



Management's Discussion and Analysis  
For the year ended December 31, 2009

## **Management's Discussion and Analysis**

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the audited financial Statements of MGM Energy Corp. ("MGM Energy" or the "Company") as at and for the year ended December 31, 2009. Information in this MD&A and the financial statements has been presented in Canadian dollars and in accordance with Canadian generally accepted accounting principles ("GAAP"), unless otherwise stated.

This MD&A contains forward-looking information. Readers are referred to the advisories concerning such matters under the heading "Forward-Looking Information Disclaimer" below.

This MD&A is dated March 15, 2010. Additional information concerning MGM Energy, including its Annual Information Form, can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com).

### **Forward-Looking Information Disclaimer**

Certain information included in this MD&A constitutes forward-looking statements under applicable securities legislation. Forward-looking statements or information typically contain or can be identified by statements that include words such as "anticipate", "assume", "based", "believe", "can", "continue", "depend", "estimate", "expect", "forecast", "if", "intend", "may", "plan", "project", "propose", "result", "upon", "will", "within" or similar words suggesting future outcomes or statements regarding an outlook. Forward-looking statements or information in this document include but are not limited to estimates of future capital expenditures, capital raising, business strategy and objectives, exploration, development and production plans and the timing thereof, operating and other costs.

Such forward-looking statements or information are based on a number of assumptions that may prove to be incorrect. Assumptions have been made regarding, among other things: the ability of MGM Energy to obtain required capital to finance its exploration, development and operations; the ability of MGM Energy to obtain equipment, services, supplies and personnel in a timely manner and at an acceptable cost to carry out its activities; the ability of MGM Energy to market its oil and natural gas successfully; the ability of MGM Energy to transport its oil and natural gas successfully to market; the timing and costs of the Mackenzie Valley pipeline and facility construction and expansion and the ability of MGM Energy to secure adequate product transportation; the ability of MGM Energy to enjoy drilling success consistent with expectations; the timely receipt of required regulatory approvals; and future oil and gas prices.

Although MGM Energy believes that the expectations reflected in such forward-looking statements or information are reasonable, undue reliance should not be placed on forward-looking statements because MGM Energy can give no assurance that such expectations will prove to be correct. Forward-looking statements or information are based on current expectations, estimates and projections that involve a number of risks and uncertainties that could cause actual results to differ materially from those anticipated by MGM Energy and described in the forward-looking statements or information.

### **Basis of Presentation**

MGM Energy 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 owns oil and natural gas resources and land in the Northwest Territories which are not currently accessible to market pending the completion of the Mackenzie Valley pipeline. The completion of the pipeline is dependent on regulatory approval, which is expected

in 2010, and a commercial decision to construct the pipeline, for which there is currently no established timeline. The Company was spun-out of Paramount Resources Ltd. (“Paramount”) on January 12, 2007, and began trading on the TSX on January 17, 2007.

Except for limited periods of testing, none of MGM Energy’s assets have ever been placed into production. As a result, MGM Energy does not have any commercial operating results and is considered a development stage enterprise.

## Results of Operations

### Statements of Loss – Selected Items

<i>(\$000s)</i>	<b>2009</b>	2008
Interest income	<b>236</b>	2,763
<b>Expenses</b>		
General and administrative	<b>4,882</b>	5,513
Stock-based compensation	<b>1,756</b>	2,357
Pipeline regulatory and access	-	55
Exploration	<b>2,404</b>	28,827
Lease rental and land costs	<b>1,286</b>	3,273
Dry hole	<b>39,147</b>	73,942
Write-down of petroleum and natural gas properties	-	10,000
Interest and financing charges	<b>783</b>	336
Accretion of asset retirement obligations and depreciation	<b>672</b>	510
Gain on settlement of asset retirement obligations	<b>(114)</b>	-
Future income tax recovery	<b>(258)</b>	(21,889)
<b>Net loss</b>	<b>(50,322)</b>	(100,161)

### Interest Income

	<b>2009</b>	2008
Interest income for the year (\$000s)	<b>236</b>	2,763
Average interest rate earned during the year (%)	<b>0.75</b>	3.48

MGM Energy earns interest income on short-term investments resulting from funds raised from equity issues prior to utilization on operating and capital expenditures. Interest income declined from \$2.8 million in 2008 to \$0.2 million in 2009 due to the effect of lower cash balances in 2009 and lower interest rates on investments as a result of a decline in market interest rate levels. Interest income for 2010 will be dependent on the prevailing market interest rates and the timing of expenditures and additional equity issues, if any. As at December 31, 2009, MGM Energy had \$12.5 million of short-term investments, which bore interest at an average rate of 0.27% per annum and have original maturities of three months or less. The Company had no investments in asset-backed commercial paper at December 31, 2009.

## General and Administrative (G&A) Expenses

(\$000s)	2009	2008
Gross G&A Expenses	4,973	5,525
Overhead Recoveries	(91)	(12)
Net G&A Expenses for the year	4,882	5,513

G&A expenses decreased by 11% from 2008 to 2009, due primarily to Company efforts to reduce costs given a lower activity level than in 2008. G&A expenses are anticipated to continue to be in the \$5 million range in 2010 unless there is a significant change in the level of activity during the year.

## Stock-Based Compensation Expense

(\$000s)	2009	2008
Stock-Based Compensation Expense for the year	1,756	2,357

Stock-based compensation expense relates to options granted to the Company's management, employees and directors. For 2009, stock-based compensation expense was \$1.8 million, a reduction of 25% from 2008. The decline was due to a lower Black-Scholes-Merton valuation of options granted in 2009 compared to those granted in 2008.

## Pipeline Regulatory and Access Expense

(\$000s)	2009	2008
Pipeline Regulatory and Access Expense for the year	-	55

Pipeline regulatory and access expense represents costs incurred by the Company associated with regulatory hearings and access on the planned Mackenzie Valley pipeline. There were no related costs during 2009 and only minor costs in 2008. There may be costs incurred in 2010 given the increased regulatory activity following the release of the Joint Review Panel report in December 2009.

## Exploration Expense

(\$000s)	2009	2008
Exploration Expense for the year	2,404	28,827

MGM Energy utilizes the successful efforts method of accounting, and therefore, all exploration costs are expensed as incurred. The costs incurred in the year ended December 31, 2009 were primarily for geological and geophysical employees and consultants as there was no seismic program completed during the year. Exploration expense of \$28.8 million in 2008 included \$26.7 million incurred for the 2007/08 winter seismic program (details under "Capital Expenditures") plus \$2.1 million for employee and consultant costs and processing costs for existing seismic data.

## Lease Rental and Land Costs

(\$000s)	2009	2008
Lease Rental and Land Cost Expense for the year	1,286	3,273

Lease rental and land cost expense represents costs associated with annual lease rentals of properties held by the Company plus the cost of unfulfilled expenditure commitments on land that expires. Under the successful efforts method of accounting, these costs are charged to expense as incurred. During 2009 these costs predominantly related to annual lease rentals on properties located in the Mackenzie Delta. During 2008 costs totalled \$3.3 million and were primarily related to expenditure commitments on two properties in the Central Mackenzie area that were not met prior to the expiry of the exploration licences.

## Dry Hole Expense

(\$000s)	2009	2008
Dry Hole Expense for the year	39,147	73,942

- Under the successful efforts method of accounting, dry hole expense represents the cost of drilling exploratory wells for which no economically recoverable reserves are found. The dry hole costs for 2009 primarily relate to costs incurred for the North Ellice J-17 and Ellice A-25 wells, which were drilled during the year and were determined to be dry. The dry hole cost of \$39.1 million incurred in 2009 represents (i) direct costs related to the 2008/09 drilling program and charged to dry hole expense of \$38.2 million plus (ii) an allocation of \$1.2 million of costs related to demobilization of equipment and other expenditures incurred by the Company resulting from the decision to not conduct a drilling program in the 2009/10 winter drilling season and (iii) a reversal of dry hole expense of \$0.3 million resulting from a downward revision in the estimate of the asset retirement obligation related to wells that were previously charged to dry hole expense.
- The dry hole costs for 2008 were related to (i) Atik P-19 and Aput C-43 wells which were drilled during the 2007/2008 drilling season and were not successful; (ii) Langley E-07 well which was the final well drilled during the 2007/08 winter drilling program and found sufficient reserves for a Significant Discovery License (SDL) but did not appear to be of a sufficient size on its own to be economic to tie in the proposed Mackenzie Valley pipeline at current gas prices; (iii) costs incurred during 2008 for the North Ellice J-17 well which was drilled during the 2008/09 winter drilling program and was not successful; and (iv) three wells drilled by Paramount and its partner in 2004 and 2005 which had not previously been charged to dry hole expense as there was an ongoing assessment of the wells, but were charged to dry hole expense during 2008 as a result of a review of the wells during the year.

The amount of dry hole expense during any period is not possible to predict, as it is dependent on the success of the drilling program, which is not known until the drilling program is completed, and oil and gas prices.

## Write-down of Petroleum and Natural Gas Properties

(\$000s)	2009	2008
Write-down of Petroleum and Natural Gas Properties for the year	-	10,000

There was no write-down of petroleum and natural gas properties in 2009. The Company determined that there were no material changes in the anticipated cash flow from the Company's discovered resources and no change in the status of the Mackenzie Valley pipeline, therefore, there were no indications of impairment of the Company's assets and a write-down was not appropriate. The write-down for 2008 was related to a \$10 million deposit on Inuvik Block lands made in 2007 and was carried as "undeveloped land". Given the lack of drilling activity and land transactions in the North to gauge a current market value, and with no immediate plans to drill on this land, the Company had determined that it was prudent for the book value to be written down to zero.

## Interest and Financing Charges

(\$000s)	2009	2008
Interest and Financing Charges for the year	783	336

Interest and financing charges include fees related to charges for letters of credit, including a fee paid for the provision of a guarantee as security for the credit facility. The increase of 133% compared to 2008 is due to (i) the impact of an increase in the fee charged on letters of credit, (ii) a higher amount of letters of credit outstanding in 2009 and (iii) the payment of a guarantee fee beginning in October 2009.

## Depreciation and Accretion

(\$000s)	2009	2008
Accretion of ARO Obligations for the year	206	128
Depreciation for the year	466	382

There was a 61% increase in the accretion of Asset Retirement Obligations ("ARO") from 2008 to 2009 due to the additional ARO liability from the North Ellice J-17 and Ellice J-27 wells drilled and not abandoned in 2009 and additional interests earned on existing Chevron/BP wells. Depreciation expense represents the depreciation of office furniture and fixtures and corporate vehicles that were purchased throughout 2007 and 2008. There was no amortization of property, plant and equipment as the Company had no production during either year.

## Income Taxes

Future income tax recovery was \$0.3 million in 2009, a 99% decrease from 2008. The amount of income tax recovery in 2009 was limited by the amount that will be reversed from renunciation of flow through shares in the first quarter of 2010. As at December 31, 2009, MGM Energy had the following estimated tax pools (\$ million):

Canadian oil and gas property expense	151
Canadian exploration expense	62
Undepreciated capital cost	6
Share issuance costs	7
Tax losses carried forward	85

Based on MGM Energy’s current capital expenditure plans and earnings forecasts, the Company is not anticipating being taxable for the foreseeable future. During 2009, MGM Energy issued a total of \$1.0 million of Common Shares on a “flow-through” basis. As a result, the Company must incur an equivalent amount of qualifying resource expenditures. The proceeds from the flow-through share issuance will be utilized to fund seismic expenditures in the winter of 2009/10.

### Net Loss and Net Loss Per Share

Net loss for 2009 was \$50.3 million, compared to a net loss of \$100.2 million in 2008, with the decrease chiefly the result of much higher dry hole and exploration expense and a write-down of \$10 million of petroleum and natural gas properties in 2008. Net loss per basic share in 2009 was \$0.19 per share (2008 - \$0.52 per share). Given that MGM Energy currently has no production, nor is any production expected until the completion of a pipeline to transport crude oil or natural gas from the areas where the Company is active, it is likely that the Company will continue to generate losses for several years.

### Funds Flow From Operations

Funds flow from operations for 2009 was negative \$6.7 million, compared to negative \$6.4 million in 2008, with lower interest income in 2009 being offset by lower general and administrative costs and lease rental and land costs. Funds flow from operations is equal to interest income less (i) G&A expenses, (ii) pipeline regulatory and access costs, (iii) lease rental and land costs and (iv) interest and financing charges, as all other income statement items are either non-cash or are expenses which are included as Capital Expenditures in “Investing Activities” for purposes of the Statement of Cash Flows. As with net loss discussed above, MGM Energy expects that funds flow from operations will continue to be negative for several years until the Company begins to generate production revenue.

### Capital Expenditures

(\$000s)	2009	2008
Drilling and logistics	52,083	67,153
Land	-	(1,000)
Geological and geophysical	2,404	28,827
Other	(171)	879
<b>Total</b>	<b>54,316</b>	<b>95,859</b>

Of the total drilling and logistics costs in 2009 of \$52.1 million, \$50.3 million relates to 2009 expenditures for MGM Energy’s 2008/09 winter drilling program on the Farm-in Properties, with three wells being drilled: Ellice J-27, North Ellice J-17 and Ellice A-25. The Ellice J-27 well was a significant gas discovery and was capitalized to petroleum and natural gas properties. The North Ellice J-17 and Ellice A-25 wells did not encounter commercial quantities of hydrocarbons and their costs were charged to dry hole expense. The remainder of the drilling and logistics costs incurred in 2009 of \$1.8 million relates to demobilization of equipment and other expenditures incurred by the Company resulting from the decision to not complete a drilling program in the 2009/10 winter drilling season.

Geological and geophysical expenditures incurred during 2009 predominantly relate to staffing and consultant costs plus other minor seismic expenditures. The “other” costs of negative \$0.2 million in 2009 represent the proceeds from the sale of certain equipment by the Company during the period. The gain on sale of the equipment was \$0.04 million.

## Fourth Quarter Results

The following is a summary of MGM Energy's results for the three months ended December 31, 2009 with comparative amounts for the three months ended September 30, 2009 and December 31, 2008:

(\$000s)	Three Months Ended		
	December 31/09	September 30/09	December 31/08
Interest income	9	7	626
<b>Expenses</b>			
General and administrative	1,525	1,011	1,841
Stock-based compensation	328	374	646
Exploration	825	571	769
Lease rental and land costs	-	233	-
Dry hole	(320)	2,378	41,510
Write-down of petroleum and natural gas properties	-	-	10,000
Interest and financing charges	241	154	122
Accretion of asset retirement obligations and depreciation	142	185	193
Gain on settlement of ARO liabilities	-	(114)	-
Future income tax expense (recovery)	-	(258)	(5,285)
<b>Net loss</b>	<b>(2,732)</b>	<b>(4,527)</b>	<b>(49,170)</b>
<b>Capital Expenditures</b>	<b>1,496</b>	<b>3,686</b>	<b>15,385</b>

The net loss for the fourth quarter of 2009 was lower than the net loss in the third quarter of 2009 and fourth quarter of 2008, primarily due to lower dry hole expense compared to the other two quarters. Interest income in the fourth quarter of 2009 represented an average interest rate of 0.26% on average cash balances of \$15 million. General and administrative expenses of \$1.5 million during the fourth quarter of 2009 were higher than third quarter expense of \$1.0 million primarily due to the accrual of bonuses during the fourth quarter of 2009. Stock based compensation expense declined in the fourth quarter of 2009 from the fourth quarter of 2008 due primarily to a lower Black-Scholes-Merton valuation of options granted during the 12 months preceding the fourth quarter of 2009 compared to the same period in 2008. The negative dry hole expense of \$0.3 million in the fourth quarter of 2009 represents a downward revision in the estimate of the asset retirement obligation related to wells that were previously charged to dry hole expense, resulting in the partial reversal of dry hole costs. Exploration expense in the fourth quarter of 2009 was consistent with the third quarter of 2009 and fourth quarter of 2008 as MGM Energy did not complete any seismic programs during those quarters.

## Summary of Quarterly Results

(\$000s, except as noted)	2009				2008			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Interest Income	9	7	31	189	626	668	435	1,034
Net Loss	(2,732)	(4,527)	(6,319)	(36,744)	(49,170)	(1,043)	(4,319)	(45,629)
Per share - (\$/share) <sup>(1)</sup>	(0.01)	(0.02)	(0.02)	(0.14)	(0.19)	(0.00)	(0.03)	(0.35)

<sup>(1)</sup> Basic and diluted.

## Liquidity and Capital Resources

As at December 31, 2009, MGM Energy had a working capital surplus of \$13.5 million, including restricted cash of \$10 million. The restricted cash represents a separate account established pursuant to the restructuring of the Chevron/BP Farm-in Agreement. The cash is available only for the payment of a \$10 million land payment penalty due in July 2010. MGM Energy invests its cash in a variety of investments in accordance with the Company's investment policy. At December 31, 2009, MGM Energy had no investments in asset-backed commercial paper.

Other than interest income on excess cash balances, MGM Energy currently has no other means of generating revenue. The Company is dependent on raising funds from the issuance of equity or debt or through asset sales to finance its ongoing operations and capital. In October 2009, the Company completed a private placement to insiders of 19.6 million common shares at \$0.125 per share and 6.7 million common shares on a flow-through basis for \$0.15 per share for gross proceeds of \$3.5 million. The proceeds will be utilized to finance \$1.0 million of seismic expenditures during the winter of 2009/10 and for general corporate purposes. The Company announced on March 15, 2010 that it will complete a private placement to insiders of 25.0 million common shares at \$0.20 per share, for gross proceeds of \$5.0 million, with the private placement to close by April 29, 2010. As a result of this share issue, the Company will have sufficient working capital to fund its forecasted expenditures based on the current level of activity and commitments until at least the 1<sup>st</sup> quarter of 2011. As the Company is fully funded for at least the next four quarters, the financial statements are presented on a "going-concern" basis.

Management is currently uncertain whether MGM Energy will continue to have access to equity from sources other than related parties, or other sources of funding such as debt or asset sales, to continue to fund operations pending greater certainty regarding the Mackenzie Valley pipeline. The Company believes that there will be sources of funding available in the mid to long term when there is confirmation that the Mackenzie Valley pipeline will be built, and that these funding sources would not necessarily be impacted by the general market conditions at the time.

MGM Energy has a senior secured revolving demand facility with a Canadian bank (the "Demand Facility"). The Demand Facility was restructured in October 2009, resulting in a decrease in the size of the facility from \$30 million to \$25 million. The facility will reduce further to \$20 million as certain letters of credit expire. As at December 31, 2009, the facility amount had been reduced to \$22.9 million and there were \$20.5 million of letters of credit outstanding. As of March 15, 2010, the amount of letters of credit outstanding was reduced to \$18.5 million, however, the amount of the Demand Facility remains at \$22.9 million. Of the authorized amount of the Demand Facility, up to \$1 million is available for borrowings and the entire amount is available for letters of credit. At the time the amount of the facility is reduced to \$20 million, existing letters of credit will have been reduced to no greater than \$16.3 million, which provides sufficient capacity under the Demand Facility to issue new letters of credit for the Company's expected near-term requirements.

Borrowings under the Demand Facility bear interest at floating rates based on the lender's prime rate or banker's acceptance rate, at the discretion of MGM Energy, plus an applicable margin. The terms of the Demand Facility require, on a quarterly basis, that MGM Energy repays the Demand Facility or has funds available in cash or short-term investments at least equal to borrowings under the facility (excluding outstanding Letters of Credit) for a period of at least three consecutive business days. An officer and director of the Company provides a \$14 million guarantee as additional security for the facility. Additional information regarding this guarantee and the compensation paid by the Company is provided under "Related Party Transactions" below.

At December 31, 2009, there were no borrowings under the Demand Facility, however, there were outstanding letters of credit totalling \$20.5 million. These letters of credit have not been drawn; however, they reduce the amount available to MGM Energy under the Demand Facility on a dollar for dollar basis.

At March 15, 2010, MGM Energy had 289.5 million Common Shares issued and outstanding and 21.5 million stock options outstanding, of which 3.6 million are exercisable.

## Contractual Obligations

MGM Energy has the following contractual obligations as at December 31, 2009:

<i>(\$000s)</i>	Recognized in financial statements	Less than 1 Year	1 – 3 years	4 – 5 years	After 5 years	Total
Asset retirement obligations	Yes- Partially	-	-	-	16,600	16,600
Obligations under leases	No	936	1,872	1,404	-	4,212
Work Commitment – Exploration Licences	No	-	31,150			31,150
Capital spending commitment	No	10,500	1,000	26,000	-	37,500
<b>Total</b>		<b>11,436</b>	<b>34,022</b>	<b>27,404</b>	<b>16,600</b>	<b>89,462</b>

MGM Energy is obligated under certain Northwest Territories Exploration Licences to fulfill minimum work commitments totalling \$31 million over the next five years. As a condition of the Exploration Licences, the Company was required to post security of 25% of its share of these work commitments via letters of credit. The posted security is released in proportion to the actual work expenditures over the life of the Exploration Licence. If no expenditures are made on an Exploration Licence 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 Licences during their terms, the maximum amount owing by the Company would be 25% of \$31 million, or approximately \$8 million.

## 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 owns, 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 totalled \$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.

## **Outlook for 2010**

The Company is not conducting any drilling activity for the winter of 2009/10. The only material capital expenditure planned for the winter is the acquisition of seismic in the Great Bear River area of the Central Mackenzie Valley, at a cost to the Company of approximately \$1 million. For the balance of 2010 there are currently no other planned expenditures other than those required to maintain and monitor the Company's existing assets.

The Company has not yet finalized its plans for the winter of 2010/11. The Company is evaluating whether to drill an oil well on its Great Bear River property, which will depend on the results of the seismic program being shot in the winter of 2009/10 and market conditions impacting the availability of capital. The Great Bear River property is located adjacent to an existing oil pipeline from Norman Wells, therefore, any oil that is discovered can be transported to market without requiring the completion of the Mackenzie Valley Pipeline. The Company is not currently anticipating that it will conduct any other drilling or seismic program during the winter of 2010/11, although operating plans will not be finalized until the third quarter of 2010.

Despite the significant reduction in the Company's activity levels this year, the Company's intention is to retain its management and technical staff as they are viewed as a key and valuable asset. During 2010, the Company will be participating in and monitoring the conclusion of the regulatory process for the Mackenzie Valley pipeline. The National Energy Board is scheduled to complete its hearing into the project application in April 2010 and to release its decision by the end of September 2010.

The Company announced a private placement of common shares on March 15, 2010 which will provide gross proceeds of \$5.0 million. This funding plus existing working capital will be sufficient to fund the operations of the Company (based on current activity levels) and meet all commitments until at least the first quarter of 2011. As the Company has no source of revenue, the Company is currently dependent on equity issues, asset sales or debt to fund its operations and capital expenditures. The Company's financial philosophy is to raise sufficient funds prior to making any major capital commitments, which in most years will be in the 2<sup>nd</sup> or 3<sup>rd</sup> quarter of the year in anticipation of a winter drilling or seismic program. The Company will consider other sources of funding, such as assets sales, farm-outs and debt once there is greater certainty regarding the timing of the Mackenzie Valley pipeline. As that certainty has not yet occurred, the Company will continue to be reliant on equity issues to fund its operations.

## Recent Accounting Pronouncements

### Transition to International Financial Reporting Standards (“IFRS”)

In February 2008, the AcSB confirmed that the use of IFRS will be required in 2011 for publicly accountable enterprises in Canada. 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 adoption 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 the IFRS Omnibus Exposure Draft.

The Company has commenced the process to transition from current Canadian GAAP to IFRS. Because the Company does not have active operations and utilizes the “successful-efforts” method of accounting for oil and gas (which is consistent with IFRS accounting for oil and gas), the cost and impact of the transition will be significantly less than for other oil and gas companies. The Company has done a preliminary assessment of all financial statement items in which there could be a material difference between Canadian GAAP and IFRS, and have to date concluded that there are only three areas of potential material difference:

**Asset Retirement Obligations (“ARO”)** – IFRS and Canadian GAAP calculate the ARO liability in the same manner (discounted cash flow of expected cost of abandoning assets), however, IFRS utilizes a higher discount rate. As a result, the ARO liability is likely to be less under IFRS than Canadian GAAP, however, a preliminary review indicates that the difference between Canadian GAAP and IFRS will not be material.

**Stock-Based Compensation** – The Company’s method of calculating stock-based compensation expense is consistent with IFRS, however, under IFRS the Company will be required to include an allowance for staff turnover that will result in a lower stock-based compensation expense under IFRS than under Canadian GAAP. The difference is not expected to be material.

**Property, Plant and Equipment (“PP&E”)** – As noted above, the Company utilizes the “successful-efforts” method of accounting, which is largely consistent with IFRS. Under Canadian GAAP, there is no requirement to test for impairment of PP&E if there have been no indications of impairment during the year, which was the case for the fiscal year ended December 31, 2009. IFRS is consistent with Canadian GAAP in that an impairment test is also not required if there is no indication of impairment. Therefore, if the Company was utilizing IFRS in 2009, there would not have been an impairment test. There is also no requirement to perform an impairment test upon conversion to IFRS, however, the Company will need to perform an impairment test if there is an indication of impairment at any time in the future. The impairment test requires the Company to compare the book value of PP&E with, in the Company’s case, the discounted cash flow value of PP&E (the present value of the estimated cash flow of PP&E utilizing a discount rate that reflects the risk specific to the assets), and to write down the book value of PP&E by the amount, if any, that the discounted cash flow value is less than the book value. The Company has not determined if the discounted cash flow value of its assets, as determined under IFRS, is greater or less than the current book value, nor has it determined if the difference is material.

In addition to the potential financial statement impact of the above differences, the Company also anticipates a significant increase in disclosure resulting from the adoption of IFRS.

Training of staff and management on IFRS began in 2009 and should be completed in 2010. The Company does not anticipate any material impact on its disclosure controls and procedures or internal controls over financial reporting or on its IT systems. The Company is planning to prepare the balance sheet as at January 1, 2010 utilizing IFRS and have the balance sheet audited by no later than the third quarter of 2010. The Company also plans that by the end of 2010 it will have prepared financial statements for the each of first three quarters of 2010 utilizing IFRS.

## **Operational and Business Risks**

### **Absence of Infrastructure to Transport the Company's Production**

To date, energy infrastructure, specifically in the form of pipelines to transport natural gas, has not yet reached regions north of the Cameron Hills area of the southern Northwest Territories. Additionally, pipelines to transport oil and other liquid hydrocarbons have not yet reached north of Norman Wells in the central Mackenzie Valley. A majority of the Company's assets are located in these areas. Until a natural gas pipeline is built from the Mackenzie Valley to connect to the Alberta or British Columbia pipeline systems, there is no commercial method to move to market natural gas which the Company, or any other entity, may discover to market. In addition, a liquids line is required north of Norman Wells to move liquid hydrocarbons discovered north of that area to market. As a result, for at least the next few years, it is unlikely that the Company will generate any revenue from the production of hydrocarbons, unless the Company has an oil discovery in close proximity to the existing oil pipeline from Norman Wells.

### **Future Financings**

The Company will require future financing to fund its future exploration, development and operations. There can be no assurance that additional financing will be available to the Company when needed or on terms acceptable to the Company. The Company's inability to raise funds to support ongoing operations and to fund capital expenditures or acquisitions may limit the Company's growth or may have a material adverse affect upon the Company.

### **Resource Estimates**

The resource estimates in respect of certain of the Company's assets and the area in which the Company's assets are located are only estimates and the ultimate resources may vary significantly from the estimates. Estimates of resources depend in large part upon the reliability of available geological and engineering data. Geological and engineering data are used to determine the probability that a reservoir of oil and/or natural gas exists at a particular location, and whether, and to what extent, such hydrocarbons are recoverable from the reservoir.

### **Access to Letter of Credit Facility**

The Company is required to provide letters of credit for different aspects of its operations. As at the date of this MD&A, the Company has a bank facility which provides for the issuance of letters of credit sufficient to meet the Company's expected needs in the near future. The credit facility is provided by a Schedule 1 Canadian bank on a demand basis. The bank has provided no indication to the Company that it will not continue to provide the facility, however, there can be no assurance that the facility will remain available for an extended period. If the credit facility was no longer available, there can be no assurance that a replacement lender would be available to provide the facility.

## **Operational Matters**

The ownership and operation of oil and natural gas wells, pipelines and facilities involves a number of operating and natural hazards that may result in blowouts, environmental damage and other unexpected or dangerous conditions resulting in damage to the Company's properties and possible liability to third parties. The Company employs prudent risk management practices and maintains suitable liability insurance, where available. The Company may become liable for damages arising from such events against which it cannot insure or against which it may elect not to insure because of high premium costs or other reasons. Costs incurred to repair such damage or pay such liabilities could have a material adverse effect on the Company, its operations and financial condition.

## **Exploration Risks**

The exploration of the Company's oil and gas properties involves a high degree of risk that no hydrocarbons will be discovered or that the discoveries made will be insufficient to recover drilling and completion costs. The costs of drilling, completing and operating wells are uncertain to a degree. Cost overruns can adversely affect the economics of the Company's exploration programs and projects. In addition, the Company's drilling plans may be curtailed, delayed or cancelled as a result of numerous factors, including, among others, equipment failures, weather or adverse climate conditions, shortages or delays in obtaining qualified personnel, shortages or delays in the delivery of or access to equipment, necessary regulatory or other third party approvals and compliance with regulatory requirements.

## **Availability of Equipment and Qualified Personnel and Related Costs**

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment and qualified personnel in the particular areas where such activities will be conducted. Demand for such limited equipment and qualified personnel may affect the availability of such equipment and qualified personnel to MGM Energy and may delay the Company's exploration and development activities. In addition, the costs of qualified personnel and equipment in the Northwest Territories where the Company's assets are located are very high due to the availability of, and demands for, such qualified personnel and equipment in the area.

## **Critical Accounting Estimates**

The preparation of the Financial Statements in accordance with GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. MGM Energy bases its estimates on historical experience and various other factors that are believed by management to be reasonable under the circumstances. Actual results could differ from these estimates. The following is a discussion of the accounting estimates that are considered critical.

## **Successful Efforts Accounting**

MGM Energy follows the successful efforts method of accounting for its 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 pending evaluation as to whether proved reserves have been found. If economically recoverable reserves are not found, such costs are charged to earnings as dry hole costs. If economically recoverable reserves are found, such costs are depleted on a unit-of-production basis. The determination of whether economically recoverable quantities of reserves are found is dependent upon, among other things, the results of planned additional wells and the cost of required capital expenditures to produce

the reserves found. The application of the successful efforts method of accounting requires the use of judgment to determine, among other things, the designation of wells as development or exploratory, and whether exploratory wells have discovered economically recoverable quantities of proved reserves. The results of a drilling operation can take considerable time to analyze, and the determination that proved reserves have been discovered requires both judgment and application of industry experience. The evaluation of petroleum and natural gas leasehold acquisition costs requires management's judgment to evaluate the fair value of exploratory costs related to drilling activity in a given area. Ultimately, these determinations affect the timing of deduction of accumulated costs and whether such costs are capitalized and amortized on a unit-of-production basis or are charged to earnings as dry hole expense.

### **Reserve Estimates**

Estimates of MGM Energy's reserves are prepared in accordance with the Canadian standards set out in the Canadian Oil and Gas Evaluation Handbook and National Instrument 51-101. Reserve engineering is a subjective process of estimating underground accumulations of petroleum and natural gas that cannot be measured in an exact manner. The process relies on interpretations of available geological, geophysical, engineering and production data. The accuracy of a reserves estimate is a function of the quality and quantity of available data, the interpretation of that data, the accuracy of various mandated economic assumptions and the judgment of the persons preparing the estimate.

At December 31, 2009, the only asset of MGM Energy that was evaluated by qualified independent reserves evaluators was the Ancillary Asset acquired from Paramount. All of the other assets owned by MGM Energy are not able to be designated as reserves given the uncertainty of the timing of the Mackenzie Valley Pipeline; therefore, they have not been evaluated by qualified independent reserve evaluators.

### **Impairment of Petroleum and Natural Gas Properties**

MGM Energy currently has no proved properties that are subject to possible impairment as the Ancillary Asset is, for accounting purposes, considered a Paramount asset given the right of Paramount to repurchase the asset. Unproved leasehold costs and exploratory drilling in progress are capitalized and reviewed periodically for impairment. Costs related to impaired prospects or unsuccessful exploratory drilling are charged to earnings.

Acquisition costs for leases that are not individually significant are charged to earnings as the related leases expire. Further impairment expense could result if petroleum and natural gas prices decline in the future, or if the Mackenzie Valley Pipeline is indefinitely delayed or if negative reserves revisions are recorded, as it may be no longer economic to develop certain unproved properties. Management's assessment of, among other things, the results of exploration activities, commodity price outlooks, the potential of the Mackenzie Valley Pipeline and planned future development and sales, impacts the amount and timing of impairment provisions.

### **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 values of asset retirement obligations are 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 was 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 in depletion, depreciation and accretion expense in the consolidated statement of earnings, and for revisions in either the timing or the amount of the original estimated cash flows associated with the liability.

Upon retirement of its oil and gas assets, MGM Energy anticipates incurring substantial costs associated with abandonment and reclamation activities. Estimates of the associated costs are subject to uncertainty associated with the method, timing and extent of future retirement activities. Accordingly, the annual expense associated with future abandonment and reclamation activities is impacted by changes in the estimates of the expected costs and reserves. The total undiscounted abandonment liability is currently estimated at \$16.6 million, which is based on management's estimate of costs and in accordance with existing legislation and industry practice.

### **Stock-based Compensation**

The Company has a stock option plan whereby officers, directors and employees are granted options to purchase common shares. The exercise price of each option equals the market price of the common shares on the date of the grant. MGM Energy uses the fair value method of accounting for stock options granted. In determining the fair value of the stock options granted, the Black-Scholes-Merton model was used and assumptions regarding interest rates, underlying volatility of the Company's stock and expected life of the options were made.

### **Disclosure and Internal Controls**

MGM Energy's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") are responsible for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting as defined in NI 52-109.

Disclosure controls and procedures have been designed to ensure that information to be disclosed by MGM Energy is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Company's CEO and CFO have evaluated the effectiveness of MGM Energy's disclosure controls and procedures as at December 31, 2009 and have concluded that they are effective in providing reasonable assurance that all material information relating to MGM Energy is disclosed in a timely manner.

MGM Energy's CEO and CFO are responsible for establishing and maintaining internal controls over financial reporting ("ICFR"). They have, as at the financial year ended December 31, 2009, designed ICFR to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The control framework used to design the Company's ICFR is the *Internal Control – Integrated Framework* (COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). As at December 31, 2009, the Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company's ICFR. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the ICFR are effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with Canadian GAAP. It should be recognized, however, that any control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

There have been no changes in the Company's internal controls over financial reporting during the year ended December 31, 2009 that materially affected, or are reasonably likely to affect, the internal controls over financial reporting.