48 |
| 1.01 – 2.00 | - | - | - | - | - | - |
| 2.01 – 3.00 | 1,568,000 | 7.20 | 2.45 | 774,000 | 7.20 | 2.46 |
| 3.01 – 4.00 | 100,000 | 1.83 | 3.17 | 50,000 | 1.83 | 3.17 |
| 4.01 – 5.00 | 1,208,000 | 1.33 | 4.98 | 881,000 | 1.33 | 4.98 |
| Total | 21,482,500 | 8.61 | 0.72 | 3,647,750 | 6.46 | 2.02 |

Up to July 2007, options granted by MGM Energy had a term of approximately 4.5 years. The term of options granted subsequent to July 2007 is 10 years.

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

The fair value of each option granted is estimated on the grant date using the Black-Scholes-Merton option pricing model with weighted average assumptions for grants as follows:

| | Year Ended December 31 | |
|--|------------------------|---------|
| | 2009 | 2008 |
| Weighted average fair value of options granted (\$/option) | \$ 0.10 | \$ 0.46 |
| Risk-free interest rate (%) | 2.82 | 3.15 |
| Expected lives (years) | 7 | 7 |
| Expected volatility | 0.70 | 0.70 |
| Annual dividend per share (\$/Common Share) | \$ - | \$ - |

Contributed Surplus

A reconciliation of contributed surplus is as follows:

| | Year Ended December 31 | |
|----------------------------------|------------------------|----------|
| | 2009 | 2008 |
| Balance, beginning of year | \$ 4,664 | \$ 2,307 |
| Stock-based compensation expense | 1,756 | 2,357 |
| Balance, end of year | \$ 6,420 | \$ 4,664 |

9. Income Taxes

The following table reconciles income taxes calculated at the Canadian statutory rate to MGM Energy's recorded future tax recovery:

| | Year Ended December 31 | |
|--|------------------------|--------------|
| | 2009 | 2008 |
| Loss before income tax | \$ (50,580) | \$ (122,050) |
| Effective Canadian statutory income tax rate | 29.0 % | 29.5 % |
| Expected tax recovery | \$ (14,668) | \$ (36,005) |
| Decrease (increase) in income tax recovery resulting from: | | |
| Statutory and other rate differences | 1,730 | 4,537 |
| Stock-based compensation | 510 | 695 |
| Valuation allowance | 12,173 | 8,559 |
| Other | (3) | 325 |
| Future tax recovery | \$ (258) | \$ (21,889) |

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

Components of Future Income Tax Asset:

| | Year Ended December 31 | |
|--|------------------------|----------|
| | 2009 | 2008 |
| Property, plant and equipment—carrying value excess over tax basis | \$ (3,711) | \$ (922) |
| Asset retirement obligations | 526 | 514 |
| Loss carryforwards | 21,832 | 14,429 |
| Share issuance costs and other | 2,343 | 3,552 |
| Valuation allowance | (20,732) | (8,559) |
| Future income tax asset | \$ 258 | \$ 9,014 |

The future income tax asset at December 31, 2009 is anticipated to be reduced to nil by March 31, 2010 as a result of the renunciation of flow-through share expenditures in the first quarter of 2010.

10. Financial Instruments

Interest rate risk

MGM Energy is exposed to interest rate risk to the extent that changes in market interest rates impact MGM Energy's short term deposits that have floating interest rates and to the extent borrowings are made under the debt facility.

Based on the average cash and cash equivalents and restricted cash balance for the year ended December 31, 2009, had interest rates during the year been 100 basis points higher, assuming all other variables remained constant, the net loss for the year would have been \$0.3 million lower. The average interest rate earned during the year ended December 31, 2009 was less than 100 basis points. If MGM Energy earned no interest income on its cash balance during the year, the net loss would have been \$0.2 million higher.

11. Changes in Non-Cash Working Capital

| | Year Ended December 31 | |
|--|------------------------|------------|
| | 2009 | 2008 |
| Accounts receivable and other current assets | \$ 200 | \$ (1,120) |
| Accounts payable and accrued liabilities | (10,027) | (3,171) |
| Due to related parties | (38) | 27 |
| | \$ (9,865) | \$ (4,264) |
| Operating activities | \$ (3,376) | \$ 2,792 |
| Investing activities | (6,489) | (7,056) |
| | \$ (9,865) | \$ (4,264) |

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

Supplemental cash flow information

| | Year Ended December 31 | |
|---------------|------------------------|------|
| | 2009 | 2008 |
| Interest paid | \$ - | \$ - |
| Taxes paid | \$ - | \$ - |

12. Related Party Transactions

Paramount Resources Ltd.

At December 31, 2009, Paramount held 43.9 million common shares of MGM Energy, representing 15.1 percent of the issued and outstanding common shares of MGM Energy at such time.

In addition to the common shares of MGM Energy held by Paramount, MGM Energy and Paramount have certain common members of management and directors. The following provides a summary of the related party transactions between MGM Energy and Paramount:

- For the year ended December 31, 2009, amounts billed by Paramount under a services agreement totaled \$0.05 million (2008 - \$0.2 million), including a 10 percent charge of approximately \$0.005 million (2008 - \$0.02 million), representing charges primarily for accounting, human resources and regulatory consulting services.

Other

Certain directors and officers of MGM Energy participated in the October 21, 2009 Common Share issuance, purchasing 18,465,333 Common Shares and 6,666,667 Common Shares issued on a flow-through basis for aggregate gross proceeds to MGM Energy of \$3.3 million.

Clayton Riddell, an officer and director of the Company, who as at December 31, 2009, owned, directly or indirectly, 24.1 percent of MGM Energy's outstanding shares, provides a \$14 million guarantee as security for the Company's bank facility. A fee is paid for the provision of the guarantee which fee is equivalent to the fees paid to the Bank under the Company's demand facility. The amount of the guarantee fee will fluctuate based on the amount and types of letters of credit outstanding. The fee was payable beginning on October 29, 2009, and totaled \$0.1 million for the year ended December 31, 2009. Based on letters of credit outstanding at December 31, 2009, the fee payable for the guarantee will be approximately \$0.1 million per quarter.

13. Contingencies and Commitments

In May 2009, MGM Energy restructured the Chevron/BP Farm-in Agreement with Chevron Canada Limited and BP Canada Energy Company. As a result of the restructured agreement, MGM Energy is not required to drill the final three wells or complete the additional seismic data acquisition required under the original Farm-in Agreement until after the decision to construct is made in connection with the Mackenzie Valley pipeline ("DTC"). MGM Energy nevertheless immediately earned the interests available to it under the Farm-in Agreement, consisting of a 50%

NOTES TO FINANCIAL STATEMENTS

(\$000s, except as noted)

interest in both the Farm-in lands and the discoveries in the Mackenzie Delta previously made by Chevron Canada and BP Canada.

Under the Amended Farm-in Agreement, MGM Energy:

- Earned 50 percent interest in existing Chevron/BP discoveries and joint venture lands immediately. The Company will drill three wells and pay 100% of costs within three winter drilling seasons after DTC occurs;
- Carries the joint account for the remainder of the seismic commitment (approximately \$26 million) on development costs after DTC occurs; and
- Acquired 100% interest in Inuvialuit Concession Areas 1 and 2 and makes all penalty payments due to the Inuvialuit Land Corporation if no wells are drilled on those lands by August, 2010

At December 31, 2009, MGM Energy had the following commitments:

| | 2010 | 2011 | 2012 | 2013 | 2014 | After 2014 |
|--|-----------|-----------|----------|-----------|--------|---------------|
| Work Commitment – Exploration Licenses | \$ - | \$ 27,250 | \$ 3,900 | \$ - | \$ - | \$ - |
| Capital spending commitments | \$ 10,500 | \$ 500 | \$ 500 | \$ 26,000 | \$ - | \$ - |
| Obligation under lease | \$ 936 | \$ 936 | \$ 936 | \$ 936 | \$ 468 | \$ - |

MGM Energy is obligated under certain Northwest Territories Exploration Licenses to fulfill minimum work commitments totaling \$31 million over the next five years, which are included in the above table. As a condition of the Exploration Licenses, the Company was required to post security of 25 percent of these work commitments, equal to \$8 million in letters of credit. The posted security is released in proportion to the actual work expenditures over the life of the Exploration License. If no expenditures are made on an Exploration License prior to its expiry, the Company must make a payment equal to the posted security, or 25% of the work commitment. Therefore, if no work is completed on the Company's various Exploration Licenses during their terms, the maximum amount owing by the Company would be equal to the amount of the letters of credit issued as security for the work commitments, or \$8 million.

14. Subsequent Events

On March 15, 2010, MGM Energy announced a non-brokered private placement of Common Shares to certain insiders of the Company for gross proceeds of \$5.0 million through the issuance of 25.0 million common shares at a price of \$0.20 per share. The offering is expected to close by April 29, 2010 and the proceeds will be utilized for general corporate purposes.