**MANAGEMENT'S DISCUSSION & ANALYSIS**

**FOR THE THREE MONTHS ENDED MARCH 31, 2016**

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*(Unless otherwise indicated, all dollar amounts are in USD)*

*This Management's Discussion and Analysis of financial condition and results of operations ("MD&A") is based on information available to May 16, 2016 and should be read in conjunction with Madalena Energy Inc.'s ("Madalena" or the "Company") unaudited condensed interim consolidated financial statements for the three months ended March 31, 2016 and the accompanying notes as well as the audited consolidated financial statements for the year ended December 31, 2015 and the accompanying notes. This MD&A contains forward-looking information about the Company's current expectations, estimates, projections and assumptions. See the Advisory for information on the risk factors that could cause actual results to differ materially and the assumptions underlying the Company's forward-looking information. Madalena's Management prepared the MD&A, while the Audit Committee of the Madalena Board of Directors (the "Board") reviewed and recommended its approval by the Board. Additional information relevant to the Company's activities contained in its continuous disclosure documents, including quarterly condensed interim consolidated financial statements and the Annual Information Form ("AIF"), is available on SEDAR at www.sedar.com and on the Company's website at www.madalenaenergy.com.*

**Basis of Presentation**

*This MD&A and the unaudited condensed interim consolidated financial statements and comparative information have been prepared in United States dollars ("USD"), in accordance with International Financial Reporting Standards ("IFRS" or "GAAP") as issued by the International Accounting Standards Board ("IASB") applying IAS 34. Unless otherwise indicated, all dollar amounts are in USD. Sales volumes are presented on a before royalties basis.*

**Non-GAAP Measures**

*Certain financial measures in this document do not have a standardized meaning as prescribed by IFRS, such as funds flow from operations and netbacks and therefore are considered non-GAAP measures. These measures may not be comparable to similar measures presented by other issuers. These measures have been described and presented in order to provide shareholders and potential investors with additional measures for analyzing the Company's ability to generate funds to finance its operations and information regarding its liquidity. The additional information should not be considered in isolation or as a substitute for measures prepared in accordance with IFRS. The definition and/or reconciliation of each non-GAAP measure is presented in the Netbacks and Reconciliation of Cash Flow from Operating Activities and Funds Flow from Operations sections of this MD&A.*

*Funds flow from operations per share is calculated using the same basic and diluted weighted average number of shares for the period, consistent with the calculations of income (loss) per share.*

*The term barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. Per boe amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil. This equivalence is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.*

## Introduction

Madalena is an independent, Argentina focused, upstream oil and gas company.

Madalena holds approximately 950,000 net acres in four provinces of Argentina where it is focused on the delineation of large shale and unconventional resources in the Vaca Muerta shale, Lower Agrio shale, and Loma Montosa oil plays. The Company is implementing horizontal drilling and completions technology to develop both its conventional and resource plays.

**Unless otherwise indicated, all dollar amounts are in USD.**

Madalena trades on the TSX Venture Exchange under the symbol MVN and on the OTCQX under the symbol MDLNF.

## Sale of Non-Core Canadian Assets

On February 8, 2016, First Mountain Exploration Inc. ("First Mountain"), Point Loma Energy Ltd. ("Point Loma") and Madalena entered into a non-binding letter of intent pursuant to which, among other things, it is proposed that Point Loma will acquire Madalena's non-core Canadian oil and gas assets for a deemed aggregate purchase price of approximately $4.0 million (CAD $5.5 million).

Proceeds to the Company will consist of 14,522,823 common shares of Point Loma, with a deemed value of $1.8 million (CAD $2.5 million), as well as a five-year $2.2 million (CAD $3 million) secured convertible debenture, bearing interest at 3% per annum, payable at the end of the debenture term. The effective date is May 1, 2016, with closing expected in early June 2016, subject to certain terms and conditions, including the successful acquisition (the "Acquisition") of Point Loma by First Mountain. The Acquisition will involve an exchange of publicly traded First Mountain common shares (TSXV: FMX) for all of the outstanding common shares of Point Loma including those received by Madalena.

## Foreign Exchange Fluctuations

The table below provides various exchange rates that illustrate the quarterly foreign exchange fluctuations between the USD, the Canadian dollar ("CAD") and the Argentine Peso ("ARS"). The table illustrates the impact of both the ARS and CAD devaluation relative to the USD in three months ended March 31, 2016 ("the Quarter" or "Q1-2016") compared to the three months ended March 31, 2015 ("Q1-2015"). Foreign exchange changes in the ARS impact the foreign exchange gains and losses recorded in the condensed interim consolidated statements of income (loss) and comprehensive loss. Foreign exchange changes in the CAD are reflected through the foreign currency translation adjustment in accumulated other comprehensive loss, as shown in Shareholders' Equity and on the condensed interim consolidated statements of comprehensive loss.

| USD | Three months ended March 31 2016 | 2015 | % Change |
|---|---|---|---|
| Average CAD to USD | 0.73 | 0.81 | (9.9%) |
| Average ARS to USD | 0.07 | 0.12 | (41.7%) |
| Period end CAD to USD | 0.77 | 0.79 | (2.5%) |
| Period end ARS to USD | 0.07 | 0.11 | (36.4%) |

## Sales Volumes

| | Three months ended March 31 | |
|---|---|---|
| | **2016** | **2015** |
| **Argentina** | | |
| Crude oil and NGLs (bbls/d) | **2,409** | 2,653 |
| Natural gas (mcf/d) | **2,976** | 3,895 |
| Total daily sales (boe/d) | **2,905** | 3,302 |
| % oil | **83%** | 80% |
| **Canada** | | |
| Crude oil and NGLs (bbls/d) | **136** | 148 |
| Natural gas (mcf/d) | **205** | 816 |
| Total daily sales (boe/d) | **170** | 284 |
| % oil | **80%** | 52% |
| **Corporate** | | |
| Total daily sales (boe/d) | **3,075** | 3,586 |

*Argentina*

Madalena's primary producing concessions are at El Surubi, Rinconada-Puesto Morales and Coiron Amargo. Other producing concessions include El Chivil, El Vinalar and Palmar Largo. All concessions produce oil and Rinconada-Puesto Morales and Coiron Amargo also produce natural gas. Approximately 84% of Madalena's current production comes from El Surubi, Rinconada-Puesto Morales, and Coiron Amargo.

Crude oil and NGL sales volumes for the the Quarter decreased to 2,409 boe/d from 2,653 boe/d in Q1-2015. The change compared to Q1-2015, can be attributed to production declines at El Surubi . Natural gas sales volumes for the Quarter of 2,976 mcf/d, decreased compared to Q1-2015 of 3,895 mcf/d due to lower production at Rinconada - Puesto Morales.

Madalena expects Q2-2016 sales volumes to average approximately 2,600 boe/d, 85% of which is oil and NGLs.

*Canada*

Sales volumes during the Quarter were 170 boe/d compared to 284 boe/d in Q1-2015. Decreased production was primarily due to the shut-down of the Keyera Paddle River gas plant on February 1, 2015. This shut-down was a direct result of the current economic conditions and the recent commodity price declines in North America.

Madalena expects the sale of the Canadian assets to close in June 2016, with an effective date of May 1, 2016. Accordingly, Q2-2016 sales volumes are expected to average approximately 50 boe/d (80% oil and liquids).

**Average Realized Prices**

| USD | Three months ended March 31 2016 | 2015 |
|---|---|---|
| **Argentina** | | |
| Crude oil and NGLs – $/bbl | **62.19** | 72.86 |
| Natural gas – $/mcf | **4.35** | 4.27 |
| Total - $/boe | **56.03** | 63.58 |
| **Canada** | | |
| Crude oil and NGLs – $/bbl | **21.78** | 28.90 |
| Natural gas – $/mcf | **1.33** | 2.26 |
| Total - $/boe | **19.01** | 21.57 |
| **Corporate** | | |
| Crude oil and NGLs – $/bbl | **60.04** | 70.53 |
| Natural gas – $/mcf | **4.16** | 3.93 |
| Total - $/boe | **53.99** | 60.25 |

*Argentina*

The Government of Argentina sets the benchmark (Medanito) price for oil. The Medanito crude quality oil posting averaged $67.50/bbl for the Quarter (Q1-2015 - $76.33). The Company's average discount to this posting is approximately $4.00 - $5.00/bbl for quality and transportation differentials. The Medanito crude quality oil posting for April and May 2016 remains at $67.50/bbl.

The average price the Company received for oil for the Quarter was $62.19/bbl, lower than the $72.86/bbl realized in Q1-2015 mainly as a result of the lower Medanito pricing.

Gas prices in Argentina are subject to seasonal demand and are negotiated between the producer and the buyer. Summer prices have been set at $4.20/mmbtu for the period October 2015 to April 2016. For the period May to September 2016, which is the Argentine winter, the price has been set at $5.35/mmbtu. Winter prices in 2015 were $5.30/mmbtu. Further, pricing for October 2016 – April 2017 has been set at $4.30/mmbtu.

The average total price received for the Quarter was $56.03/boe, lower than the $63.58/boe realized in Q1-2015 mainly as a result of 10% Medanito oil price reduction in December 2015.

The Company anticipates Argentina prices to average $59.00 per boe during Q2 – 2016.

*Canada*

For the Quarter, Madalena realized a 12% decrease in per boe selling price to $19.01 for the Quarter compared to $21.57 for Q1-2015 as a result of lower crude oil and natural gas prices.

The Company anticipates Canadian prices to average $25.00 per boe during Q2-2016.

**Oil and Natural Gas Revenue**

| USD 000s, except per boe | Three months ended March 31 2016 | 2015 |
|---|---|---|
| **Argentina** | | |
| Crude oil | **13,633** | 17,395 |
| Natural gas | **1,178** | 1,498 |
| | **14,811** | 18,893 |
| **Canada** | | |
| Crude oil and NGLs | **269** | 386 |
| Natural gas | **25** | 166 |
| | **294** | 552 |
| **Corporate Total** | **15,105** | 19,445 |
| Corporate - $/boe | **53.99** | 60.25 |

*Argentina*

Oil and gas revenue was $14.8 million for the Quarter compared to $18.9 million for Q1-2015 due to lower sales volumes of 12% compounded with an approximate 10% decrease in prices per boe. The 12% decrease in sales volumes is primarily a result of natural production declines at El Surubi and Rinconada - Puesto Morales.

*Canada*

Oil and gas revenue decreased to $0.3 million in the Quarter compared to $0.6 million in Q1-2015 due to both lower oil and gas sales (the majority of the production has been shut in since the beginning of February 2015) and lower oil and gas prices.

**Royalties**

| USD 000s, except per boe | Three months ended March 31 2016 | 2015 |
|---|---|---|
| **Argentina** | | |
| Royalties | **2,323** | 2,617 |
| As % of revenue from Argentina | **16%** | 14% |
| **Canada** | | |
| Royalties | **28** | 62 |
| As % of revenue from Canada | **9%** | 11% |
| **Corporate total** | **2,351** | 2,679 |
| Corporate - $/boe | **8.40** | 8.30 |

*Argentina*

Royalty expenses were $2.3 million for the Quarter compared to $2.6 million in Q1-2015 due lower production volumes that were partially offset by a 3% increase in the royalty rate paid at Rinconada – Puesto Morales pursuant to the concession extension in June 2015. The Company expects royalty rates for the remainder of 2016 to be consistent with this quarter.

*Canada*
Royalty expenses were $28 thousand for the Quarter compared to $62 thousand in Q1-2015 due to the decline in oil and gas production volumes.

**Operating Costs**

| USD 000s, except per boe | Three months ended March 31<br>2016 | 2015 |
|---|---|---|
| **Argentina** | | |
| Compensation costs | **1,077** | 1,067 |
| Transportation and processing | **1,581** | 2,065 |
| Maintenance, workovers and other | **3,268** | 4,247 |
| | **5,926** | 7,379 |
| $/boe | **22.42** | 24.83 |
| **Canada** | | |
| Transportation and processing | **104** | 338 |
| Maintenance, workovers and other | **302** | 422 |
| | **406** | 760 |
| $/boe | **26.34** | 29.70 |
| **Corporate total** | **6,332** | 8,139 |
| Corporate - $/boe | **22.63** | 25.22 |

*Argentina*
Operating costs during the Quarter decreased to $5.9 million from $7.4 million in Q1–2015 as a result of the devaluation of the ARS and a decrease in transportation costs due to fewer deliveries. On a per boe basis, operating costs for the Quarter decreased 9.7% to $22.42 per boe from $24.83 per boe in Q1-2015.

Management expects operating costs to average approximately $25.00 - $27.00 per boe in Q2-2016.

*Canada*
Operating costs during the Quarter decreased to $0.4 million from $0.8 million in Q1–2015 as a result of lower sales volumes. On a per boe basis, operating costs for the Quarter decreased to $26.27 per boe from $29.70 per boe in Q1–2015.

Management expects average operating costs to average $26.00 per boe in Q2-2016.

**Netbacks** (1)

| USD/boe | Three months ended March 31 2016 | 2015 |
|---|---|---|
| **Argentina** | | |
| Oil and gas revenue | **56.03** | 63.58 |
| Royalties | **(8.79)** | (8.81) |
| Operating expenses | **(22.42)** | (24.83) |
| Netbacks | **24.82** | 29.94 |
| **Canada**(2) | | |
| Oil and gas revenue | **19.01** | 21.57 |
| Royalties | **(1.80)** | (2.43) |
| Operating expenses | **(26.34)** | (29.70) |
| Netbacks (Loss) | **(9.13)** | (10.56) |
| **Corporate total** | | |
| Oil and gas revenue | **53.99** | 60.25 |
| Royalties | **(8.40)** | (8.30) |
| Operating expenses | **(22.63)** | (25.22) |
| Netbacks | **22.96** | 26.73 |

(1) The term “netback” is a non-GAAP measure and may not be comparable with the calculation of other entities. Netback is calculated as the average unit sales price, less royalties and operating expenses and represents the cash margin for every barrel of oil equivalent sold. The Company uses this measure to analyze operating performance and considers netback a key measure as it demonstrates its profitability relative to current commodity prices.

(2) The majority of the Canadian production was shut-in on February 1, 2015.

**General and Administration ("G&A") Expenses**

| USD 000s | Three months ended March 31<br>2016 | 2015 |
|---|---|---|
| **Argentina** | | |
| Gross G&A | | |
| Compensation costs | **837** | 1,068 |
| Other | **543** | 478 |
| | **1,380** | 1,546 |
| Capitalized | **(210)** | (256) |
| | **1,170** | 1,290 |
| **Canada** | | |
| Gross G&A | | |
| Compensation costs | **1,080** | 554 |
| Other | **750** | 776 |
| | **1,830** | 1,330 |
| Capitalized | **(184)** | (200) |
| | **1,646** | 1,130 |
| **Consolidated** | | |
| Net G&A total | **2,816** | 2,420 |

*Argentina*
Gross G&A expenses for the Quarter were down slightly compared to Q1–2015. The Company currently employs 38 office employees in Argentina, consistent with the end of 2015. The Company intends to continue to optimize in areas where efficiencies can be realized.

During the Quarter, $0.2 million (2015 - $0.3 million) of directly attributable G&A costs in Argentina were capitalized to property, plant and equipment.

G&A expenses for Q2-2016 for Argentina, net of amounts capitalized, are estimated at approximately $1.2 million.

*Canada*
Gross G&A expenses for the Quarter were $1.8 million compared to $1.3 million in Q1-2015. The increase was due to severance and retracted financing related costs of approximately $1.0 million, which were partially offset by a reduction in the number of Canadian employees. The Company will continue to optimize in areas where efficiencies can be realized.

During the Quarter, $0.2 million (2015 - $0.2 million) of directly attributable G&A costs in Canada were capitalized to property, plant and equipment in Argentina.

G&A expenses for Q2-2016 for Canada, net of amounts capitalized, are estimated at approximately $1.0 million.

**Finance Income and Expenses**

| USD 000s | Three months ended March 31 2016 | 2015 |
|---|---|---|
| **Argentina** | | |
| Bank charges and fees | **271** | 420 |
| Foreign exchange loss - unrealized | **57** | 136 |
| Accretion | **67** | 66 |
| Interest and other (income)/expenses | **19** | 72 |
| | **414** | 694 |
| **Canada** | | |
| Foreign exchange (gain) loss - unrealized | **1,180** | (2,120) |
| Accretion | **17** | 21 |
| Interest and other expenses | **-** | 9 |
| | **1,197** | (2,090) |
| **Consolidated** | **1,611** | (1,396) |

*Argentina*

*Bank Charges and Fees*

Bank charges and fees relate to various forms of taxation in Argentina outside of royalties and income taxes. Bank charges and fees for the Quarter were $0.3 million and decreased from $0.4 million in Q1-2015 as a result of lower transaction activity compared to Q1-2015.

Bank charges for Q2-2016 are estimated at approximately $0.3 million.

*Foreign exchange (gain) loss – unrealized*

During the Quarter and in Q1-2015, as a result of transaction activity, the Company recorded an unrealized foreign exchange loss of $0.1 million.

*Accretion*

Accretion expense was $0.1 million for the Quarter (Q1-2015– $0.1 million).

*Interest and other (income)/expenses*

Interest and other (income)/expenses relate primarily to interest on the Argentine ICBC loan (see heading "Credit Facilities") offset by a net gain of $0.5 million on the sale of Petroleo Plus bonds during the Quarter.

Had the Buenos Aires Deposits of Large Amount Rate ("BADLAR") interest rate associated with the Argentine ICBC loan increased by 5%, associated interest expense would have increased by $60 thousand for the quarter ended March 31, 2016. A decrease of 5% on BADLAR would result in a decrease in associated interest expense of $78 thousand for the quarter ended March 31, 2016. The change amounts vary due to the fact that certain amounts in the interest rate formula are fixed.

*Canada*

*Foreign exchange (gain) loss*

During the Quarter, the Company recorded an unrealized foreign exchange loss of $1.2 million (Q1-2015 - gain of $2.1 million) related to the intercompany loans due from the Argentine subsidiaries and held in Canada that are not treated as part of the net investment in these subsidiaries as a result of a 6% decrease in the USD against the CAD.

*Accretion*
Accretion expense was $17 thousand for the Quarter (Q1-2015 – $21 thousand).

**Share-based Compensation**
The Company has issued stock options as incentive programs that allow officers, directors, consultants and certain employees to purchase shares in the Company. During the Quarter, 8.7 million (2015 - nil) options were granted to directors, officers and employees. Share based compensation was $0.6 million in the Quarter compared to $0.2 million for Q1-2015, of which $0.1 million was capitalized (2015 - nil).

**Depletion and Depreciation ("D&D")**

| | Three months ended March 31 | |
|---|---|---|
| USD 000s | **2016** | **2015** |
| **Argentina** | **5,870** | 5,429 |
| $/boe | **22.20** | 18.27 |
| **Canada** | **174** | 257 |
| $/boe | **11.29** | 10.03 |
| **Consolidated** | **6,044** | 5,686 |
| $/boe | **21.60** | 17.62 |

*Argentina*
D&D increased to $5.9 million in the Quarter compared to $5.4 million in Q1-2015 due to a higher depletion rate partially offset by lower production. On a per boe basis, D&D for the Quarter increased to $22.20 per boe from $18.27 per boe in Q1-2015 primarily a result of increased future development costs.

*Canada*
D&D expenses for the Quarter decreased to $0.2 million from $0.3 million in Q1-2015 as a result of lower production. On a per boe basis, D&D for the Quarter increased to $11.29 per boe from $10.03 per boe in Q1–2015.

**Impairment**
At March 31, 2016 and March 31, 2015, Madalena determined that there were no indicators of impairment for any of its Argentine or Canadian Cash Generating Units.

**Income Tax Expense (Recovery)**

| | Three months ended March 31 | |
|---|---|---|
| USD 000s | **2016** | **2015** |
| **Argentina** | | |
| Current | **353** | 1,139 |
| Deferred | **1,962** | (420) |
| **Canada** | | |
| Current and Deferred | **-** | - |
| **Total** | | |
| Current | **353** | 1,139 |
| Deferred | **1,962** | (420) |

*Argentina*
Madalena has four legal entities in Argentina, 2 of which had taxable income in the Quarter. The income tax rate in Argentina is 35%. The 2 entities that are not taxable are subject to minimum taxes, which are generally taxed at 1% of net assets. Current income tax expense (including minimum tax) for the Quarter was $0.5 million compared to $1.1 million for Q1-2015.

The Company booked a deferred income tax expense of $2.0 million during the Quarter (Q1-2015 – recovery of $0.4 million).

Current income taxes for Q2-2016 are estimated at approximately $0.5 million.

*Canada*
The Company does not anticipate being taxable in the foreseeable future.

**Reconciliation of Cash Flow from Operating Activities and Funds Flow from Operations**

As detailed previously in this MD&A, funds flow from operations is a term that does not have any standardized meaning under GAAP. Madalena's method of calculating funds flow from operations may differ from that of other companies, and accordingly, may not be comparable to measures used by other companies. Funds flow from operations is calculated as cash flow from operating activities before decommissioning obligations settled, changes in non-cash working capital, and changes in non-current assets.

| | **Three months ended March 31** | |
|---|---|---|
| USD 000s | **2016** | **2015** |
| Cash flow from operating activities | **6,460** | 7,067 |
| Change in non-cash working capital | **(3,947)** | (3,075) |
| Change in other long term assets | **450** | 728 |
| Funds flow from operations | **2,963** | 4,720 |

**Funds flow from operations, Net Income (Loss) and Comprehensive Loss**

| USD 000s | **Three months ended March 31** | |
|---|---|---|
| (except per share amounts) | **2016** | **2015** |
| Funds flow from operations | **2,963** | 4,720 |
| Per share - basic & diluted | **0.01** | 0.01 |
| Net income (loss) | **(6,834)** | 1,003 |
| Per share - basic & diluted | **(0.01)** | 0.00 |
| Comprehensive loss | **(5,471)** | (1,780) |

Madalena's funds flow from operations for the Quarter decreased to $3.0 million from $4.7 million in Q1-2015. The decrease in funds flow from operations was principally due to lower sales volumes and commodity prices.

The net loss for the Quarter was $6.8 million (Q1-2015 – net income of $1.0 million), predominately due to lower oil and natural gas revenues as a result of lower production and lower realized commodity prices together with higher finance expenses and increased taxes in the current Quarter.

A summary of the foreign exchange impact as it relates to the foreign currency translation adjustment is as follows:

| USD 000s | Three months ended March 31<br>2016 | <br>2015 |
|---|---|---|
| Foreign currency translation adjustment | **1,419** | (2,783) |

For the Quarter, the Company recorded a gain of $1.4 million in foreign currency translation adjustment. Since December 31, 2015, the USD decreased by 6% against the CAD, which resulted in a $2.6 million gain on the translation of the Canadian parent into USD, offset by a $1.2 million loss on the intercompany loans from Canada to Argentina which are not considered part of the net investment in the subsidiaries.

During Q1-2015, the USD increase by 9% against the CAD, and a $2.8 million loss was recorded on the translation of the Canadian parent into USD. All intercompany loans from Canada to Argentina were considered part of the net investment at March 31, 2015.

**Capital Expenditures**

| USD 000s | Three months ended March 31<br>2016 | <br>2015 |
|---|---|---|
| **Argentina** | | |
| Land and associated renewal fees | **20** | - |
| Geological and geophysical | **216** | 104 |
| Drilling and completions | **3,876** | 9,954 |
| Well equipment and facilities | **591** | 756 |
| Other | **158** | 545 |
| Argentina total | **4,861** | 11,359 |
| **Canada** | | |
| Land and associated renewal fees | **-** | - |
| Geological and geophysical | **-** | - |
| Drilling and completions | **-** | 317 |
| Well equipment and facilities | **-** | 28 |
| Other | **-** | 33 |
| Canada total | **-** | 378 |
| **Consolidated** | **4,861** | 11,737 |

*Argentina*

During the Quarter, the Company completed both the vertical exploration well at Curamhuele (Yapai 1001) and completed and placed on-stream the horizontal well at Coiron Amargo (CAN-6). The Yapai well will require additional testing operations, fluid sampling and production well logging to evaluate the opportunity to optimize the deliverability of the well. The Company is pursuing a strategic partner to help further delineate the Lower Agrio shale and Vaca Muerta shale resources and further assess the Mulichinco tight sand formation on the Curamhuele property.

During Q1-2015 the Company drilled two wells; a horizontal well at Coiron Amargo (CAN-16(h)) and a horizontal multi-frac well at Puesto Morales (PMS-1135). The CAN-16(h) was placed on production March 15, 2015 while the PMS-1135 started producing oil on April 2, 2015 with solution gas conservation commencing on April 9, 2015.

*Canada*
There was virtually no activity in Canada during the Quarter or in Q1-2015. This was a result of the Company's focus on Argentina in response to the shut-in of the Keyera processing plant as well as reduced commodity prices realized in Canada.

**FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES**

Liquidity, working capital and shareholders' equity

| USD 000s | March 31 2016 | December 31 2015 |
|---|---|---|
| Working capital deficit | | |
| Argentina | **(2,015)** | (415) |
| Canada | **(1,314)** | 877 |
| | **(3,329)** | 462 |
| Long-term debt | **875** | 1,972 |
| Shareholders' equity | **95,223** | 100,093 |

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. The following outlines the Company's risk exposures and explains how these risks and its capital structure are managed.

***Credit Facilities***
*Argentina*
In May 2015, one of the Company's Argentine subsidiaries, Madalena Energy Argentina S.R.L (Argentina) ("MEA"), obtained an ARS 90 million credit facility with Industrial and Commercial Bank of China (Argentina) S.A. ("ICBC"), the details of which are described in note 8 of the Company's consolidated financial statements for the year ended December 31, 2015 and in note 5 of the Company's unaudited interim condensed consolidated financial statements for the three months ended March 31, 2016. The amount outstanding at March 31, 2016 was $4.4 million and is repayable in five equal quarterly instalments of ARS 12.9 million ($0.9 million using the March 31, 2016 exchange rate) with the next payment due on May 31, 2016. The current portion of $3.5 million is included in the working capital balance noted above and the remaining balance of $0.9 million is included in long-term debt.

The loan bears interest at the variable rate of BADLAR plus 8%, resulting in a current borrowing rate of approximately 37%.

Security for this loan is provided by the assignment of MEA's receivables 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 are calculated on a four quarter rolling basis. At March 31, 2016, MEA was in compliance with this covenant at 0.26, and is expected to be for the remainder of the year. There was no credit facility in place in Argentina at March 31, 2015.

***Capital management***
The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the

underlying oil and natural gas assets. The Company considers its capital structure to include shareholders' equity, existing credit facilities and working capital. In order to maintain or adjust the capital structure, the Company may obtain new credit facilities; adjust its capital spending to manage current and projected debt levels, farm-out existing opportunities or issue shares.

***Liquidity risk and going concern***

The Company evaluates its ability to meet its future obligations on a regular basis. Budgets are reviewed monthly and updated as necessary depending on varying factors including current and forecast prices, actual capital deployment and general industry conditions. 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. Although the Government of Argentina sets the benchmark price for oil, the current world-wide economic environment relating to the oil and gas industry has made access to capital challenging for many companies, Madalena included. In addition, the Argentina government reduced the benchmark oil price by 10% from $75.00 to $67.50 per barrel in January 2016.

Although the Company has a largely unleveraged balance sheet at March 31, 2016, it does have a working capital deficit of $3.3 million, and continues to face liquidity challenges. The Company is actively pursuing alternative sources of capital, including potential debt and equity financing and ways to monetize its assets, including, without limitation, asset sales or swaps, joint ventures or other transactions with industry partners, all with a view to enhancing liquidity to execute on its business plan.

Capital commitments in 2016 and 2017 are expected to exceed anticipated future funds from operations and, accordingly, the Company has included a note on going concern uncertainty in the condensed interim consolidated financial statements. In the event the Company cannot access the required funding and certain work commitments are not fulfilled prior to the commitment deadlines, the Company will attempt to extend its commitments with the regulators. There is no certainty that any extensions will occur in the future and failure to obtain such extensions may result in the loss of concessions and the rights attached to them.

At March 31, 2016, $4.4 million, or 86%, of Madalena's cash and cash equivalents were deposited with banks in Argentina (December 31, 2015 - $2.1 million or 54%) and are held in ARS.

At March 31, 2016, the consolidated working capital deficit position of the Company was $3.3 million (December 31, 2015 – positive working capital of $0.5 million), consisting of a working capital deficiency of $2.0 million (December 31, 2015 – working capital deficiency of $0.4 million) in Argentina and working capital deficiency of $1.3 million (December 31, 2015 – positive working capital of $0.9 million) in Canada.

***Repatriation of Funds to Canada***

Until December 16, 2015, there were a number of monetary and currency exchange control measures in Argentina that included restrictions on the free disposition of funds deposited with banks and tight restrictions on transferring funds abroad, including the need to register intercompany debt to a foreign creditor. On December 16, 2015, these restrictions were lifted.

During 2015, the Company repatriated $7.8 million to Canada, of which $0.8 million was repatriated in Q1-2015. The Company has not repatriated any funds to Canada in 2016.

***Share Capital Issued and Options Granted***

*Outstanding Share Capital*

During the Quarter, no common shares were issued pursuant to the exercise of options. During Q1-2015, 533,333 common shares were issued pursuant to the exercise of options for cash proceeds of $0.1 million.

During the Quarter, 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 in Q1-2015.

As at May 16, 2016, the Company had 542.1 million shares and 43.2 million options outstanding.

***Fair value of Financial Instruments***

The Company's financial instruments include cash and cash equivalents, available for sale securities, trade and other receivables, current portion of long-term debt, trade and other payables, taxes payable and long-term debt the carrying values of which approximate their fair values due to their short-term nature and in the case of the long-term debt, as a result of the variable interest rate. Commodity contracts (held for trading) and available for sale securities are recorded at fair value through the statements of income (loss) and other comprehensive loss, respectively.

***Decommissioning Obligations***

Decommissioning obligations result from net ownership interests in property, plant and equipment and involve critical accounting estimates. There are significant uncertainties related to the estimated costs and the timing of settlement of decommissioning obligations, and the impact on the financial statements could be material. The main factors that can cause expected decommissioning obligations to change are changes to laws and regulations, construction of new facilities, changes in reserve estimates and life, changes in technology, and discount and/or inflation rates applied.

The Company expects the decommissioning obligations for its Argentina portfolio to be invoiced in USD and settled in ARS.

Changes to Madalena's estimates of decommissioning, restoration and similar liabilities are recorded directly to the related asset with a corresponding entry to the provision. Madalena's estimates are reviewed at the end of each reporting period for changes in regulatory requirements, discount rates, and effects of inflation.

At March 31, 2016, inflation rates of 1.0% and 2.0% were used in Argentina and Canada, respectively (December 31, 2015 – 1.0% and 2.0%). The risk free rate used to discount the liability at March 31, 2016 was 2.3% (December 31, 2015 – 2.7%) in Argentina and a range of 0.5-2.0% (December 31, 2015 – 0.5-2.0%) in Canada.

***Commitments and Contingencies***

*Development and Exploration Commitments*

*Coiron Amargo Block (35% working interest – non-operated)*

| USD 000s | **2016** | **2017** | **Beyond** |
|---|---|---|---|
| Concession commitments | - | 17,500 | nil |

*Curamhuele Block (90% working interest)*

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.

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

*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 May 16, 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. Negotiations continue and are currently ongoing with the province of Salta to reach a multi-year extension agreement.

As at March 31, 2016 the second exploration phase required additional work commitments of $3.75 million of which no qualifying expenditures had been made.

**QUARTERLY FINANCIAL RESULTS**

| USD 000s, unless otherwise noted | Q1 2016 | Q4 2015 | Q3 2015 | Q2 2015 |
|---|---|---|---|---|
| Oil and natural gas revenues | **15,105** | 18,304 | 21,200 | 24,699 |
| Other income | **-** | - | 13,857 | - |
| Net income (loss) | **(6,834)** | (14,310) | 5,479 | (5,876) |
| Shares outstanding – millions | **542.1** | 542.1 | 542.1 | 541.0 |
| Net income (loss) per share – basic and diluted | **(0.01)** | (0.03) | 0.01 | (0.01) |

| USD 000s, unless otherwise noted | Q1 2015 | Q4 2014 | Q3 2014 | Q2 2014 |
|---|---|---|---|---|
| Oil and natural gas revenues | 19,445 | 23,446 | 28,327 | 8,397 |
| Net income (loss) | 1,003 | (28,273) | (635) | (3,019) |
| Shares outstanding – millions | 540.3 | 539.8 | 539.8 | 525.0 |
| Net income (loss) per share – basic and diluted | (0.00) | (0.05) | (0.00) | (0.01) |

The Company's decrease in oil and gas revenues during the Quarter, Q4-2015 and Q3-2015 can be primarily attributed to lower sales volumes due to natural declines. Q2-2015 increases were favourably impacted by successful horizontal drilling in Argentina, the $3.00 per barrel oil incentive and increased production in Argentina resulting from the Acquisition.

The Company recorded $13.9 million of other income as settlement of past Petroleo Plus incentive credits in Q3-2015.

The Company recorded pre-tax impairment charges of $1.3 million, $2.1 million and $2.0 million in Canada in Q4-2015, Q3-2015 and Q2-2015, respectively, and $8.4 million in Argentina in Q4-2015. The Company recorded pre-tax impairment charges of $24.7 million, $0.5 million, and $1.8 million in Q4-2014, Q3-2014, and Q2-2014, respectively, impacting the net income (loss) recognized in those periods. The Company also incurred $1.6 million and $0.1 million of business combination costs relating to the Acquisition in Q2-2014 and Q3-2014, respectively.

The Company issued 14.7 million shares for gross proceeds of $7.0 million during Q3-2014, 98.1 million shares for gross proceeds of $46.7 million during Q2-2014, 29.8 million shares as partial consideration for the Acquisition totalling $14 million during Q2-2014.

## CRITICAL ACCOUNTING JUDGMENTS, ESTIMATES AND ACCOUNTING POLICIES

For more details regarding the Company's critical accounting judgments, estimates and accounting policies the following should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2015.

Management is required to make judgments, estimates and assumptions in the application of accounting policies that could have a significant impact on the Company's financial results. Actual results may differ from those estimates and those differences may be material. The estimates and assumptions used are subject to updates based on experience and the application of new information. The Company's critical accounting policies and estimates are reviewed annually by the Audit Committee of the Board. Further details on the basis of presentation and significant accounting policies can be found in the Company's notes to the consolidated financial statements for the year ended December 31, 2015.

### Critical Accounting Judgments in Applying Accounting Policies

Critical judgments are those judgments made by Management in the process of applying accounting policies that have the most significant effect on the amounts recognized in the Company's Consolidated Financial Statements and accompanying notes for the year ended December 31, 2015. Further information on Management's critical accounting judgments in applying accounting policies can be found in the notes to the consolidated financial statements for the year ended December 31, 2015.

### Critical accounting estimates

Critical accounting estimates are those estimates that require Management to make particularly subjective or complex judgments about matters that are inherently uncertain. Estimates and underlying assumptions are reviewed on an ongoing basis and any revisions to accounting estimates are recognized in the period in which the estimates are revised. During the Quarter, there were no changes to the Company's key sources of estimation uncertainty. Further information on the Company's key sources of estimation uncertainty can be found in the notes to the consolidated financial statements for the year ended December 31, 2015.

### Accounting Changes

Prior to December 31, 2015, the Company had presented its consolidated financial statements using CAD. As a result of increasing focus on the Company's Argentine operations and the reducing size of the Canadian operations over the past two years, the Company believed that changing its presentation currency effective December 31, 2015 to the USD would provide improved comparability of results period over period. The Company's Argentine operations have a USD functional currency and translating their results from USD to CAD for reporting purposes was creating significant volatility in the consolidated financial statements due to the significant changes in the CAD and USD exchange rates. For comparative purposes, historical financial statements have been recast to reflect the financial results had they always been presented using the USD. To accomplish this change, foreign denominated assets and liabilities were translated at the closing rate in effect at the end of the comparative periods; revenues, expenses and cash flows were translated at the average rate in effect for the comparative periods; and equity transactions were translated at historical rates.

### Future Accounting Pronouncements

In July 2014, the IASB issued IFRS 9 "Financial Instruments" to replace International Accounting Standard ("IAS") 39 "Financial Instruments Recognition and Measurement". The new standard replaces the current multiple classification and measurement models for financial instruments with a single model that has only two classifications categories: amortized cost and fair value.

In May 2014 the IASB issued IFRS 15 “Revenue from Contracts with Customers” to replace IAS 18 “Revenue”, IAS 11 “Construction Contracts”, and related interpretations. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

As of January 1, 2018, Madalena will be required to adopt the above two standards.

In January 2016, IASB issued IFRS 16 “Leases”. The goal of the standard is to bring leases on the balance sheet for lessees. There will be a single lease accounting model for all leases. As of January 1, 2019, Madalena will be required to adopt this standard.

Management is evaluating the impact these standards may have on Madalena’s condensed interim consolidated financial statements.

## RISK MANAGEMENT

For a full understanding of the risks that impact the Company, the following discussion should be read in conjunction with the Company’s consolidated financial statements for the year ended December 31, 2015.

The Company is exposed to a number of risks through the pursuit of its strategic objectives. Some of these risks impact the oil and gas industry as a whole and others are unique to its operations and its involvement in Argentina. Actively managing these risks improves the Company’s ability to effectively execute its business strategy. The factors that impact the Company’s exposure to liquidity risk, safety risk, capital project execution and operating risk, reserves replacement risk, environmental risk and regulatory risk has not changed substantially since December 31, 2015. For a further and more in-depth discussion of the Company’s risk management see the Company’s Consolidated Financial Statements for the year ended December 31, 2015.

A description of the risk factors and uncertainties affecting the Company can be found in the Advisory and a full discussion of the material risk factors affecting the Company can be found in the Company’s Annual Information Form for the year ended December 31, 2015.

## ADVISORY

### Forward Looking Statements

This MD&A may include forward-looking statements including opinions, assumptions, estimates and management’s assessment of future plans and operations, expected depletion, depreciation and accretion expenses, expectations as to the taxability of the Company and planned capital expenditures and the timing and funding thereof. When used in this document, the words “anticipate,” “believe,” “estimate,” “expect,” “intent,” “may,” “project,” “plan”, “should” and similar expressions are intended to be among the statements that identify forward-looking statements. Forward-looking statements are subject to a wide range of risks and uncertainties, and although the Company believes that the expectations represented by such forward-looking statements are reasonable, there can be no assurance that such expectations will be realized. Any number of important factors could cause actual results to differ materially from those in the forward-looking statements including, but not limited to, risks associated with petroleum and natural gas exploration, development, exploitation, production, marketing and transportation, the volatility of petroleum and natural gas prices, currency fluctuations, the ability to implement corporate strategies the ability to repatriate funds from Argentina, the state of domestic capital markets, the ability to obtain financing, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, changes in petroleum and natural gas acquisition and drilling programs, delays resulting from inability to obtain required regulatory approvals, delays resulting from inability to obtain drilling rigs and other services, labour supply risks, environmental risks, competition from other producers, imprecision of reserve estimates, changes in general economic conditions, ability to execute farm-in and farm-out opportunities, and other factors, all of which are more fully described from time to time in the reports and filings made by the Company with securities regulatory authorities.

Statements relating to “reserves” or “resources” are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves and resources described can be profitably produced in the future.

The forward looking statements contained in this MD&A are expressly qualified by this cautionary statement. Readers are cautioned not to place undue reliance on forward-looking statements, as no assurances can be given as to future results, levels of activity or achievements. Except as required by applicable securities laws, the Company does not undertake any obligation to publicly update or revise any forward-looking statements.

**Reserves and Other Oil and Gas Disclosure**

Any references in this MD&A to test rates, flow rates, initial and/or final raw test or production rates, early production, test volumes behind pipe and/or "flush" production rates are useful in confirming the presence of hydrocarbons, however, such rates are not necessarily indicative of long-term performance or of ultimate recovery. Such rates may also include recovered "load" fluids used in well completion stimulation. Readers are cautioned not to place reliance on such rates in calculating the aggregate production for Madalena. In addition, the Vaca Muerta and Agrio shales are unconventional resource plays which may be subject to high initial decline rates.

**Analogous Information**

Certain information in this MD&A may constitute "analogous information" as defined in National Instrument 51-101 - Standards of Disclosure for Oil and Gas Activities ("NI 51-101"), including, but not limited to, information relating to areas, assets, wells, industry activity and/or operations that are in geographical proximity to or believed to be on-trend with lands held by Madalena. Such information has been obtained from public sources, government sources, regulatory agencies or other industry participants. Management of Madalena believes the information may be relevant to help define the reservoir characteristics within lands on which Madalena holds an interest and such information has been presented to help demonstrate the basis for Madalena's business plans and strategies. However, management cannot confirm whether such analogous information has been prepared in accordance with NI 51-101 and the Canadian Oil and Gas Evaluation Handbook and Madalena is unable to confirm that the analogous information was prepared by a qualified reserves evaluator or auditor. Madalena has no way of verifying the accuracy of such information. There is no certainty that the results of the analogous information or inferred thereby will be achieved by Madalena and such information should not be construed as an estimate of future production levels or the actual characteristics and quality Madalena's assets. Such information is also not an estimate of the reserves or resources attributable to lands held or to be held by Madalena and there is no certainty that such information will prove to be analogous in the future. The reader is cautioned that the data relied upon by Madalena may be in error and/or may not be analogous to such lands to be held by Madalena.

**Numerical Amounts**

The reporting and the measurement currency is the USD. Natural gas reserves and volumes are converted to barrels of oil equivalent (boe) on the basis of six thousand cubic feet (mcf) of gas to one barrel (bbl) of oil. Boe’s may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf to 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

This MD&A uses the term “netback” which is a term that does not have standardized meanings under GAAP and this non-GAAP measurement may not be comparable with the calculation of other entities. The Company uses this measure to analyze operating performance.

The term "netback", which is calculated as the average unit sales price, less royalties and operating expenses, represents the cash margin for every barrel of oil equivalent sold. The Company considers this a key measure as it demonstrates its profitability relative to current commodity prices. This term does not have any standardized meaning prescribed by GAAP and, therefore, might not be comparable with the calculation of a similar measure for other companies.

**ABBREVIATIONS**

The following is a summary of the abbreviations used in this MD&A:

**Oil and Natural Gas Liquids**

| | |
|---|---|
| bbl | barrel |
| bbls/d | barrels per day |
| NGLs | Natural gas liquids |
| boe | barrel of oil equivalent |
| boe/d | barrel of oil equivalent per day |

**Natural Gas**

| | |
|---|---|
| Mcf | thousand cubic feet |
| WI | Working interest |