

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Madalena Energy Inc.

We have audited the accompanying consolidated financial statements of Madalena Energy Inc. which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012, the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Madalena Energy Inc. as at December 31, 2013 and 2012, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Accountants

KPMG LLP

April 28, 2014
Calgary. Canada

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Consolidated Statements of Financial Position

Canadian $000s	Note	As at December 31 2013	As at December 31 2012
Assets			
Current assets			
Cash and cash equivalents	14	**14,835**	38,253
Trade and other receivables		**4,057**	2,256
Other current assets		**1,075**	894
		19,967	41,403
Property, plant and equipment	5,6,9	**39,062**	30,714
Exploration and evaluation assets	6,7	**35,745**	35,760
Other non-current assets		**1,512**	1,139
		96,286	109,016
Liabilities			
Current liabilities			
Trade and other payables		**11,951**	11,377
Flow-through share liability	10	**385**	62
Decommissioning obligations	5,9	**4,947**	5,191
		17,283	16,630
Shareholders' Equity			
Share capital	10	**159,574**	141,676
Contributed surplus		**12,645**	11,920
Accumulated other comprehensive loss		**(17,094)**	(8,373)
Deficit		**(76,122)**	(52,837)
		79,003	92,386
		96,286	109,016

Commitments (Note 16)

Subsequent Event (Notes 18, 20)

See the accompanying Notes to the Consolidated Financial Statements.

On behalf of the Board:

[signed] "Ray Smith"

Ray Smith
Chairman

[signed] "Keith Macdonald"

Keith Macdonald
Director

Consolidated Statements of Loss and Comprehensive Loss

Canadian $000s, except per share amounts	Note	Year ended December 31 2013	2012
Revenues			
Oil and natural gas revenues		**17,960**	5,545
Royalties		**(2,375)**	(885)
		15,585	4,660
Interest and other income (expense)		**335**	632
Foreign exchange gain (loss)		**3,586**	(19)
Unrealized loss on commodity contracts	18	**(90)**	-
		19,416	5,273
Expenses			
Operating		**9,536**	2,976
General and administrative		**6,050**	4,902
Finance cost	9	**137**	73
Share-based compensation	11	**1,234**	1,945
Depletion and depreciation	6	**6,638**	1,723
Impairment	6,7	**19,719**	2,519
		43,314	14,138
Loss before income taxes		**(23,898)**	(8,865)
Income taxes			
Deferred income tax recovery	13	**613**	-
Net loss		**(23,285)**	(8,865)
Foreign currency translation adjustment		**(8,721)**	(3,211)
Comprehensive loss		**(32,006)**	(12,076)
Loss per share			
Basic and diluted	17	**(0.07)**	(0.03)

See the accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

Canadian $000s	Share Capital (Note10)	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total Equity
Balance at December 31, 2012	141,676	11,920	(8,373)	(52,837)	92,386
Net loss	-	-	-	(23,285)	(23,285)
Other comprehensive loss	-	-	(8,721)	-	(8,721)
Gross proceeds from financings	19,454	-	-	-	19,454
Share issue costs	(1,766)	-	-	-	(1,766)
Flow-through share liability	(936)	-	-	-	(936)
Stock options exercised	1,146	(515)	-	-	631
Share based payments	-	1,240	-	-	1,240
Balance at December 31, 2013	**159,574**	**12,645**	**(17,094)**	**(76,122)**	**79,003**
Balance at December 31, 2011	77,863	10,074	(5,162)	(43,972)	38,803
Net loss	-	-	-	(8,865)	(8,865)
Other comprehensive loss	-	-	(3,211)	-	(3,211)
Public offering of shares	63,485	-	-	-	63,485
Stock options exercised	328	(143)	-	-	185
Share based payments	-	1,989	-	-	1,989
Balance at December 31, 2012	141,676	11,920	(8,373)	(52,837)	92,386

See the accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Canadian $000s	Note	Year ended December 31 2013	2012
Cash provided by (used in):			
Operating			
Net loss		**(23,285)**	(8,865)
Items not affecting cash:			
Depletion and depreciation	6	**6,638**	1,723
Impairment	6,7	**19,719**	2,519
Accretion		**137**	73
Unrealized loss on commodity contracts	18	**90**	-
Share-based compensation	11	**1,234**	1,945
Decommissioning costs incurred	9	**(92)**	-
Deferred income tax recovery	13	**(613)**	-
Change in other non-current assets		**-**	209
Change in non-cash working capital	15	**(1,860)**	(248)
Net cash used in operating activities		**1,968**	(2,644)
Investing			
Business combination		**-**	(16,090)
Property, plant and equipment additions	6	**(22,751)**	(11,168)
Evaluation and exploration assets additions	7	**(20,545)**	(11,684)
Change in other non-current assets		**(631)**	(1,149)
Change in non-cash working capital	15	**613**	5,510
Net cash used in investing activities		**(43,314)**	(34,581)
Financing			
Shares issued, net of issue costs	10	**18,320**	63,671
Repayment of demand bank loan		**-**	(4,420)
Change in non-cash working capital	15	**-**	-
Net cash from financing activities		**18,320**	59,251
Change in cash and cash equivalents		**(23,026)**	22,026
Cash and cash equivalents, beginning of period		**38,253**	16,439
Impact of foreign exchange on cash balances		**(392)**	(212)
Cash and cash equivalents, end of period		**14,835**	38,253

See the accompanying Notes to the Consolidated Financial Statements.

Tabular amounts in thousands of Canadian dollars, except per share amounts

1. Reporting Entity

Madalena Energy Inc. (the "Company" or "Madalena") is involved in the exploration, development and production of oil and natural gas in in Argentina and in Alberta, Canada and its principal place of business is Suite 200, 707 – 7th Avenue S.W., Calgary, Alberta, T2P 3H6.

Online Energy Inc., a wholly owned subsidiary acquired by the Company on November 1, 2012, amalgamated with Madalena Energy Inc. on April 1, 2013. Effective July 30, 2013, the Company changed its name from Madalena Ventures Inc. to Madalena Energy Inc.

The consolidated financial statements are comprised of the results of the Company and the following wholly-owned subsidiaries in the indicated legal jurisdictions:

- Madalena Austral S.A. (Argentina)
- Madalena Ventures International Holding Company Inc. (Barbados)
- Madalena Ventures International Inc. (Barbados)

2. Basis of Preparation

Future operations

These consolidated financial statements have been prepared on the basis that the Company is a going concern and will realize assets and discharge liabilities in the normal course of operations for the foreseeable future. Presently, Madalena has limited cash flow from operating activities. The Company currently relies substantially on equity financing to pay for exploration activities. Therefore, the Company's ability to continue operations is dependent on identifying commercial oil and gas reserves, generating profitable operations and raising sufficient capital to complete planned exploration and development activities. The outcome of these matters cannot be predicted at this time.

Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. These consolidated financial statements follow the same accounting policies and method of computation as outlined in Note 3.

The consolidated financial statements were approved and authorized for issue by the Company's Board of Directors on April 28, 2014.

Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis.

Functional and Presentation Currency

Items included in the financial statements of each of the Company's consolidated subsidiaries are measured using the currency of the primary economic environment in which the subsidiary operates ("the functional currency"). The consolidated financial statements are presented in Canadian dollars, which is Madalena's functional currency. The Argentine peso is the functional currency of Madalena Austral S.A. and the United States dollar is the

functional currency of both Madalena Ventures International Holding Company Inc. and Madalena Ventures International Inc.

Use of Estimates and Judgments

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are reviewed and in any future years affected.

Critical Judgments in Applying Accounting Policies

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the consolidated financial statements.

The Company's assets are aggregated into cash-generating units for the purpose of calculating impairment. Cash generating units ("CGU" or "CGUs") are based on an assessment of the unit's ability to generate independent cash inflows. The determination of these CGUs was based on management's judgment in regards to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risk and materiality.

Judgments are required to assess when impairment indicators exist and impairment testing is required. In determining the recoverable amount of assets, in the absence of quoted market prices, impairment tests are based on estimates of reserves, production rates, future oil and natural gas prices, future costs, discount rates, market value of land and other relevant assumptions.

The Company's concessions are, from time to time, subject to renewal which require approvals from regulatory authorities. As there is no indication that pending extensions will not be approved, management has used judgment to conclude that all extensions will be approved. If the Company fails to obtain extension renewals, the carrying value of the Company's exploration and evaluation assets may be negatively impacted.

The application of the Company's accounting policy for exploration and evaluation assets requires management to make certain judgments as to future events and circumstances as to whether economic quantities of reserves have been found.

The Company's functional currency is based on the primary economic environment in which it operates and is based on an analysis of several factors including which currency principally affects sales prices of products sold by the Company, which currency influences the main expenses of providing services, in which currency the Company keeps it receipts from operating activities and in which currency the Company has received financing. Management used its judgment to assess these factors and concluded its functional currency was the Canadian dollar.

The determination of the Company's Argentine operation's functional currency requires assessing several factors, including the dominant currency used in transactions such as the settlement of revenues and operational and capital expenditures. Management used its judgment to assess these factors and concluded its functional currency was the Argentine peso.

Judgments are made by management to determine the likelihood of whether deferred income tax assets at the end of the reporting period will be realized from future taxable earnings.

Key Sources of Estimation Uncertainty

The following are key estimates and their assumptions made by management affecting the measurement of balances and transaction in these consolidated financial statements.

Estimation of recoverable quantities of proven, probable and possible and/or contingent reserves include estimates and assumptions regarding future commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows as well as the interpretation of complex geological and geophysical models and data. Changes in reported reserves can affect the impairment of assets, the decommissioning obligations, the economic feasibility of exploration and evaluation assets and the amounts reported for depletion, depreciation and amortization of property, plant and equipment.

The Company estimates the decommissioning obligations for oil and natural gas wells and their associated production facilities and pipelines. In most instances, removal of assets and remediation occurs many years into the future. Amounts recorded for the decommissioning obligations and related accretion expense require assumptions regarding removal date, future environmental legislation, the extent of reclamation activities required, the engineering methodology for estimating cost, inflation estimates, future removal technologies in determining the removal cost, and the estimate of the specific discount rates for these liabilities in order to determine the present value of these cash flows.

In a business combination, management makes estimates of the fair value of assets acquired and liabilities assumed which includes assessing the value of oil and gas properties based upon the estimation of recoverable quantities of proven, probable and possible and/or contingent reserves being acquired.

Compensation costs recognized under the share based payments to directors and employee are subject to an estimation of the expected lives of options including forfeiture rates, risk-free rates of return and stock price volatility.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements.

(a) Basis of Consolidation

i. Subsidiaries

Subsidiaries are entities controlled by Madalena. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

Inter-company balances and transactions, including unrealized income and expenses arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

ii. Jointly Controlled Operations and Assets

Some of the Company's oil and natural gas activities involve jointly controlled assets. The consolidated financial statements include the Company's share of these jointly controlled assets and a proportionate share of the relevant revenue and related costs.

(b) Foreign Currency

Items included in the financial statements of each of the Company's consolidated subsidiaries are measured using the currency of the primary economic environment in which the subsidiary operates ("the functional currency"). The consolidated financial statements are presented in Canadian dollars, which is Madalena's functional currency. The Argentine peso is the functional currency of Madalena Austral S.A. and the United States dollar is the functional currency of both Madalena Ventures International Holding Company Inc. and Madalena Ventures International Inc.

Foreign currency transactions are translated into the respective functional currencies of Madalena and its subsidiaries using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit and loss.

The results and financial position of all the Company's consolidated subsidiaries that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

i. assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that balance sheet;

ii. income and expenses for each year are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

iii. all resulting exchange differences are recognized in a separate component of equity called 'accumulated other comprehensive income'.

When a foreign operation is disposed of, a proportionate share of the cumulative exchange differences previously recognized in equity is recognized in the statement of loss, as part of the gain or loss on sale where applicable.

(c) Financial Instruments

i. Financial assets

Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Company determines the classification of its financial assets at initial recognition.

Fair value through profit or loss
A financial asset or liability is classified in this category if it is held for trading. Financial assets at fair value through profit or loss are initially recognized at fair value with changes in fair value recorded through profit or loss.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement at fair value, such financial assets are subsequently measured at amortized cost less impairment. Loans and receivables are comprised of trade and other receivables.

Held-to-maturity investments
These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in profit or loss.

Available-for-sale financial assets
Non-derivative financial assets not included in the above categories are classified as available-for- sale. They are carried at fair value with changes in fair value recognized as other comprehensive income and classified as a component of equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in the income statement. When financial assets classified as available for sale are sold, the accumulated fair value adjustments recognized in other comprehensive income are included in profit or loss.

ii. Financial liabilities

Financial liabilities are classified as financial liabilities at fair value through profit or loss and other financial liabilities, as appropriate. The Company determines the classification of its financial liabilities at initial recognition.

Fair value through profit or loss
This category comprises derivatives or liabilities acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in profit or loss.

Other financial liabilities
This category includes trade and other payables, which are recognized at amortized cost.

(d) Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at banks and short-term deposits with an original maturity of three months or less. For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(e) Property, Plant and Equipment and Exploration and Evaluation Assets

i. Business combinations

Business combinations are accounted for using the acquisition method. The identifiable assets acquired and liabilities and contingent liabilities assumed are measured at their fair values at the acquisition date. The cost of an acquisition is measured as the aggregate consideration transferred, measured at the acquisition date fair value. If the cost of the acquisition is less than the fair value of the net assets acquired, the difference is recognized immediately in net profit. If the cost of the acquisition is more than the fair value of the net assets acquired, the difference is recognized on the balance sheet as goodwill. Acquisition costs incurred are expensed.

ii. Pre-license costs

Exploration and evaluation ("E&E") costs incurred prior to receiving the legal rights to explore an area are expensed when incurred.

iii. Exploration and evaluation assets

Exploration licenses, unproved property acquisition costs, geological and geophysical costs and costs directly associated with an exploration well and appraisal activities are capitalized within exploration and evaluation assets. The costs are accumulated in cost centers by well, field or exploration area pending determination of their technical feasibility and commercial viability. E&E assets are not depleted but are assessed for impairment when there are indicators of impairment.

The technical feasibility and commercial viability of E&E assets is considered to be determinable when proven plus probable reserves are determined to exist. A review of each exploration area is carried out to ascertain whether proven plus probable reserves have been discovered and there is a reasonable assessment of the economics associated with the future production of those reserves, required government and regulatory approvals have been obtained or are likely to be obtained, and management has made the decision to proceed with development and production of those reserves by incurring the future capital costs attributed to them. Upon determination of proven plus probable reserves, E&E assets attributable to those reserves are first tested for impairment and then reclassified from exploration and evaluation assets to property, plant and equipment.

iv. Property, plant and equipment assets

Property, plant and equipment ("PP&E") assets are measured at cost less accumulated depletion, depreciation and amortization and accumulated impairment losses. Development and production assets are accumulated into major area cost centers and represent the cost of developing the commercial reserves and initiating production. Capitalized costs include the purchase price or construction cost of the asset, any costs directly attributable to bringing the asset into operation, the estimate of any decommissioning obligation, and borrowing costs for qualifying assets, if any. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalized value of a finance lease is also included within PP&E.

v. Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing components of equipment are recognized as property, plant and equipment only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are expensed as incurred. Such capitalized amounts generally represent costs incurred in developing proved and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of PP&E are recognized in profit or loss income as incurred.

An asset within PP&E is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on de-recognition of the asset (calculated

as the difference between the net disposal proceeds and the carrying amount of the item) is included in profit or loss in the period in which the item is derecognized.

Exchanges of assets within PP&E are measured at fair value unless the exchange transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. Unless the fair value of the asset received is more clearly evident, the cost of the acquired asset is measured at the fair value of the asset given up. Where fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. The gain or loss on de-recognition of the asset given up is recognized in net income.

vi. Depletion and depreciation

Depletion of oil and natural gas properties and depreciation of production equipment are calculated on a field basis using the unit-of-production method, based on the field's volumes of total proved and probable oil and natural gas reserves and production before royalties, as determined by independent petroleum reservoir engineers. Natural gas reserves and production are converted to equivalent barrels of oil based upon the energy equivalent conversion ratio of six thousand cubic feet of natural gas to one barrel of oil, calculated in accordance with National Instrument 51-101 - *Standards of Disclosure for Oil and Gas Activities*. The depletion base includes all capitalized costs and estimated future development costs of proved and probable undeveloped reserves.

Corporate assets primarily consist of office furniture and equipment and leasehold improvements, which are stated at cost less accumulated depreciation and are depreciated over the estimated useful lives of the assets. Office furniture and equipment in Canada is depreciated on a declining balance basis at rates ranging from 20 to 30%. Office furniture and equipment in Argentina is depreciated on a straight line basis over 3 to 10 years and leasehold improvements on a straight line basis over the term of the lease.

vii. Impairment

The carrying amounts of the Company's PP&E and E&E assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

For the purpose of impairment testing, assets are grouped together into the group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

E&E assets are allocated to related CGU's when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (oil and natural gas interests in property, plant and equipment).

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

Impairment losses recognized in prior years are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

(f) Share Based Payments

The grant date fair value of equity settled options granted to employees and directors is recognized as compensation expense with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is subsequently adjusted each period to eventually reflect the actual number of options or performance warrants that vest. Upon exercise of the stock options, the consideration received plus the amount previously recorded in contributed surplus is recorded as an increase in share capital.

(g) Decommissioning Obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. A decommissioning obligation is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of reflects current market assessments of the time value of money and the risks specific to the liability. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the decommissioning obligation due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(h) Revenue

Revenue from the sale of oil and natural gas is recorded when the significant risks and rewards of ownership of the product is transferred to the purchaser which is when legal title passes to the purchaser. This is generally at the time product enters the pipeline or is shipped.

Royalty income is recognized as it accrues in accordance with the terms of the overriding royalty agreements.

(i) Income Taxes

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

(j) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity.

(k) Earnings Per Share

The Company presents basic and diluted earnings per share (EPS) data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential common shares.

4. Changes in Accounting Policies

On January 1 2013, the Company adopted IFRS 10 *Consolidated Financial Statements* ("IFRS 10"), IFRS 11 *Joint Arrangements* ("IFRS 11"), IFRS 12 *Disclosure of Interest in Other Entities* ("IFRS 12"), IFRS 13 *Fair Value Measurement* ("IFRS 13"), as well as the amendments to IAS 1 *Presentation of Financial Statements* ("IAS 1"), IAS 27 *Separate Financial Statements* ("IAS 27") and IAS 28 *Investments in Associate and Joint Ventures* ("IAS 28") as described in the December 31, 2012 annual Consolidated Financial Statements.

The Company reviewed its consolidation methodology and determined that the adoption of IFRS 10 did not result in a change in the consolidation status of its subsidiaries and investees. The Company performed a comprehensive review of its interests in other entities and identified no interests that would require different accounting treatment under IFRS 11 or disclosures required under IFRS 12. The Company applied IFRS 13 prospectively as required and there has been no change to the Company's methodology for determining fair value for its financial assets and liabilities and as such, the adoption of IFRS 13 did not result in any measurement adjustments as at January 1, 2013 and it did not result in any additional disclosure in the notes to the consolidated financial

statements as the carrying value of all of the Company's financial assets and liabilities approximate their fair values. The amendments to IAS 1, IAS 27 and IAS 28 had no impact on the consolidated financial statements.

Future Accounting Pronouncements

There were no new or amended standards issued during the year ended December 31, 2013 that are applicable to the Company in future periods.

5. Business Combination

On November 1, 2012, the Company acquired all of the issued and outstanding common shares of Online Energy Inc. ("Online"), a junior Canadian oil and gas company, for cash consideration of $16,090,000. The acquisition has been accounted for as a business combination.

Purchase price allocation

Canadian $000s	
Net assets acquired	
Property, plant and equipment	16,530
Exploration and evaluation assets	8,455
Working capital deficiency	(1,160)
Demand bank loan	(4,420)
Decommissioning obligation	(3,315)
	16,090
Consideration	
Cash	16,090

The Company incurred transaction costs of $0.5 million in conjunction with the acquisition which have been which have been included in general and administrative costs in profit and loss. Had the transaction closed on January 1, 2012, the estimated incremental revenue and net loss that would have been reported by the Company was $4.1 million and $2.5 million, respectively. Revenues and net loss included in the Company's results for the period from the date of acquisitions, November 1, 2012 to December 31, 2012 was $1.6 million and $0.5 million, respectively. The fair value of receivables acquired was $0.9 million which is the same as their gross contractual flows since all receivables have a short maturity date. All acquired receivables have been collected or are expected to be collected.

6. Property, Plant and Equipment

Canadian $000s	Oil and Natural Gas Assets	Corporate	Total
Cost			
At December 31, 2011	7,490	227	7,717
Acquired on business combination	16,489	41	16,530
Additions	12,461	27	12,488
Effect of change in foreign exchange rates	(1,259)	(3)	(1,262)
At December 31, 2012	35,181	292	35,473
Additions	22,643	(15)	22,628
Effect of change in foreign exchange rates	(3,674)	(8)	(3,682)
At December 31, 2013	**54,150**	**269**	**54,419**

Canadian $000s	Oil and Natural Gas Assets	Corporate	Total
Accumulated depreciation, depletion and impairment			
At December 31, 2011	(452)	(144)	(596)
Depreciation and depletion	(1,715)	(19)	(1,734)
Impairment	(2,519)	-	(2,519)
Effect of change in foreign exchange rates	88	2	90
At December 31, 2012	(4,598)	(161)	(4,759)
Depreciation and depletion	(6,647)	(25)	(6,672)
Impairment	(5,000)	-	(5,000)
Effect of change in foreign exchange rates	1,067	6	1,073
At December 31, 2013	**(15,178)**	**(180)**	**(15,358)**

Canadian $000s	Oil and Natural Gas Assets	Corporate	Total
Net book value			
At December 31, 2012	30,583	131	30,714
At December 31, 2013	**38,972**	**89**	**39,061**

At December 31, 2013, Madalena determined that there were no indications of impairment for its Argentine CGU at Coiron Amargo North. At December 31, 2012, the Company recognized an impairment of $2.5 million related to this CGU. In assessing its Canadian CGU for impairment at December 31, 2013, the Company observed triggers for impairment that included a decrease in the long term forward Canadian natural gas prices as at December 31, 2013,

as listed by McDaniel & Associates Consultants Ltd., relative to those estimated at December 31, 2012, reserve revisions on certain of the mature producing assets, increases in operating costs and significant facility upgrades on the Company's older facilities. The Company's testing of its Canadian CGU recoverable value relative to its carrying value revealed an impairment charge of $5.0 million (2012-nil). The impairment test was based on proved plus probable reserves, using a discount rate of 10% and forward commodity price estimates. The impairment test used the following benchmark prices from McDaniel & Associates Consultants Ltd. price forecast, effective January 1, 2014.

Year	WTI (US$/bbl)	AECO - Spot ($/MMBtu)	Exchange Rate ($US/$Cdn)
2014	95.00	4.00	0.95
2015	95.00	4.25	0.95
2016	95.00	4.55	0.95
2017	95.00	4.75	0.95
2018	95.30	5.00	0.95
2019	96.60	5.25	0.95
2020	95.50	5.35	0.95
2021	100.50	5.45	0.95
2022	102.50	5.55	0.95
2023	104.60	5.65	0.95
2024	106.70	5.75	0.95
2025	108.80	5.90	0.95
2026	111.00	6.00	0.95
2027	113.20	6.15	0.95
2028	115.50	6.25	0.95
Thereafter	+2%/yr	+2%/yr	0.95

At December 31, 2013, the net book value of the Argentinean and Canadian PP&E assets were $12.0 million (December 31, 2012 - $10.9 million) and $27.1 million (December 31, 2012 - $19.8 million), respectively.

The amounts capitalized as PP&E assets in Argentina at December 31, 2013 includes $3.3 million of Value Added Tax ("VAT") (December 31, 2012 - $2.4 million). VAT is payable on goods and services supplied to the Company and is not recoverable from the Government of Argentina; however, the Company is allowed to retain VAT on any sales that it collects to the extent of the VAT recorded and paid on previous expenditures.

Depletion expense for the year ended December 31, 2013 included $30.6 million (December 31, 2012 – $23.7 million) for estimated future development costs associated with proved and probable reserves.

7. Exploration and Evaluation Assets

Canadian $000s	
Cost	
At December 31, 2011	17,339
Acquired on business combination	8,455
Additions	11,924
Effect of change in foreign exchange rates	(1,958)
At December 31, 2012	35,760
Additions	20,491
Impairment	(14,719)
Effect of change in foreign exchange rates	(5,787)
At December 31, 2013	**35,745**

Exploration and Evaluation ("E&E") assets consist of the Company's intangible exploration projects in Argentina and Canada pending the 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.

At December 31, 2013, the net book value of the Argentinean and Canadian E&E assets were $28.6 million (December 31, 2012 - $25.2 million) and $7.1 million (December 31, 2012 - $10.6 million), respectively.

The Company has recorded an impairment charge of $14.7 million on its Canadian exploration and evaluation assets at December 31, 2013. Included in this impairment charge are all the costs incurred to December 31, 2013 on the three wells described below.

In late 2012, the Company spud a well in an attempt to establish a resource project from horizontal drilling in the Nordegg formation. The well was completed in 2013 and was unsuccessful in establishing commercial reserves. This well was abandoned during the first quarter of 2014.

In late 2013, the Company drilled a vertical exploration well (which qualified for Canadian "CEE" expenses), which was unsuccessful in establishing commercial reserves. The well was also abandoned in the first quarter of 2014.

Also in late 2013, the Company drilled a horizontal step-out Ostracod well. While work continues on the evaluation of this well, the Company does not believe that the costs incurred at December 31, 2013 will be recovered. Accordingly, all costs incurred through December 31, 2013 are included in the impairment charge.

The amounts capitalized as Argentina E&E assets at December 31, 2013 included $6.4 million of VAT (December 31, 2012 - $5.6 million).

8. Credit Facility

At December 31, 2013, the Company had a revolving operating demand loan credit facility with the National Bank of Canada to a maximum of $10 million with interest charged at the bank's prime rate plus 1.0% per annum. Security for this facility is provided by way of a charge over the petroleum and natural gas assets of the Company. The facility includes a working capital ratio covenant, whereby the Company's working capital deficiency (excluding any unrealized hedging gains or losses) may not exceed $10 million. The Company had positive working capital at December 31, 2013 of $8.0 million (2012 - $30.0 million). Standby fees associated with the facility are 0.25% per annum on the undrawn portion.

In addition, The Company has an acquisition / development demand loan credit facility with the National Bank of Canada to a maximum of $3 million with interest charged at the bank's prime rate plus 1.5% per annum.

Both facilities are subject to a periodic review by the bank and the next review is scheduled on or before May 1, 2014. The facilities were unutilized at December 31, 2013 and 2012.

As the credit facility is a demand loan, it may be called at any time. Accordingly, there is no assurance that the credit facility will be renewed when the next scheduled review is completed. Should the bank not extend the loan, the Company would need to seek alternative forms of debt or equity financing or dispose of certain assets to repay any outstanding indebtedness.

9. Decommissioning Obligations

	Year ended December 31	
Canadian $000s	**2013**	**2012**
Balance, beginning of period	**5,191**	331
Assumed in business combination	**-**	3,315
Incurred from development activities (Note 6)	**210**	198
Incurred from exploration activities	**50**	-
Accretion expense	**137**	73
Revisions	**-**	1,236
Revision of estimates	**(448)**	83
Obligations settled	**(92)**	**-**
Effect of change in foreign exchange rates	**(101)**	(45)
Balance, end of period	**4,947**	5,191

At December 31, 2012, the Company used The Alberta Energy Regulator Directive 011 as its primary source of estimating future decommissioning obligations. In 2012, the cost estimates did not reflect the entire increase in estimated abandonment and reclamation costs, as intended in the directive. In addition, certain assumptions used in estimating the decommissioning obligation relating to an oil treating facility were incorrect. As a result, the Company's PP&E and decommissioning obligations have been recast to reflect an immaterial correction to the consolidated statement of financial position at December 31, 2012 resulting in an increase in PP&E and decommissioning obligations of $1.2 million.

The total undiscounted amount of cash flows at December 31, 2013 required to settle Madalena's decommissioning obligations is approximately $8.7 million (December 31, 2012 – $8.9 million) with the majority of the costs to be incurred between 2018 and 2030. 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. Inflation rates of 10.9% and 2.0% were used to calculate the future value of the undiscounted decommissioning obligations in Argentina and Canada, respectively (December 31, 2012 – 10.8% and 2%). The risk free rate used to discount the liability was 17.18% (December 31, 2012 – 14.66%) in Argentina and 1.1 to 2.99% (December 31, 2012 – 1.0 to 2.45%) in Canada.

10. Share Capital

The Company is authorized to issue an unlimited number of common shares and preference shares. The holders of common shares are entitled to receive dividends as declared by the Company and are entitled to one vote per share.

Share Capital

	Number of Shares 000s	Share Capital $000s
Balance at December 31, 2011	260,021	77,863
Shares issued pursuant to financing	54,000	67,500
Share issue costs	-	(4,015)
Stock options exercised	286	328
Balance at December 31, 2012	314,307	141,676
Shares issued on financing	46,763	19,454
Share issue costs	-	(1,766)
Flow through share liability	-	(936)
Stock options exercised	2,959	1,146
Balance at December 31, 2013	**364,029**	**159,574**

On July 11, 2013, the Company raised approximately $7.25 million through the issuance of:

i) 11,765,000 common shares issued as CEE "flow-through shares" at a price of $0.34 by way of a "bought deal" private placement; and

ii) 200,000 common shares at a price of $0.31 per share, 4,780,000 common shares issued as CDE "flow-through shares" at a price of $0.32 per share and 4,886,765 common shares issued as CEE "flow-through shares" at a price of $0.34 per share by way of a Private Placement.

iii) Certain directors and officers of the Company acquired an aggregate of 200,000 common shares and 400,000 CEE "flow-through" shares under the non-brokered Private Placement.

A flow-through share liability in the amount of $936,242 was recorded to recognize the difference between the flow-through share price and the price of the common shares. This liability was reduced to $384,847 as at December 31, 2013 as qualifying expenditures were incurred.

On November 21, 2013, the Company issued 5,555,556 common shares, issued as "flow-through shares" ("CDE Flow-Through Shares") within the meaning of the Income Tax Act (Canada) at a price of $0.54 per CDE Flow-Through Share, for gross proceeds of $3 million pursuant to a Private Placement.

On December 5, 2013, the Company closed a bought deal financing of 19,575,300 common shares at a price of $0.47 per common share, including 2,553,300 common shares issued pursuant to the exercise of the over-allotment option in full by the underwriters, for aggregate gross proceeds of $9.2 million.

In March 2012, the Company issued 54,000,000 common shares at a price of $1.25 per common share for gross proceeds of $67,500,000.

11. Employee Compensation

Under the Company's stock option plan, directors, officers, employees and certain consultants are eligible to receive options to acquire common stock of the Company. The exercise price of the granted options is no less than the closing trading price per share on the last day preceding the date of the grant. Total options granted cannot exceed 10% of the issued and outstanding common shares of the Company. Options granted to directors, officers, employees and consultants may vest immediately or over three years on each anniversary of the grant date. Options expire three to five years from the grant date. There are no cash settlement alternatives for employees under the Company's stock option plan.

The weighted average share price of the Company's common shares on the exercise date during the year ended December 31, 2013 was $0.40.

During the period ended December 31, 2013, 7,260,000 options were granted to certain officers, employees, consultants and directors of the Corporation and its subsidiaries. Fair value was estimated at the period end date using the Black-Scholes valuation model with weighted average assumptions as follows:

Inputs used to fair value options

Fair value	$ 0.26
Share price	$ 0.36
Exercise price	$ 0.36
Expected Volatility - %	96%
Forfeiture rate	9.8%
Option life – years	4.35
Risk-free interest rate - %	1.25%

Expected volatility is estimated by considering historic daily share price volatility. A 10.8% estimated forfeiture rate was used when recording share-based compensation for stock options. This estimate will be adjusted each period until the vesting date.

Share-based compensation expense arising from the issuance of stock options recognized in the year ended December 31, 2013 was $1.24million (2012 - $1.95 million) with an offsetting credit to contributed surplus.

Movements in the number of stock options outstanding and their related weighted average exercise prices are summarized as follows:

Number of share options

	Number of options 000s	Weighted average exercise price CDN$
Outstanding at December 31, 2011	13,977	0.57
Granted	9,480	0.34
Exercised	(286)	0.65
Forfeited	(37)	0.74
Expired or cancelled	(800)	0.60
Outstanding at December 31, 2012	22,334	0.47
Granted	7,260	0.36
Exercised	(2,959)	0.21
Forfeited	(1,842)	0.42
Expired or cancelled	(5,263)	0.76
Outstanding at December 31, 2013	**19,530**	**0.40**
Exercisable at December 31, 2013	**7,923**	**0.48**

The range of exercise prices of the outstanding options

Exercise price ($)	Number of Options Outstanding 000s	Weighted Average Contractual Life of options outstanding (years)	Number of outstanding options that are exercisable 000s
0.105	97	(0.08)[1]	97
0.125	200	0.41	200
0.210	1,117	1.08	1,117
0.290	5,810	3.92	1,936
0.320	300	1.55	300
0.350	6,000	4.66	-
0.405	1,060	4.18	-
0.420	2,020	3.47	1,347
0.690	450	2.92	450
0.790	1,860	1.97	1,860
0.800	316	1.90	316
0.960	300	2.12	300
	19,530	**3.59**	**7,923**

(1) Options currently being extended pursuant to a blackout status on trading in the securities of the Company.

Personnel expenses:

Madalena's statement of operations is prepared primarily by nature of expense, with the exception of compensation costs which are included in both operating and general and administrative expenses.

The aggregate payroll expense of employees and executive management included in operating and general and administrative expenses comprises:

	Year ended December 31	
Canadian $000s	**2013**	**2012**
Salaries and wages	2,232	1,150
Short-term employee benefits	70	50
Share-based payments[1]	1,229	1,999
	3,531	**3,199**

[1]Represents the amortization of stock based compensation associated with options granted in the consolidated financial statements.

In addition to salaries, the Company provides non-cash benefits and share based compensation to executive officers. Key management personnel include the Chief Executive Officer, Chief Financial Officer, Vice President - Exploration and all Corporate Directors. Key management personnel compensation comprises:

	Year ended December 31	
Canadian $000s	**2013**	**2012**
Short-term employee benefits, including wages	1,924	795
Share-based payments	1,048	1,595
	2,972	**2,390**

12. Related Parties

These consolidated financial statements incorporate the financial statements of the Company and the subsidiaries listed in the following table:

	% of Ownership	Jurisdiction
Madalena Austral S.A.	100%	Argentina
Madalena Ventures International Holding Company Inc.	100%	Barbados
Madalena Ventures International Inc.	100%	Barbados

A director of the Company is a partner of a law firm that provides legal services to the Company. During the year ended December 31, 2013, the Company incurred fees of $551,179 (2012 - $448,531) from this firm for legal fees related to legal matters of which $35,976 is included in accounts payable and accrued liabilities at December 31, 2013.

A director of one of the Company's subsidiaries provides legal and consulting services to the Company. During the year ended December 31, 2013, the Company incurred fees of $260,905 (2012 - $444,099) of which $21,942 is included in accounts payable and accrued liabilities at December 31, 2013.

13. Income Taxes

The provision for income tax differs from the result that would be obtained by applying the combined Canadian federal and provincial tax rate of 25% (2012 - 25%) to the loss before taxes. The difference results from the following:

	Year ended December 31,	
	2013	**2012**
Net loss before tax	(23,898)	(8,865)
Tax rate	25%	25%
Expected income tax recovery	(5,975)	(2,216)
Increase (decrease) resulting from:		
Effect of foreign tax rates	(354)	(365)
Share-based compensation	309	486
Unrecognized deferred tax benefit and other	4,919	1,993
Flow-through shares	1,587	-
Canadian tax rate adjustments	300	-
Non-taxable differences on foreign operations	(461)	54
Minimum presumed (foreign) income tax	188	57
Flow through share premium	(613)	-
Other	100	(9)
Income tax expense	(613)	**-**

The current income tax expense relates to minimum taxes based on the book value of assets in Argentina.

Deferred tax assets have not been recognized for the following deductible temporary differences:

	Year ended December 31	
Canada	**2013**	**2012**
Property, plant and equipment	5,651	-
Decommissioning obligations	3,988	3,376
Share issue costs	4,830	5,728
Non-capital losses (expire 2026 to 2031)	30,431	15,307
Total unrecognized temporary differences	**44,900**	**24,411**

Argentina	Year ended December 31 2013	2012
Total unrecognized temporary differences	**3,362**	**4,200**

(1) Non-capital losses expire between 2014 to 2017

Barbados	Year ended December 31 2013	2012
Non-capital losses (expire 2017 to 2022)	493	425
Total unrecognized temporary differences	**493**	**425**

The components of the recognized deferred income tax asset (liability) are as follows:

	Year ended December 31 2013	2012
Foreign exchange	-	(350)
Property, plant and equipment	(2,325)	(1,551)
Decommissioning obligations	430	
Non-capital losses	1,895	1,901
Unrecognized deferred tax asset	-	**-**

The Company has temporary differences associated with its investment in its foreign subsidiaries and branches. As at December 31, 2013 the Company has no deferred tax liabilities in respect of those temporary differences.

14. Cash and Cash Equivalents

	Year ended December 31 2013	2012
Bank balances	13,605	15,795
Guaranteed investment certificates	1,230	22,458
Cash and cash equivalents	**14,835**	**38,253**

15. Supplemental Cash Flow Information

Changes in non-cash working capital

Canadian $000s	Year ended December 31 2013	2012
Trade and other receivables	(2,128)	(735)
Other current assets	(310)	(435)
Repayment of demand bank loan	-	4,420
Trade and other payable	1,191	2,012
Change in non-cash working capital	**(1,247)**	5,262
Attributable to:		
Operating activities	(1,860)	(248)
Financing activities	-	-
Investing activities	613	5,510
	(1,247)	5,262

16. Commitments

Rental Commitments

Canadian $000s	2014	2015	2016	2017
Leased office premises	193	149	154	13

Leased office premises includes estimated operating costs.

Development & Exploration Commitments

Coiron Amargo Block (35% working interest)

The Coiron Amargo block is divided into two regions called Coiron Amargo Norte (northern portion of the block) and Coiron Amargo Sur (southern portion of the block). Coiron Amargo Norte is currently under a 25 year exploitation (development) concession which was approved by the Province of Neuquén in 2012.

In October 2013, following an application and approval process by Madalena and its partners over several months, the exploration period for Coiron Amargo Sur was extended until November 8, 2014 by way of an official decree signed by the Province of Neuquén in Argentina. The remaining work commitments in Coiron Amargo Sur are estimated at approximately USD$ 2.35 million plus VAT (net to Madalena) as of December 31, 2013. After satisfying these remaining work commitments, Madalena has the ability to extend Coiron Amargo Sur through further exploration, evaluation and/or exploitation (development) phases.

Curamhuele Block (90% working interest)

In June 2013 the exploration period was extended by way of an official decree signed by the Province of Neuquén until November 8, 2014.

To accelerate exploration and development activities in Argentina, the Company continues to assess different opportunities with RBC Capital Markets ("RBC"), Madalena's exclusive advisor related to its Neuquén basin assets, in respect of a possible joint venture partnership or other transaction. The Company cautions that there are no assurances that an acceptable joint venture arrangement or other transaction will be reached.

Madalena's remaining share of future work commitments associated with the Curamhuele block as of December 31, 2013 is approximately US$13.8 million plus VAT. After satisfying these remaining work commitments, Madalena expects to either convert certain area(s) of the acreage into an exploitation (development) concession and/or enter into a new exploration period(s) or unconventional evaluation phase, to further explore and appraise the Curamhuele block.

Cortadera Block (37.8% working interest)

On January 15, 2014, the Corporation announced that, on the Cortadera Block, the joint venture partnership signed an amended contract agreement to formalize a multi-year agreement for the extension of the initial exploration period and inclusion of subsequent exploration periods. Subsequent to that agreement and following an application and approval process, the first exploration period for Cortadera was extended by way of an official decree which was signed by the Province of Neuquén in Argentina. This extension provides the partnership until October 26, 2014 to satisfy the remaining work commitments on the block, which involves the upcoming re-entry work. Madalena believes that its share of any work performed is not expected to be significant.

Under the amended agreement, and subsequent to conducting the upcoming re-entry work, the partnership at Cortadera has the option to enter into subsequent exploration periods involving a second exploration period extending to October 25, 2018 and a third exploration upon which the partnership has the option to enter into subsequent exploration periods involving a second exploration period extending to October 25, 2021, or extend the Cortadera Block through potential further evaluation and/or exploitation phases.

Flow-through Shares Commitments

During 2013, the Company completed a CEE flow through share financing in the amount of $5.7 million and CDE flow through share financings of $4.5 million (see Note 10). As at December 31, 2013, all of the CDE flow-through funds had been expended and $1.3 million of the CEE flow-through funds had been expended. The Company has until December 31, 2014 to expend the remaining CEE flow through funds in the amount of $4.4 million on qualified expenditures.

The Company had a previous flow-through share commitment of $462,450 to be renounced by December 31, 2013. As at December 31, 2013, all of these funds had been expended.

17. Loss Per Share

The following table reconciles the weighted average number of common shares used in the basic and diluted net loss per share calculations:

Basic and diluted loss per share

	Year ended December 31	
	2013	**2012**
Net loss - $000s CDN	(23,285)	(8,865)
Weighted average number of common shares:		
Basic and diluted – '000s	328,771	304,523

All share options were excluded from the preceding calculation of diluted earnings per share as their effect is anti-dilutive.

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

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 issue shares, adjust its capital spending to manage current and projected debt levels or farm-out existing opportunities.

The Company's strategy is to maintain a prudent level of working capital and available cash on hand. In order to facilitate the management of its capital structure, the Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, actual capital deployment and general industry conditions.

The Company's capital is not subject to external restrictions except for the credit facility covenant described in Note 8. The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the next twelve months. There were no changes in the Company's approach to capital management during the year.

The Company's capital management is currently focused on completion of existing exploration commitments and providing for the Company's share of any development programs.

Credit risk

The Company's operations are conducted in Canada and Argentina. The Company is exposed to credit risk in relation to its cash and cash equivalents and trade and other receivables.

Cash and cash equivalents are held with highly rated Canadian and international banks, and therefore the Company does not believe these financial instruments are subject to material credit risk.

In Argentina, the majority of the Company's oil production is sold to the Argentina subsidiaries of major international oil and gas companies. In Canada, receivables from oil and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any collection issues with its oil and natural gas marketers.

The Company does not anticipate any default as it transacts with creditworthy customers and management does not expect any losses from non-performance by these customers. As such a provision for doubtful accounts has not been recorded at December 31, 2013 and December 31, 2012.

Maximum exposure to credit risk for loans and receivables by type of customer

	Year Ended December 31	
	2013	2012
Oil and natural gas marketing companies	**2,120**	1,191
Federal and provincial governments and other	**1,937**	1,065
Total trade and other receivables	**4,057**	2,256

Amounts due from oil and gas marketing companies were subsequently collected by the Company.

Aged trade and other receivables

In Canadian dollars	Year Ended December 31
Current (less than 90 days)	**2,808**
Past due (more than 90 days)	**1,249**
Total	**4,057**

Liquidity risk

Liquidity risk is the risk that the Company will not meet its financial obligations as they fall due. The Company manages its liquidity risk through management of its capital structure and annual budgeting of its revenues, expenditures and cash flow. The Company has a working capital surplus of $8.0 million at December 31, 2013 (December 31, 2011 - $30.0 million) and a $13 million credit facility with a Canadian chartered bank (see Note 8 for further details). Subsequent to year-end, the Company issued common shares for gross proceeds of $23.0 million.

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.

Commodity price risk

Price fluctuations for both crude oil and natural gas are determined by world supply and demand factors. Additionally, a significant part of the Company's oil and gas revenue is from an oil property in Argentina. Oil prices

in Argentina are subject to domestic market discounts which result in prices significantly below benchmark prices. The Company had the following physical natural gas and oil contracts in place at December 31, 2013:

Type	Period	Volume	Price Floor	Price Ceiling	Index
Natural gas fixed	April 1, 2014 to Oct. 31, 2014	500 GJ/d	$3.45CDN	$3.45 CDN	AECO
Natural gas fixed	April 1, 2014 to Oct. 31, 2014	300 GJ/d	$3.55CDN	$3.55 CDN	AECO
Natural gas fixed	April 1, 2014 to Oct. 31, 2014	300 GJ/d	$4.43CDN	$4.43 CDN	AECO
Natural gas fixed	April 1, 2014 to Oct. 31, 2014	300 GJ/d	$4.52CDN	$4.52 CDN	AECO
Crude oil call options	Jan. 1, 2014 to Dec. 31, 2014	50 bbl/d	-	$100 US	WTI
Crude oil call options	Jan. 1, 2014 to Dec. 31, 2014	50 bbl/d	-	$100 US	WTI
Crude oil call options	Jan. 1, 2015 to Dec. 31, 2015	50 bbl/d	-	$95 US	WTI

The fair value of commodity contracts is determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes. The fair value of commodity contracts as at December 31, 2013 was a net liability and an unrealized loss of $90,387 (2012 - $nil). Realized gains as at December 31, 2013 were $132,814 (2012 - $nil) and are included in interest and other income on the statement of loss and comprehensive loss. The commodity contracts currently on the final statements are classified as level 2 within the fair value hierarchy.

On January 17, 2014, the Company entered into the following contract:

Type	Period	Volume	Price Floor	Price Ceiling	Index
Crude oil swap	Feb 1, 2014 to Dec 31, 2014	50 bbl/d	-	$100 CDN	WTI

Interest rate risk

The Company is exposed to interest rate fluctuations on its investments of excess cash in short-term money market investments held with international banks.

Foreign currency exchange rate risk

A significant portion of the Company's exploration and development activities are conducted in foreign jurisdictions and a portion of the Company's cash and cash equivalents are denominated Argentina Pesos (ARS). Consequently, the Company is exposed to foreign currency exchange risk on a substantial portion of its financial assets. The Company has not entered into derivative exchange rate contracts to mitigate this risk.

The following table provides information on the foreign currency denominated working capital balances of the Company at December 31, 2013:

	Balance Denominated in US$	Balance Denominated in ARS	Total CDN$ Equivalent
Cash and cash equivalents	19	6,418	1,067
Trade and other receivables	-	7,684	1,254
Other current assets	-	5,747	938
Trade and other payables	31	26,752	4,398

A 10% change in ARS to Canadian dollar exchange rates on the working capital balances would have resulted in a $113,000 change in comprehensive loss at December 31, 2013 (2012- $138,000).

Fair value of financial instruments

The Company's financial instruments include cash and cash equivalents, trade and other receivables and trade and other payables, the carrying values of which approximate their fair values due to their short-term nature. The Company has no bank indebtedness.

19. Segmented information

The Company is engaged primarily in the exploration and development of oil and gas. The Company's reportable segments are based on geographic area and comprise Canada and Argentina. The Company's operations in Barbados are not a reportable segment and are included in the Argentina segment because the level of activity in Barbados was not significant at December 31, 2013 and December 31, 2012.

	As at and for year ended December 31, 2013		
Canadian $000s	Canada	Argentina	Total
Total assets	50,881	45,405	96,286
Total liabilities	(12,384)	(4,899)	(17,283)
Revenues	12,723	5,237	17,960
Loss	(20,792)	(2,493)	(23,285)
Capital expenditures	28,286	15,010	43,296

	As at and for year ended December 31, 2012		
Canadian $000s	Canada	Argentina	Total
Total assets	69,068	39,948	109,016
Total liabilities	(11,752)	(4,878)	(16,630)
Revenues	1,573	3,972	5,545
Loss	(4,844)	(4,021)	(8,865)
Capital expenditures	4,570	18,282	22,852

20. Subsequent Event

On February 11, 2014, the Company closed a bought deal financing of 32,857,225 common shares at a price of $0.70 per common share, including 4,285,725 common shares issued pursuant to the exercise of the over-allotment option in full by the Underwriters, for aggregate gross proceeds of $23,000,058.