



CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015

(UNAUDITED)



Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

USD 000s	Note	As at September 30 2016 (note 3)	As at December 31 2015 (note 3)
Assets			
Current assets			
Cash and cash equivalents		2,874	3,912
Available for sale securities	14	-	5,361
Trade and other receivables		10,463	17,882
Inventory		1,590	2,415
Other current assets		572	622
		15,499	30,192
Property, plant and equipment	4	61,516	89,365
Exploration and evaluation assets	5	42,302	43,767
Investments	6	3,862	-
Other long-term assets	8	3,778	593
		126,957	163,917
Liabilities			
Current liabilities			
Current portion of long-term debt	7	2,519	3,944
Trade and other payables		15,897	23,216
Taxes payable		922	2,570
		19,338	29,730
Convertible debentures	9	1,168	-
Long-term debt	7	-	1,972
Deferred income tax liability		7,915	9,906
Decommissioning obligations	10	17,285	20,641
Other long-term liabilities		1,362	1,575
		47,068	63,824
Shareholders' Equity			
Share capital	11	238,973	238,758
Contributed surplus		15,867	14,520
Equity component of convertible debenture	9	76	-
Accumulated other comprehensive loss		(26,730)	(32,062)
Deficit		(148,297)	(121,123)
		79,889	100,093
		126,957	163,917

Going concern (note 2)

Commitments and Contingencies (note 17)

Subsequent Event (note 17, and 21)

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



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

USD 000s, except per share amounts	Note	Three months ended September 30		Nine months ended September 30	
		2016	2015	2016	2015
		(note 3)	(note 3)	(note 3)	(note 3)
Revenues					
Oil and natural gas revenues		11,728	20,816	39,609	63,824
Royalties		(1,938)	(3,033)	(6,254)	(10,450)
Other income	14	401	13,857	401	13,857
		10,191	31,640	33,756	67,231
Expenses					
Operating	20	6,229	8,675	17,211	24,759
General and administrative	20	2,159	2,587	7,041	7,921
Finance (income) expenses	15	1,317	(254)	3,583	(433)
Share-based compensation	12	426	325	1,286	754
Depletion and depreciation	4	4,723	6,473	15,999	18,858
Impairment	4,5	11,963	-	11,963	-
		26,817	17,806	57,083	51,859
Income (loss) before income taxes		(16,626)	13,834	(23,327)	15,372
Income tax recovery (expense)					
Current		(222)	(3,312)	(1,362)	(5,797)
Deferred		4,133	(2,583)	1,992	(3,230)
		3,911	(5,895)	630	(9,027)
Income (loss) from continuing operations		(12,715)	7,939	(22,697)	6,345
Net loss from discontinued operations	3a	-	(2,460)	(4,477)	(5,740)
Net income (loss)		(12,715)	5,479	(27,174)	605
Foreign currency translation adjustment		(266)	(1,947)	1,247	(4,245)
Available for sale securities	14	-	(138)	(68)	(138)
Comprehensive income (loss)		(12,981)	3,394	(25,995)	(3,778)
Net income (loss) per share					
Basic and diluted - continuing	11	(0.02)	0.01	(0.04)	0.01
Basic and diluted - combined	3a	(0.02)	0.01	(0.05)	(0.00)

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



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

USD 000s	Share Capital (note 11)	Contributed Surplus	Equity Component of Convertible Debentures (note 9)	Accumulated Other Comprehensive Loss	Deficit	Total Equity
Balance at December 31, 2015	238,758	14,520	-	(32,062)	(121,123)	100,093
Net loss	-	-	-	-	(27,174)	(27,174)
Recycle of other comprehensive loss due to discontinued operations (note 3a)	-	-	-	4,153	-	4,153
Foreign currency translation adjustment	-	-	-	1,247	-	1,247
Share-based compensation (note 12)	-	1,347	-	-	-	1,347
Common shares issued	215	-	-	-	-	215
Equity component of convertible debentures	-	-	76	-	-	76
Available for sale securities (note 14)	-	-	-	(68)	-	(68)
Balance at September 30, 2016	238,973	15,867	76	(26,730)	(148,297)	79,889
Balance at December 31, 2014	237,928	13,555	-	(27,049)	(107,418)	117,016
Net income	-	-	-	-	605	605
Foreign currency translation adjustment	-	-	-	(4,246)	-	(4,246)
Stock options exercised	568	(91)	-	-	-	477
Share-based compensation	-	880	-	-	-	880
Available for sale securities (note 14)	-	-	-	(138)	-	(138)
Balance at September 30, 2015	238,496	14,344	-	(31,433)	(106,813)	114,594

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



Condensed Interim Consolidated Statements of Cash Flows
(Unaudited)

		Three months ended September 30		Nine months ended September 30	
USD 000s	Note	2016	2015	2016	2015
		(note 3)	(note 3)	(note 3)	(note 3)
Cash provided by (used in):					
Operating					
Net Income (loss)		(12,715)	5,479	(27,174)	605
Items not affecting cash:					
Depletion and depreciation	3a, 4	4,723	6,561	16,162	19,277
Impairment	3a	11,963	2,063	11,963	4,015
Accretion	3a, 15	53	97	197	262
Fair value change on convertible debentures held	6	333	-	333	-
Unrealized (gain) /loss on commodity contracts		-	-	-	152
Share-based compensation	3a, 12	426	334	1,307	737
Deferred income tax expense (recovery)		(4,133)	2,583	(1,992)	3,230
Unrealized (gain) loss on foreign exchange	15	190	(1,438)	754	(3,109)
Non-cash reduction of contingent liability		-	-	-	(1,060)
Realized other comprehensive loss	3a	-	-	4,153	-
Loss on sale of discontinued operations	3a	-	-	18	-
Change in other long-term assets		346	25	(3,185)	(680)
Change in non-cash working capital	16	(1,013)	(9,148)	7,064	(13,961)
Cash flow from operating activities		173	6,556	9,600	9,468
Investing					
Property, plant and equipment additions	4	(595)	(13,234)	(2,346)	(25,444)
Evaluation and exploration assets additions	5	(27)	(1,259)	(3,662)	(3,265)
Change in other long-term assets		-	131	-	1,548
Change in non-cash working capital	16	(1,432)	2,999	(3,264)	1,995
Net cash used in investing activities		(2,054)	(11,363)	(9,272)	(25,166)
Financing					
Issue of common shares	11	-	169	-	477
Convertible debenture proceeds, net of fees	9	1,241	-	1,241	-
Bank loan repayment	7	(856)	-	(2,690)	-
Bank loan proceeds	7	-	-	-	9,992
Net cash from (used in) financing activities		385	169	(1,449)	10,469
Change in cash and cash equivalents		(1,496)	(4,638)	(1,121)	(5,229)
Cash and cash equivalents, beginning of period		4,371	10,849	3,912	11,572
Impact of foreign exchange on cash balances		(1)	73	83	(59)
Cash and cash equivalents, end of period		2,874	6,284	2,874	6,284⁽¹⁾

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

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



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

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

1. Reporting Entity

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

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

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

2. Basis of Preparation and Going Concern

These condensed interim consolidated financial statements have been prepared on the basis that the Company is a going concern and will continue to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. As at September 30, 2016, the Company has incurred year-to-date losses of \$27.2 million, had a working capital deficit of approximately \$3.8 million and significant future capital commitments to develop its properties. It is currently anticipated that forecasted cash flow from operating activities will not be sufficient to resolve the current working capital deficit and fund the 2016 and 2017 anticipated capital commitments as outlined in note 17.

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

The ability of the Company to continue as a going concern is dependent upon the Company's ability to access additional funding to resolve the current working capital deficit and to meet its anticipated 2016 and 2017 capital commitments and/or opportunities to monetize its assets. Potential additional sources of capital include: (i) credit facilities on acceptable terms; (ii) proceeds from the sale of non-core assets; (iii) proceeds from equalization payments, if any; and (iv) the issuance of equity on acceptable terms.

The current year-to-date losses, current working capital deficiency, the expectation of reduced near term cash flow resulting from lower oil prices in Argentina, as well as the capital commitments in 2016 and 2017 are expected to result in cash outflows that exceed anticipated future funds from operations. Without an infusion of capital and/or a successful outcome from the strategies described above in the near term, Madalena may not be able to continue as a going concern.

These condensed interim consolidated financial statements do not reflect adjustments in the carrying values of the assets and liabilities, expenses and the condensed interim consolidated statements of financial position



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

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classifications that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

Statement of Compliance

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

The condensed interim consolidated financial statements were approved and authorized for issue by the Company's Board of Directors on November 22, 2016.

3. Discontinued Operations

On May 17, 2016, the Company signed an asset purchase and sale agreement ("PSA") with First Mountain Exploration Inc ("First Mountain") and Point Loma Energy Inc. ("Point Loma"), to dispose of its non-core Canadian petroleum and natural gas assets for proceeds valued at approximately \$4.3 million.

These non-core assets consist of the Canadian operating segment and are presented as discontinued operations. The comparative condensed interim consolidated statements of income (loss) and comprehensive income (loss) have been presented to show the discontinued operations separately from continuing operations. The condensed interim consolidated statements of financial position reflect the removal of the Canadian operating segment as at June 28, 2016, although the comparatives still contain the Canadian operating segment, as required under international financial reporting standards. The condensed interim consolidated statements of cash flows contain the Canadian operating segment in the current and comparative period, with the cash flow results of the discontinued operation outlined in note 3c, below.

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

Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

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

a. Net loss from discontinued operations

USD 000s	For the three months ended September 30		For the nine months ended September 30	
	2016	2015	2016	2015
Revenues				
Oil and natural gas revenues	-	384	430	1,520
Royalties	-	(64)	(7)	(315)
	-	320	423	1,205
Expenses (recoveries)				
Operating	-	522	395	2,177
General and administrative	-	78	127	289
Finance (income) and expenses	-	20	23	62
Share-based compensation	-	9	21	(17)
Depletion and depreciation	-	88	163	419
Impairment	-	2,063	-	4,015
		2,780	729	6,945
Income loss from operating activities of discontinued operations	-	(2,460)	(306)	(5,740)
Loss on sale of discontinued operations (note 3b)	-	-	(18)	-
Realized accumulated other comprehensive loss on disposition of Canadian operations ⁽¹⁾	-	-	(4,153)	-
Net loss from discontinued operations	-	(2,460)	(4,477)	(5,740)
Basic and Diluted EPS	-	(0.00)	(0.01)	(0.01)

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

(1)

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

b. Loss on sale of discontinued operations

USD 000s	
Proceeds (note 6):	
Common shares – Point Loma	1,918
Debenture including conversion feature	2,351
	4,269
Property, plant and equipment disposed of	(6,589)
Exploration and evaluation assets disposed of	(2,515)
Decommissioning liabilities disposed of	4,868
Transaction costs attributable to sale	(166)
Foreign exchange from effective to close date	115
	(4,287)
Loss on sale of discontinued operation – June 28, 2016	(18)



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

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

c. Cash flows from (used in) discontinued operations

USD 000s	For the nine months ended September 30	
	2016	2015
Net cash from (used in) operating activities	(41)	(126)
Net cash from (used in) investing activities	12	(3,316)
Net cash flow for period	(29)	(3,442)

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

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Cost			
At December 31, 2014	150,669	1,312	151,981
Additions	30,851	810	31,661
Effect of change in foreign exchange rates	(7,586)	(130)	(7,716)
At December 31, 2015	173,934	1,992	175,926
Additions	3,268	39	3,307
Disposals	(39,542)	-	(39,542)
Effect of change in foreign exchange rates	14	38	52
At September 30, 2016	137,674	2,069	139,743

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Accumulated depreciation and depletion			
At December 31, 2014	(54,237)	(268)	(54,505)
Depreciation and depletion	(25,981)	(388)	(26,369)
Impairment	(11,651)	-	(11,651)
Effect of change in foreign exchange rates	5,918	46	5,964
At December 31, 2015	(85,951)	(610)	(86,561)
Depreciation and depletion	(15,425)	(372)	(15,797)
Impairment	(9,300)	-	(9,300)
Disposals	33,452	-	33,452
Effect of change in foreign exchange rates	-	(21)	(21)
At September 30, 2016	(77,224)	(1,003)	(78,227)



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

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

USD 000s

Net book value

At December 31, 2015	87,983	1,382	89,365
At September 30, 2016	60,450	1,066	61,516

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

At September 30, 2016, Madalena determined that an indicator of impairment existed in one of its Argentine CGUs due to lower than forecasted production from one of its properties. As a result, an impairment test was performed over that CGU and it was deemed to be impaired as the estimated recoverable amount was lower than the carrying amount. The recoverable amount, calculated as \$22.0 million, resulted in a pre-tax impairment charge of \$9.3 million for the three and nine month period ended September 30, 2016. The impaired CGU's recoverable value was estimated using a value in use calculation based on future net cash flows expected to be derived from the CGU's proven plus probable reserves from the externally prepared December 31, 2015 reserve report using a pre-tax discount rate ranging from 22% to 28% depending on the category of reserves, adjusted internally for 2016 year-to-date production and capital spending adjustments, and used the following forward commodity price estimates:

Year	Oil Price (USD/bbl)
2016	62.00
2017	61.89
2018	61.78
2019	61.66
2020	61.55
2021	63.03
2022	67.66
2023	72.28
2024	75.38
2025	76.99
2026	78.53

Had the discount rate used been 1% higher for the range of discount rates used, an additional impairment charge of \$0.9 million would have resulted for the three and nine month period ended September 30, 2016.

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

The depletion expense calculation for the three and nine month period ended September 30, 2016 included \$92 million (December 31, 2015 – \$92.7 million) for estimated future development costs associated with proved and probable reserves in Argentina.

During the three and nine month period ended September 30, 2016, approximately \$0.4 million and \$1.1 million (2015 - \$0.5 million and \$1.5 million) of directly attributable general and administration costs were capitalized to property, plant and equipment in Argentina. In addition, share-based compensation recoveries of \$0.2 million and



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

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an expense of \$39 thousand was recovered and capitalized for the three and nine month period ended September 30, 2016 respectively (2015 - \$0.1 million and \$0.1 million capitalized).

5. Exploration and Evaluation Assets ("E&E")

USD 000s	
Cost	
At December 31, 2014	37,824
Additions	8,716
Impairment	(2,107)
Effect of change in foreign exchange rates	(666)
At December 31, 2015	43,767
Additions	3,507
Impairment	(2,663)
Disposals	(2,309)
At September 30, 2016	42,302

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

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

At September 30, 2016, Madalena determined that an impairment trigger existed related to one of its E&E assets. The Cortadera concession was relinquished to the Province of Neuquen in October 2016. As a result, the net book value of the Cortadera E&E assets of \$2.7 million was written off and recorded as part of Impairment on the condensed interim consolidated statements of income (loss) for the three and nine month period ended September 30, 2016.

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

6. Investments

As a result of the disposal of the non-core Canadian assets effective May 1, 2016 (note 3), the Company received the following investments as proceeds on June 28, 2016:

- 6,244,814 common shares of Point Loma Energy Ltd. ("Point Loma") (TSXV: PLX.V). This common share ownership amounts to an investment in an associate and is accounted for using the equity method of accounting. The initial value assigned on acquisition at June 28, 2016 was \$1.9 million. Equity earnings for the period ended September 30, 2016 are not material.
- A five-year \$2.4 million subordinated secured 3% convertible debenture from Point Loma, with principal and interest payable at the end of the debenture term. This convertible debenture is a financial instrument and is designated as fair value through profit and loss as a level III financial asset, and is convertible at the Company's election, into Point Loma common shares. The value of the debenture on the closing date of June 28, 2016 was estimated to be \$1.8 million using an annual interest rate of 12%.

Notes to the Condensed Interim Consolidated Financial Statements

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Management estimated the fair value of the conversion feature to be \$0.6 million at June 28, 2016, which factored in a 50% reduction in market price of Point Loma common shares given the limited time the shares have been listed, as well as the following Black-Scholes pricing model assumptions:

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

The fair value of the debenture on September 30, 2016 was \$1.5 million, using an interest rate of 12%. The fair value of the conversion feature at September 30, 2016 was \$0.4 million, using the same assumptions noted above, and updating for the Point Loma share price to the September 30, 2016 market value, resulting in a weighted average fair value of CAD \$0.09 per share.

The change in the fair value of the debenture, and the conversion feature for the period ended September 30, 2016 of \$0.1 million and \$0.2 million respectively, was recorded as part of finance (income) expenses on the condensed interim consolidated statements of income (loss) and comprehensive income (loss).

7. Long-term Debt

Argentina

The amount outstanding at September 30, 2016 was \$2.5 million (December 31, 2015 - \$5.9 million) and is repayable in three remaining equal quarterly instalments of Argentine Pesos ("ARS") 12.9 million (\$0.8 million using the September 30, 2016 exchange rate) with the next payment due on November 30, 2016.

The loan bears interest at the variable rate of BADLAR plus approximately 14%, resulting in a current borrowing rate of 37.4%.

Security for the Argentine loan is provided by the assignment of the receivables of Madalena Energy Argentina S.R.L. (Argentina) ("MEA") that arise from the sale of crude oil. The facility includes a quarterly financial covenant, whereby MEA's ratio of debt to earnings before income taxes, depletion, interest and other non-cash items must be equal to or less than 1:1. The earnings before income taxes, depletion, interest and other non-cash items is calculated on a four quarter rolling basis. At September 30, 2016, MEA was in compliance with this covenant at 0.26.

Canada

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

8. Other Long-term Assets

Other long-term assets are comprised of long-term receivables for which fair value approximates the carrying value. The long-term receivables primarily relate to ARS denominated value added tax receivable of \$2.2 million (December 31, 2015 - nil) and receivable balances due from an Argentina provincial oil and gas company of \$1.0 million (December 31, 2015 - \$0.6 million).

9. Convertible Debentures

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

These debentures are a level III financial liability with an embedded conversion derivative. As a result, the equity and debt components must be bifurcated. The value assigned to the liability on July 13, 2016 was the present value of the contractually determined stream of future cash flows discounted at 15%, being the rate estimated to be equivalent to that which the market would apply to an instrument with comparable credit status and provide substantially the same cash flows, on the same terms, but without the conversion option. From the date of issuance, the liability component accretes up to its principal value using the effective interest method, with the charge recorded in finance (income) expenses on the condensed interim consolidated statement of income (loss) and comprehensive income (loss). For the three month period ended September 30, 2016, \$14 thousand was booked as accretion expense. The following table reconciles the principal amount, liability and equity components of the convertible debentures:

USD 000s	Liability Component	Equity Component	Total
July 13, 2016 issuance	1,165	76	1,241
Discount accretion (note 15)	14	-	14
Impact of foreign exchange	(11)	-	(11)
Balance September 30, 2016	1,168	76	1,244

Transaction costs totaling \$0.1 million were deducted from the amounts issued, on a pro-rata basis between the liability and equity.

10. Decommissioning Obligations

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

The total undiscounted amount of cash flows required to settle Madalena's remaining decommissioning obligations at September 30, 2016 is approximately \$18.9 million (December 31, 2015 – \$26.5 million) with the majority of the costs to be incurred between 2026 and 2027. The decommissioning obligations have been estimated using existing technology at current prices and discounted using discount rates that reflect current market assessments of the time value of money and the risks specific to each liability.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three and Nine Months Ended September 30, 2016 and 2015 (Unaudited)

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

At September 30, 2016, an inflation rate of 1% was used, and is unchanged from December 31, 2015. The risk free rate used to discount the liability at September 30, 2016 was 2% (December 31, 2015 – 2.7%). The liability is expected to be invoiced in USD and settled through payments in ARS.

11. Share Capital

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

	Number of Shares 000s	Share Capital \$000s
Balance at December 31, 2014	539,783	237,928
Stock options exercised	2,300	830
Balance at December 31, 2015	542,083	238,758
Common shares issued	1,697	215
Balance at September 30, 2016	543,780	238,973

2016

On July 21, 2016, 1,696,970 common shares were issued at a deemed price of CAD \$0.165 pursuant to a settlement agreement with a former employee, reducing the contractual severance liability owed by \$0.2 million.

2015

In the first quarter of 2015, 533,333 common shares were issued pursuant to the exercise of options for cash proceeds of \$125 thousand. In the second quarter of 2015, 716,667 common shares were issued pursuant to the exercise of options for cash proceeds of \$184 thousand. In the third quarter of 2015, 1,050,000 of common shares were issued pursuant to the exercise of options for cash proceeds of \$168 thousand.

Net income (Loss) Per Share

As at September 30, 2016, there is no dilutive impact of the convertible debentures or share options as their effect is anti-dilutive. The following table provides the weighted average number of common shares used in the per share calculations:

	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Weighted average number of common shares - basic – 000s	543,558	541,333	542,578	540,658
Weighted average number of common shares – diluted – 000s	549,673	541,333	547,583	540,658
Net income (loss) from continuing operations- USD 000s	(12,715)	7,939	(22,697)	6,345
Per share – basic & diluted - continuing operations (\$/share)	(0.02)	0.01	(0.04)	0.01

12. Share-based 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 vest 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.

During the three and nine month period ended September 30, 2016, nil and 8,650,000 options were granted to directors, officers, and employees of the Company, respectively (September 30, 2015 three and nine month period ended – 15,563,000).

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

	Number of options 000s	Weighted average exercise price
Outstanding at December 31, 2014	25,880	0.42
Granted	15,963	0.30
Exercised	(2,300)	0.26
Forfeited	(1,954)	0.39
Expired or cancelled	(2,770)	0.61
Outstanding at December 31, 2015	34,819	0.35
Granted	8,650	0.27
Forfeited	(7,295)	0.30
Expired or cancelled	(393)	0.85
Outstanding at September 30, 2016	35,781	0.34
Exercisable at September 30, 2016	21,664	0.36

Share-based compensation expense arising from the movements in stock options outstanding recognized for the three and nine month period ended September 30, 2016 was \$0.2 million and \$1.3 million, respectively, (2015 - \$0.3 million expense and \$0.8 million expense) with an offsetting credit to contributed surplus.

The fair value of options granted was estimated at the period end date using the Black-Scholes valuation model, resulting in a per option fair value of CAD \$0.15 (2015 – CAD \$0.18) with weighed average assumptions as follows:



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

Inputs used to fair value share options granted

	Nine months ended September 30
	2016
Share price (CAD \$)	0.27
Exercise price (CAD \$)	0.27
Expected Volatility (%)	75
Forfeiture rate (%)	9.8
Option life (years)	4.05
Risk-free interest rate (%)	0.63

During the three and nine month period ended September 30, 2016, \$0.2 million and \$39 thousand of share-based compensation was recovered and capitalized, respectively, to PP&E (2015 – \$0.1 million and \$0.1 million capitalized), leaving \$0.4 million and \$1.3 million (2015 - \$0.3 million and \$0.7 million) as share-based compensation expense.

13. Long-term Incentive Plan

On August 25, 2016, the Board of Directors approved a long-term cash incentive plan ("LTIP"), whereby certain directors, officers, employees and consultants of the Company are provided an opportunity to benefit as a result of appreciation of the trading price of Madalena's common shares from the issue date, through the payment of cash upon vesting.

On August 26, 2016, 6,505,000 LTIP units ("the units") were issued to Argentina personnel at an exercise price of CAD\$0.145 per common share. The units vest one-third on each of the first, second and third anniversary dates and are exercisable for a period no later than:

- (a) December 1 of the third year in which the units vest; and
- (b) Five years from the date of the grant of the units.

The fair value of the units was CAD \$0.08/unit and was calculated using a Black-Scholes valuation model as at August 26, 2016. To the extent that the fair value changes, the LTIP expense will be adjusted and is recorded as part of operating or general and administrative expense as appropriate, in the condensed interim consolidated statements of income (loss) and comprehensive income (loss). Any associated liability is recorded as part of Other long-term liabilities on the condensed interim consolidated statements of financial position to the extent it relates to a long-term settlement requirement, and as part of trade and other payables on the condensed interim consolidated statements of financial position in relation to the portion that vests within the coming one year period.

The fair value of the units calculated at August 26, 2016 used the following Black-Scholes valuation model with the following assumptions:

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

Inputs used to fair value share options units granted

	Three months ended September 30 2016
Share price (CAD \$)	CAD \$0.145
Exercise price (CAD \$)	CAD \$0.145
Expected Volatility (%)	76%
Unit life (years)	5
Risk-free interest rate (%)	0.66%

The LTIP expense recorded as part of general and administrative expenses in the condensed interim consolidated statements of income(loss) for the three months ended September 30, 2016 was \$22 thousand.

14. Other Income

Other Income relates primarily to Petroleo Plus Settlement Bonds (Available for Sale Securities).

Amounts previously recorded in other comprehensive income due to fair value reporting relating to the Petroleo Plus Settlement Bonds of \$68 thousand for the nine months ended September 30, 2016 (nine months ended September 30, 2015 - \$138 thousand) were recycled through finance (income) expenses on the condensed interim consolidated statements of income (loss) and comprehensive income (loss).

15. Finance (Income) Expenses

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

	Three months ended September 30		Nine months ended September 30	
USD 000s	2016	2015	2016	2015
Bank charges	284	601	960	1,644
Foreign exchange loss (gain) - unrealized	190	(1,438)	754	(3,109)
Decommissioning liability accretion (note 10)	39	77	160	200
Accretion of debt portion of convertible debenture issued (note 9)	14	-	14	-
Interest and other expenses (note 14)	457	506	1,362	832
Fair value change on convertible debentures held (note 6)	333	-	333	-
	1,317	(254)	3,583	(433)

	Nine months ended September 30	
USD 000s	2016	2015
Currency exchange rate at period end:		
\$1 USD = CAD	1.31	1.33
\$1 USD = ARS	15.31	9.42

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

16. Supplemental Cash Flow Information

Changes in non-cash working capital

	Three months ended September 30		Nine months ended September 30	
USD 000s	2016	2015	2016	2015
Available for sale securities	-	(13,719)	5,361	(13,719)
Trade and other receivables	1,188	1,919	8,040	(1,688)
Other current assets, including inventory	91	693	515	625
Deferred debenture financing	(1,120)	-	-	-
Trade, tax and other payables	(1,773)	5,650	(8,014)	3,091
Impact of foreign exchange on working capital	289	(692)	(2,102)	(275)
Change in non-cash working capital ⁽¹⁾	(1,325)	(6,149)	3,800	(11,966)
Restricted cash	(1,120)	-	-	-
	(2,445)	(6,149)	3,800	(11,966)
Attributable to:				
Operating activities	(1,013)	(9,148)	7,064	(13,961)
Investing activities	(1,432)	2,999	(3,264)	1,995
	(2,445)	(6,149)	3,800	(11,966)

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

Other cash flow information

	Three months ended September 30		Nine months ended September 30	
USD 000s	2016	2015	2016	2015
Interest paid	445	838	1,750	1,297
Interest received	11	348	11	456
Taxes paid	785	934	3,426	4,183

17. Commitments and Contingencies

Development and Exploration Commitments

Coiron Amarqo ("CA") Block (CA-Sur Este 90% working interest - operated)

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

Pursuant to definitive agreements entered into on July 11, 2016 and government approvals and Executive Decree, which were received on October 13, 2016, the previous work commitments at CA-Sur of \$17.5 million that were required to be incurred by November 8, 2017 have been superseded by the following work commitments at CA-Sur Este:

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

As a result of the above agreements, CA-Sur was divided into two evaluation lots – CA-Sur Este and CA-Sur Oeste. Madalena assigned its 35% working interest in CA-Sur Oeste in return for an additional 55% working interest at CA-Sur Este, resulting in the Company having a 90% working interest at CA-Sur Este and operatorship. Gas y Petróleo del Neuquén S.A. ("G&P"), a provincial government entity retained its 10% working interest in the block.

CA Block (CA-Norte 35% working interest – non-operated)

At CA-Norte, Madalena holds a non-operated 35% working interest (9,309 net acres) at September 30, 2016 with no future commitments. The Company's working capital deficit at September 30, 2016 included approximately \$2 million relating to overdue amounts payable to the operator at CA-Norte. This payable was fully recorded as part of trade and other payables in the condensed interim consolidated statements of financial position at September 30, 2016.

Madalena has received a notice from this operator relating to Madalena's overdue payable and has been advised that Madalena's share of oil and gas sales are being applied against the outstanding payable. The Company is in discussions with the operator to satisfy the outstanding payable. Should the matter not be resolved prior to April 21, 2017, a potential outcome is the ultimate forfeiture of Madalena's working interest at CA-Norte.

Curamhuele Block (90% working interest-operated)

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

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

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

Discussions have commenced with the Province of Neuquén to potentially enter into an evaluation period to further appraise the Curamhuele block.

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

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

The Company is in discussions with the Province to move \$4.4 million of 2016 commitments to 2017.



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Santa Victoria Block (100% working interest - operated)

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

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

El Chivil Block (100% working interest – operated)

The concession's one year extension expiry occurred on September 7, 2016 and during the quarter, the province of Formosa granted a further six month extension to negotiate a 10-year exploitation period extension. At November 22, 2016, the Company remains in discussions with the Province.

El Vinalar Block (100% working interest – operated)

Salta province granted a block extension to file an investment plan which expired on November 11, 2016. The Company has requested a further extension from the Province.

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.

Liquidity risk

Although the Company has a largely unleveraged balance sheet at September 30, 2016, it does have a working capital deficit of \$3.8 million, and continues to face liquidity challenges. Unless the Company is able to raise additional capital or renegotiate its commitments, it does not expect that forecasted cash flows from operating activities will be sufficient to meet its anticipated 2016 and 2017 capital commitments and resolve the current working capital deficit. The Company is actively pursuing alternative sources of capital, in the form of debt financings, asset sales or swaps of both core and non-core assets and joint ventures or other transactions with industry partners, all with a view to enhancing liquidity to execute on its business plan.

At September 30, 2016, \$2.8 million, or 96%, of Madalena's cash and cash equivalents was deposited with banks in Argentina (December 31, 2015- \$2.1 million, 54%), and is held in ARS.

At September 30, 2016, the consolidated working capital deficit of the Company was \$3.8 million (December 31, 2015 – positive working capital of \$0.5 million), consisting of working capital deficiency of \$1.7 million (December 31, 2015 - \$0.4 million) in Argentina and a working capital deficiency of \$2.1 million (December 31, 2015 – positive working capital of \$0.9 million) in Canada.

Market risk

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

Commodity price risk

The Government of Argentina sets the benchmark (Medanito) price for oil. Medanito crude oil averaged \$67.50 per barrel for the three months ended September 30, 2016 (2015 - \$75.00) and \$67.50 per barrel for the nine months ended September 30, 2016 (2015 - \$76.33). In early 2016, the government regulator in Argentina advised that 2016 oil pricing will be set at \$67.50 per barrel for Medanito crude quality oil. Although



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Medanito was set by the government, there can be no certainty that the official oil price will not be further adjusted. See note 21.

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

Interest rate risk

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

Foreign currency exchange risk

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

The impact of a 10% change in foreign exchange rates on gains and losses recorded on financial instruments, when translating from ARS and/or CAD to USD at September 30, 2016 would have changed the unrealized foreign exchange loss (gain) recorded on the condensed interim consolidated statements of income (loss) by \$0.5 million for the nine months ended September 30, 2016. The amount recorded as foreign currency translation adjustment in comprehensive income on the condensed interim consolidated statements of comprehensive income (loss) would have changed by \$0.1 million for the nine months ended September 30, 2016 as it relates to loans owed from Argentina that are not considered part of the net investment in the subsidiaries.

19. Segmented information

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



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

As at and for the nine months ended September 30, 2016				
USD 000s	Argentina	Corporate	Intersegment Eliminations	Total
Total assets	122,587	26,098	(21,728)	126,957
Total liabilities	65,262	3,534	(21,728)	47,068
Oil and natural gas revenues	39,609	-	-	39,609
Operating expenses	17,211	-	-	17,211
General & administrative expenses	3,796	3,245	-	7,041
Depletion and depreciation	15,827	172	-	15,999
Impairment	11,963	-	-	11,963
Current income tax expense	1,362	-	-	1,362
Net loss – continuing operations	16,806	5,891	-	22,697
Capital expenditures ⁽¹⁾	6,008	-	-	6,008

As at and for the nine months ended September 30, 2015				
USD 000s	Argentina	Corporate ⁽²⁾	Intersegment Eliminations	Total
Total assets	170,887	27,751	(26,404)	172,234
Total liabilities	86,718	2,849	(26,404)	63,163
Oil and natural gas revenues	63,824	-	-	63,824
Other income	13,857	-	-	13,857
Operating expenses	24,759	-	-	24,759
General & administrative expenses	4,839	3,082	-	7,921
Depletion and depreciation	18,701	157	-	18,858
Current income tax expense	5,797	-	-	5,797
Net income – continuing operations	6,145	200	-	6,345
Capital expenditures ⁽¹⁾	28,220	37	-	28,257

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

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

Intersegment eliminations relate to intercompany loans between Canada and Argentina.

20. Supplemental disclosure

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



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

	Three months ended September 30		Nine months ended September 30	
USD 000s	2016	2015	2016	2015
Operating expenses				
Compensation costs	1,103	1,370	2,988	3,828
Transportation and processing	2,107	2,346	5,463	7,669
Maintenance, workovers and other	3,019	4,959	8,760	13,262
	6,229	8,675	17,211	24,759
General & administrative expenses⁽¹⁾				
Compensation costs	1,343	1,886	4,405	5,236
Other	816	701	2,636	2,685
	2,159	2,587	7,041	7,921

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

21. Subsequent Event

While the Argentine government has not announced adjustments to regulated Medanita oil pricing, the Company has been advised by the refineries to which it delivers its oil production that the oil price it will receive for November and December 2016 oil production will be reduced by approximately 30%, bringing prices to be received in those months in line with international levels. The Company received an average oil price per barrel during the third quarter of \$61.65.

The Company is undertaking a review of its operating assets in order to determine the extent of the financial impact caused by lower oil prices. While this analysis is not complete, it is clear that the reduction in oil prices communicated to the Company by the refiners will have a significant negative impact.