



**Quarterly Report**

**For the Three and Six Months Ended June 30, 2010  
(unaudited)**

## President's Message

In my first message as President of the Company I am pleased to be able to report that drilling and related activities are underway on two of the Company's three exploration blocks in the Neuquén basin, Argentina. After a period of several years during which time the Company focused on creating an attractive portfolio of exploration prospects in a known and prolific oil and gas basin, the commencement of drilling and drilling related activities represents a significant milestone in the development of the Company.

Each of the Company's three blocks in Argentina, namely Coiron Amargo, Curamhuele and Cortadera, consist of high working interests in large land positions in an oil and gas basin that is still relatively unexplored. In early August 2010, we commenced drilling the CAN X-3 exploratory well situated on a separately defined 3D drilling anomaly located approximately 8 kilometers east of the CAN X-2 discovery well drilled in early 2009. The CAN X-3 exploratory well is the first of two wells to be drilled on separate features on the Coiron Amargo Block as part of a two stage multi-well drilling program on the block with a company that has extensive experience operating in the Neuquén basin. Drilling of the CAN X-3 exploratory well is expected to be completed in the first week of September, 2010 and if successful, a workover rig is expected to be brought in to complete the well. Immediately following the drilling of CAN X-3, the drilling rig is expected to be mobilized to drill the CAN X-1 location, another separately defined 3D anomaly midway between the CAN X-2 producing well and the CAN X-3 location. Both wells are scheduled to be drilled to approximately 3,300 metres depth and are planned to penetrate not only the primary objective horizon in the Sierras Blancas formation, but also allow examination of the prospective Quintuco and Vaca Muerta horizons above, and the Lotena formation below.

On the Curamhuele Block, road and site construction has begun after the Company obtained approval of the environmental impact assessment for two well locations associated with the Truncation play. The location for the Corporation's first exploration well on the block has been selected based on 3D seismic acquired during the last half of 2008 and is situated up-structure and approximately 2.4 kilometers south west of the existing cased well, Curamhuele X-1.

At Cortadera, seismic interpretation is currently being high graded to select optimal drilling targets on the block. The Company has also identified a tight gas play on the block and may consider conducting additional seismic to further evaluate its potential. An unusually cold winter in Argentina this year has recently highlighted issues in country regarding future natural gas supply and prices. Madalena, having recently received extensions to the exploration period on all three of its exploration blocks in Argentina, has identified significant potential prospectivity for both oil and gas within this block.

To close, I'd like to thank Madalena's former President and Chief Executive Officer, Ken Broadhurst, for the vision and leadership he has provided the Company over the past four years. I'd also like to welcome Keith Macdonald and Barry Larson to the Board of Directors, and look forward to working with them during this next phase in the Company's development.

Dwayne Warkentin  
President and Chief Executive Officer

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management Discussion and Analysis ("MD&A") is provided by management of Madalena Ventures Inc. ("Madalena" or the "Company"), as at and for the three and six months ended June 30, 2010 and 2009. This MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2009 and 2008 and the unaudited interim consolidated financial statements for the three and six months ended June 30, 2010. The Company's financial statements and other public disclosure documents, including its annual information form ("AIF"), are filed on SEDAR at [www.sedar.com](http://www.sedar.com). The commentary in this MD&A is based on information available to August 24, 2010. Unless otherwise stated, all dollar amounts are expressed in Canadian dollars.

Unless otherwise stated, all calculations converting natural gas to barrels of oil equivalent ("boe") have been made using a conversion ratio of six thousand cubic feet (six "Mcf") of natural gas to one barrel of oil. The use of boe may be misleading, particularly if used in isolation, as the conversion ratio of six Mcf of natural gas to one barrel of oil is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

### Forward-looking Statements

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

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

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

### Non-GAAP Measurements

This MD&A contains the terms "funds from operations" and "funds from operations per share" which are not defined under Generally Accepted Accounting Principles ("GAAP"), and may not be comparable to similar measures reported by other companies. Management considers these measures to be useful supplementary information when analyzing operational and financial performance.

Funds from operations, is a useful measure of how the Company generates funds to cover operating and capital spending. Funds from operations, is defined as cash flow from operating activities before changes in non-cash working capital items. Funds from operations and cash flow from operating activities per share are calculated using the same weighted average shares outstanding as net loss per common share. The following table reconciles cash flow used in operating activities to funds used in operations:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Cash flow used in operating activities	\$ (825,274)	\$ (483,721)	\$ (1,541,007)	\$ (1,258,839)
Change in non-cash working capital	144,876	1,829	29,966	35,807
<b>Funds used in operations</b>	<b>\$ (680,398)</b>	<b>\$ (481,892)</b>	<b>\$ (1,511,041)</b>	<b>\$ (1,223,032)</b>

## HIGHLIGHTS

Highlights in the six months ended June 30, 2010 include:

- Sale of Tunisian assets to focus on core, high interest projects in Argentina;
- Finalization of environmental impact assessments at Coiron Amargo and commencement of drilling in August 2010;
- Identification of a second prospect (Truncation play) on the Curamhuele Block expected to be drilled during the third quarter of 2010;
- Extension of exploration period on all three exploration blocks in Argentina; and
- The Company remains debt free with a net working capital position of \$11.4 million, and cash of \$11.4 million at the end of Q2 2010.

## OVERVIEW

Madalena is an independent, Canadian-based, international upstream oil and gas company whose main business activities include exploration, development and production of crude oil, natural gas liquids and natural gas. The Company has exploration operations in South America.

In March 2010, the Company sold its Tunisian assets. The Company is moving forward with ongoing exploration and development of the Company's core high working interest projects in the Neuquén Basin of Argentina.

In December 2009, the Company strengthened its financial position by completing a public offering of 66,667,000 units at an issue price of \$0.15 per unit for gross proceeds to Madalena of \$10,000,050. Each unit consisted of one common share and one-half (1/2) common share purchase warrant. Each whole warrant issued entitles the holder thereof to purchase one common share at a price of \$0.25 per share until December 30, 2010. The Company also issued 3,333,350 agents' warrants. Each agent warrant entitles the holder thereof to purchase one common share at a price of \$0.15 per share until December 30, 2010.

### Argentina

In November 2009, the Company entered into a two stage, multi-well drilling program ("Farmout") on its Coiron Amargo Block with a company that has extensive experience operating in the Neuquén basin. The terms of the Farmout provide for the Farmee to drill a minimum of two exploration wells on the block to earn 25% (net 17.5%) of Madalena's current 70% net working interest in the block (excluding the Norte 2 structure in which the CAN X-2 well was drilled) with the option to drill two additional earning wells to earn an additional 25% (net 17.5%) of Madalena's current 70% net working interest in the block, including 50% (net 35%) of the Norte 2 structure. Madalena will continue to own a net 52.5% working interest in the block after the first two wells have been

drilled, and a net 35% working interest in the block in the event the two option wells are drilled. Should cumulative investments under the Farmout exceed US\$18.4 million (including VAT), the Farmee will automatically earn 50% (net 35%) of Madalena's current 70% net working interest in the block (including the Norte 2 structure) and each working interest owner would be responsible for subsequent costs based on their participating interest. Madalena estimates the potential for approximately 38 additional wells to be drilled on the block based on the Company's 3D seismic interpretation over the block and the results of the successful CAN X-2 discovery well drilled on the block in 2009.

The Farmout provides Madalena with an opportunity to further exploit the exploration and development potential identified by the initial exploration discovery well by utilizing third party capital to further develop the block, while maintaining a significant working interest in the future potential production and cash flow. In the second quarter, three sites on separate features were surveyed and received approved environmental impact assessments. In August 2010, the Company commenced drilling the CAN X-3 exploratory well. The well is situated on a separately defined 3D drilling anomaly located approximately 8 kilometres east of the CAN X-2 discovery well. Drilling operations are expected to be completed in the first week of September 2010 and if successful, a completion of the well will be performed.

Immediately following the drilling of CAN X-3, the drilling rig will be mobilized to drill the CAN X-1 location, another separately defined 3D anomaly midway between the CAN X-2 producing well and the CAN X-3 location. Both wells are scheduled to be drilled to approximately 3,300 metre depth and will penetrate not only the primary objective horizon in the Sierras Blancas formation, but will also allow examination of the prospective Quintuco and Vaca Muerta horizons above, and the Lotena formation below.

At Curamhuele, the Company has completed processing and interpretation of 3D seismic data from its earlier seismic exploration programs and has identified a second prospect (Truncation play) east of the previously identified foothills thrust fault play. The Company has obtained approval of the environmental impact assessment for two well locations associated with the Truncation play. The location for the Company's first exploration well on the block has been selected based on 3D seismic acquired during the last half of 2008 and is situated up-structure and approximately 2.4 kilometres south west of the existing cased well, Curamhuele X-1. The well is planned to be drilled to a drilling depth of approximately 2,700 metres in order to penetrate the Lower Troncoso and Avile formations which tested 190 barrels of fluid per day (2% being oil) and 145 barrels of fluid per day (26% being 37 API gravity oil), respectively, from the Curamhuele X-1 well. The Lower Troncoso and Avile formations are the main productive horizons from the El Trapial, Chihuido de la Sierra Negra and Lomita Sur fields located approximately 20 - 30 kilometres east of Curamhuele where they have produced over 750 million barrels of oil to date.<sup>1</sup>

Work on location and future drilling of the foothills thrust fault play is also ongoing. Interpretation of the 3D seismic data for this play indicates structures in the Avile, Troncoso, and Mulichinco formations which are similar in nature to structures which have been successfully drilled and developed on the Filo Morado and El Porton fields to the north. The Filo Morado field has produced approximately 64 million barrels of oil equivalent since its discovery in 1986, and the El Porton field has produced approximately 66 million barrels of oil equivalent since its discovery in 1990.<sup>1</sup> Field studies confirmed the presence of source rock and reservoir rock located directly on the Curamhuele and Cortadera blocks.

At Cortadera, seismic interpretation is currently being high graded to select optimal drilling targets on the block. The Company has also identified a tight gas play on the block and may consider conducting additional seismic to further evaluate its potential.

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<sup>1</sup> The production data associated with the El Trapial, Chihuido de la Sierra Negra, Lomita Sur, Filo Morado and El Porton fields may constitute "analogous information". Such information was released in the Concession Production, Reserves and Resources Statistics Report effective December 31, 2008 from the Secretaria de Energia de la Nacion Argentina. The data relates to production in geographical proximity to prospective lands held by Madalena. Management believes the information is relevant as it helps to define the reservoir characteristics in which the Company may have an interest. The Company is unable to confirm that the analogous information was prepared by a qualified reserves evaluator or auditor or in accordance with the COGE Handbook and therefore, the reader is cautioned that the data relied upon by Madalena may be in error and/or may not be analogous to Madalena's land holdings.

On May 25, 2010, the Company announced that it had received extensions on all three of its exploration blocks in Argentina. On the Coiron Amargo and Curamhuele blocks, the Company has received extension periods totaling three years on each block commencing from the end of their initial three year exploration periods on November 9, 2010. The first extension period is a one year continuation to the existing exploration period to be followed by a new two year exploration period. There will be no requirement to relinquish non-commercial or non-prospective acreage on either block until the end of the one year continuation. The subsequent new two year exploration periods for Coiron Amargo and Curamhuele will require additional work commitments the equivalent of US\$3.1 million (Madalena share pre Farmout – US\$2.4 million) and US\$2.0 million (Madalena share – US\$1.6 million), respectively, which will include the drilling of at least one well on each block. These drilling commitments will be fulfilled by Madalena's drilling programs commencing this summer. The expenditures for the drilling programs will be credited towards the new work commitments by virtue of Madalena having already satisfied the majority of its outstanding work commitments for the first exploration period on each block.

At Cortadera the Company has received a second three year exploration period commencing on October 26, 2010. The new three year exploration period will require an additional work commitment the equivalent of US\$2.0 million (Madalena share – US\$2.0 million) which may be fulfilled through conducting additional seismic or the drilling of a well. The Company is scheduled to relinquish a portion of the non-prospective acreage at the end of the first exploration period.

All three exploration blocks qualify for an additional one year extension period at the end of their second exploration periods in the fourth quarter of 2013.

#### Tunisia

In March 2010, the Company sold its interest in the Remada Sud Permit in Tunisia for cash consideration of US\$4.0 million. The Company intends to use proceeds from the sale for the ongoing exploration and development of the Company's core high working interest projects in the Neuquén Basin of Argentina.

### Financial and Operating Results

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
<b>Financial Information</b>				
Interest income	\$ 17,492	\$ 1,350	\$ 45,865	\$ 8,515
Funds used in operations (1)	(680,398)	(481,892)	(1,511,041)	(1,223,032)
Funds used in operations per share (1)	-	-	(0.01)	(0.01)
Cash flow used in operating activities	(825,274)	(483,721)	(1,541,007)	(1,258,839)
Cash flow used in operating activities per share	(0.01)	-	(0.01)	(0.01)
Cash flow from discontinued operations	(8,426)	(11,713)	3,523,670	31,852
Cash flow from discontinued operations per share	-	-	0.02	-
Net loss from continuing operations	(762,563)	(641,103)	(1,681,554)	(1,486,596)
Net loss from continuing operations per share	-	(0.01)	(0.01)	(0.01)
Net loss and other comprehensive loss	(733,878)	(2,075,920)	(1,620,837)	(2,948,781)
Net loss and other comprehensive loss per share	-	(0.02)	(0.01)	(0.03)
Total assets	25,522,340	21,259,811	25,522,340	21,259,811
Working capital	11,408,141	918,434	11,408,141	918,434
Capital expenditures	76,065	1,806,650	255,074	4,711,363
Debt	-	-	-	-

(1) See "Non-GAAP measurements" above. All amounts per common share are basic and diluted amounts per common share.

## RESULTS OF OPERATIONS

The following paragraphs provide information about the results of Madalena's on-going operations for the three and six months ended June 30, 2010. See the paragraphs entitled "Results from Discontinued Operations" for information on Madalena's discontinued operations for the three and six months ended June 30, 2010.

### Interest income

Interest income for the three months ended June 30, 2010 totaled \$17,492 compared to \$1,350 in the second quarter of 2009. Interest income increased due to higher cash balances. Interest income in the first half of 2010 totaled \$45,865 compared to \$8,515 in the first half of 2009 due to higher cash balances and interest income earned on proceeds from the sale of the Remada Sud Permit in Tunisia.

### Foreign exchange loss (gain)

The Company reported a foreign exchange gain of \$4,877 in the three months ended June 30, 2010 compared to a foreign exchange loss of \$172,445 in the second quarter of 2009. Foreign exchange losses decreased to \$71,522 in the first half of 2010 compared to \$357,692 in the first half of 2009. The Company's operations in Argentina are subject to foreign exchange rate fluctuations for account balances denominated in US dollars and Argentine pesos. The Company had significantly greater exposure to fluctuations in the Argentina peso in the first half of 2009 due to greater capital spending in that period. Currently, the Company does not hedge its exposure to foreign currency fluctuations.

### General and administrative ("G&A") expenses

G&A expenses increased to \$697,358 for the three months ended June 30, 2010 from \$385,090 for the second quarter of 2009 primarily as a result of higher compensation and administration costs and increased legal and registration costs in Argentina. G&A expenses increased to \$1,479,742 in the first half of 2010 compared to \$916,559 in the first half of 2009 as a result of higher annual compensation costs, bonus payments of \$150,000 paid in the first quarter of 2010 (2009 - \$nil), higher office and administration costs and increased legal and registration costs in Argentina.

A breakdown of general and administrative expenses is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Corporate expenses:				
Compensation	\$ 234,801	\$ 131,924	\$ 608,414	\$ 272,909
Office and administration	89,340	57,404	182,348	143,596
Professional fees	66,217	59,398	187,112	125,932
Travel	55,479	41,099	105,827	92,693
	445,837	289,825	1,083,701	635,130
International expenses	251,521	95,265	396,041	281,429
	\$ 697,358	\$ 385,090	\$ 1,479,742	\$ 916,559

### Stock-based compensation ("SBC") expense

SBC expense in the three months ended June 30, 2010 totaled \$75,096 compared to \$74,836 in the second quarter of 2009. SBC expense decreased to \$151,086 in the first half of 2010 compared to \$195,774 in the first half of 2009 as a result of a number of employee options becoming fully vested and no longer included in the SBC expense calculation as well as a result of reduced stock prices which are used in calculating SBC.

SBC for consultants is capitalized to property and equipment to the extent that the consultant's activities are directly related to the exploration for or development of petroleum and natural gas reserves. SBC for consultants is revalued each reporting period based on the period end price of the Company's outstanding common stock. In the three months ended June 30, 2010, the Company capitalized \$28,326 compared to \$5,442 in the second quarter of 2009. The Company capitalized \$51,002 of SBC in the first half of 2010 to property and equipment, compared to \$16,547 in the first half of 2009. The increase in capitalized SBC expense in 2010 is due to an increase in the number of options granted to consultants and in increase in stock prices used to calculate SBC for consultant's options.

At June 30, 2010, the Company has approximately \$615,000 of unamortized SBC that will be charged to income over the remaining vesting period of the outstanding options.

### Depreciation and accretion expense

Depreciation and accretion expense for the three months ended June 30, 2010 totaled \$12,478 compared to \$10,082 in the second quarter of 2009. Depreciation and accretion expense decreased to \$25,069 in the first half of 2010 compared to \$25,086 in the first half of 2009. No new asset retirement obligations were recorded in the first half of 2010.

### Net loss from continuing operations

The Company realized a net loss from continuing operations of \$762,563 for the three months ended June 30, 2010, compared to a net loss from continuing operations of \$641,103 in the second quarter of 2009. Net loss from continuing operations increased to \$1,681,554 in the first half of 2010 compared to \$1,486,596 in the first half of 2009. Net loss from continuing operations increased due to higher general and administrative expenses in the first and second quarter of 2010 partially offset by lower foreign exchange losses.

### Net loss and other comprehensive loss

The Company realized a net loss of \$733,878 for the three months ended June 30, 2010, compared to a net loss of \$2,075,920 in the second quarter of 2009. Net loss decreased to \$1,620,837 in the first half of 2010 compared to \$2,948,781 in the first half of 2009. Higher general and administrative expenses in both the first and second quarter of 2010 compared to the corresponding periods in 2009 were offset by lower foreign exchange losses and higher income from discontinued operations in the periods. See "Results from Discontinued Operations".

### Funds used in operations

Funds from operations and cash flow from operating activities are negative as the Company's activities in Argentina are in the pre-production stage at June 30, 2010 and the Company has no other source of revenue other than interest income on cash balances. Funds used in operations increased to \$680,398 for the three months ended June 30, 2010, compared to funds used in operations of \$481,892 in the second quarter of 2009. Funds used in operations increased to \$1,511,041 in the first half of 2010 compared to funds used in operations of \$1,223,032 for the corresponding period in 2009. Funds used in operations increased in the three and six month periods ended June 30, 2010 as a result of higher general and administrative expenses in the periods partially offset by lower foreign exchange losses.

## Capital expenditures

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Argentina:				
Geological and geophysical	\$ 59,940	\$ 170,054	\$ 153,437	\$ 659,519
Land	48,549	-	58,393	14,891
Drilling and completion	8,539	1,147,506	8,539	3,319,729
Well equipment and facilities	21,872	108,853	129,445	108,853
Other	(63,897)	321,150	(118,527)	547,272
	75,003	1,747,563	231,287	4,650,264
Tunisia:				
Geological and geophysical	-	-	33,282	-
Drilling and completion	-	39,471	2,600	39,471
Other	-	-	(13,460)	-
	-	39,471	22,422	39,471
Canada:				
Drilling and completion	-	19,616	-	21,616
Well equipment and facilities	-	-	-	12
Other	1,062	-	1,365	-
	1,062	19,616	1,365	21,628
<b>Total Capital Expenditures</b>	<b>\$ 76,065</b>	<b>\$ 1,806,650</b>	<b>\$ 255,074</b>	<b>\$ 4,711,363</b>

In the first quarter of 2009, the Company completed drilling of the CAN X-2 well on the Coiron Amargo block (located in the Province of Neuquén, Argentina approximately 650 miles southwest of Buenos Aires and 75 miles east of the Cortadera block) identifying potential hydrocarbon production from the Sierras Blancas formation. Since March 2009, the Company has production tested the CAN X-2 well. Commercial production status can be applied for by the Company upon completion of the test production period. As at June 30, 2010 the test production period had not been completed, and production revenues, operating costs, and royalties have been capitalized for accounting purposes and therefore excluded from production and revenue information. For the three and six month periods ended June 30, 2010, net operating revenue of \$51,156 (2009 – costs of \$103,417) and \$84,159 (2009 – costs of \$103,417), respectively, was credited to Argentina pre-production costs.

In the three months ended June 30, 2010, Madalena incurred capital expenditures on petroleum and natural gas properties and office furniture and fixtures totaling \$76,065 compared to \$1,806,650 in the second quarter of 2009. Capital expenditures decreased to \$255,074 in the first half of 2010 compared to \$4,711,363 in the first half of 2009. Capital expenditures were significantly higher in the first and second quarters of 2009 as a result of drilling the CAN X-2 well in Argentina.

At June 30, 2010, \$1,386,137 of Value Added Taxes (“VAT”) incurred on Argentina capital expenditures was included in property and equipment (at December 31, 2009 - \$1,375,432). The VAT is not recoverable from the Argentina Government, however the Company can retain VAT it collects on revenue produced to the extent that it has un-recovered VAT that it has previously paid.

## RESULTS FROM DISCONTINUED OPERATIONS

The Company recorded income from discontinued operations of \$28,685 for the three month period ended June 30, 2010 compared to a loss from discontinued operations of \$1,434,817 for the second quarter of 2009. Income from discontinued operations increased to \$60,717 in the first half of 2010 compared to a loss from discontinued operations of \$1,462,185 in the first half of 2009. The increase in income from discontinued operations is due to the write down of the Company’s Canadian oil and gas properties in the second quarter of 2009.

On August 27, 2009, the Company completed the sale of all of its Canadian petroleum and natural gas properties for cash proceeds of \$554,000 prior to closing adjustments. The Company has reclassified its comparative figures to record the net loss from discontinued operations as a separate item on the income statement.

In March 2010, the Company sold its interest in the Remada Sud Permit in Tunisia for cash consideration of US\$4 million. As a result of the sale and disposal of the Company's Tunisia cost center, the Company has reclassified the property and equipment and asset retirement obligations associated with the Tunisia property as at December 31, 2009 as separate assets and liabilities on the balance sheet. The Company recorded a write-down and reduced the carrying value of the Tunisia cost center at December 31, 2009 by \$2,110,666. During the six months ended June 30, 2010, net operating revenue of \$18,660 (2009 – \$ nil) was credited to Tunisia pre-production costs.

The following table provides information on the results recorded as income (loss) from discontinued operations during the three and six months ended June 30, 2010 and 2009.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Canada:				
Petroleum and natural gas revenues	\$ -	\$ 69,404	\$ -	\$ 182,942
Royalties	31,384	(9,970)	31,384	(21,771)
Operating costs	(2,699)	(21,104)	(2,699)	(60,209)
Depletion	-	(1,473,147)	-	(1,563,147)
	28,685	(1,434,817)	28,685	(1,462,185)
Gain on sale of Tunisia property and equipment	-	-	32,032	-
Income (loss) from discontinued operations	\$ 28,685	\$ (1,434,817)	\$ 60,717	\$ (1,462,185)

The following table provides information on the gain on sale of property and equipment used in discontinued operations for the period ended June 30, 2010.

Cash proceeds	\$ 4,084,400
Asset retirement obligations	50,968
Net book value of property and equipment related to discontinued operations	(4,103,336)
Gain on sale of Tunisia property and equipment	\$ 32,032

## LIQUIDITY AND CAPITAL RESOURCES

Madalena is in the initial exploration stage on its international oil and gas prospects. The Company earns interest income on its cash reserves, but the cash generated from interest income is not sufficient to cover operating costs and other overhead.

At June 30, 2010 Madalena had working capital of \$11,408,141 compared to \$8,871,993 at December 31, 2009. Working capital increased as a result of the sale in March 2010 of the Company's interest in the Remada Sud Permit in Tunisia.

The Company had negative funds from operations in the three and six month periods ended June 30, 2010 totaling \$680,398 (2009 – \$481,892) and \$1,511,041 (2009 – \$1,223,032), respectively. Negative funds from operations increased in 2010 as a result of higher general and administrative expenses partially offset by lower foreign exchange losses.

Historically, the Company has raised funds from equity financings to fund its exploration and development activities and operating cash flow requirements. The Company's ability to continue operations is dependent on raising sufficient capital to complete planned exploration and development activities, successfully producing economic quantities of petroleum and natural gas from its exploration properties in Argentina, properly managing its existing cash resources, identifying additional commercial oil and gas reserves, and generating profitable operations. The Company has no outstanding debt.

While there has been improvement in global economic conditions, access to debt and equity financing sources may not be readily available. Other opportunities to further strengthen the liquidity and capital resources of the Company may be considered including any or all of the following activities, depending on existing economic conditions and access to external capital sources:

- Issue new shares through a public offering or private placement
- Raise fixed or floating interest rate debt
- Consolidate outstanding common shares
- Farm-out existing exploration opportunities

## **TRANSACTIONS WITH RELATED PARTIES**

During the three and six month periods ended June 30, 2010, the Company incurred fees of approximately \$15,000 (2009 - \$22,000) and \$32,000 (2009 - \$23,000), respectively, payable to a law firm in which a director of the Company is a partner.

## **SHARE INFORMATION**

At June 30, 2010, the Company had 179,637,609 common shares, 33,308,500 warrants, 2,198,109 agents' warrants and 14,813,334 stock options outstanding. On August 24, 2010, the Company had 180,477,859 common shares, 32,563,500 warrants, 2,102,859 agents' warrants and 15,113,334 stock options outstanding.

## **BUSINESS RISKS AND UNCERTAINTIES**

The Company operates in the petroleum and natural gas industry which is subject to numerous risks that can affect the amount of cash flow from operating activities and the ability to grow. These risks include but are not limited to:

- Global financial crisis and the resulting economic uncertainty;
- Volatility in commodity pricing, exchange and interest rates;
- Government and regulatory risk with respect to royalty and income tax regimes;
- Operation risks that may affect the quality and recoverability of reserves;
- Geological risks associated with accessing and recovering new quantities of reserves;
- Ability to capitalize on farm-in and farm-out opportunities as they arise;
- Production risks associated with the ability to extract commercial quantities of petroleum and natural gas;
- Transportation risk with respect to the ability to transport petroleum and natural gas to market;
- Third party credit risk and the resulting ability to collect amounts owed;
- Capital markets risk and the ability to finance future growth;
- Weather risk with respect to the ability to enter and drill wells in wet areas;
- Uncertainty as to the nature of evolving environmental legislation that is likely to result in stricter standards and enforcement;
- Gas processing risk with respect to the ability to process natural gas into third party owned facilities; and
- Environmental risk with respect to the ability to remedy spills, releases or emissions of various substances produced in association with petroleum and natural gas operations.

The Company will seek to minimize these business risks by:

- Employing management, technical staff and consultants with extensive industry experience;
- Maintaining a low cost structure;
- Maintaining prudent financial practices;
- Controlling timing and magnitude of operating and capital costs; and
- Maintaining insurance in accordance with industry standards to address the risk of liability for pollution, blow-outs, property damage, personal injury and other hazards.

#### Foreign operations

Following the sale of the Company's Canadian oil and gas assets in 2009 and Tunisian assets in March 2010, the Company's only significant remaining investment is in Argentina. A number of risks are associated with conducting foreign operations over which the Company has no control, including currency instability, potential and actual civil disturbances, restriction of funds movement outside of these countries, the ability of joint venture partners to fund their obligations, changes of laws affecting foreign ownership and existing contracts, crude oil and natural gas price and production regulation, royalty rates, potential expropriation of property without fair compensation, retroactive tax changes and possible interruption of oil deliveries.

#### Market uncertainty

Market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions during the latter part of 2008 have caused significant volatility to commodity prices and global stock markets. These conditions worsened in the latter part of 2008 and continued in the first and second quarters of 2009, causing a loss of confidence in the broader Canadian, U.S. and global credit and financial markets and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused further deterioration in credit markets and substantial declines in stock markets. These factors have negatively impacted company valuations and will impact the performance of the global economy going forward and the ability of companies to raise money in the capital markets.

Petroleum prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies, OPEC actions and the ongoing global credit and liquidity concerns.

#### Substantial capital requirements

In order to completely exploit its existing properties and create future growth, the Company anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. In addition, uncertain levels of near term industry activity coupled with the present global credit downturn exposes the Company to limited access to capital. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's business financial condition, results of operations and prospects.

For addition detail regarding the Company's risks and uncertainties, refer to the Company's most recent AIF on SEDAR at [www.sedar.com](http://www.sedar.com).

## **CONTRACTUAL OBLIGATIONS**

The Company has lease commitments for office space and rental accommodations in Canada and Argentina. The total estimated remaining lease payments at June 30, 2010, including operating costs, are approximately \$169,000.

On acquisition of the Argentine exploration properties the Company and its joint venture partners agreed to work programs with the Province of Neuquen in Argentina. The work programs required that a total of US\$10,500,000 be spent by November 2010 of which Madalena's share was US\$8,722,222. At June 30, 2010, the Company estimates that it has met its share of the amount to be spent to satisfy the total dollar value of the initial work programs.

On May 25, 2010, the Company announced that it had received an extension of the exploration period on all three of its exploration blocks in Argentina. On the Coiron Amargo and Curamhuele blocks, the Company has received extension periods totaling three years on each block commencing from the end of their initial three year exploration periods on November 9, 2010. The first extension period is a one year continuation to the existing exploration period to be followed by a new two year exploration period. There will be no requirement to relinquish non-commercial or non-prospective acreage on either block until the end of the one year continuation. The subsequent new two year exploration periods for Coiron Amargo and Curamhuele will require additional work commitments the equivalent of US\$3.1 million (Company share pre Farmout – US\$2.4 million) and US\$2.0 million (Company share – US\$1.6 million), respectively, which will include the drilling of at least one well on each block. These drilling commitments will be fulfilled by Madalena's drilling programs commencing this summer. The expenditures for the drilling programs will be credited towards the new work commitments by virtue of Madalena having already satisfied the majority of its outstanding work commitments for the first exploration period on each block.

On the Cortadera block, the Company has received a second three year exploration period commencing on October 26, 2010. The new three year exploration period will require an additional work commitment the equivalent of US\$2.0 million (Company share – US\$2.0 million) which may be fulfilled through conducting additional seismic or the drilling of a well. The Company is scheduled to relinquish a portion of the non-prospective acreage at the end of the first exploration period.

All three exploration blocks qualify for an additional one year extension period at the end of their second exploration periods in the fourth quarter of 2013.

## **OUTLOOK**

The Company has experienced a high level of success in its international exploration and development projects. Following the sale of the Company's Tunisia assets in March 2010, the Company's focus in 2010 will be on its high impact, high working interest core areas in the Neuquén Basin of Argentina.

Recent extensions to the exploration period of all three exploration blocks in Argentina allow the Company to confidently move forward with its exploration and development plans. If the drilling program currently underway on the Coiron Amargo Block is successful and commercial hydrocarbons are found, the Company anticipates a development plan will be prepared in 2011 to convert the exploration block to an exploitation concession with a 25 year term.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Significant accounting policies used by Madalena are disclosed in note 2 to the December 31, 2009 audited consolidated financial statements. Preparing financial statements in accordance with Canadian GAAP requires management to make certain judgments and estimates. Changes to these judgments and estimates could have a material effect on the Company's financial statements and financial position. There were no changes to Madalena's critical accounting estimates during the three and six month period ended June 30, 2010.

## NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

The following describes new accounting pronouncements that have been issued but are not yet effective:

### Business combinations, Non-controlling interests, Consolidated financial statements

Effective January 1, 2011 the Company will be required to adopt the new Canadian accounting standards for “*Business Combinations*”, “*Non-controlling Interests*” and “*Consolidated Financial Statements*”. All three new standards were issued in contemplation of convergence with International Financial Reporting Standards (“IFRS”) as discussed below. The new standards address accounting for business combinations, both at the time of acquisition and subsequent to the initial purchase accounting, and includes guidance on accounting for non-controlling interests and subsequent preparation of consolidated financial statements. The Company has no transactions that are affected by these new standards. Early adoption of the standards is allowed, and will be considered if and when applicable transactions arise.

### IFRS

In February 2008, the CICA Accounting Standards Board (“AcSB”) confirmed that IFRS will become Canadian GAAP effective January 1, 2011 for profit-oriented Canadian publicly accountable enterprises.

Madalena commenced its IFRS convergence project in 2008 and is currently executing a specific convergence plan which will include assessment and quantification of anticipated impacts, identifying and implementing associated changes to processes and information systems, updating and ensuring compliance with internal controls and educating staff and other stakeholders. The convergence plan has been designed with sufficient flexibility to adapt to changes and new developments in existing Canadian GAAP and IFRS standards.

In 2009 the Company continued its research and planning for convergence to IFRS. Management has identified a number of key accounts that will be impacted by IFRS, the most significant of which is property and equipment the differences for which are as follows:

- First time adoption exemption – the International Accounting Standards Board has approved exemptions for the retrospective application of IFRS for first time adopters. Of most relevance to the Company is an exemption that allows full cost oil and gas companies to elect, at the date of transition to IFRS, to measure exploration evaluation assets at the amount determined under Canadian GAAP and to measure oil and gas assets in the development or production phases by allocating the amount determined under Canadian GAAP to the underlying assets pro-rata using reserve volumes or reserve values as of that date.
- Re-classification of exploration and evaluation (“E&E”) expenditures from property and equipment (“PP&E”) on the consolidated balance sheet – this will consist of the book value of the Company’s undeveloped land that relates to its Argentina properties which are currently excluded from the depletion calculation and are assessed for impairment. E&E assets will not be depleted and must be assessed for impairment when indicators suggest the possibility of impairment.
- Defining for future depletion expense and impairment calculations, the definition of a cash generating unit.

In addition, foreign currency translation methods and the functional currency of the Company’s foreign operations must be re-evaluated – under IFRS, the functional currency emphasizes the currency that determines the pricing of the transactions that are undertaken, rather than focusing on the currency in which those transactions are denominated.

At this time, the impact on the Company's financial position and results of operations has not been determined for the accounting policy differences previously identified. The Company did not materially progress its convergence plan in the second quarter of 2010 as a result of personnel changes. Madalena's implementation plan includes the assessment of accounting policy alternatives and systems changes and the Company will commence the calculation of 2010 results under IFRS in the second half of 2010.

## QUARTERLY FINANCIAL INFORMATION

	Interest Income	Net Loss	Net Loss Per Share
<b>2010</b>			
Second quarter	\$ 17,492	\$ (733,878)	\$ -
First quarter	28,373	(886,959)	(0.01)
<b>Total</b>	<b>\$ 45,865</b>	<b>\$ (1,620,837)</b>	<b>\$ (0.01)</b>
<b>2009</b>			
Fourth quarter	\$ 254	\$ (2,721,709)	\$ (0.02)
Third quarter	643	(692,859)	(0.01)
Second quarter	1,350	(2,075,920)	(0.02)
First quarter	7,165	(872,861)	(0.01)
<b>Total</b>	<b>\$ 9,412</b>	<b>\$ (6,363,349)</b>	<b>\$ (0.06)</b>
<b>2008</b>			
Fourth quarter	\$ 41,349	\$ (869,238)	\$ (0.01)
Third quarter	61,313	(246,875)	-
Second quarter	70,188	(528,911)	(0.01)
First quarter	91,628	(188,767)	-
<b>Total</b>	<b>\$ 264,478</b>	<b>\$ (1,833,791)</b>	<b>\$ (0.02)</b>

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Interim Consolidated Financial Statements of

**MADALENA VENTURES INC.**

As at and for the three and six month periods ended June 30, 2010 (unaudited)

# MADALENA VENTURES INC.

Consolidated Balance Sheets (unaudited)

As at	June 30, 2010	December 31, 2009
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 11,361,837	\$ 10,131,040
Accounts receivable	503,438	187,193
Prepaid expenses	244,143	154,972
	<u>12,109,418</u>	<u>10,473,205</u>
Property and equipment (note 2)	13,412,922	13,143,782
Property and equipment related to discontinued operations (note 3)	-	4,080,914
	<u>\$ 25,522,340</u>	<u>\$ 27,697,901</u>
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	\$ 701,277	\$ 1,601,212
Asset retirement obligations (note 4)	314,925	304,370
Asset retirement obligations related to discontinued operations (note 3)	-	50,968
	<u>1,016,202</u>	<u>1,956,550</u>
<b>Shareholders' equity</b>		
Share capital (note 5)	38,629,356	38,345,561
Warrants (note 5)	2,286,914	2,380,678
Contributed surplus (note 6)	7,201,099	7,005,506
Deficit	(23,611,231)	(21,990,394)
	<u>24,506,138</u>	<u>25,741,351</u>
	<u>\$ 25,522,340</u>	<u>\$ 27,697,901</u>

Commitments (note 9)

*See accompanying notes to the interim consolidated financial statements*

# MADALENA VENTURES INC.

Consolidated Statements of Operations, Comprehensive Loss and Deficit (unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
<b>Revenue</b>				
Interest income	\$ 17,492	\$ 1,350	\$ 45,865	\$ 8,515
<b>Expenses</b>				
General and administrative	697,358	385,090	1,479,742	916,559
Stock-based compensation	75,096	74,836	151,086	195,774
Foreign exchange loss (gain)	(4,877)	172,445	71,522	357,692
Depreciation and accretion	12,478	10,082	25,069	25,086
	780,055	642,453	1,727,419	1,495,111
<b>Loss from continuing operations</b>	(762,563)	(641,103)	(1,681,554)	(1,486,596)
Income (loss) from discontinued operations (note 3)	28,685	(1,434,817)	60,717	(1,462,185)
<b>Net loss and other comprehensive loss</b>	(733,878)	(2,075,920)	(1,620,837)	(2,948,781)
Deficit - beginning of the period	(22,877,353)	(16,499,906)	(21,990,394)	(15,627,045)
<b>Deficit - end of the period</b>	\$ (23,611,231)	\$ (18,575,826)	\$ (23,611,231)	\$ (18,575,826)
Weighted average number of shares:				
Basic and diluted	178,563,139	111,743,702	178,491,046	111,743,702
Loss from continuing operations per share:				
Basic	\$ -	\$ (0.01)	\$ (0.01)	\$ (0.01)
Diluted	-	(0.01)	(0.01)	(0.01)
Income (loss) from discontinued operations per share:				
Basic	\$ -	\$ (0.01)	\$ -	\$ (0.01)
Diluted	-	(0.01)	-	(0.01)
Net loss and other comprehensive loss per share:				
Basic	\$ -	\$ (0.02)	\$ (0.01)	\$ (0.03)
Diluted	-	(0.02)	(0.01)	(0.03)

See accompanying notes to the interim consolidated financial statements

# MADALENA VENTURES INC.

Consolidated Statements of Cash Flows (unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
<b>Cash provided by (used in):</b>				
<b>Operating activities</b>				
Loss from continuing operations	\$ (762,563)	\$ (641,103)	\$ (1,681,554)	\$ (1,486,596)
Items not involving cash:				
Stock-based compensation	75,096	74,836	151,086	195,774
Depreciation and accretion	12,478	10,082	25,069	25,086
Foreign exchange loss (gain)	(5,409)	74,293	(5,642)	42,704
	(680,398)	(481,892)	(1,511,041)	(1,223,032)
Change in non-cash working capital items (note 8)	(144,876)	(1,829)	(29,966)	(35,807)
	(825,274)	(483,721)	(1,541,007)	(1,258,839)
<b>Discontinued operations (note 3)</b>				
Income (loss) from discontinued operations	28,685	(1,434,817)	60,717	(1,462,185)
Items not involving cash:				
Depletion included in discontinued operations	-	1,473,147	-	1,563,147
Gain on sale of property and equipment	-	-	(32,032)	-
Abandonment costs	-	(607)	-	(2,570)
Additions to discontinued property and equipment	-	(59,087)	(22,422)	(61,099)
Proceeds on sale of property and equipment	-	-	4,084,400	-
Change in non-cash working capital (note 8)	(37,111)	9,651	(566,993)	(5,441)
	(8,426)	(11,713)	3,523,670	31,852
<b>Financing activities</b>				
Issue of common shares	175,149	-	183,536	-
Change in non-cash working capital items (note 8)	-	-	(124,014)	-
	175,149	-	59,522	-
<b>Investing activities</b>				
Additions to property and equipment	(76,065)	(1,747,563)	(232,652)	(4,650,264)
Change in non-cash working capital items (note 8)	(83,199)	(329,324)	(587,327)	80,654
	(159,264)	(2,076,887)	(819,979)	(4,569,610)
Change in cash and cash equivalents	(817,815)	(2,572,321)	1,222,206	(5,796,597)
Cash and cash equivalents, beginning of the period	12,158,714	4,660,428	10,131,040	7,861,868
Impact of foreign exchange on cash balances	20,938	(145,431)	8,591	(122,595)
<b>Cash and cash equivalents, end of the period</b>	<b>\$ 11,361,837</b>	<b>\$ 1,942,676</b>	<b>\$ 11,361,837</b>	<b>\$ 1,942,676</b>

See accompanying notes to the interim consolidated financial statements

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

As at and for the three and six month periods ended June 30, 2010 (unaudited)

## 1. Nature of business and basis of presentation

Madalena Ventures Inc. ("Madalena" or the "Company") is incorporated pursuant to the laws of the Province of Alberta. Madalena is based in Calgary, Alberta and is involved in the exploration, development and production of petroleum and natural gas in Argentina. In August 2009 and March 2010, the Company sold its Canadian and Tunisian oil and gas assets, respectively.

These interim 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 minimal production and limited cash flow from operating activities. The Company currently relies on equity financing to pay for exploration activities and overhead expenses. 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.

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), and have been prepared following the same accounting policies and methods of computation as the audited financial statements for the year ended December 31, 2009. The interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the year ended December 31, 2009. Certain comparative information has been reclassified to be consistent with current period presentation. The Company's reporting currency is Canadian dollars (\$).

## 2. Property and equipment

As at June 30, 2010	Cost	Accumulated depletion and depreciation	Net book value
Argentina pre-production costs	\$ 13,363,368	\$ -	\$ 13,363,368
Furniture and fixtures	168,428	(118,874)	49,554
	<u>\$ 13,531,796</u>	<u>\$ (118,874)</u>	<u>\$ 13,412,922</u>

As at December 31, 2009	Cost	Accumulated depletion and depreciation	Net book value
Argentina pre-production costs	\$ 13,081,079	\$ -	\$ 13,081,079
Furniture and fixtures	167,063	(104,360)	62,703
	<u>\$ 13,248,142</u>	<u>\$ (104,360)</u>	<u>\$ 13,143,782</u>

At June 30, 2010 the Argentina cost center was considered to be in the pre-production stage and all costs directly attributable to this center was capitalized and excluded from costs subject to depletion and depreciation. The amounts capitalized for Argentina at June 30, 2010 include \$1,386,137 of Value Added Tax ("VAT") (December 31, 2009 - \$1,375,432). 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.

Revenues and operating expenses realized from the testing of wells in pre-production stage cost centers are recorded in the full cost pool. During the six months ended June 30, 2010, net operating revenue of \$84,159 (2009 – net operating costs of \$103,417) was credited to Argentina pre-production costs.

During the six months ended June 30, 2010, stock-based compensation directly related to exploration and development activities totaling \$51,002 (2009 - \$16,547) was capitalized.

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

As at and for the three and six month periods ended June 30, 2010 (unaudited)

## 3. Discontinued operations

On August 27, 2009, the Company completed the sale of all of its Canadian petroleum and natural gas properties for cash proceeds of \$554,000 prior to closing adjustments. The Company has reclassified its comparative figures to record the net loss from discontinued operations as a separate item on the income statement.

In March 2010, the Company sold its interest in the Remada Sud Permit in Tunisia for cash consideration of US\$4 million. As a result of the sale and disposal of the Company's Tunisia cost center, the Company reclassified the property and equipment and asset retirement obligations associated with the Tunisia property as at December 31, 2009 as separate assets and liabilities on the balance sheet. The Company recorded a write-down and reduced the carrying value of the Tunisia cost center at December 31, 2009 by \$2,110,666. During the six months ended June 30, 2010, net operating revenue of \$18,660 (2009 – \$ nil) was credited to Tunisia pre-production costs.

The following table provides a summary of the income (loss) from discontinued operations for the three and six month periods ended June 30, 2010 and 2009.

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Canada:				
Petroleum and natural gas revenues	\$ -	\$ 69,404	\$ -	\$ 182,942
Royalties	31,384	(9,970)	31,384	(21,771)
Operating costs	(2,699)	(21,104)	(2,699)	(60,209)
Depletion	-	(1,473,147)	-	(1,563,147)
	28,685	(1,434,817)	28,685	(1,462,185)
Gain on sale of Tunisia property and equipment	-	-	32,032	-
Income (loss) from discontinued operations	\$ 28,685	\$ (1,434,817)	\$ 60,717	\$ (1,462,185)

The following table summarizes the gain on sale of property and equipment used in discontinued operations.

Cash proceeds	\$ 4,084,400
Asset retirement obligations	50,968
Net book value of property and equipment related to discontinued operations	(4,103,336)
Gain on sale of Tunisia property and equipment	\$ 32,032

## 4. Asset retirement obligations

Asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. At June 30, 2010, the estimated total undiscounted amount of cash flows required to settle the Company's asset retirement obligations are approximately US\$1,100,000 (December 31, 2009 – US\$1,100,000). These costs are expected to be incurred over the next 15 - 25 years. A credit adjusted risk-free interest rate of 8% and an inflation rate of 7.85% was used to calculate the fair value of the asset retirement obligations.

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

As at and for the three and six month periods ended June 30, 2010 (unaudited)

A reconciliation of the total asset retirement obligations is provided below:

	June 30, 2010	December 31, 2009
Balance, beginning of period	\$ 355,338	\$ 356,378
Obligations accrued	-	78,865
Accretion expense	10,555	23,321
Costs incurred	-	(2,570)
Related to discontinued operations	(50,968)	(100,656)
Balance, end of period	\$ 314,925	\$ 355,338

## 5. Share capital

### a) Common Shares

#### Authorized

The authorized share capital of the Company consists of an unlimited number of common shares without nominal or par value.

#### Issued and outstanding

The following table provides a summary of the issued and outstanding common share activity:

	Common shares	
	Number	Amount
Balance - December 31, 2008	111,743,702	\$ 31,491,768
Public offering	66,667,000	7,890,040
Share issue costs	-	(1,036,247)
Balance - December 31, 2009	178,410,702	38,345,561
Exercise of stock options	66,666	13,495
Exercise of warrants	25,000	7,832
Exercise of agents' warrants	1,135,241	262,468
Balance - June 30, 2010	179,637,609	\$ 38,629,356

In December 2009, the Company completed a public offering of 66,667,000 units at an issue price of \$0.15 per unit for gross proceeds to Madalena of \$10,000,050. Each unit consisted of one common share and one-half (1/2) common share purchase warrant. Each whole warrant issued entitles the holder thereof to purchase one common share at a price of \$0.25 per share until December 30, 2010. The Company also issued 3,333,350 agents' warrants. Each agent warrant entitles the holder thereof to purchase one common share at a price of \$0.15 per share until December 30, 2010.

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

As at and for the three and six month periods ended June 30, 2010 (unaudited)

## b) Warrants

	Warrants		Average Exercise Price
	Number	Amount	
Balance - December 31, 2008	-	\$ -	\$ -
Public offering	33,333,500	2,110,010	0.25
Agents' warrants	3,333,350	270,668	0.15
Balance - December 31, 2009	36,666,850	2,380,678	\$ 0.24
Exercise of warrants	(25,000)	(1,582)	0.25
Exercise of agents' warrants	(1,135,241)	(92,182)	0.15
Balance - June 30, 2010	35,506,609	\$ 2,286,914	\$ 0.24

The fair value of the warrants at the issue date was estimated using the Black Scholes option pricing model with the following assumptions: Risk free interest rate – 1.46%; expected life – 12 months; expected volatility – 147%; expected dividend yield – nil.

## c) Stock options

Under the Company's stock option plan, directors, officers, employees and consultants are eligible to receive options to acquire common stock. The exercise price of each stock option is the average market price of the Company's stock for the five trading days prior to the grant date. Total options granted cannot exceed 10% of the issued and outstanding common shares of the Company.

Options granted to officers, employees, and consultants vest equally over three years on each anniversary of the grant date. Options granted to directors may vest immediately or over three years on each anniversary of the grant date. All options expire five years from the grant date.

The following table presents the Company's stock option activity:

As at and for the period ended	June 30, 2010		December 31, 2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding - beginning of period	10,405,000	\$ 0.55	11,155,000	\$ 0.57
Granted	4,625,000	0.21	300,000	0.13
Exercised	(66,666)	0.11	-	-
Expired	(150,000)	0.77	(1,050,000)	(0.61)
Outstanding - end of period	14,813,334	\$ 0.44	10,405,000	\$ 0.55
Exercisable - end of period	9,345,001	\$ 0.59	9,168,333	\$ 0.59

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

As at and for the three and six month periods ended June 30, 2010 (unaudited)

The following table presents the estimated remaining life of outstanding stock options and the number of shares that may be issued at June 30, 2010:

Exercise Price (\$)	Outstanding		Exercisable
	Number of options	Weighted average remaining life (years)	Number of options
0.105	908,334	3.42	308,334
0.120	1,000,000	0.27	1,000,000
0.125	300,000	3.92	100,000
0.210	4,600,000	4.59	-
0.320	25,000	1.25	-
0.405	30,000	2.58	20,000
0.410	300,000	0.50	300,000
0.600	1,400,000	1.97	1,400,000
0.660	4,300,000	0.66	4,300,000
0.700	100,000	2.30	66,667
0.730	800,000	0.72	800,000
0.850	1,050,000	1.33	1,050,000
0.445	14,813,334	2.27	9,345,001

## Stock-based compensation

The Company accounts for its stock-based compensation using the fair value method. The fair value of each stock option granted is estimated using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 2.19% (2009 – 0.92%), expected life of 4.46 years (2009 – 3.00 years), expected volatility of 140% (2009 – 171%) and 0% dividend yield (2009 – 0%). The grant date weighted average fair value of stock options granted in the six month period ended June 30, 2010 was \$0.20 per option (2009 - \$0.11 per option). The fair value, estimated at the grant date for options issued to directors, officers and employees and the measurement date for options issued to consultants, is expensed on a straight-line basis over the vesting terms of the options.

## **d) Per share information**

	June 30, 2010	June 30, 2009
Basic common shares outstanding	179,637,609	111,743,702
Dilutive effect of:		
Share options outstanding	14,813,334	10,930,000
Shares issuable for warrants	33,308,500	-
Shares issuable for agents' warrants	2,198,109	-
Fully diluted common shares outstanding	229,957,552	122,673,702
Weighted average shares outstanding	178,491,046	111,743,002
Dilutive effect of options, warrants and agents' warrants	-	-
Diluted weighted average shares outstanding	178,491,046	111,743,002

At June 30, 2010 and 2009, all share options, warrants and agents' warrants were excluded from the calculation of diluted weighted average shares outstanding as they were anti-dilutive.

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

As at and for the three and six month periods ended June 30, 2010 (unaudited)

## 6. Contributed surplus

	June 30, 2010	December 31, 2009
Balance - beginning of the period	\$ 7,005,506	\$ 6,709,251
Stock-based compensation expensed	151,086	260,860
Stock-based compensation capitalized	51,002	35,395
Transferred to share capital on exercise of stock options	(6,495)	-
<b>Balance - end of the period</b>	<b>\$ 7,201,099</b>	<b>\$ 7,005,506</b>

## 7. Segmented information

Following the sale of the Company's Tunisia assets in March 2010, the Company has two remaining operating segments, Canada and Argentina. Financial information pertaining to continuing and discontinued operating segments is presented in the following tables:

	Three months ended June 30, 2010		Six months ended June 30, 2010		
	Revenue	Income (Loss)	Revenue	Income (Loss)	Identifiable Assets
Canadian corporate	\$ 17,492	\$ (503,315)	\$ 45,865	\$ (1,203,434)	\$ 11,112,381
Argentina	-	(230,563)	-	(449,435)	14,409,959
Tunisia	-	-	-	32,032	-
<b>Total</b>	<b>\$ 17,492</b>	<b>\$ (733,878)</b>	<b>\$ 45,865</b>	<b>\$ (1,620,837)</b>	<b>\$ 25,522,340</b>

	Three months ended June 30, 2009		Six months ended June 30, 2009		
	Revenue	Income (Loss)	Revenue	Income (Loss)	Identifiable Assets
Canadian corporate	\$ 70,753	(1,718,134)	\$ 191,451	\$ (2,365,695)	\$ 2,455,295
Argentina	-	(280,410)	-	(505,710)	12,989,702
Tunisia	1	(77,376)	6	(77,376)	5,814,814
<b>Total</b>	<b>\$ 70,754</b>	<b>\$ (2,075,920)</b>	<b>\$ 191,457</b>	<b>\$ (2,948,781)</b>	<b>\$ 21,259,811</b>

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

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## 8. Supplemental cash flow information

Change in non cash working capital items	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Accounts receivable	\$ (244,609)	\$ 75,678	\$ (308,009)	\$ 17,486
Prepaid expenses	(71,550)	(140,214)	(85,968)	(110,311)
Accounts payable and accrued liabilities	50,973	(256,966)	(914,323)	132,231
Change in non-cash working capital	\$ (265,186)	\$ (321,502)	\$ (1,308,300)	\$ 39,406
Attributable to:				
Operating activities	\$ (144,876)	\$ (1,829)	\$ (29,966)	\$ (35,807)
Discontinued operations	(37,111)	9,651	(566,993)	(5,441)
Financing activities	-	-	(124,014)	-
Investing activities	(83,199)	(329,324)	(587,327)	80,654
	\$ (265,186)	\$ (321,502)	\$ (1,308,300)	\$ 39,406

## 9. Commitments

The Company's commitment for office space and rental accommodation is as follows:

Year	Amount
2010	\$ 97,000
2011	72,000

On acquisition of the Argentine exploration properties the Company and its joint venture partners agreed to work programs with the Province of Neuquen in Argentina. The work programs required that a total of US\$10,500,000 be spent by November 2010 of which Madalena's share was US\$8,722,222. At June 30, 2010, the Company estimates that it has met its share of the amount to be spent to satisfy the total dollar value of the initial work programs.

On May 25, 2010, the Company announced that it had received an extension of the exploration period on all three of its exploration blocks in Argentina. On the Coiron Amargo and Curamhuele blocks, the Company has received extension periods totaling three years on each block commencing from the end of their initial three year exploration periods on November 9, 2010. The first extension period is a one year continuation to the existing exploration period to be followed by a new two year exploration period. There will be no requirement to relinquish non-commercial or non-prospective acreage on either block until the end of the one year continuation. The subsequent new two year exploration periods for Coiron Amargo and Curamhuele will require additional work commitments the equivalent of US\$3.1 million (Company share - US\$2.4 million) and US\$2.0 million (Company share - US\$1.6 million), respectively, which will include the drilling of at least one well on each block.

On the Cortadera block, the Company has received a second three year exploration period commencing on October 26, 2010. The new three year exploration period will require an additional work commitment the equivalent of US\$2.0 million (Company share - US\$2.0 million) which may be fulfilled through conducting additional seismic or the drilling of a well. The Company is scheduled to relinquish a portion of the non-prospective acreage at the end of the first exploration period. All three exploration blocks qualify for an additional one year extension period at the end of their second exploration periods in the fourth quarter of 2013.

# MADALENA VENTURES INC.

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## 10. Financial risk and capital 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 objective is to maintain a strong capital position in order to execute on its exploration and development plans and maximize shareholder value.

The Company currently defines its capital as shareholders' equity. Changes to the relative weighting of the capital structure is driven by our business plans, changes in economic conditions and risks inherent in the oil and gas industry. In order to maintain or adjust the capital structure, the Company may consider any or all of the following activities, depending on existing economic conditions and access to external capital sources:

- Issue new shares through a public offering or private placement
- Raise fixed or floating interest rate debt
- Consolidate outstanding common shares
- Farm-out existing exploration opportunities

The Company is not subject to any external restrictions on its capital structure and has no debt facilities.

The Company periodically reviews its capital structure in relation to its expected exploration and development budgets. As the Company is primarily in the exploration phase, certain quantitative measures used by industry peers, such as return on equity, return on capital employed and debt to equity ratios, are not relevant measures for the Company.

The current global economic conditions, including lower interest rates, the fluctuating Canadian dollar, lower commodity prices and the limited access to external debt and equity financing markets has required Madalena to refocus its capital management policies and processes. The Company's capital management is currently focused on conserving cash balances and focusing on high impact, low capital cost exploration and development programs. There were no changes to the way the Company manages its capital during the three month period ended June 30, 2010.

### Credit risk

The Company is exposed to credit risk in relation to its cash and cash equivalents and accounts receivable.

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.

The Company's accounts receivable are exposed to the risk of financial loss if the counterparty fails to meet its contractual obligations. The Company's accounts receivable include amounts due from its Argentine operators which are subject to normal industry credit risk. The carrying amounts of cash and cash equivalents and accounts receivable represents the Company's maximum credit exposure. The Company has not recorded an allowance for doubtful accounts and has not written off any accounts receivable in the six month period ended June 30, 2010 or the year ended December 31, 2009.

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

As at and for the three and six month periods ended June 30, 2010 (unaudited)

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## 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. As of June 30, 2010, the Company has a working capital surplus of \$11,408,141 (December 31, 2009 - \$8,871,993) which given planned capital expenditures, administrative overhead requirements and commitments, is sufficient to meet all financial obligations in the current year.

## 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 and North American supply and demand factors. The Company has no influence over the pricing of oil and natural gas and has not attempted to mitigate commodity price risk through the use of financial derivatives.

### *Interest rate risk*

The Company is exposed to interest rate fluctuations on its investments of excess cash in short-term discount notes issued by international banks.

### *Foreign currency exchange rate risk*

A substantial 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 in US dollars (USD) and Argentine 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.

### *Sensitivity analysis*

The following table presents an estimate of the impact on net earnings of the market risk factors discussed above and is calculated based on the noted change in the market factor applied to the balance at the end of the period.

	Change in market factor	Increase (decrease) in loss before tax
Market risk		
Foreign exchange - effect of strengthening CAD \$		
USD denominated financial assets and liabilities	3%	(5,700)
ARS denominated financial assets and liabilities	3%	19,800

# MADALENA VENTURES INC.

Notes to the Interim Consolidated Financial Statements

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## Fair value of financial instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities, the carrying values of which approximate their fair values due to their short-term nature. The Company has no bank indebtedness.

The following table provides information on the foreign currency denominated financial instruments held by the Company at June 30, 2010:

	<u>Balance denominated in</u>		Total CAD equivalent
	USD	ARS	
Cash and cash equivalents	32,444	1,371,758	\$ 398,330
Accounts receivable	6,760	1,798,063	484,043
Prepaid expenses	-	737,539	195,595
Accounts payable and accrued liabilities	217,595	1,426,936	\$ 610,074

## **11. Related party transactions**

During the six month period ended June 30, 2010, the Company incurred fees of \$32,000 (2009 - \$23,000) payable to a law firm in which a director of the Company is a partner.

**DIRECTORS**

Raymond G. Smith  
*Chairman, Madalena Ventures Inc.  
President and Chief Executive Officer,  
Bellatrix Exploration Ltd.*

Dwayne H. Warkentin  
*President and Chief Executive Officer,  
Madalena Ventures Inc.*

Barry B. Larson  
*Vice President Operations and Chief Operating Officer,  
Parex Resources Inc.*

Michael J. Lock  
*President,  
Upsilon Holdings Ltd.*

Keith MacDonald,  
*President,  
Bamako Investment Management Ltd.*

Anthony J. Potter  
*Vice President, Finance and Chief Financial Officer,  
Madalena Ventures Inc.*

Jay Reid  
*Partner, Burnet, Duckworth and Palmer LLP*

Ving Y. Woo  
*Vice-President, Operations,  
Bellatrix Exploration Ltd.*

**OFFICERS**

Dwayne H. Warkentin  
*President and Chief Executive Officer*

Anthony J. Potter  
*Vice President, Finance and Chief Financial Officer*

**HEAD OFFICE LOCATION**

Suite 200, 441 – 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta, Canada  
T2P 2V1

**LEGAL COUNSEL**

Burnet, Duckworth and Palmer LLP  
*Calgary, Alberta*

**BANKERS**

BMO Bank of Montreal

**AUDITORS**

KPMG LLP  
*Calgary, Alberta*

**INDEPENDENT ENGINEERS**

Paddock Lindstrom & Associates Ltd.

**REGISTRAR AND TRANSFER AGENT**

Inquiries regarding change of address, registered shareholdings, stock transfers or lost certificates should be directed to:

Alliance Trust Company  
*Calgary, Alberta*

**STOCK EXCHANGE LISTING**

TSX Venture Exchange  
Trading Symbol: "MVN"