

**MAGNUM ENERGY INC.**

**FINANCIAL STATEMENTS**

For Year Ended August 31, 2010

## Auditors' Report

---

To the Shareholders  
Magnum Energy Inc.

We have audited the balance sheets of Magnum Energy Inc. as at August 31, 2010 and 2009 and the statements of operations, comprehensive loss and 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 August 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) "Collins Barrow Calgary LLP"

CHARTERED ACCOUNTANTS

Calgary, Alberta  
November 26, 2010, except as to note 16  
which is as of December 9, 2010

**MAGNUM ENERGY INC.**  
BALANCE SHEETS

	August 31 2010	August 31 2009
<b>ASSETS</b>		
<b>Current assets:</b>		
Accounts receivable	\$ 376,878	\$ 95,955
Prepaid expenses and deposits	85,709	46,236
	<u>462,587</u>	<u>142,191</u>
Property and equipment (note 5)	11,288,043	5,527,309
Future income tax asset (note 7)	-	203,000
	<u>\$ 11,750,630</u>	<u>\$ 5,872,500</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued liabilities	\$ 1,172,267	\$ 839,274
Bank debt (note 6)	4,248,301	1,387,759
	<u>5,420,568</u>	<u>2,227,033</u>
Future income tax liability (note 7)	82,300	-
Asset retirement obligations (note 8)	481,200	293,230
	<u>5,984,068</u>	<u>2,520,263</u>
<b>Shareholders' equity:</b>		
Share capital (note 9)	8,099,711	5,212,749
Warrants (note 9)	9,400	222,000
Contributed surplus (note 10)	1,144,870	747,510
Deficit	(3,487,419)	(2,830,022)
	<u>5,766,562</u>	<u>3,352,237</u>
	<u>\$ 11,750,630</u>	<u>\$ 5,872,500</u>
Commitments (note 12)		
Subsequent events (note 16)		

See accompanying notes to financial statements

**Approved by the Directors:**

"Richard A. Nemeth"  
Richard A. Nemeth

"Gordon J. Dolph"  
Gordon J. Dolph

**MAGNUM ENERGY INC.****STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT**

For the years ended August 31

	<b>2010</b>	<b>2009</b>
<b>Revenue</b>		
Oil and natural gas sales	\$ 2,448,282	\$ 1,528,419
Royalties	(269,285)	(216,657)
Interest	-	4,806
	<b>2,178,997</b>	<b>1,316,568</b>
<b>Expenses</b>		
Operating	574,310	365,478
General and administrative	920,447	840,696
Interest and bank charges	218,616	79,941
Stock-based compensation	193,350	68,460
Depletion, depreciation and accretion	1,128,425	578,337
	<b>3,035,148</b>	<b>1,932,912</b>
<b>Loss from operations</b>	<b>(856,151)</b>	<b>(616,344)</b>
Settlement of account payable (note 9)	19,264	12,138
<b>Loss before income taxes</b>	<b>(836,887)</b>	<b>(604,206)</b>
Future income tax recovery (note 7)	179,490	203,000
<b>Net loss and comprehensive loss</b>	<b>(657,397)</b>	<b>(401,206)</b>
<b>Deficit, beginning of year</b>	<b>(2,830,022)</b>	<b>(2,428,816)</b>
<b>Deficit, end of year</b>	<b>\$ (3,487,419)</b>	<b>\$ (2,830,022)</b>
<b>Loss per share - basic and diluted (note 9)</b>	<b>\$ (0.02)</b>	<b>\$ (0.02)</b>

*See accompanying notes to financial statements*

**MAGNUM ENERGY INC.**  
**STATEMENTS OF CASH FLOWS**  
For the years ended August 31

	2010	2009
<b>CASH PROVIDED BY (USED IN):</b>		
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (657,397)	\$ (401,206)
Adjustments for items not involving cash:		
Depletion, depreciation and accretion	1,128,425	578,337
Stock-based compensation	193,350	68,460
Settlement of account payable	(19,264)	(12,138)
Future income tax recovery	(179,490)	(203,000)
	465,624	30,453
Changes in non-cash working capital items related to operating:		
Accounts receivable	(122,712)	185,345
Prepaid expenses and deposits	(39,773)	341
Accounts payable and accrued liabilities	(43,929)	27,112
	259,210	243,251
<b>INVESTING ACTIVITIES</b>		
Property and equipment expenditures	(6,926,175)	(2,051,947)
Changes in non-cash working capital items related to investing:		
Accounts receivable	(158,211)	15,783
Prepaid expenses and deposits	300	(3,300)
Accounts payable and accrued liabilities	621,172	363,925
	(6,462,914)	(1,675,539)
<b>FINANCING ACTIVITIES</b>		
Proceeds from share issuance (net of issuance costs)	3,343,162	-
Bank debt proceeds, net of repayments	2,860,542	837,759
	6,203,704	837,759
<b>Decrease in cash and cash equivalents</b>	-	(594,529)
<b>Cash and cash equivalents, beginning of period</b>	-	594,529
<b>Cash and cash equivalents, end of period</b>	\$ -	\$ -
<b>Supplementary cash flow information:</b>		
Interest paid	\$ 176,234	\$ 90,162
Income taxes paid	\$ -	\$ -

**Non-cash transactions (note 13)**

See accompanying notes to financial statements

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**1. Nature of Operations**

Magnum Energy Inc. (the "Company") was incorporated on June 27, 2003 under the laws of British Columbia, Canada and was continued under the Alberta Business Corporations Act on February 18, 2010. The Company is a public company whose Class A common shares trade on the TSX Venture Exchange. The Company is in the business of the acquisition, exploration, development and production of oil and gas properties in Alberta.

**2. Significant Accounting Policies**

**Basis of Presentation**

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

**Cash and cash equivalents**

Cash and cash equivalents are comprised of amounts on deposit with banks and short term, highly liquid investments with maturities of ninety days or less.

**Oil and Gas Properties**

*Capitalized Costs*

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of acquiring, exploring for and developing oil and gas reserves are initially capitalized on a country-by-country basis. Such costs include land acquisition costs, lease rentals, geological and geophysical activities, carrying charges on non-producing properties, costs of drilling productive and non-productive wells, tangible production equipment, asset retirement costs and overhead charges directly related to acquisition and exploration activities.

Proceeds from a sale of oil and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would change the depletion and depreciation rate by 20% or more.

*Depletion and Depreciation*

Depletion and depreciation of oil and natural gas properties is calculated using the unit-of-production method based on production volumes, before royalties, in relation to total proved reserves as estimated by independent engineers. Natural gas volumes are converted to equivalent oil volumes based on a relative energy content of six thousand cubic feet of natural gas to one barrel of oil. In determining costs subject to depletion, the Company includes estimated future costs to be incurred in developing proved reserves and removes estimated salvage values. Costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

*Ceiling Test*

In applying the full cost method, the Company calculates a ceiling test whereby the carrying value of oil and natural gas properties is compared to the sum of the undiscounted cash flows expected to result from the proved reserves and the lower of cost or market of unproved properties. Cash flows used in the ceiling test are based on independent third party quoted forward prices, adjusted for contracted prices and quality differentials. Should the ceiling test result in an excess of carrying value, the Company would then measure the amount of impairment by comparing the carrying amounts of oil and natural gas properties to an amount equal to the estimated net present value of proved and probable reserves and the lower of cost and market of unproved properties. A risk-free interest rate is used to arrive at the net present value of future cash flows. Carrying values in excess of the estimated discounted future cash flows would be recorded as an impairment.

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**2. Significant Accounting Policies** (continued)

*Asset Retirement Obligations*

Asset retirement obligations include the abandonment of oil and natural gas wells, the dismantling and removal of tangible equipment such as oil batteries and natural gas facilities and returning the land to its original condition. The Company recognizes the fair value of the obligations in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. Fair value is estimated based on the present value of the estimated future cash outflows to abandon the asset, discounted at the Company's credit-adjusted risk-free interest rate. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset. Revisions to the original estimated cost or the timing of the cash outflows may result in a change to the liability. Actual costs incurred to settle an obligation reduce the liability.

*Joint Ventures*

A portion of the Company's oil and gas operations are conducted jointly with others and accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

**Equipment**

Equipment is recorded at cost less accumulated depreciation which is provided on a straight-line basis over the life of the related assets.

**Income Taxes**

The Company follows the asset and liability method of accounting for income taxes. Under this method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the recovery or settlement of assets and liabilities at carrying values. Income tax assets are also recognized for the benefits from tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on substantively enacted tax laws and rates that are anticipated to apply in the period of realization.

**Flow-through Shares**

Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. To recognize the foregone tax benefits of flow-through shares, the tax effect related to renounced expenditures is recorded as a reduction to share capital and the recognition of a future income tax liability for the amount of the tax reduction when the expenditures are renounced to the shareholders.

**Stock-based Compensation**

The Company has a stock-based compensation plan (note 9), whereby stock options are granted in accordance with the policies of regulatory authorities. The fair value of all stock options granted is expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of stock options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital. Stock option forfeitures are accounted for as they occur.

The Company uses the Black-Scholes valuation model to determine the fair value of stock options and warrants at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected life of the option and warrant, the expected price volatility of the underlying security and the risk-free interest rate.

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**2. Significant Accounting Policies** (continued)

**Per Share Amounts**

Basic income (loss) per share information is computed by dividing the income (loss) for the year by the weighted average number of Class A common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if potentially dilutive securities were exercised or converted to common stock. The dilutive effect of options and warrants and their equivalent is computed by application of the treasury stock method and the effect of convertible securities by the "if converted" method. The treasury stock method assumes that any proceeds received by the Company upon the exercise of in-the-money options and warrants plus the unamortized portion of stock-based compensation would be used to buy back Class A common shares at the average market price for the period. The weighted average number of shares outstanding is then adjusted by the net change.

**Revenue Recognition**

Revenue from the sale of oil and natural gas is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating and maintenance costs, transportation and production based royalty expenses are recognized in the same period in which the related revenue is earned and recorded.

Interest revenue is recognized as earned.

**Measurement Uncertainty**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingencies. Such estimates primarily relate to unsettled transactions and events at the balance sheet date. Actual results could differ from those estimated.

Accounts receivable are stated after evaluation as to their collectability and an appropriate allowance for doubtful accounts is provided.

The amounts recorded for depletion, depreciation, asset retirement obligations and the ceiling test are based on estimated proved reserves, production rates, future petroleum and natural gas prices and future costs.

The amounts recorded to estimate fair values of stock options and warrants are based on estimates of future volatility of the Company's share price, expected lives of the options and warrants, expected dividends to be paid by the Company and other relevant assumptions.

The amounts recorded and disclosed related to future income tax asset, liability and recovery are based on estimates of the probability of the Company utilizing certain tax pools and assets which in turn, is dependent on estimates of proved and probable reserves production rates and future petroleum and natural gas prices.

By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

**Financial Instruments**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial assets and financial liabilities are recognized on the balance sheet at the time the Company becomes a party to the contractual provisions. Upon initial recognition, financial instruments are measured at fair value. Measurement in subsequent periods is dependent on the classification of the financial instrument. These instruments are classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale or other financial liabilities.

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**2. Significant Accounting Policies** (continued)

Held-for-trading instruments are financial assets and liabilities typically acquired with the intention of generating revenues in the short-term. However, an entity is allowed to designate any financial instrument as held-for-trading on initial recognition even if it would otherwise not satisfy the definition. Financial assets and financial liabilities required to be classified or designated as held-for-trading are measured at fair value, with gains and losses recorded in net earnings for the period in which the change occurs.

Held-to-maturity investments are non-derivative financial assets, with fixed or determinable payments and with a fixed maturity and an entity has the intention and ability to hold to maturity. These financial assets are measured at amortized cost using the effective interest method. As at August 31, 2010, the Company did not have any financial assets classified as held-to-maturity.

Available-for-sale financial assets are non-derivative assets that are designated as available-for-sale or that are not classified as loans and receivables, held-to-maturity investments or held-for-trading. Available-for-sale financial assets are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in earnings. Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources and other comprehensive income comprises revenue, expenses, gains and losses that are recognized in comprehensive income but excluded from net income. Available-for-sale assets are measured at fair value, except for assets that do not have a readily determinable fair value which are recorded at cost. As at August 31, 2010, the Company does not have any financial assets classified as available-for-sale and the Company does not have any comprehensive income items requiring separate disclosure.

Financial assets classified as loans and receivables are measured at amortized cost using the effective-interest method.

Other financial liabilities are measured at amortized cost using the effective interest method and include all liabilities other than derivatives or liabilities that have been identified as held-for-trading.

Derivatives are to be measured at fair value and unrealized gains and losses reported in the statement of operations unless the "normal sale and purchase" exemption is utilized or the derivatives are designated as cash flow or net investment hedges. All changes in fair value are included in earnings unless cash flow hedge or net investment accounting is used, in which case changes in fair value are recorded in other comprehensive income to the extent the hedge is effective and in earnings to the extent it is ineffective. The Company has not identified any material imbedded derivatives in any of its financial instruments. The Company has not designated any of its derivatives as hedges.

The significance of inputs used in making fair value measurements are examined and classified according to a fair value hierarchy. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement.

The Company will assess at each reporting period whether there is any objective evidence that a financial asset, other than those classified as held-for-trading, is impaired.

Accounts receivable are designated as loans and receivables. Accounts payable and accrued liabilities and bank debt are designated as other financial liabilities.

**3. Adoption of New Accounting Policies**

**Business Combinations**

Effective September 1, 2011, the Company is required to adopt Canadian Institute of Chartered Accountants ("CICA") Section 1582 with respect to the requirement to use the acquisition method for business combinations and related disclosures with earlier application permitted. The Company adopted this standard prospectively effective September 1, 2009 and the adoption of this standard will only have impact on its

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**3. Adoption of New Accounting Policies** (continued)

results of operations or financial position for business combinations entered into subsequent to the date of adoption.

**Consolidated Financial Statements and Non-controlling Interests**

Effective September 1, 2011, the Company is required to adopt Section 1601, **Consolidated Financial Statements**, and 1602, **Non-controlling Interests**, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 with earlier application permitted. The Company adopted these standards effective September 1, 2009 and adoption did not have an impact on its results of operations or financial position.

**Financial Instruments - Disclosures**

In June 2009, the CICA issued amendments to Section 3862, Financial Instruments - Disclosures. The amendments include enhanced disclosures related to the fair value of financial instruments and the liquidity risk associated with financial instruments. The amendments are effective for annual financial statements for fiscal years ending after September 30, 2009. The Company has included these incremental disclosures for the year ended August 31, 2010 in note 14.

**4. Future Accounting Pronouncements**

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

In February, 2008, the CICA Accounting Standards Board confirmed that the changeover to IFRS from GAAP will be required for publicly accountable enterprises effective for the interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition from current GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

Although IFRS is principles based and uses a conceptual framework similar to GAAP, there are significant differences and choices in accounting policies, as well as increased disclosure requirements under IFRS. The International Accounting Standards Board has issued certain amendments and exemptions to IFRS 1 relating to full cost oil and gas accounting. The amendments permit the Company to apply IFRS prospectively to their full cost pool of capitalized exploration and development expenses, with an initial impairment test, at the transition date. The Company will then be required to adopt a form similar to "successful efforts" method of accounting for oil and gas on a prospective basis.

The Company has not completed development of its IFRS changeover plan, which will include project structure governance, resourcing and training, analysis of key GAAP differences and a phase plan to assess accounting policies under IFRS as well as potential first time adoption of IFRS exemptions. The Company plans to complete its project scoping, which will include a timetable for assessing the impact on data systems, internal controls over financial reporting and business activities, such as financing and compensation arrangements during 2011. The Company will disclose the key elements of its plan and progress on the project as information becomes available during the transition period beginning September 1, 2010.

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**5. Property and Equipment**

As at August 31, 2010, \$1,110,000 (2009- \$970,000) of oil and natural gas property costs are undeveloped and have not been subject to depletion. The calculation of depletion included future development costs of \$1,800,000 (2009 - \$600,000). During the year ended August 31, 2010 the Company capitalized approximately \$67,000 (2009 - \$43,000) of general and administrative expenses.

<b>August 31, 2010</b>			
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net Book Value</b>
Oil and natural gas properties	\$ 15,239,618	\$ 3,960,033	\$ 11,279,585
Equipment	38,201	29,743	8,458
	<b>\$ 15,277,819</b>	<b>\$ 3,989,776</b>	<b>\$ 11,288,043</b>

  

<b>August 31, 2009</b>			
	<b>Cost</b>	<b>Accumulated Depletion and Depreciation</b>	<b>Net Book Value</b>
Oil and natural gas properties	\$ 8,380,901	\$ 2,867,955	\$ 5,512,946
Equipment	35,678	21,315	14,363
	<b>\$ 8,416,579</b>	<b>\$ 2,889,270</b>	<b>\$ 5,527,309</b>

The Company performed a ceiling test calculation at August 31, 2010, to assess the recoverable value of the oil and natural gas properties. The oil and natural gas future prices are based on the August 31, 2010 commodity price forecast of the Company's independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to the Company. Benchmark price and exchange assumptions used are as follows:

<b>Year</b>	<b>Crude Oil Edmonton (Cdn\$/bbl)</b>	<b>Natural Gas AECO (\$/mcf)</b>
2010	81.81	4.28
2011	84.70	4.75
2012	86.62	5.45
2013	88.55	5.92
2014	90.47	6.39
2015	92.16	6.52
2016	93.89	6.66

*Escalated at 2% thereafter*

**MAGNUM ENERGY INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
For The Years Ended August 31, 2010 and 2009

**6. Bank Debt**

As at August 31, 2010, the Company has available a demand revolving operating loan facility with a Canadian financial institution with a borrowing base of \$5,000,000. The credit facility may be extended and revolve beyond the initial fifteen month period, if requested by the Company and accepted by the lender. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lender, based primarily on reserves and using commodity prices estimated by the lender as well as other factors. A decrease in the borrowing base could result in a reduction to the credit facility, which may require a repayment to the lender at any time with a 45 day notice.

The credit facility provides direct advances which bear interest at the lender's prime rate plus 2.0% (changed to 2.5% effective October 7, 2010). A general security agreement over all present and after acquired personal property and a floating charge on all lands has been provided as security. As at August 31, 2010, \$4,248,301 was outstanding on this facility.

The facility is subject to a financial-based covenant requiring the Company to maintain a working capital ratio of no less than 1:1. At August 31, 2010, the Company's working capital ratio was 1.03:1.

The next review of the credit facility is scheduled to take place on or before January 31, 2011.

**7. Income Taxes**

The provision for future income taxes differs from that which would be expected by applying the effective combined Canadian federal and provincial income tax rates of 28.3% (2009 - 29.2%) to loss before income taxes. The principal reasons for this difference are as follows:

	2010	2009
Expected income tax recovery on loss before taxes	\$ 236,839	\$ 176,428
Increase (decrease) resulting from:		
Stock-based compensation	(54,718)	(19,990)
Change in tax rates	(2,631)	(13,431)
Future income tax asset recognized	-	59,993
	\$ 179,490	\$ 203,000

The components of the Company's future tax asset (liability) are as follows:

	2010	2009
Carrying value of property and equipment and asset retirement obligations in excess of available tax deductions	\$ (784,500)	\$ (275,000)
Non-capital losses carried forward	650,700	450,000
Share issue costs	51,500	28,000
	\$ (82,300)	\$ 203,000

**8. Asset Retirement Obligations**

The Company has estimated the total future asset retirement obligation based on the Company's net ownership interest in all wells and facilities. This includes all estimated costs to dismantle, remove, reclaim and abandon the wells and facilities and the estimated time period during which these costs will be incurred in the future. The Company has estimated the total undiscounted cash flows required to settle the asset retirement obligations to be approximately \$697,000 (2009: \$511,000). These payments are expected to be made over the next five to fifteen years. A credit-adjusted risk free rate of 6% (2009 - 7%) was used to calculate the fair value of the asset retirement obligations.

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**8. Asset Retirement Obligations** (continued)

The following table reconciles the asset retirement obligations associated with the retirement of oil and gas properties:

	<b>2010</b>	<b>2009</b>
Balance, beginning of year	\$ 293,230	\$ 163,003
Liabilities incurred	295,890	119,188
Liabilities sold	(135,839)	-
Accretion expense	27,919	11,039
<b>Balance, end of year</b>	<b>\$ 481,200</b>	<b>\$ 293,230</b>

**9. Share Capital**

**Authorized:**

Unlimited	Class A voting common shares without par value
10,000,000	Class B voting common shares without par value
10,000,000	Class C non-voting common shares without par value
10,000,000	Class A preferred shares with a par value of \$10 each
10,000,000	Class B preferred shares with a par value of \$0.01 each

**Issued and Outstanding:**

	<b>Number of Shares</b>	<b>Stated Value</b>
<b>Class A voting common shares</b>		
<b>Balance, August 31, 2008</b>	24,929,514	\$ 5,179,934
Shares issued for debt settlement	214,058	32,815
<b>Balance, August 31, 2009</b>	25,143,572	\$ 5,212,749
Private placements	9,128,249	3,468,860
Exercise of options	240,579	106,770
Share issuance costs (net of income tax effect of \$57,910)		(165,968)
Future income tax effect related to flow-through shares		(522,700)
<b>Balance, August 31, 2010</b>	<b>34,512,400</b>	<b>\$ 8,099,711</b>

**Settlement of Account Payable**

On March 22, 2009, the Company issued 214,058 Class A common shares to a certain creditor of the Company in exchange for an outstanding debt owed to them of \$64,218. The shares were subject to a four month hold period. The shares have been ascribed a value of \$0.153 per share based on the trading price of the shares at the time of the issuance with the share price differential of \$12,138 recognized as income attributable to the settlement of the accounts payable as of August 31, 2009. The remaining \$19,264 of the debt was included in accounts payable at August 31, 2009 and was recognized as income during the three months ended November 30, 2009, when certain conditions regarding the trading price of the shares of the Company were met.

**Issuance of Class A common shares**

In October 2009, the Company issued 3,000,000 Class A common shares at \$0.20 per share for total proceeds of \$600,000. In June and July 2010, the Company issued 2,332,250 Class A common shares at \$0.40 per share for total proceeds of \$932,900.

**Flow-through Shares**

In December 2009, the Company issued 3,795,999 flow-through Class A common shares at \$0.51 per share for total proceeds of \$1,935,960.

**MAGNUM ENERGY INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
For The Years Ended August 31, 2010 and 2009

**9. Share Capital** (continued)

In February 2010, the Company renounced \$1,935,960 of qualifying expenditures on its flow-through shares issued in 2009. The Company recorded a recovery of future income tax assets with a corresponding reduction in share capital of \$522,700 in 2010 with respect to the renunciation. Of the expenditures renounced, \$1,034,000 was renounced under the one year look-back rule that allows companies to renounce qualifying expenditures prior to incurring the expenditures. A Part XII.6 tax was levied commencing March 1, 2010 at a prescribed rate applied to the difference between the amount renounced and the actual expenditures incurred. For the year ended August 31, 2010, \$2,100 (2009 - \$26,000) of Part XII.6 tax is included with interest expense. As at August 31, 2010, the Company had fully incurred the qualifying expenditures related to these renouncements.

**Per Share Amounts**

The table below summarizes the weighted average number of Class A common shares used in calculating loss per share.

	<b>2010</b>	<b>2009</b>
Basic and diluted	30,644,277	25,024,521

The weighted average number of shares outstanding for the years ended August 31, 2010 and 2009 were not increased for outstanding stock options and warrants for purposes of calculating diluted loss per share as the effect would be anti-dilutive.

**Warrants**

Share purchase warrants transactions for the year are summarized below:

	<b>Fair Value of Warrants</b>	<b>Number of Warrants</b>	<b>Weighted Average Exercise Price</b>
<b>Balance as at August 31, 2008</b>	\$ 222,000	7,831,093	\$0.42
Expired	-	(6,246,093)	0.42
<b>Balance as at August 31, 2009</b>	222,000	1,585,000	\$0.40
Expired	(222,000)	(1,585,000)	0.40
Broker's warrants granted	9,400	117,583	0.40
<b>Balance as at August 31, 2010</b>	\$ 9,400	117,583	\$0.40

On June 22, 2010, 117,583 Class A common share broker warrants were granted with an exercise price of \$0.40 and a one year expiry date. The fair value of the warrants granted was estimated at \$0.08 per warrant using the Black-Scholes option pricing model using a one year expected life, a 0% dividend yield, an expected volatility of 37% and a risk-free interest rate of 2.77%.

**Stock Options**

The Company has established a stock option plan in accordance with the policies of the TSX Venture Exchange under which it is authorized to grant share purchase options up to 10% of its outstanding Class A common shares. Options are issued at the market price of the Company's stock on the date of the grant.

**MAGNUM ENERGY INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
For The Years Ended August 31, 2010 and 2009

**9. Share Capital** (continued)

Unless otherwise stated, the options vest when granted. The options are issued for a maximum term of five years. Stock option transactions for the year and the number of stock options outstanding are summarized below:

	Number of Options	Weighted Average Exercise Price (\$)
<b>Balance as at August 31, 2008</b>	2,085,000	0.36
Granted	669,000	0.18
Cancelled	(340,000)	0.42
<b>Balance as at August 31, 2009</b>	2,414,000	0.28
Granted	931,579	0.37
Expired	(275,000)	0.35
Cancelled	(150,000)	0.18
Exercised	(240,579)	0.37
<b>Balance as at August 31, 2010</b>	2,680,000	0.23

As at August 31, 2010, stock options were outstanding as follows:

Number of Options	Exercise Price (\$)	Remaining contractual life in years	Expiry Date	Number of Options Exercisable
150,000	0.18	0.48	February 22, 2011	150,000
650,000	0.18	1.23	November 24, 2011	650,000
500,000	0.18	1.75	June 1, 2012	500,000
200,000	0.18	3.44	February 5, 2014	200,000
225,000	0.18	3.67	May 1, 2014	225,000
244,000	0.18	3.72	May 20, 2014	244,000
100,000	0.26	4.09	October 1, 2014	100,000
561,000	0.37	4.16	October 27, 2014	561,000
50,000	0.45	4.30	December 17, 2014	50,000
2,680,000		2.66		2,680,000

During the year ended August 31, 2009, the Company applied to the TSX Venture Exchange to re-price, to \$0.18 per share, 1,575,000 options outstanding at an average exercise price of \$0.36 per share. The re-pricing was approved at the Annual General and Special Meeting of the Company held on January 20, 2010.

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

	2010	2009
Fair value	\$0.04 to \$0.31	\$0.09 to \$0.12
Risk-free interest rate	1.04% - 2.77%	2.07% - 2.22%
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	37% - 89%	84% - 85%
Expected life of options (years)	1 - 5	5

**MAGNUM ENERGY INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
For The Years Ended August 31, 2010 and 2009

**10. Contributed Surplus**

The following summarizes the Company's contributed surplus:

	<b>2010</b>	<b>2009</b>
Balance, beginning of year	\$ 747,510	\$ 679,050
Options vested	193,350	68,460
Options exercised	(17,990)	-
Warrants expired	222,000	-
Balance, end of year	\$ 1,144,870	\$ 747,510

**11. Related Party Transactions**

During the year, the Company incurred consulting fees totaling \$164,300 charged by companies controlled by directors or officers of the Company (2009 -\$277,650), and legal fees totaling \$34,300 charged by a firm where a director is a partner (2009 - \$31,300). These transactions were measured at the exchange amount which is the amount agreed upon by the transacting parties.

The Company shares office space with another public company which has certain directors and officers who are also directors and officers of the Company. During the year ended August 31, 2010, the Company paid approximately \$20,800 (2009 - \$24,800) for office and equipment rentals to that company under a cost sharing agreement. These transactions were measured at the exchange amount which is the amount agreed upon by the transacting parties.

Included in accounts payable and accrued liabilities at August 31, 2010 is approximately \$25,100 (2009 - \$24,800) with respect to unpaid consulting fees, legal fees and general administration owing to related companies which is due under normal credit terms.

**12. Commitments**

The Company has lease commitments for base rental payments for offices and equipment through 2014. The approximate minimum lease commitments including operating costs for the next five years and thereafter are as follows:

2011	\$ 159,144
2012	31,126
2013	12,000
2014	12,000
2015	10,000
	<u>\$ 224,270</u>

On October 15, 2010, the Company entered into a consulting agreement whereby the consultant will provide certain investment relations services. The terms of the agreement are for \$7,500 per month for one year subject to a review after the first three months.

**13. Non-cash Transactions**

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the statements of cash flows during the years ended August 31 as follows:

- the Company recorded an asset retirement obligation of \$295,890 (2009 - \$119,188) on its property and equipment
- in 2009 the Company issued 214,058 Class A common shares at a deemed price of \$0.30 per share for payment of an outstanding payable
- in 2010 the Company recorded \$9,400 in non-cash share issuance expenses related to the grant of 117,583 Broker warrants
- in 2010 the Company sold its interest in the Cherry area natural gas wells and facilities in exchange for the outstanding net charges payable to the operator of approximately \$225,000.

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**14. Financial Instruments and Risk Management**

The nature of the Company's operations exposes the Company to market, liquidity and credit risk. The Company employs risk management strategies and policies to ensure that any exposure to risk is in compliance with the Company's business objectives and risk tolerance levels. Risk management is ultimately established by the Board of Directors and is implemented by senior management and monitored by the risk management function within the Company.

**Market Risk**

Market risk is the risk that changes in market prices, such as commodity prices, interest rates and foreign exchange rates will affect the Company's net earnings or the value of financial instruments. The objective of the Company is to manage and mitigate market risk exposures within acceptable limits, while maximizing returns.

**Commodity Price Risk**

The nature of the Company's operations results in exposure to fluctuations in commodity prices. Management continuously monitors commodity prices to manage its cash flow. Commodity prices for oil and natural gas are impacted by numerous factors, including supply and demand, the relationship between the Canadian and U.S. dollar, the political climate and other market forces. As of August 31, 2010, the Company had entered into no derivative financial instruments for the purpose of managing commodity price risk.

**Interest Rate Risk**

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that changes in market interest rates impact its borrowings under the floating rate credit facility. The floating rate debt is subject to interest rate cash flow risk, as the cash required to service the debt will fluctuate as a result of changes in market rates. The Company had no interest rate swaps or financial contracts in place as at or during the year ended August 31, 2010. If interest rates had been 1% lower with all other variables held constant, after tax net loss for the year ended August 31, 2010 would have been approximately \$37,000 lower, due to lower interest expense. An equal opposite impact would have occurred to net loss had interest rates been 1% higher.

**Foreign Exchange Risk**

Foreign exchange risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of the Company's oil and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for oil and natural gas are denominated in U.S. dollars, and therefore, are impacted by changes in the exchange rate between the Canadian and U.S. dollar. As at August 31, 2010, the Company had no forward foreign exchange contracts in place, nor any significant working capital items denominated in foreign currencies.

The Company is also subject to the risk of fluctuating exchange rates relating to the purchase of services in U.S. dollars. At August 31, 2010, \$nil (2009 – \$19,298) of accounts payable is denominated in U.S. dollars.

**Credit Risk**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Cash and cash equivalents consisted of cash bank balances and term deposits maturing in 30 days. The Company manages the credit exposure related to short-term investments by selecting counterparties based on credit ratings and monitors all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

The majority of the Company's accounts receivables are due from companies in the oil and gas industry and are subject to normal industry credit risks including commodity price fluctuations and escalating costs. The Company generally extends unsecured credit to these customers and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**14. Financial Instruments and Risk Management** (continued)

mitigated by the size and reputation of the companies to which they extend credit. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued by the partner. The Company has not experienced any credit loss in the collection of accounts receivable to date. As at August 31, 2010, the Company's receivables consisted of approximately \$126,400 from joint venture partners, \$133,250 from oil and gas marketers and \$117,220 from government agencies.

The Company sells the majority of its production to two petroleum and natural gas marketers and therefore is subject to concentration risk. At August 31, 2010, the Company's largest credit exposure to the petroleum and natural gas marketers represents 35% of accounts receivable. Management does not believe that this concentration of credit risk will result in any loss to the Company based on past payment experience. Receivables from petroleum and natural gas marketers are normally collected on the 25<sup>th</sup> day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large gas marketers. The Company does not obtain collateral from petroleum and natural gas marketers or others in the event of non-payment.

The carrying amount of accounts receivable represents the maximum credit exposure and therefore, the Company reviews its outstanding receivables on an ongoing basis. As of August 31, 2010, there were no significant receivables greater than 90 days.

**Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure it will have sufficient liquidity to meet its liabilities when due. By nature, the oil and gas industry is very capital intensive. As a result, the Company prepares annual capital expenditure budgets and utilizes authorizations for expenditures to manage capital expenditures. The Company also has a revolving operating credit facility, to facilitate the management of its liquidity risk.

**Fair Value of Financial Instruments**

Financial instruments of the Company carried on the balance sheet consist mainly of accounts receivable, accounts payable and accrued liabilities, and bank debt. The estimated fair value of the financial instruments approximates their carrying value due to their short terms to maturity and the floating interest rate on the Company's debt. At August 31, 2010, the Company does not hold any financial instruments for which it has elected to apply hedge accounting under Section 3865.

**15. Capital Management**

There was no change to the Company's capital management during the year ended August 31, 2010. The Company actively manages its capital structure which includes shareholders' equity, bank debt and working capital. In order to maintain or adjust the capital structure, the Company considers the following: incremental investment and acquisition opportunities, the current level of credit available from the Company's lender, the level of credit that may be obtainable from the Company's lender as a result of growth in reserve values, the availability of other sources of debt with different characteristics than the existing bank debt, the sale of assets, limiting the size of the investment program, and new share issuances if available on favourable terms. The Company's objective is to maintain a flexible structure that will allow it to execute its investment program, including exploration and development of its oil and gas properties and acquisition and disposition transactions that will carry varying amounts of risk. The Company continually strives to balance the proportion of debt and equity in its capital structure to take into account the level of risk being incurred in its investment program. The Company may from time to time issue shares and adjust its capital spending to manage current and projected debt levels.

The Company monitors its capital monthly by forecasting expected cash flows from oil and natural gas based on current price and production information. The Company also monitors compliance with the financial covenants it has under its credit facility whereby certain ratios are required to be maintained between specific reserve value data and financial data is monitored. As of August 31, 2010, the Company was in compliance with all required covenants with its banker.

**MAGNUM ENERGY INC.**  
NOTES TO FINANCIAL STATEMENTS  
For The Years Ended August 31, 2010 and 2009

**16. Subsequent Events**

On November 3, 2010, the Company announced it had entered into a letter of intent to acquire lands, producing oil wells and related production facilities in a Viking Oil prospect at a cost of \$2,800,000 before closing adjustments. Per the terms of the agreement, the Acquisition is schedule to close on January 15, 2011.

On December 8, 2010, the Company announced that it had arranged a non-brokered private placement of up to \$1,000,000 through the issuance of up to 3,448,276 flow-through Class A common shares at a price of \$0.29 per share. The private placement is subject to the approval of the TSX-Venture Exchange and had not closed as of the date of these financial statements.

Subsequent to August 31, 2010, the Company granted 300,000 stock options, vesting one quarter at the end of each of January 15, 2011, April 15, 2011, July 15, 2011 and October 15, 2011 and expiring in 2 years, at a exercise price of \$0.295 per share.

# **MAGNUM ENERGY INC.**

## **Management's Discussion & Analysis**

For the Year Ended August 31, 2010

## **MANAGEMENT'S DISCUSSION & ANALYSIS**

**December 14, 2010**

This management's discussion and analysis (MD&A) of financial condition and results of operations for the three month period and year ended August 31, 2010 should be read in conjunction with the annual audited financial statements of Magnum Energy Inc. (the "Company" or "Magnum") as well as the Statement of Reserves Data and Other Oil and Gas Information. These documents and other statutory filings are available on SEDAR at [www.sedar.com](http://www.sedar.com) and at the Company's website at [www.magnumenergy.com](http://www.magnumenergy.com).

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

### **FORWARD LOOKING STATEMENTS**

This document contains certain forward-looking statements, including management's assessment of future plans and operation, and capital expenditures and the timing thereof, that involve substantial known and unknown risks and uncertainties, certain of which are beyond Magnum's control. Such risks and uncertainties include, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources, the impact of general economic conditions in Canada, the United States, and overseas, industry conditions, changes in laws and regulations (including the adoption of new environmental laws and regulations) and changes in how they are interpreted and enforced, increased competition, the lack of availability of qualified personnel or management, fluctuations in foreign exchange or interest rates, stock market volatility and market valuations of companies with respect to announced transactions and the final valuations thereof, and obtaining required approvals of regulatory authorities. Magnum's actual results, performance or achievements could differ materially from those expressed in, or implied in, these forward-looking statements and, accordingly, no assurances can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits, including the amount of proceeds, that Magnum will derive therefrom. Readers are cautioned that the foregoing list of factors is not exhaustive. All subsequent forward-looking statements, whether written or oral, attributable to Magnum or persons acting on its behalf are expressly qualified in their entirety by these cautionary statements. Furthermore, the forward-looking statements contained in this document are made as of the date of this document and Magnum does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

### **BASIS OF PRESENTATION**

For the purpose of reporting sales and production volume information, reserves and calculating unit prices and costs, natural gas volumes have been converted to a barrel of oil equivalent (boe) using six thousand cubic feet equal to one barrel. A boe conversion ratio of 6:1 is based upon an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. This conversion conforms to the Canadian Securities Administrators' National Instrument 51-101 when boe information is disclosed. Boe information may be misleading, particularly if used in isolation. All references to dollar values are to Canadian dollars.

## NON-GAAP MEASURES

The MD&A contains the term cash flow from operations, which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian GAAP. Cash flow from operations is used by Magnum to analyze operating performance, leverage and liquidity. Cash flow from operations as presented does not have any standardized meaning prescribed by Canadian GAAP and, therefore, may not be comparable with the calculation of similar measures by other entities. Cash flow from operations per share is calculated using the same weighted average number of shares outstanding as used in the calculation of loss per share. Cash flow, as discussed in this report, appears as a separate subtotal on the Company's cash flow statement and is reconciled to net loss.

Magnum also uses "operating netbacks" as a key performance indicator of field results by commodity. Operating netbacks do not have a standardized meaning prescribed by Canadian GAAP and therefore may not be comparable with the calculation of similar measures by other companies. Operating netbacks are determined by deducting royalties and operating expenses from oil and natural gas sales.

Cash flow from operations and operating netbacks are not intended to represent operating profits, nor should they be viewed as an alternative to cash flow provided by operating activities, net loss or other measures of financial performance in accordance with Canadian GAAP.

## OVERVIEW

Magnum Energy Inc. (the "Company" or "Magnum") was incorporated under the *Company Act* (British Columbia) on June 27, 2003 and was continued under the Business Corporations Act of Alberta on February 18, 2010. The Company is a public company whose Class A common shares trade on the TSX Venture Exchange. Magnum was formed to operate in Canada as an oil and gas exploration, development and production company.

## SELECTED ANNUAL INFORMATION

	August 31 2010	August 31 2009	August 31 2008
Oil and natural gas sales	\$ 2,448,282	\$ 1,528,419	\$ 1,868,137
Production :			
Oil & NGLs (bbls)	6,109	14,915	11,114
Gas (mcf)	466,594	146,677	108,720
BOE	83,875	39,361	29,234
Average sales price:			
Oil & NGLs (\$/bbl)	68.70	64.52	98.24
Gas (\$/mcf)	4.35	3.86	7.14
Cash flow provided by operations	\$ 465,624	\$ 30,453	\$ 407,385
Per share -basic	\$ 0.02	\$ 0.00	\$ 0.02
Per share -diluted	\$ 0.01	\$ 0.00	\$ 0.02
Per BOE	\$ 5.55	\$ 0.77	\$ 13.94
Net loss	\$ (657,397)	\$ (401,206)	\$ (82,825)
Per share (basic & diluted)	\$ (0.02)	\$ (0.02)	\$ (0.00)
Capital expenditures (net of dispositions)	\$ 6,701,189	\$ 2,051,947	\$ 1,198,037
Total assets	\$ 11,750,630	\$ 5,872,500	\$ 4,858,361
Weighted average number of shares			
-basic	30,644,277	25,024,521	24,536,069

## HIGHLIGHTS FOR THE YEAR ENDED AUGUST 31, 2010

- Petroleum and natural gas production was 83,875 boes for the year, an increase of 113% compared to 39,361 boes for the year ended August 31, 2009.
- The Company's total proved and probable reserves increased to 1,558,219 boes from 714,757, an increase of 118%.
- Magnum installed 100% owned compression facilities for its Sedalia gas producing wells thereby increasing capacity from 1.5 mmcf/d to 7.0 mmcf/d.
- Operating costs were reduced from an average of \$9.29 per boe in 2009 to \$6.85 per boe for 2010.
- Lands owned by Magnum increased by 66% from 6,877 net acres to 11,391 net acres.

## RESULTS OF OPERATIONS

	Three months ended August 31		Year ended August 31	
	2010	2009	2010	2009
<b>Revenue</b>				
Oil and natural gas sales	\$ 527,387	\$ 329,349	\$ 2,448,282	\$ 1,528,419
Royalties	(48,770)	(43,051)	(269,285)	(216,657)
Interest	-	308	-	4,806
	<u>478,617</u>	<u>286,606</u>	<u>2,178,997</u>	<u>1,316,568</u>
<b>Expenses</b>				
Operating	149,092	125,137	574,310	365,478
General and administrative	196,761	215,998	920,447	840,696
Interest and bank fees	64,043	29,063	218,616	79,941
Stock-based compensation	115,600	-	193,350	68,460
Depletion, depreciation and accretion	271,541	128,522	1,128,425	578,337
	<u>797,037</u>	<u>498,720</u>	<u>3,035,148</u>	<u>1,932,912</u>
<b>Loss from operations</b>	(318,420)	(212,114)	(856,151)	(616,344)
Settlement of account payable	-	12,138	19,264	12,138
<b>Loss before income taxes</b>	(318,420)	(199,976)	(836,887)	(604,206)
Future income tax recovery	54,740	203,000	179,490	203,000
<b>Net loss and comprehensive loss</b>	(263,680)	3,024	(657,397)	(401,206)
<b>Deficit, beginning of period</b>	(3,223,739)	(2,833,046)	(2,830,022)	(2,428,816)
<b>Deficit, end of period</b>	\$ (3,487,419)	\$ (2,830,022)	\$ (3,487,419)	\$ (2,830,022)
<b>Loss per share - basic and diluted</b>	\$ (0.01)	\$ 0.00	\$ (0.02)	\$ (0.02)
<b>Weighted average number of shares</b>				
-basic and diluted	32,984,328	24,929,514	30,644,277	25,024,521

## Revenues

	Three months ended August 31		Year ended August 31	
	2010	2009	2010	2009
Oil	\$ 50,408	\$ 126,123	\$ 337,074	\$ 925,310
Gas	433,918	193,860	2,028,608	565,962
Natural gas liquids	43,061	9,366	82,600	37,147
	\$ 527,387	\$ 329,349	\$ 2,448,282	\$ 1,528,419

## Average selling prices

	Three months ended August 31		Year ended August 31	
	2010	2009	2010	2009
Oil and NGLs(\$/bbl)	61.25	63.52	68.70	64.53
Gas (\$/mcf)	3.81	2.97	4.35	3.86
Total (\$/boe)	25.73	25.32	29.19	38.83

Oil revenues decreased for both the three month period and year ended August 31, 2010 over 2009 due to decreased production from the McLeod property.

Gas sales for the year increased by 258% to \$2,028,608 due mainly to a 218% increase in production and also to an increase in the price of gas over 2009. For the three months ended August 31, 2010, gas revenue increased by 124% due to increases in both production and gas prices compared to the same period in 2009.

Magnum markets its oil, natural gas and liquids in the Alberta spot market at various delivery points.

## Production

	Three Months Ended August 31		Year Ended August 31	
	2010	2009	2010	2009
Oil and NGL's (bbls)	1,526	2,133	6,109	14,915
Gas (mcf)	113,837	65,241	466,594	146,677
Combined (boe)	20,499	13,007	83,875	39,361

Production for the year ended August 31, 2010 increased by 113% on a per boe basis as compared to 2009, due mainly to new gas wells in the Sedalia area two of which commenced production in April 2009 and the third in August, 2009. Six producing gas wells were acquired in October, 2009 and workovers and re-completions performed in late 2009 also resulted in increased production. An additional well drilled early in 2010 commenced production in March 2010. Three additional wells began production late in August, 2010 as the result of a completion, a recompletion and the drilling of a new well, all in the Sedalia area. Gas production from the Enchant well has been shut-in since September, 2008 and was brought onstream again in August, 2010. For the three months ended August 31, 2010, production increased to an average of 222 boe/d due to the Sedalia gas wells.

Production by area for the two years ended August 31 follows:

2010	Cherry	Enchant	McLeod	Sedalia	Total
Oil & ngl's – bbls	-	-	5,946	163	6,109
Gas – mcf	10,672	1,931	10,147	443,845	466,595
Total – boe	1,779	322	7,637	74,137	83,875

2009	Cherry	Enchant	McLeod	Sedalia	Total
Oil & ngl's – bbls	-	8	14,907	-	14,915
Gas – mcf	35,479	841	18,001	92,356	146,677
Total – boe	5,913	148	17,907	15,393	39,361

The Cherry area was sold effective December 31, 2009 to allow the Company to focus its efforts in its core areas.

## Royalties

	Three Months Ended August 31		Year ended August 31	
	2010	2009	2010	2009
Crown	\$ 43,485	\$ 40,909	\$ 247,310	\$ 200,535
GORR	5,285	2,142	21,975	16,122
Total royalties expense	\$ 48,770	\$ 43,051	\$ 269,285	\$ 216,657
Royalties as a percent of revenue	9.2%	13.1%	11.0%	14.2%
Royalties expense per BOE	\$ 2.38	\$ 3.31	\$ 3.21	\$ 5.50

Royalties for the year ended August 31, 2010 were 11.0% of total revenue (2009 – 14.2%); the decrease was due to lower royalty rates on lower productivity wells and oil crown royalties having less of an impact due to decreased oil production. Also, many of the Company's Sedalia wells have benefitted from the reduced royalty rates announced early in 2009 and have a maximum 5% crown royalty burden for the first year of production. Magnum anticipates its average royalty rates will remain approximately 10% through to the end of 2011.

## Operating costs

	Three Months ended August 31		Year ended August 31	
	2010	2009	2010	2009
Operating expenses	\$ 130,078	\$ 107,566	\$ 482,723	\$ 300,679
Transportation costs	19,014	17,571	91,587	64,799
Total operating costs	\$ 149,092	\$ 125,137	\$ 574,310	\$ 365,478
Operating costs per BOE	\$ 7.27	\$ 9.62	\$ 6.85	\$ 9.29

Operating costs have decreased for the year ended August 31, 2010 over 2009 due to the lower costs of operating the Sedalia area wells (averaged \$6.32 per boe for 2010). The Cherry and McLeod wells' average production costs were \$17.98 and \$6.26, respectively, per boe for the year. Operating costs per boe are expected to decline in the future due to increased production from additional wells in the Sedalia area.

## General and administrative expenses

General and administrative expenses increased by \$79,751 (9%) in 2010 due to the Company's increased activity level. Increases were incurred mainly in the areas of consulting and salaries and shareholder and trust services. Magnum capitalized approximately \$67,000 of general and administrative expenses in 2010 as compared to \$43,000 in 2009 as a result of the Company's increased capital expenditure program.

	Three Months Ended August 31		Year ended August 31	
	2010	2009	2010	2009
General and administrative expense	\$ 196,761	\$ 215,998	\$ 920,447	\$ 840,696
General and administrative expense per BOE	\$ 9.60	\$ 16.61	\$ 10.97	\$ 21.36

Details of general and administrative expenses by category are:

	Year ended August 31	
	2010	2009
Accounting and auditing	\$ 96,263	\$ 116,104
Consulting and Salaries	422,635	380,442
Directors' fees	69,885	68,000
Shareholder and trust services	93,168	33,682
Legal fees	49,587	33,452
Office and miscellaneous	51,984	72,191
Rent	129,766	121,821
Reserve evaluations	32,855	38,746
Travel and entertainment	46,497	18,955
Overhead recoveries	(72,193)	(42,697)
General and administrative expense	\$ 920,447	\$ 840,696

## Interest

Interest expensed during the year ended August 31, 2010 was \$218,616 (2009 – \$79,941) and consists primarily of interest and bank fees on Magnum's credit facility of \$216,600 (2008 - \$53,300) and Part XII.6 tax of approximately \$2,000 (2009 - \$26,600). The Part XII.6 tax was levied at a prescribed rate applied to the difference between the amounts of flow-through expenditures renounced effective December 31 of the previous year but not incurred until the following year.

## Stock-based compensation

During the year ended August 31, 2010, the Company granted 931,579 (2009 - 669,000) stock options to various officers, consultants and directors of the Company at an average price of \$0.37 (2009 - \$0.18 per share). The fair value of the options granted ranged from \$0.04 to \$0.31 (2009 - \$0.09 to \$0.12) per share for a total stock based compensation expense for the year of \$193,350 (2009 - \$68,460).

In May, 2009, Magnum applied to the TSX Venture Exchange to re-price, to \$0.18 per share, 1,575,000 options outstanding at an average exercise price of \$0.36 per share. The re-pricing was approved by the non-interested shareholders at the 2010 Annual and Special Meeting of the Company.

All options issued and outstanding as of August 31, 2010 were fully vested and expire as follows:

Number of Options	Exercise Price (\$)	Remaining contractual life in years	Expiry Date
150,000	0.18	0.48	February 22, 2011
650,000	0.18	1.23	November 24, 2011
500,000	0.18	1.75	June 1, 2012
200,000	0.18	3.44	February 5, 2014
225,000	0.18	3.67	May 1, 2014
244,000	0.18	3.72	May 20, 2014
100,000	0.26	4.09	October 1, 2014
561,000	0.37	4.16	October 27, 2014
50,000	0.45	4.30	December 17, 2014
2,680,000		2.66	

Subsequent to August 31, 2010 the Company granted 300,000 options, vesting one quarter at the end of each of January 15, 2011, April 15, 2011, July 15, 2011 and October 15, 2011 and expiring in two years, at an exercise price of \$0.295 per share.

### Depletion, depreciation and accretion

	Three Months ended August 31		Year ended August 31	
	2010	2008	2010	2009
Oil and natural gas properties	\$ 269,327	\$ 123,787	\$ 1,092,078	\$ 558,094
Equipment	705	2,255	8,428	9,204
Accretion of asset retirement obligation	1,509	2,480	27,919	11,039
	\$ 271,541	\$ 128,522	\$ 1,128,425	\$ 578,337
Depletion, depreciation and accretion per boe	\$ 13.25	\$ 9.88	\$ 13.45	\$ 14.69

Depletion and accretion increased during both the year and three month periods ended August 31, 2010 as compared to 2009 due to increased production from the Sedalia area and an increase in the underlying depletable capital expenditures as compared to the prior year.

### Future income tax recovery

For the year ended August 31, 2009, Magnum recorded a future income tax recovery of \$179,490 (2009 - \$203,000). The recoveries were the result of the recognition of excess of tax deductions available over the carrying value of property and equipment.

### Income tax deductions

The Company has approximately \$10,454,000 of available income tax deductions and does not expect to incur cash taxes in its 2011 fiscal year. The following table summarizes Magnum's available approximate income tax deductions as at August 31, 2010:

	Amount	Annual Rate of Deduction (%)
Non-capital losses	\$ 2,412,000	100
Share issuance costs	194,000	20
Canadian exploration expenses	1,942,000	100
Canadian development expenses	332,000	30
Canadian oil and gas property expenses	2,146,000	10
Undepreciated capital costs	3,428,000	25-45
	\$ 10,454,000	

## Net loss

The Company incurred a loss of \$657,397 (\$0.02 per share) for the year ended August 31, 2010 as compared to a loss of \$401,206 (\$0.02 per share) for the same period in 2009. A loss before tax of \$199,976 (\$0.01 per share) was earned during the three months ended August 31, 2009, as compared to a loss of \$318,420 (\$0.01 per share) for the three months ended August 31, 2010. The increase in the loss was due to increased interest, stock based compensation and depletion expenses.

## Per boe information

	Three Months ended August 31		Year ended August 31	
	2010	2009	2010	2009
<b>(\$/boe)</b>				
Average sales price	\$ 25.73	\$ 25.32	\$ 29.19	\$ 38.83
Operating	(7.27)	(9.62)	(6.85)	(9.29)
Royalties	(2.38)	(3.31)	(3.21)	(5.50)
<b>Operating netback per boe</b>	16.08	12.39	19.13	24.04
General and administrative costs	(9.60)	(16.61)	(10.97)	(21.36)
Interest income	-	0.02	-	0.12
Interest expense	(3.13)	(2.23)	(2.61)	(2.03)
<b>Cash flow from operations per boe</b>	3.35	(6.43)	5.55	0.77

## Cash flow from operations

For the year ended August 31, 2010, the Company's cash flow from operations was \$465,624 (\$0.01 per share) as compared to \$30,453 (\$0.00 per share) for the year ended August 31, 2009 due to increased oil and natural gas revenues.

## SELECTED QUARTERLY FINANCIAL INFORMATION

The following is a summary of selected quarterly information that has been derived from the unaudited financial statements of Magnum. The summary should be read in conjunction with the unaudited financial statements of the Company as contained in the public record.

Three months ended:	August 31 2010	May 31 2010	February 28 2010	November 30 2009
Total revenue	\$ 527,387	\$ 659,775	\$ 842,464	\$ 418,656
Net income (loss)	\$ (263,680)	\$ (169,177)	\$ 15,471	\$ (240,011)
Per share, basic and diluted	\$ (0.01)	\$ (0.00)	\$ (0.00)	\$ (0.01)
Production (boe)	20,499	25,179	23,023	15,174
Average pricing (\$/boe)	25.73	26.20	36.59	27.59

Three months ended:	August 31 2009	May 31 2009	February 28 2009	November 30 2008
Total revenue	\$ 329,657	\$ 346,048	\$ 223,718	\$ 633,802
Net income (loss)	\$ 3,024	\$ (183,552)	\$ (152,763)	\$ (67,915)
Per share, basic and diluted	\$ (0.00)	\$ (0.02)	\$ (0.01)	\$ (0.00)
Production (boe)	13,007	11,405	5,878	9,071
Average pricing (\$/boe)	25.32	30.31	37.86	69.54

## CAPITAL EXPENDITURES

During the years ended August 31, 2010 and 2009, Magnum incurred capital expenditures as follows:

	Year ended August 31	
	2010	2009
Land acquisition and retention	\$ 189,928	\$ 4,954
Geological	92,752	23,781
Drilling and completions	2,268,755	1,117,193
Well equipping and facilities	1,601,435	905,544
Property acquisition	2,770,782	-
Property disposition	(224,986)	-
Office equipment	2,523	475
Total	6,701,189	2,051,947
Dispositions	-	-
Net	\$ 6,701,189	\$ 2,051,947

The land acquisitions in 2010 were incurred in the Sedalia area. Drilling, completions, equipping and pipelines were concentrated in the Sedalia area in both 2009 and 2010. The drilling and completions expenditures incurred in 2010 are net of \$204,660 in drilling royalty credits.

On October 20, 2009, the Company closed an acquisition of lands, producing gas wells and related gathering and processing facilities in the Sedalia area (the "Acquisition") at a cost of \$2,825,000 before closing adjustments. The acquisition had an effective date of July 1, 2009. The Cherry property was sold effective December 31, 2009 in exchange for the outstanding net charges payable to the operator.

During the year, Magnum's land holdings increased from 6,879 net acres as at August 31, 2009 to 11,391 net acres as at August 31, 2010.

## RESERVES

The reserves data set forth below is based upon an evaluation by Ryder Scott Company LLP (Ryder), an independent reserves evaluator, with an effective date of August 31, 2010. The reserves data summarizes the oil, ngl and natural gas reserves of Magnum and the future net revenues for these reserves using forecast prices and costs which are summarized below.

The reserves data conforms to the requirements of National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities (NI 51-101). The Company engaged Ryder to provide an evaluation of proved and proved plus probable reserves and no attempt was made to evaluate possible reserves. All of Magnum's reserves are in Alberta, Canada.

It should not be assumed that the estimate of future net revenues presented in the tables below represent the fair market value of the reserves. There is no assurance that the forecast prices and costs and cost assumptions will be attained, and variances could be material. The recovery and reserve estimates of the Company's oil, ngl and natural gas reserves provided below are estimates only and there is no guarantee that the estimated reserves will be recovered. Actual oil, ngl and natural gas reserves may be greater than or less than the estimates provided.

## SUMMARY OF RESERVES AS OF AUGUST 31, 2010 (Forecast Prices & Costs)

Estimated Gross (Pre-Royalties) Reserves:

Product	Reserves Category					
	Proved Developed Producing	Proved Developed Non-Producing	Proved Undeveloped	Total Proved	Probable	Total Proved + Probable
Oil – barrels	7,595	Nil	Nil	7,595	10,571	18,166
NGL – barrels	2,232	Nil	Nil	2,232	4,167	6,399
Sales Gas – mcf	2,399,517	2,169,800	570,000	5,139,317	4,062,608	9,201,925

Estimated Net (After Royalties) Reserves:

Product	Reserves Category					
	Proved Developed Producing	Proved Developed Non-Producing	Proved Undeveloped	Total Proved	Probable	Total Proved + Probable
Oil – barrels	6,339	Nil	Nil	6,339	8,713	15,052
NGL – barrels	1,542	Nil	Nil	1,542	2,868	4,410
Sales Gas – mcf	2,251,422	1,928,441	541,500	4,721,363	3,588,469	8,309,832

The prices used in the following table were Ryder forecast prices as at August 31, 2010. The estimated future net revenues are presented after deducting estimated future abandonment costs and future capital costs associated with non-producing, undeveloped and probable additional reserves. Estimated values disclosed do not necessarily represent fair market value.

Year	Crude Oil WTI (U.S./bbl)	Natural Gas AECO (Cdn\$/mmbtu)	Edmonton Condensate (Cdn\$/bbl)	Exchange Rate (\$U.S./\$Cdn.)
<b>Historical</b>				
2004	41.46	6.79	55.77	0.77
2005	56.47	8.48	77.30	0.82
2006	66.11	6.98	78.05	0.89
2007	72.31	6.61	82.05	0.93
2008	104.89	5.79	116.36	0.96
2009	61.69	4.14	68.88	0.87
2010 Q1	78.63	5.36	88.27	0.95
2010 Q2	77.97	3.86	85.00	0.98
<b>Forecast</b>				
2010	79.00	4.28	88.90	0.95
2011	82.00	4.75	92.12	0.95
2012	84.00	5.45	94.26	0.95
2013	86.00	5.92	96.41	0.95
2014	88.00	6.39	98.55	0.95
2015	89.76	6.52	100.44	0.95
2016 (1)	91.56	6.66	102.37	0.95

(1) prices escalated at 2% thereafter; exchange rate at 0.95 thereafter

**SUMMARY OF NET PRESENT VALUE OF FUTURE NET REVENUE  
AS OF AUGUST 31, 2010 (Forecast Prices & Costs)**

	Future Net Revenue (\$000) <b>Before</b> Income Tax					
	Proved Developed Producing	Proved Developed Non-Producing	Proved Un-developed	Total Proved	Probable	Total Proved + Probable
Undiscounted	8,822	7,785	1,025	17,632	15,850	33,482
Discounted @ 5%	7,284	6,466	604	14,354	11,030	25,384
Discounted @ 10%	6,232	5,493	305	12,030	8,012	20,042
Discounted @ 15%	5,473	4,753	89	10,315	6,024	16,339
Discounted @ 20%	4,899	4,178	(70)	9,007	4,658	13,665

	Future Net Revenue (\$000) <b>After</b> Income Tax					
	Proved Developed Producing	Proved Developed Non-Producing	Proved Un-developed	Total Proved	Probable	Total Proved + Probable
Undiscounted	8,822	6,083	786	15,691	11,885	27,576
Discounted @ 5%	7,284	5,275	499	13,058	8,342	21,400
Discounted @ 10%	6,232	4,688	240	11,160	6,102	17,262
Discounted @ 15%	5,473	4,194	73	9,740	4,614	14,354
Discounted @ 20%	4,899	3,796	(54)	8,641	3,585	12,226

The following table provides a reconciliation of the changes of Magnum's gross reserves; based on forecast prices and costs.

Item		Light & Medium Crude And Natural Gas Liquids			Associated & Non-Associated Gas		
		Gross Proved (bbls)	Gross Probable (bbls)	Gross Proved + Probable (bbls)	Gross Proved (mcf)	Gross Probable (mcf)	Gross Proved + Probable (mcf)
	<b>August 31, 2009</b>	<b>15,581</b>	<b>17,700</b>	<b>33,281</b>	<b>2,991,379</b>	<b>1,097,478</b>	<b>4,088,857</b>
(i)	Extensions						
(ii)	Improved Recovery				240,807	75,089	315,896
(iii)	Technical Revisions				-328,757	-1,340,749	-1,669,506
(iv)	Discoveries				686,272	1,024,000	1,710,272
(v)	Acquisitions				2,007,416	3,219,075	5,226,491
(vi)	Dispositions						
(vii)	Economic Factors	355	-2,962	-2,607	8,794	-12,285	-3,491
(viii)	Production	-6,109	Nil	-6,109	-466,594	Nil	-466,594
	<b>August 31, 2010</b>	<b>9,827</b>	<b>14,738</b>	<b>24,565</b>	<b>5,139,317</b>	<b>4,062,608</b>	<b>9,201,925</b>

## FINDING AND DEVELOPMENT (F&D) COSTS

	2008	2009	2010	Three year Total
<b>Reserve additions</b>				
Total Proved	88,048	514,144	866,380	1,468,572
Probable Reserves	62,293	200,613	691,839	954,745
Total Proved Plus Probable	150,341	714,757	1,558,219	2,423,317
<b>Capital expenditures - Proved</b>				
Change in future developments costs	(330,500)	455,000	1,200,000	1,324,500
Capital expenditures	1,179,729	2,051,472	6,698,666	9,929,867
Total capital - Proved	849,229	2,506,472	7,898,666	11,254,367
<b>Capital expenditures - Proved and Probable</b>				
Change in future development costs	(475,500)	455,000	2,775,000	2,754,500
Capital expenditures	1,179,729	2,051,472	6,698,666	9,929,867
Total capital - Proved and Probable	704,229	2,506,472	9,473,666	12,684,367
<b>F&amp;D per boe</b>				
Proved	23.66	5.38	18.11	12.01
Proved + Probable	19.44	4.15	10.22	8.09

The table above summarizes finding and development costs for 2008, 2009 and 2010 as well as the three year average for proved and proved plus probable reserves. The 2010 results include capital expenditures of approximately \$934,000 for the installation of a compressor, dehydrator and tanks at the Company's Sedalia gas processing facility. Significant future capital expenditures, included in the calculation of F&D costs per boe above, will be required to bring a portion of the current estimated reserves on production in the future.

## RESERVE LIFE INDEX

Reserve life index is a measurement of the time theoretically remaining to fully deplete a company's reserves. Based on the forecast 2011 proved and proved plus probable reserve production and the most recent independent evaluation of total remaining reserves, the Company's reserve life index is as follows:

	Total Proved Reserves	Total Proved Plus Probable Reserves
Total company interest reserves (boe)	866,380	1,558,219
Annualized forecast production (boe)	158,672	171,698
Reserve life index in years	5.5	9.1

## LIQUIDITY AND CAPITAL RESOURCES

During the year ended August 31, 2010, the Company had cash flows from operations of \$465,624 (2009 – \$30,453). As at August 31, 2010, the Company had a working capital deficit of \$4,957,981 (2009 - \$2,084,842).

At August 31, 2010, the Company has available a demand revolving line of credit availability to a maximum of \$5,000,000 bearing interest at the financial institution's prime lending rate plus 2% per annum. As collateral security for the loan facility, there is a general security agreement from the

Company providing a security interest over all present and future acquired property and a floating charge on all lands owned by the Company. The facility may be repaid in whole or in part at any time without penalty and is payable in full on demand by the Lender who may terminate the availability of the facility at any time without notice. As of December 14, 2010 the Company had fully drawn on its available line.

Pursuant to a private placement in October 2009, the Company issued 3,000,000 Class A common shares at a price of \$0.20 per share for gross proceeds of \$600,000. In December 2009, the Company closed two non-brokered private placements totaling 3,795,999 flow-through Class A common shares at a price of \$0.51 per share for total proceeds of \$1,935,960. In June and July, 2010 Magnum issued 2,332,250 Class A common shares at \$0.40 per share for total proceeds of \$932,900. Share issuance costs on the placements totaled approximately \$224,000.

The Company anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If the Company's revenues or reserves decline, the Company may have limited ability to raise the capital necessary to undertake or complete future drilling programs.

## **OUTSTANDING SHARE DATA**

As at August 31, 2010, 34,512,400 Class A common shares were issued and outstanding. Up to an additional 3,448,276 Class A common shares may be issued prior to the end of December, 2010 pursuant to a private placement of flow-through shares announced on December 8, 2010.

As at August 31, 2010, 2,680,000 options were issued and outstanding. In October 2010, an additional 300,000 stock options were granted to a consultant at an exercise price of \$0.295 per share. No options have been exercised since August 31, 2010.

## **FINANCIAL INSTRUMENTS**

Cash and cash equivalents are designated as held-for-trading instruments and are measured at carrying value, which approximates fair value due to the short term nature of these instruments. Accounts receivable are designated as loans and receivables. Accounts payable and accrued liabilities and bank debt are designated as other financial liabilities. The Company did not have any commodity contracts related to production or prices during the year ended August 31, 2010 and has not entered into any as at December 14, 2010.

## **OFF-BALANCE SHEET ARRANGEMENTS**

Magnum does not have any special purpose entities nor is it a party to any arrangements that would be excluded from the balance sheet.

## **COMMITMENTS**

### **Viking Oil Acquisition**

On November 3, 2010, the Company announced it had entered into a letter of intent to acquire lands, producing oil wells and related production facilities in a Viking Oil prospect at a cost of \$2,800,000 before closing adjustments. As of the date of this MD&A the agreed upon date for the closing of the acquisition is January 15, 2011.

## Leased Office Space and Equipment

The Company has lease commitments for base rental payments for offices and equipment through 2015. The approximate minimum lease commitments including operating costs for the next five years and thereafter are as follows:

2011	\$	159,144
2012		31,126
2013		12,000
2014		12,000
2015		10,000
	\$	224,270

In October 2010, the Company entered into a consulting agreement whereby the consultant will provide certain investment relations services. The terms of the agreement are for \$7,500 per month for one year subject to a review after the first three months.

## Flow-through Shares

On December 8, 2010, the Company announced that it had arranged a non-brokered private placement of up to \$1,000,000 through the issuance of up to 3,448,276 flow-through Class A common shares at a price of \$0.29 per share. The private placement is subject to the approval of the TSX-Venture Exchange and had not closed as of the date of these financial statements. Pursuant to the terms of the private placement, the Company will commit to renounce to the subscribers up to \$1,000,000 of expenditures that qualify as Canadian Exploration Expense ("CEE") and Canadian Development Expense ("CDE") for Canadian income tax purposes and to incur the expenditures no later than December 31, 2011.

Under certain conditions, a provision of Canadian income tax legislation referred to as the one year look-back rule allows corporations to renounce qualifying expenditures to flow-through share subscribers prior to incurring the expenditures. Under these rules, corporations have until December 31 of the year following the year in which the flow-through shares are issued to incur the qualifying expenditures. Corporations that use the one year look-back rule are required to pay Part XII.6 Tax. The tax is effectively a financing charge and is levied commencing March 1 of the look-back year. The tax is calculated monthly based on a prescribed rate applied to the difference between the qualified expenditures renounced and the actual cumulative expenditures incurred. In the event the amount renounced is not fully incurred by the end of the look-back year, the Company is required to reduce the amount of qualifying expenditures renounced to subscribers. Furthermore, there is an additional Part XII.6 Tax equal to ten percent of any shortfall. Pursuant to the terms of the agreements, the Company has agreed to indemnify subscribers for the amount of tax benefits lost in the event the amount of qualifying expenditures renounced to subscribers was reduced.

## RELATED PARTY TRANSACTIONS

During the year, the Company incurred consulting fees totaling \$164,300 charged by companies controlled by directors or officers of the Company (2009 -\$277,650), and legal fees totaling \$34,300 charged by a firm where a director is a partner (2009 - \$31,300). These transactions were measured at the exchange amount which is the amount agreed upon by the transacting parties.

The Company shares office space with another public company which has certain directors and officers who are also directors and officers of the Company. During the year ended August 31, 2010, the Company paid approximately \$20,800 (2009 - \$24,800) for office and equipment rentals to that

company under a cost sharing agreement. These transactions were measured at the exchange amount which is the amount agreed upon by the transacting parties.

Included in accounts payable and accrued liabilities at August 31, 2010 is approximately \$25,100 (2009 - \$24,800) with respect to unpaid consulting fees, legal fees and general administration owing to related companies which is due under normal credit terms.

## **CHANGES IN ACCOUNTING POLICIES**

### **Business Combinations**

Effective September 1, 2011, the Company is required to adopt Canadian Institute of Chartered Accountants ("CICA") Section 1582 with respect to the requirement to use the acquisition method for business combinations and related disclosures with earlier application permitted. The Company adopted this standard prospectively effective September 1, 2009 and the adoption of this standard will only have impact on its results of operations or financial position for business combinations entered into subsequent to the date of adoption.

### **Consolidated Financial Statements and Non-controlling Interests**

Effective September 1, 2011, the Company is required to adopt Section 1601, **Consolidated Financial Statements**, and 1602, **Non-controlling Interests**, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 1, 2011 with earlier application permitted. The Company adopted these standards effective September 1, 2009 and adoption did not have an impact on its results of operations or financial position.

### **Financial Instruments - Disclosures**

In June 2009, the CICA issued amendments to Section 3862, Financial Instruments - Disclosures. The amendments include enhanced disclosures related to the fair value of financial instruments and the liquidity risk associated with financial instruments. The amendments are effective for annual financial statements for fiscal years ending after September 30, 2009. The Company has included these incremental disclosures for the year ended August 31, 2010 in its financial statements.

## **FUTURE ACCOUNTING PRONOUNCEMENTS**

### **International Financial Reporting Standards ("IFRS")**

In February, 2008, the CICA Accounting Standards Board confirmed that the changeover to IFRS from GAAP will be required for publicly accountable enterprises effective for the interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition from current GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

Although IFRS is principles based and uses a conceptual framework similar to GAAP, there are significant differences and choices in accounting policies, as well as increased disclosure requirements under IFRS. The International Accounting Standards Board has issued certain amendments and exemptions to IFRS 1 relating to full cost oil and gas accounting. The amendments permit the Company to apply IFRS prospectively to their full cost pool of capitalized exploration and development expenses, with an initial impairment test, at the transition date. The Company will then

be required to adopt a form similar to “successful efforts” method of accounting for oil and gas on a prospective basis.

The Company has not completed development of its IFRS changeover plan, which will include project structure governance, resourcing and training, analysis of key GAAP differences and a phase plan to assess accounting policies under IFRS as well as potential first time adoption of IFRS exemptions. The Company plans to complete its project scoping, which will include a timetable for assessing the impact on data systems, internal controls over financial reporting and business activities, such as financing and compensation arrangements during 2011. The Company will disclose the key elements of its plan and progress on the project as information becomes available during the transition period beginning September 1, 2010.

## **CRITICAL ACCOUNTING ESTIMATES**

The Company’s financial and operating results contain estimates made by management in the following areas:

- capital expenditures are based on estimates on projects in various stages of completion
- drilling royalty credits receivable are based on estimates of future crown royalty costs not yet billed
- royalties and operating costs are based on estimates for which costs had not yet been billed
- asset retirement obligations are based on estimates of future costs and timing of expenditures
- depletion, depreciation and accretion are based on estimates of oil and natural gas reserves that Magnum expects to recover in the future
- asset retirement obligations are based on estimates of future costs and timing of expenditures
- the future recoverable value of oil and gas properties is also based on estimates that the Company expects to realize
- stock-based compensation and warrants are based on estimates of the fair value of options and warrants
- income taxes are based on estimates of the deductibility of certain expenditures and of future tax rates and laws

Management’s assumptions are based on factors that, in management’s opinion, are relevant and appropriate. Management’s assumptions may change over time as operating conditions change.

## **Oil and gas reserves determination**

The process of estimating reserves is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. Reserve estimates are based on current production forecasts, prices and economic conditions. These estimates may change substantively as additional data from ongoing development and production activities becomes available and as economic conditions impact oil and gas prices and costs.

## **Depletion**

The Company uses the full cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development activities, whether successful or not, are capitalized. The aggregate of net capitalized costs (less costs of unproved properties) and estimated future development costs (less estimated salvage values) is amortized using the unit-of-production method based on estimated proved oil and gas reserves. An increase in such estimated reserves or a decrease in estimated future development costs would each result in a corresponding reduction in depletion expense.

## **Impairment of oil and gas properties**

Magnum is required to review the carrying value of all oil and gas assets for potential impairment. Impairment is indicated if the carrying amount of the oil and gas properties is not recoverable by the future undiscounted cash flows attributed to them. If impairment is indicated, the amount by which the carrying value of the properties exceeds their estimated fair value is charged to earnings as part of depletion expense. The assessment of impairment is dependent upon estimates of reserves, production rates, future prices, future foreign exchange rates, future royalty rates, future operating costs and other relevant assumptions.

## **Stock-based compensation**

Under the fair value method of accounting for stock options and warrants, compensation expense and warrants are determined on the date of grant using the Black-Scholes option pricing model which was developed for use in estimating the fair value of options and warrants that are fully transferable and have no vesting restrictions. The Company's stock options and warrants are not transferable, cannot be traded and are subject to vesting restrictions that would tend to reduce value. The Black-Scholes model requires the input of several variables including estimated volatility of Magnum's stock price over the life of the options and warrants, estimated forfeitures and the estimated life of the options and warrants. Changes in these estimates would alter the fair value of the options and warrants and any related expense as determined by the Black-Scholes model.

## **Asset retirement obligations**

The Company is required to provide for future abandonment and restoration costs. Magnum must estimate these costs in accordance with existing laws, contracts or other policies. The fair value of the liability for the Company's asset retirement obligations is recorded in the current period and is calculated as the cost that is expected to be incurred at the expected inflation rate, discounted to its present value using the Company's credit-adjusted risk-free interest rate. This same value is recorded in the carrying amount of oil and gas properties. The liability amount is increased each reporting period to its current discounted present value and the amount of change is charged to earnings as an accretion expense. Revisions to either the estimated timing or costs of future abandonment and restoration cash outflows could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

## **Income tax accounting**

The determination of Magnum's income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability and/or future income tax asset may differ substantially from that estimated and recorded by management.

## **RISKS AND UNCERTAINTIES**

Magnum's production and exploration activities are concentrated in the Western Canadian Sedimentary Basin where activity is highly competitive and includes companies ranging from smaller junior producers to the much larger integrated petroleum companies. The Company is subject to various types of business risks and uncertainties including:

- finding and developing oil and natural gas reserves at economic costs
- production of oil and natural gas in commercial quantities
- marketability of oil and natural gas produced
- substantial capital requirements and access to capital markets

- volatility of commodity prices
- environmental risks
- insurance
- reliance on operators and key employees
- third party credit risk
- changes in legislative and incentive programs

In order to reduce exploration risk, Magnum strives to employ highly qualified and motivated professionals with a demonstrated ability to generate quality proprietary geological prospects. To help maximize drilling success, the Company targets low to moderate risk prospects.

Oil and gas exploration and production can involve environmental risks such as pollution of the environment and destruction of natural habitat, as well as safety risks such as personal injury. In order to mitigate such risk, the Company conducts its operations at high standards and follows safety procedures intended to reduce the potential for personal injury to contractors and the public at large. Magnum maintains current insurance coverage for general and comprehensive insurance as well as limited pollution liability. The amount and terms of this insurance are reviewed on an ongoing basis and adjusted as necessary to reflect changing corporate requirements as well as industry standards and government regulations.

### **Insurance**

The Company's involvement in the exploration for and development of oil and gas properties may result in the Company becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although the Company will obtain insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances, be insurable or, in certain circumstances, the Company may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to the Company. The occurrence of a significant event that the Company is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on the Company's financial position, results of operations or prospects.

### **Prices, Markets and Marketing of Crude Oil and Natural Gas**

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of the Company. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of the Company's oil and gas reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to the Company are in part determined by the borrowing base of the Company. A sustained material decline in prices from historical average prices could limit or reduce the Company's borrowing base, therefore reducing the bank credit available to the Company, and could require that a portion of any existing bank debt of the Company be repaid.

In addition to establishing markets for its oil and natural gas, the Company must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas, which may be acquired or discovered by the Company, will be affected by numerous factors beyond its control. The Company will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by the Company. The ability of the Company to market its

natural gas may depend upon its ability to acquire space on pipelines, which deliver natural gas to commercial markets. The Company will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. The Company has limited direct experience in the marketing of oil and natural gas.

### **Substantial Capital Requirements; Liquidity**

The Company anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If the Company's revenues or reserves decline, the Company may have limited ability to raise the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. Moreover, future activities may require the Company to alter its capitalization significantly. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's financial condition, results of operations or prospects.

### **Competition**

The Company will actively compete for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial resources than the Company. The Company's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

The oil and gas industry is highly competitive. The Company's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them than the Company.

Certain of the Company's customers and potential customers will themselves be exploring for oil and natural gas, and the results of such exploration efforts could affect the Company's ability to sell or supply oil or gas to these customers in the future. The Company's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

### **Environmental Risks**

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and state and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger

finances and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require the Company to incur costs to remedy such discharge. No assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect the Company's financial condition, results of operations or prospects.

### **Reserve Replacement**

The Company's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on the Company successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves the Company may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in the Company's reserves will depend not only on the Company's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. There can be no assurance that the Company's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

### **Reliance on Operators and Consultants**

The Company may not be the operator of certain oil and gas properties in which it acquires an interest. To the extent the Company is not the operator of its oil and gas properties, the Company will be dependent on such operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the success of the Company will be largely dependent upon the performance of its management and consultants. The Company does not have any key man insurance policies, and therefore there is a risk that the death or departure of any member of management or any consultants could have a material adverse effect on the Company.

### **Corporate Matters**

To date, the Company has not paid any dividends on its outstanding common shares. Certain of the directors and officers of the Company are involved in managerial and/or director positions of other oil and gas companies, partnerships or other entities involved in natural resource exploration and development, and conflicts of interest may arise between their duties as officers, managers or directors of the Company and as officers and directors of such other companies, partnerships or other entities. Such conflicts must be disclosed in accordance with, and are subject to such other procedures and remedies as apply under, the *Business Company's Act* (B.C.).

### **Permits and Licenses**

The operations of the Company may require licenses and permits from various governmental authorities. There can be no assurance that the Company will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development at its projects.

### **Additional Funding Requirements**

The Company's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, the Company may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause the Company to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If the Company's revenues from its

reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect the Company's ability to expend the necessary capital to replace its reserves or to maintain its production. If the Company's cash flow from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on favourable terms.

### **Issuance of Debt**

From time to time, the Company may enter into transactions to acquire assets or the shares of other companies. These transactions may be financed partially or wholly with debt, which may increase the Company's debt levels above industry standards. Neither the Company's articles nor its by-laws limit the amount of indebtedness that the Company may incur. The level of the Company's indebtedness from time to time could impair the Company's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

### **Availability of Drilling Equipment and Access Restrictions**

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities.

### **Kyoto Protocol**

Canada is a signatory to the United Nations Framework Convention on Climate Change and has ratified the Kyoto Protocol established thereunder. The Kyoto Protocol, which entered into force as an international treaty on February 16, 2005, sets legally binding targets to reduce Canada's nationwide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases". The Company's exploration and production facilities and other operations and activities will emit a small amount of greenhouse gases which may subject The Company to legislation regulating emissions of greenhouse gases. The Government of Canada has put forward a Climate Change Plan for Canada which suggests further legislation will set greenhouse gases emission reduction requirements for the various industrial activities, including oil and gas exploration and production. Future federal legislation, together with provincial emission reduction requirements, such as those contained in Alberta's *Climate Change and Emissions Management Act*, may require the reduction of emissions or emissions intensity produced by the Company's operations and facilities. The direct or indirect costs of these regulations may adversely affect the business of the Company.

### **ADDITIONAL INFORMATION**

Additional information regarding the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.magnumenergyinc.com](http://www.magnumenergyinc.com).