



CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015
(UNAUDITED)



Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

USD 000s	Note	As at June 30 2016 (note 3)	As at December 31 2015 (note 3)
Assets			
Current assets			
Cash and cash equivalents		4,371	3,912
Restricted cash	9	1,120	-
Available for sale securities	13	-	5,361
Trade and other receivables		11,030	17,882
Inventory		1,599	2,415
Other current assets		796	622
		18,916	30,192
Property, plant and equipment	4	74,924	89,365
Exploration and evaluation assets	5	45,093	43,767
Investments	6	4,258	-
Other long-term assets	8	4,124	593
		147,315	163,917
Liabilities			
Current liabilities			
Deferred debenture financing	9	1,120	-
Current portion of long-term debt	7	3,419	3,944
Trade and other payables		18,484	23,216
Taxes payable		1,227	2,570
		24,250	29,730
Long-term debt	7	-	1,972
Other long-term liabilities		1,359	1,575
Deferred income tax liability		12,048	9,906
Decommissioning obligations	10	17,317	20,641
		54,974	63,824
Shareholders' Equity			
Share capital	11	238,758	238,758
Contributed surplus		15,630	14,520
Accumulated other comprehensive loss		(26,464)	(32,062)
Deficit		(135,583)	(121,123)
		92,341	100,093
		147,315	163,917

Going concern (note 2)

Commitments and contingencies (note 16)

Subsequent events (note 9, 16, and 20)

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



Condensed Interim Consolidated Statements of Loss and Comprehensive Loss
(Unaudited)

USD 000s, except per share amounts	Note	Three months ended June 30		Six months ended June 30	
		2016 (note 3)	2015 (note 3)	2016 (note 3)	2015 (note 3)
Revenues					
Oil and natural gas revenues		13,070	24,115	27,881	43,008
Royalties		(1,993)	(4,800)	(4,317)	(7,417)
		11,077	19,315	23,564	35,591
Expenses					
Operating	19	5,055	8,705	10,981	16,084
General and administrative	19	2,123	3,058	4,884	5,334
Finance (income) expenses	14	671	1,239	2,265	(179)
Share-based compensation	12	400	205	860	429
Depletion and depreciation	4	5,352	6,904	11,276	12,934
		13,601	20,111	30,266	34,602
Income (loss) before income taxes		(2,524)	(796)	(6,702)	989
Income tax (expense) recovery					
Current		(787)	(1,346)	(1,140)	(2,485)
Deferred		(180)	(1,067)	(2,141)	(647)
Total income tax expense		(967)	(2,413)	(3,281)	(3,132)
Net loss from continuing operations		(3,491)	(3,209)	(9,983)	(2,143)
Net loss from discontinued operations	3a	(4,135)	(2,668)	(4,477)	(3,280)
Net loss		(7,626)	(5,877)	(14,460)	(5,423)
Foreign currency translation adjustment		96	484	1,513	(2,299)
Available for sale securities	13	(12)	-	(68)	-
Comprehensive loss		(7,542)	(5,393)	(13,015)	(7,722)
Net loss per share					
Basic and diluted - continuing	11	(0.00)	(0.01)	(0.02)	(0.00)
Basic and diluted - combined	3a	(0.01)	(0.01)	(0.03)	(0.01)

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



Condensed Interim Consolidated Statements of Changes in Shareholders' Equity
(Unaudited)

USD 000s	Share Capital (note 11)	Contributed Surplus	Accumulated Other Comprehensive Loss	Deficit	Total Equity
Balance at December 31, 2015	238,758	14,520	(32,062)	(121,123)	100,093
Net loss	-	-	-	(14,460)	(14,460)
Recycle of other comprehensive loss due to discontinued operations (note 3a)	-	-	4,153	-	4,153
Foreign currency translation adjustment	-	-	1,513	-	1,513
Share-based compensation (note 12)	-	1,110	-	-	1,110
Available for sale securities (note 13)	-	-	(68)	-	(68)
Balance at June 30, 2016	238,758	15,630	(26,464)	(135,583)	92,341
Balance at December 31, 2014	237,928	13,555	(27,049)	(107,418)	117,016
Net loss	-	-	-	(5,424)	(5,424)
Foreign currency translation adjustment	-	-	(2,299)	-	(2,299)
Stock options exercised	399	(90)	-	-	309
Share-based compensation	-	429	-	-	429
Balance at June 30, 2015	238,327	13,894	(29,348)	(112,842)	110,031

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



Condensed Interim Consolidated Statements of Cash Flows
(Unaudited)

USD 000s	Note	Three months ended June 30		Six months ended June 30	
		2016 (note 3)	2015 (note 3)	2016 (note 3)	2015 (note 3)
Cash provided by (used in):					
Operating					
Net loss		(7,626)	(5,877)	(14,460)	(5,423)
Items not affecting cash:					
Depletion and depreciation	3a, 4	5,395	7,030	11,439	13,266
Impairment	3a	-	1,952	-	1,952
Accretion	3a, 14	59	77	144	165
Unrealized (gain) /loss on commodity contracts		-	(2)	-	152
Share-based compensation	3a, 12	411	209	881	403
Deferred income tax expense (recovery)		180	1,067	2,141	647
Unrealized (gain) loss on foreign exchange	14	(673)	315	564	(1,670)
Non-cash reduction of contingent liability		-	(1,060)	-	(1,060)
Realized other comprehensive loss	3a	4,153		4,153	-
Loss on sale of discontinued operations	3a	18		18	-
Change in other long-term assets		(3,081)	23	(3,531)	(706)
Change in non-cash working capital	15	4,130	(7,889)	8,078	(4,814)
Cash flow from (used in) operating activities		2,966	(4,155)	9,427	2,912
Investing					
Property, plant and equipment additions	4	(569)	(836)	(1,751)	(12,210)
Evaluation and exploration assets additions	5	45	(1,643)	(3,635)	(2,006)
Change in other long-term assets		-	1,899	-	1,417
Change in non-cash working capital	15	(2,275)	(3,692)	(1,832)	(1,004)
Net cash used in investing activities		(2,799)	(4,272)	(7,218)	(13,803)
Financing					
Issue of common shares	11	-	184	-	309
Bank loan repayment	7	(988)	-	(1,834)	-
Bank loan proceeds	7	-	9,992	-	9,992
Net cash from (used in) financing activities		(988)	10,176	(1,834)	10,301
Change in cash and cash equivalents		(821)	1,749	375	(590)
Cash and cash equivalents, beginning of period		5,188	9,079	3,912	11,572
Impact of foreign exchange on cash balances		4	21	84	(133)
Cash and cash equivalents, end of period		4,371	10,849⁽¹⁾	4,371	10,849⁽¹⁾

(1) Cash and cash equivalents net of Canadian operating loan that was terminated on October 13, 2015.

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

1. Reporting Entity

Madalena Energy Inc. (the "Company" or "Madalena") is involved in the exploration, development and production of oil and natural gas in Argentina and its principal place of business is Suite 3200, 500 – 4th Avenue S.W., Calgary, Alberta, T2P 2V6.

The condensed interim consolidated financial statements include the results of the following wholly-owned subsidiaries:

- Madalena Petroleum Ltd. (Canada)
- Madalena Austral S.A. (Argentina)
- Madalena Energy Argentina S.R.L. (Argentina)
- Madalena Petroleum Americas Limited (Barbados)
- Madalena Petroleum Holdings Limited (Barbados)
- Madalena Ventures International Holding Company Inc. (Barbados)
- Madalena Ventures International Inc. (Barbados)
- Pet-Ja S.A. (Argentina)

2. Basis of Preparation

These condensed interim consolidated financial statements have been prepared on the basis that the Company is a going concern and will continue to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. As at June 30, 2016, the Company had a working capital deficit of approximately \$5.3 million and significant future capital commitments to develop its properties. Further, in January 2016, the Argentina government reduced the benchmark oil price by 10% from \$75.00 to \$67.50 per barrel and there is no guarantee that oil prices will not continue to be adjusted downward to meet world market prices. Forecasted cash flow from operating activities will not be sufficient to resolve the current working capital deficit and fund the 2016 and 2017 anticipated capital commitments as outlined in note 16.

The Company's business is capital intensive and additional capital is required on a periodic basis. As part of its business plan, the Company regularly evaluates sources of funding. The current world-wide economic environment relating to the oil and gas industry has made access to capital challenging for many companies, Madalena included. As a result, although the Company continues with a relatively unleveraged balance sheet, the Company continues to face liquidity challenges.

The ability of the Company to continue as a going concern is dependent upon the Company's ability to access additional funding to resolve the current working capital deficit and to meet its anticipated 2016 and 2017 capital commitments and/or opportunities to monetize its assets. Potential additional sources of capital include: (i) credit facilities on acceptable terms; (ii) proceeds from the sale of non-core assets; (iii) proceeds from equalization payments, if any, received from a possible partner at Curamhuele; and (iv) the issuance of equity on acceptable terms. There is no certainty that these and other strategies will be sufficient to permit the Company to continue as a going concern.

The need to raise capital to fund ongoing operations creates a material uncertainty that may cast significant doubt over the Company's ability to continue as a going concern. These condensed interim consolidated financial statements do not reflect adjustments in the carrying values of the assets and liabilities, expenses and the condensed interim consolidated statements of financial position classifications that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

Statement of Compliance

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34, “Interim Financial Reporting” and are presented in United States Dollars (“USD”), unless otherwise indicated. These condensed interim consolidated financial statements follow the same accounting policies and method of computation as the annual consolidated financial statements for the year ended December 31, 2015. The disclosures provided below are incremental to those included with the annual consolidated financial statements. Certain information and disclosures normally included in the notes to the annual consolidated financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, these condensed interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2015, which have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board (“IASB”).

The condensed interim consolidated financial statements were approved and authorized for issue by the Company’s Board of Directors on August 23, 2016.

3. Discontinued Operations

On May 17, 2016, the Company signed an asset purchase and sale agreement (“PSA”) with First Mountain Exploration Inc (“First Mountain”) and Point Loma Energy Inc. (“Point Loma”), to dispose of its non-core Canadian petroleum and natural gas assets for proceeds valued at approximately \$4 million.

These non-core assets consist of the Canadian operating segment and are presented as discontinued operations. The comparative condensed interim consolidated statements of loss and comprehensive loss have been presented to show the discontinued operations separately from continuing operations. The condensed interim consolidated statements of financial position reflect the removal of the Canadian operating segment as at June 30, 2016, although the comparatives still contain the Canadian operating segment, as required under international financial reporting standards. The condensed interim consolidated statements of cash flows contain the Canadian operating segment in the current and comparative period, with the cash flow results of the discontinued operation outlined in note 3c, below.

The transaction closed on June 28, 2016, with an effective date of May 1, 2016, and proceeds to the Company consisted of 6,244,814 common shares of Point Loma, with a fair value of \$1.9 million, as well as a five-year \$2.4 million subordinated secured convertible debenture, bearing interest at 3% per annum plus an origination fee of 3% of the principal remaining on maturity, payable at the end of the debenture term. The Point Loma shares were the result of a reverse takeover of First Mountain by Point Loma on June 28, 2016. Madalena can convert all or part of the debenture plus accrued interest and origination fee into common shares, at Madalena’s election, at a fixed price of CAD \$0.50 per common share (note 6). The fair value of the convertible debenture is \$2.4 million, which includes the fair value of the conversion feature, of \$0.6 million.

a. Net loss from discontinued operations

USD 000s	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Revenues				
Oil and natural gas revenues	137	584	430	1,136
Royalties (expense) recovery	20	(189)	(7)	(251)



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

	157	395	423	885
Expenses (recoveries)				
Operating	(12)	894	395	1,654
General and administrative	74	67	127	211
Finance (income) and expenses	5	20	23	42
Share-based compensation	11	4	21	(26)
Depletion and depreciation	43	126	163	332
Impairment	-	1,952	-	1,952
	121	3,063	729	4,165
Income (loss) from operating activities of discontinued operations	36	(2,668)	(306)	(3,280)
Loss on sale of discontinued operations (note 3b)	(18)	-	(18)	-
Realized accumulated other comprehensive loss on disposition of Canadian operations ⁽¹⁾	(4,153)	-	(4,153)	-
Net loss from discontinued operations	(4,135)	(2,668)	(4,477)	(3,280)
Basic and Diluted EPS	(0.01)	(0.00)	(0.01)	(0.01)

(1) This is the cumulative translation adjustment on the sale of the Canadian assets that is recycled through the statement of loss on disposition.

Current and deferred taxes were not impacted by the disposal of the Canadian operating segment.

b. Loss on sale of discontinued operations

USD 000s	For the six months ended June 30, 2016
Proceeds (note 6):	
Common shares – Point Loma	1,918
Debenture including conversion feature	2,351
	4,269
Property, plant and equipment disposed of	(6,589)
Exploration and evaluation assets disposed of	(2,515)
Decommissioning liabilities disposed of	4,868
Transaction costs attributable to sale	(166)
Foreign exchange from effective to close date	115
	(4,287)
Loss on sale of discontinued operation	(18)



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

c. Cash flows from (used in) discontinued operations

USD 000s	For the six months ended June 30,	
	2016	2015
Net cash from (used in) operating activities	(41)	(562)
Net cash from (used in) investing activities	12	(3,068)
Net cash flow for period	(29)	(3,630)

4. Property, Plant and Equipment ("PP&E")

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Cost			
At December 31, 2014	150,669	1,312	151,981
Additions	30,851	810	31,661
Effect of change in foreign exchange rates	(7,586)	(130)	(7,716)
At December 31, 2015	173,934	1,992	175,926
Additions	2,894	27	2,921
Disposals	(39,617)	-	(39,617)
Effect of change in foreign exchange rates	-	49	49
At June 30, 2016	137,211	2,068	139,279

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Accumulated depreciation and depletion			
At December 31, 2014	(54,237)	(268)	(54,505)
Depreciation and depletion	(25,981)	(388)	(26,369)
Impairment	(11,651)	-	(11,651)
Effect of change in foreign exchange rates	5,918	46	5,964
At December 31, 2015	(85,951)	(610)	(86,561)
Depreciation and depletion	(10,971)	(246)	(11,217)
Disposals	33,452	-	33,452
Effect of change in foreign exchange rates	-	(29)	(29)
At June 30, 2016	(63,470)	(885)	(64,355)

USD 000s			
Net book value			
At December 31, 2015	87,983	1,382	89,365
At June 30, 2016	73,741	1,183	74,924



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As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

On May 1, 2016 (note 3b), the PP&E assets associated with the Canadian operating segment amounting to \$6.6 million were disposed.

At June 30, 2016 and June 30, 2015, Madalena determined there were no triggers for impairment for any of its Argentine CGUs.

The depletion expense calculation for the three and six months ended June 30, 2016 included \$92.1 million (December 31, 2015 – \$92.7 million) for estimated future development costs associated with proved and probable reserves in Argentina.

During the three and six months ended June 30, 2016, approximately \$0.3 million and \$0.7 million (2015 - \$0.5 million and \$0.7 million) of directly attributable general and administration costs were capitalized to property, plant and equipment in Argentina. In addition, share-based compensation amounting to \$0.1 million and \$0.2 million were capitalized for the three and six months ended June 30, 2016 (2015 - \$62 thousand and \$62 thousand).

5. Exploration and Evaluation Assets (“E&E”)

USD 000s	
Cost	
At December 31, 2014	37,824
Additions	8,716
Impairment	(2,107)
Effect of change in foreign exchange rates	(666)
At December 31, 2015	43,767
Additions	3,635
Disposals	(2,309)
At June 30, 2016	45,093

E&E assets consist of the Company’s intangible exploration projects in Argentina pending determination of proven or probable reserves. Additions represent the Company’s share of costs incurred on E&E assets during the period. E&E assets are not depreciated or depleted.

On May 1, 2016 (note 3b), the E&E assets associated with the Canadian operating segment amounting to \$2.5 million were disposed.

At June 30, 2016 and June 30, 2015, Madalena determined there were no triggers for impairment on the E&E assets in any of its Argentine CGUs.

6. Investments

As a result of the disposal of the non-core Canadian assets on May 1, 2016 (note 3), the Company has received the following investments as proceeds:

- 6,244,814 common shares of Point Loma Energy Ltd. (“Point Loma”) (TSXV: PLX), recorded at fair value of \$1.9 million, and are classified as a fair value through profit or loss level I financial asset.
- A five-year \$2.4 million subordinated secured 3% convertible debenture from Point Loma, with principal and interest payable at the end of the debenture term. This convertible debenture is a financial



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

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instrument and is designated as fair value through profit and loss as a level II financial asset, and is convertible at the Company’s election, into Point Loma common shares. The value of the debenture on the closing date of June 28, 2016 was \$1.8 million using an annual interest rate of 12%. Management has estimated the fair value of the conversion feature at \$0.6 million, based upon a 50% reduction in market price of Point Loma common shares given the limited time the shares have been listed, as well as the following Black-Scholes pricing model assumptions:

Weighted average conversion price	CAD \$0.50 per share
Expected average volatility	100%
Risk-free average interest rate	0.57%
Expected average life (years)	5 years
Weighted average fair value	CAD \$0.14 per share

The fair value of the conversion feature at June 30, 2016 had not significantly changed from June 28, 2016, and therefore there was no profit or loss impact recorded for this period.

7. Long-term Debt

Argentina

The amount outstanding at June 30, 2016 was \$3.4 million (December 31, 2015 - \$5.9 million) and is repayable in four equal quarterly instalments of Argentine Pesos (“ARS”) 12.9 million (\$0.9 million using the June 30, 2016 exchange rate) with the next payment due on August 31, 2016.

The loan bears interest at the variable rate of BADLAR plus 8%, resulting in a current borrowing rate of approximately 45%.

Security for the Argentine loan is provided by the assignment of the receivables of Madalena Energy Argentina S.R.L. (Argentina) (“MEA”) that arise from the sale of crude oil. The facility includes a quarterly financial covenant, whereby MEA’s ratio of debt to earnings before income taxes, depletion, interest and other non-cash items must be equal to or less than 1:1. The earnings before income taxes, depletion, interest and other non-cash items is calculated on a four quarter rolling basis. At June 30, 2016, MEA was in compliance with this covenant at 0.24, and is expected to be for the remainder of the year.

Canada

The Company has no bank debt in Canada at June 30, 2016.

8. Other Long-term Assets

Other long-term assets are comprised of long-term receivables for which fair value approximates the carrying value. The long-term receivables primarily relate to ARS denominated value added tax receivable of \$2.3 million (December 31, 2015 – nil), receivable balances due from the Argentina state oil and gas company of \$1.4 million (December 31, 2015 - \$0.6 million).

9. Restricted Cash and Deferred Debenture Financing

During June 2016, the Company received cash amounting to \$1.1 million associated with the anticipated convertible debenture private placement financing described below. This \$1.1 million is recorded as restricted cash



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

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on the condensed interim consolidated statement of financial position at June 30, 2016 with the corresponding balance recorded to deferred debenture financing.

On July 13, 2016, the Company completed the first tranche of a private placement of CAD \$1.8 million 12% secured convertible debentures, primarily to insiders, with a June 30, 2019 maturity date. Under this private placement, the Company is authorized to issue up to CAD \$10 million of convertible debentures, and as such, additional closings may occur. The debentures are convertible into common shares of the Company at a conversion price of CAD \$0.25 per common share. Interest on the debentures is payable semi-annually, in arrears, on December 31 and June 30. The Company may, at its option and upon providing notice to the debenture holders, repay the outstanding indebtedness. Such repayments involve premiums that reduce as the date to maturity approaches. Although insiders participated in the first tranche, the terms and conditions were the same as those available to third parties.

10. Decommissioning Liabilities

During the current quarter, decommissioning liabilities associated with the Canadian operating segment in the amount of \$4.9 million were relinquished as part of the disposition of the Canadian operating segment, as disclosed in note 3b. The remainder of the change in decommissioning liabilities is primarily due to the impact of discount rate changes associated with the valuation of the liability.

The total undiscounted amount of cash flows required to settle Madalena's remaining decommissioning obligations at June 30, 2016 is approximately \$18.8 million (December 31, 2015 – \$26.5 million) with the majority of the costs to be incurred between 2026 and 2027. The decommissioning obligations have been estimated using existing technology at current prices and discounted using discount rates that reflect current market assessments of the time value of money and the risks specific to each liability.

At June 30, 2016, an inflation rate of 1% was used, and is unchanged from December 31, 2015. The risk free rate used to discount the liability at June 30, 2016 was 1.9% (December 31, 2015 – 2.7%). The liability is expected to be invoiced in USD and settled through payments in ARS.

11. Share Capital

The Company is authorized to issue an unlimited number of common shares and preferred shares. The holders of common shares are entitled to receive dividends as declared by the Company and are entitled to one vote per share. No preferred shares were outstanding at June 30, 2016 or December 31, 2015.

2016

No common shares were issued for the three or six month period ended June 30, 2016.

2015

In the first quarter 2015, 533,333 common shares were issued pursuant to the exercise of options for cash proceeds of \$125 thousand and in the second quarter 716,667 common shares were issued pursuant to the exercise of options for cash proceeds of \$184 thousand.

Net Loss Per Share

There is no dilutive impact to the weighted average number of common shares at June 30, 2016 or June 30, 2015. All share options were excluded from the calculation of diluted earnings per share as their effect is anti-dilutive. The following table provides the weighted average number of common shares used in the per share calculations:



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Weighted average number of common shares - basic & diluted – 000s	542,083	540,730	542,083	540,314
Net loss from continuing operations - USD 000s	(3,491)	(3,209)	(9,983)	(2,143)
Per share – basic & diluted (\$/share)	(0.00)	(0.01)	(0.02)	(0.00)

12. Share-based Compensation

There were no options exercised during the three and six months ended June 30, 2016 (June 30, 2015 – 716,667 and 1,250,000). The weighted average share price of the Company's common shares on the exercise date for the options exercised during the six months ended June 30, 2015 was CAD \$0.30.

During the six months ended June 30, 2016, 8,650,000 options were granted to certain employees and directors of the Company at an exercise price of CAD \$0.27 per share. No options were granted during the six months ended June 30, 2015. There were 300,000 and 278,000 options that expired and forfeited, respectively, at exercise prices of CAD \$0.96 and CAD \$0.50 for the six months ended June 30, 2016, leaving 42.9 million options outstanding at a weighted average exercise price of CAD \$0.33.

The fair value of options granted was estimated at the period end date using the Black-Scholes valuation model, resulting in a per option fair value of CAD \$0.16 (2015 – nil) with weighed average assumptions as follows:

Inputs used to fair value share options granted

	Six months ended June 30 2016
Share price (CAD \$)	0.27
Exercise price (CAD \$)	0.27
Expected Volatility (%)	76
Forfeiture rate (%)	9.8
Option life (years)	4.35
Risk-free interest rate (%)	0.63

Share-based compensation arising from the issuance of stock options recognized for the three and six months ended June 30, 2016 was \$0.5 million and \$1.1 million (2015 - \$0.3 million and \$0.4 million) with an offsetting credit to contributed surplus. During the three and six months ended June 30, 2016, \$0.1 million and \$0.2 million of share-based compensation was capitalized to PP&E (2015 – \$62 thousand and \$62 thousand), leaving \$0.4 million and \$0.9 million (2015 - \$0.2 million and \$0.4 million) as share-based compensation expense.

13. Available for Sale Securities

During the three and six months ended June 30, 2016, the remaining Petroleo Plus Settlement Bonds as disclosed in the December 31, 2015 financial statements were sold for proceeds of \$0.7 million and \$5.8 million, resulting in a net gain of \$0.1 million and \$0.4 million. The net gain was reduced for an early settlement penalty of \$0.1 million and \$0.5 million for the three and six months ended June 30, 2016, and was recorded as part of interest and other expenses in finance (income) expenses on the condensed interim consolidated statements of loss.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

Amounts previously recorded in other comprehensive income due to fair value reporting of \$12 thousand for the three months ended June 30, 2016 and \$68 thousand for the six months ended June 30, 2016 were recycled through finance (income) expenses on the condensed interim consolidated statements of loss and comprehensive loss.

14. Finance (Income) Expenses

Finance (Income) and Expenses are made up of the following:

USD 000s	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Bank charges	405	624	676	1,043
Foreign exchange loss (gain) - unrealized	(673)	315	564	(1,670)
Accretion (note 10)	54	57	121	123
Interest and other expenses (note 13)	885	243	904	325
	671	1,239	2,265	(179)

USD 000s	Six months ended June 30	
	2016	2015
Currency exchange rate at period end:		
\$1 USD = CAD	\$1.29	\$1.25
\$1 USD = ARS	14.96	9.15

15. Supplemental Cash Flow Information

Changes in non-cash working capital

USD 000s	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Available for sale securities	624	-	5,361	-
Trade and other receivables	5,606	(6,108)	6,852	(3,607)
Other current assets, including inventory	772	(73)	424	(68)
Deferred debenture financing	1,120	-	1,120	-
Trade, tax and other payables	(6,118)	(5,194)	(6,240)	(2,559)
Impact of foreign exchange on working capital	(1,269)	(206)	(2,391)	416
Change in non-cash working capital ⁽¹⁾	735	(11,581)	5,126	(5,818)
Restricted cash	1,120	-	1,120	-
	1,855	(11,581)	6,246	(5,818)



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

Attributable to:				
Operating activities	4,130	(7,889)	8,078	(4,814)
Investing activities	(2,275)	(3,692)	(1,832)	(1,004)
	1,855	(11,581)	6,246	(5,818)

(1) Change in non-cash working capital excludes the current portion of long-term debt, as this is considered part of financing activities.

Other cash flow information

USD 000s	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Interest paid	790	42	1,305	93
Taxes paid	2,155	757	2,641	741

16. Commitments and Contingencies

Development and Exploration Commitments

Coiron Amargo Block (Coiron Amargo Norte ("CA-Norte") 35% working interest – non-operated and Coiron Amargo Sur Este ("CA-Sur Este") 90% working interest - operated)

USD 000s	2016	2017	Beyond
Concession commitments at CA-Sur Este	-	5,000	5,000

Pursuant to definitive agreements entered into on July 11, 2016 and subject to government approvals and Executive Decree, the previous work commitments at Coiron Amargo Sur of \$17.5 million that were required to be incurred by November 8, 2017 have been superseded by the following work commitments at CA-Sur Este:

- \$5 million before November 8, 2017 to evaluate either the Vaca Muerta or tight gas commerciality; and
- an additional \$5 million, subject to the results in (1) above, before November 8, 2019.

There are no commitments at CA-Norte.

Curamhuele Block (90% working interest-operated)

In December 2015, Madalena further ratified an extension of its second exploration term with the Province of Neuquén to September 9, 2016, after which a further extension is available.

At March 31, 2016, the remaining work commitment relating to the existing Curamhuele block concession agreement was fulfilled by completing the Yapai.x 1001 well in the Mulichinco and Lower Agrio shales.

The Company has posted a performance bond for \$17.6 million relating to amounts committed under this exploration permit. The assets of Madalena Austral S.A., a subsidiary of the Company, are held as security for the bond. Once the province certifies that the Company has fulfilled its obligations, the Company anticipates that the bond will be cancelled.

Discussions have commenced with the Province of Neuquén to extend the exploration period to further appraise the Curamhuele block.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

Cortadera Block (38% working interest – non-operated)

In 2014, Madalena and its working interest partner satisfied the remaining commitments related to the first exploration period on the block and have the option to enter into a second exploration period extending to October 25, 2018 and potentially a third exploration period extending to October 25, 2021.

Madalena and its partner have submitted an application to the province of Neuquén requesting that the block pass into the second exploration period with the relinquishment of approximately 50% of the block and a commitment to shoot 3D seismic on a portion of the remainder of the block. As of August 23, 2016, Madalena has not received confirmation of approval of this application.

Rinconada-Puesto Morales Block (100% working interest-operated)

USD 000s	2016	2017	Beyond
Concession commitments	4,400	13,300	14,800

Santa Victoria Block (100% working interest - operated)

The contract is currently in the second of three exploration phases, with the second exploration phase having expired in April 2015. An application has been submitted and negotiations continue and are currently ongoing with the province of Salta to reach a multi-year extension agreement.

As at June 30, 2016 the second exploration phase required additional work commitments of \$3.75 million of which no qualifying expenditures had been made.

17. Financial Instruments and Risk Management

The Company is exposed to various risks that arise from its business environment and the financial instruments it holds. The Board of Directors has overall responsibility for the establishment and oversight of the Company’s risk management framework, policies and procedures.

Liquidity risk

Although the Company has a largely unleveraged balance sheet at June 30, 2016, it does have a working capital deficit of \$5.3 million, and continues to face liquidity challenges. Unless the Company is able to raise additional capital or renegotiate its commitments, it does not expect that forecasted cash flows from operating activities will be sufficient to meet its anticipated 2016 and 2017 capital commitments and resolve the current working capital deficit. The Company is actively pursuing alternative sources of capital, in the form of debt financings, asset sales or swaps of both core and non-core assets and joint ventures or other transactions with industry partners, all with a view to enhancing liquidity to execute on its business plan.

At June 30, 2016, \$4.2 million, or 97%, of Madalena’s cash and cash equivalents was deposited with banks in Argentina (December 31, 2015- \$2.1 million, 54%), and is held in ARS.

At June 30, 2016, the consolidated working capital deficit of the Company was \$5.3 million (December 31, 2015 – positive working capital of \$0.5 million), consisting of working capital deficiency of \$3.0 million (December 31, 2015 - \$0.4 million) in Argentina and a working capital deficiency of \$2.3 million (December 31, 2015 – positive working capital of \$0.9 million) in Canada.

Market risk

Changes in commodity prices, interest rates and foreign currency exchange rates can expose the Company to fluctuations in its net earnings and in the fair value of its financial assets and liabilities.



Notes to the Condensed Interim Consolidated Financial Statements

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(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

Commodity price risk

The Government of Argentina sets the benchmark (Medanito) price for oil. Medanito crude oil averaged \$67.50 per barrel for the three months ended June 30, 2016 (2015 - \$75.00) and \$67.50 per barrel for the six months ended June 30, 2016 (2015 - \$76.33). In early 2016, the government regulator in Argentina advised that 2016 oil pricing will be set at \$67.50 per barrel for Medanito crude quality oil. There can be no certainty that the oil price will not be further adjusted within the year.

Gas prices in Argentina are subject to seasonal demand and are negotiated between the producer and the buyer. For the period May to September 2016, which is the Argentine winter, the price has been set at \$5.35/mbtu. Winter prices in 2015 were \$5.30/mbtu. Summer pricing for the period from October 2016 to April 2017 has been set at \$4.30/mbtu.

Interest rate risk

Had the BADLAR rate associated with the Argentina long-term debt changed by 5%, associated interest expense would have changed by \$0.1 million for the six month period ended June 30, 2016.

Foreign currency exchange risk

The majority of the Company's exploration and development activities are conducted in Argentina and the majority of the Company's cash and cash equivalents are denominated in ARS. The Company is exposed to currency risk to the extent that revenue, expenses and monetary assets and liabilities are denominated in currencies that differ from the functional currency of the respective entity within the consolidated group.

The impact of changes in foreign exchange rates on gains and losses recorded when translating from ARS and/or CAD to USD at June 30, 2016 are not significant to the condensed interim consolidated financial statements, with the exception of ARS denominated financial instruments recorded on the books of the Company's subsidiary entities, and a 10% change of the USD vs ARS exchange rate would have changed the unrealized foreign exchange loss (gain) recorded by \$0.4 million for the six months ended June 30, 2016.

18. Segmented information

The Company is engaged in the exploration and development of oil and gas. With the disposition of the Canadian operating segment on June 28, 2016 (note 3), Madalena's continuing operations are represented by its Argentine petroleum and natural gas producing assets which form one reportable segment and its corporate costs in Canada, which form a second segment. The Company does not have separate operations in Barbados. Barbados entities hold a direct interest in the Argentine businesses and the chief operating decision maker views Barbados as an extension of the Argentine operations. Together they collectively comprise the Argentina operating segment.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Six Months Ended June 30, 2016 and 2015 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

As at and for the six months ended June 30, 2016				
USD 000s	Argentina	Corporate	Intersegment Eliminations	Total
Total assets	141,247	28,935	(22,867)	147,315
Total liabilities	73,936	3,905	(22,867)	54,974
Oil and natural gas revenues	27,881	-	-	27,881
Operating expenses	10,981	-	-	10,981
General & administrative expenses	2,410	2,474	-	4,884
Depletion and depreciation	11,163	113	-	11,276
Current income tax expense	1,140	-	-	1,140
Net loss – continuing operations	5,279	4,704	-	9,983
Capital expenditures ⁽¹⁾	5,386	-	-	5,386

As at and for the six months ended June 30, 2015				
USD 000s	Argentina	Corporate ⁽²⁾	Intersegment Eliminations	Total
Total assets	156,055	28,167	(27,381)	156,841
Total liabilities	79,388	2,289	(27,381)	54,296
Oil and natural gas revenues	43,008	-	-	43,008
Operating expenses	16,084	-	-	16,084
General & administrative expenses	3,153	2,181	-	5,334
Depletion and depreciation	12,831	103	-	12,934
Current income tax expense	2,485	-	-	2,485
Net loss – continuing operations	(1,808)	(335)	-	(2,143)
Capital expenditures ⁽¹⁾	13,777	27	-	13,804

(1) Capital expenditures include cash additions to PP&E and E&E.

(2) For comparative purposes, the Canadian operations have been removed from these amounts (note 3).

Intersegment eliminations relate to intercompany loans between Canada and Argentina.

19. Supplemental disclosure

Madalena's condensed interim consolidated statements of loss and comprehensive loss are prepared primarily by nature of expenses, with the exception of employee compensation costs which are included in both the operating and general and administrative expense line items on the condensed interim consolidated statements of loss and comprehensive loss. The following table details the amount of total employee compensation costs included in the operating and general and administrative expense line items in the condensed interim consolidated statements of loss and comprehensive loss.



Notes to the Condensed Interim Consolidated Financial Statements

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(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

USD 000s	Three months ended June 30		Six months ended June 30	
	2016	2015	2016	2015
Operating expenses				
Compensation costs	807	1,391	1,884	2,458
Transportation and processing	1,775	3,258	3,356	5,323
Maintenance, workovers and others	2,473	4,056	5,741	8,303
	5,055	8,705	10,981	16,084
General & administrative expenses⁽¹⁾				
Compensation costs	1,180	1,841	3,062	3,348
Other	943	1,217	1,822	1,986
	2,123	3,058	4,884	5,334

(1) Six months ended June 30, 2016 amounts include severance and retracted financing costs of \$1.0 million.

20. Subsequent Event

Madalena has initiated a review of strategic alternatives which may include, among other things, asset sales, a merger, sale or recapitalization transaction, joint ventures or other opportunities.