

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") is provided by management of Madalena Ventures Inc. ("Madalena" or the "Company"), for the years ended December 31, 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, 2010 and 2009. 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 April 28, 2011. 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:

Year ended December 31	2010	2009
Cash flow used in operating activities	\$ (3,040,347)	\$ (2,642,064)
Change in non-cash working capital	299,646	270,891
Funds used in operations	\$ (2,740,701)	\$ (2,371,173)

Operating netback is a useful measure for comparing prices received, royalties paid, and operating costs incurred, with industry peers. Netback and operating netback are defined as total petroleum and natural gas revenue less royalties and operating expenses. Additional information on operating netbacks is provided in "Netbacks".

## HIGHLIGHTS

Highlights in the year ended December 31, 2010 include:

- Sale of Tunisian assets to focus on core, high interest projects in Argentina;
- Extension of exploration period on all three Argentina exploration blocks;
- Completion of the drilling of two successful exploration wells on the Coiron Amargo Block;
- Commencement of exploration drilling program on the Curamhuele Block;
- Significant farm-out of the Cortadera Block to Apache Energia Argentina S.R.L.;
- Completion of \$26.5 million bought deal equity financing in November 2010; and
- Production in December 2010 of 179 barrels of oil per day.

## 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 currently has production and exploration operations in Argentina and is focused on international oil and gas opportunities in South America.

In November 2010, the Company issued 40,775,000 common shares at an issue price of \$0.65 per share for gross proceeds to Madalena of \$26,503,750. The Company also received in 2010 gross proceeds of \$8,833,378 from the exercise of warrants. The Company exited 2010 in a strong financial position and anticipates in 2011 participating in a mix of exploration, appraisal and development type expenditures across its portfolio of high working interest projects in the Neuquén Basin of Argentina.

### Coiron Amargo Block

In August and September 2010 the Company drilled the CAN X-3 and CAN X-1 exploration wells, respectively, in the northern portion of the block. Both wells encountered hydrocarbon potential in the Vaca Muerta and Sierras Blancas formations. In the fourth quarter of 2010, both wells tested oil from the Sierras Blancas formation and were placed on production along with the Company's CAN X-2 well drilled in 2009. To date, production from the wells has been restricted until the drilling of CAN X-4 has been completed and production can be gathered to a central facility to include gas sales. Due to the successful fracture stimulation of the CAN

X-1 well, further fracture stimulation treatments on the other Sierras Blancas production wells is being examined. Additional capital expenditures are planned in 2011 to increase production and sales from the area.

Information gathered from the CAN X-3 and CAN X-1 wells on the Vaca Muerta formation has been combined by the joint venture group with other regional and analogous information and studies. In 2011, the Company plans to test the Vaca Muerta shale formation. The Company may also re-enter the CAN X-2 well and drill a horizontal leg into the formation.

In March 2011, the Company drilled the CAS X-1 exploration well in the southern portion of the block. Both oil and gas shows were evident during the drilling of the Vaca Muerta and Sierras Blancas formations. Based on electric logs, the Vaca Muerta formation is similar to the Vaca Muerta formation encountered in the previous three wells drilled on the northern portion of the block. In addition, the Company acquired for further study nine sidewall cores at various intervals over the entire formation. The Sierras Blancas formation has a potential gross hydrocarbon column of 75 feet and two sidewall cores were obtained in the formation for further study. The coring and electric log information will be used by the joint venture in planning a completion and testing program for the well.

After previously drilling the CAN X-3 and CAN X-1 wells at no cost to Madalena, the Farmee elected to exercise its option and enter into the second stage of a multi-well drilling program ("Farm-out") to earn an additional working interest in the block. The CAS X-1 well is the first well in the second stage of the Farm-out and is situated 16 km south of the CAN wells. Madalena's working interest in the block will decrease from 52.5% to 35% in the event the final two option wells are drilled and completed. The fourth well under the Farm-out is the CAN X-4 well currently being drilled in the northern portion of the block between the CAN X-1 and CAN X-2 wells.

#### Curamhuele Block

In April 2011, the Company completed drilling the Curamhuele X-1001 exploration well (truncation play) to a total depth of 8,430 feet without encountering commercial quantities of hydrocarbons and subsequently abandoned the well. The Company has now commenced drilling the Yapai X-1001 well (thrust play prospect) to a minimum planned depth of 8,600 feet depth to penetrate the Lower Troncoso, Avile and Mulichinco formations. Two previous wells drilled on the block, Curamhuele X-1 and Yapai X-1, have been drilled into the Mulichinco formation and will be reviewed for potential re-entry to test the third play on the block, the Vaca Muerta shale formation.

The Company has a 90% working interest in the block following the Company's agreement in October 2010 to acquire the operator's 20% working interest in the block.

#### Cortadera Block

In March 2011, the Company received final government approval of a farm-out agreement for the Cortadera Block with Apache Energia Argentina S.R.L. ("Apache"). The terms of the farm-out provide for Apache to carry Madalena's exploration commitments on the block including the drilling of at least one exploration well on the block to earn a 50% working interest in the block. Madalena will retain a 40% working interest in the block. The capital commitment under the farm-out is US\$6 million. The earning well, CorS x-1, is planned to target the Quintuco, Mulichinco, Vaca Muerta shale and Tordillo formations and is expected to commence drilling in mid to late May 2011.

## Financial and Operating Results

	Three Months Ended December 31,		Year Ended December 31,	
	2010	2009	2010	2009
<b>Financial Information</b>				
Revenue	\$ 247,721	\$ 254	\$ 307,073	\$ 9,412
Funds used in operations (1)	(751,700)	(452,596)	(2,740,701)	(2,371,173)
Funds used in operations per share (1)	-	-	(0.01)	(0.02)
Cash flow used in operating activities	(1,056,413)	(524,531)	(3,040,347)	(2,642,064)
Cash flow used in operating activities per share	(0.01)	(0.01)	(0.02)	(0.02)
Cash flow from (used in) discontinued operations	167,475	(588,767)	3,693,380	665,218
Cash flow from (used in) discontinued operations per share	-	(0.01)	0.02	0.01
Net loss from continuing operations	(2,150,275)	(610,556)	(4,420,272)	(2,832,223)
Net loss from continuing operations per share	(0.01)	(0.01)	(0.02)	(0.03)
Net loss and other comprehensive loss	(1,841,434)	(2,721,709)	(4,038,752)	(6,363,349)
Net loss and other comprehensive loss per share	(0.01)	(0.02)	(0.02)	(0.06)
Total assets	63,104,062	27,697,901	63,104,062	27,697,901
Working capital	37,033,741	8,871,993	37,033,741	8,871,993
Capital expenditures	6,600,511	135,713	7,174,904	5,788,312
Debt	-	-	-	-
<b>Production</b>				
Oil production (barrels per day) (2)	105	-	105	-

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

(2) Average daily oil production since October 1, 2010

## RESULTS OF OPERATIONS

The following paragraphs provide information about the results of Madalena's on-going operations for the quarter and year ended December 31, 2010. See the paragraphs entitled "Results from Discontinued Operations" for information on Madalena's discontinued operations for the quarter and year ended December 31, 2010.

### Oil and gas revenue

Oil and gas revenue in the year and fourth quarter ended December 31, 2010 was \$241,381 compared to \$nil for the corresponding periods in 2009. The increase in oil and gas revenue in 2010 is due to the recognition of oil and gas sales revenue from the Coiron Amargo Block in the fourth quarter of 2010 after two new wells drilled on the block were placed on production and the block was no longer classified as an unproven property. The Company's share of oil production from the Coiron Amargo Block in the fourth quarter and year ended December 31, 2010 was 9,625 barrels or 105 barrels per day when calculated over the entire fourth quarter. The Company's share of December 2010 oil production was 179 barrels per day. Oil production from the block is currently stored and periodically sold once a sufficient quantity is reached.

### Royalties

Royalty expense totaled \$42,686 in the year and fourth quarter ended December 31, 2010. Production from the Coiron Amargo Block is subject to a 15% provincial royalty rate until the block is converted from an exploration concession to an exploitation concession. On conversion of the block to an exploitation concession, a 12% provincial royalty is payable to the Province of Neuquén.

### Interest Income

Interest income for the year was \$108,378 compared to \$9,412 in 2009 due to higher cash balances during the year. Interest income in the fourth quarter of 2010 was \$49,026 compared to \$254 in the fourth quarter of 2009. Interest income increased significantly in the fourth quarter of 2010 due to higher cash balances related to the completion of the Company's equity financing in November 2010 and the exercise of warrants.

### Operating costs

Operating costs in the fourth quarter and year ended December 31, 2010 totaled \$93,887 compared to \$nil for the comparable periods in 2009. Operating costs increased as the Coiron Amargo Block was no longer categorized as an unproven property in the fourth quarter of 2010.

### Netbacks

Year ended December 31	2010		2009	
	Amount	Per boe	Amount	Per boe
Petroleum and natural gas revenues	\$ 241,381	\$ 55.06	\$ -	\$ -
Royalties	(42,686)	(9.74)	-	-
Operating costs	(93,887)	(21.42)	-	-
Operating netback (1)	\$ 104,808	\$ 23.90	\$ -	\$ -

(1) Operating netbacks are a non-GAAP measure - see "Non-GAAP measurements" above.

The Company realized an operating netback of \$23.90/boe in the three and twelve months ended December 31, 2010. On a boe basis, operating costs in the period were higher than future expected operating costs due to costs associated with new field operations and expected operating efficiencies associated with increased production. In 2009, all test production revenues, operating costs and royalties related to production from the Coiron Amargo Block in Argentina were capitalized for accounting purposes.

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

G&A expenses totaled \$2,792,647 for the year ended December 31, 2010 compared to \$1,964,104 in 2009. G&A expenses increased as a result of higher compensation costs, higher professional fees and increased legal and registration costs in Argentina. G&A expenses increased to \$778,817 in the fourth quarter of 2010 from \$543,502 for the fourth quarter of 2009 primarily as a result of higher professional fees associated with business development activities and reporting requirements.

A breakdown of general and administrative expenses is as follows:

	Three months ended December 31,		Year ended December 31,	
	2010	2009	2010	2009
Corporate expenses:				
Compensation	\$ 137,871	\$ 129,992	\$ 884,157	\$ 535,458
Office and administration	48,023	103,198	245,346	295,986
Professional fees	221,841	137,367	561,048	336,202
Travel	57,395	25,187	184,728	170,119
	465,130	395,744	1,875,279	1,337,765
International expenses	313,687	147,758	917,368	626,339
	\$ 778,817	\$ 543,502	\$ 2,792,647	\$ 1,964,104

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

SBC expense in the year ended December 31, 2010 totaled \$1,533,515 compared to \$260,860 in 2009. SBC expense increased in the year due to new option grants in 2010 compared to the prior year when a number of employee options had become fully vested. SBC expense increased to \$1,311,590 in the fourth quarter of 2010 compared to \$23,777 in the fourth quarter of 2009 due to new option grants in 2010 a third of which vested immediately.

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 year ended December 31, 2010, the Company capitalized \$72,866 of SBC to property and equipment, compared to \$35,395 in 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 December 31, 2010, the Company has approximately \$3,100,000 (2009 - \$121,000) of unamortized SBC that will be charged to income over the remaining vesting period of the outstanding options.

### Foreign exchange loss (gain)

The Company's operations in Argentina are subject to foreign exchange rate fluctuations for account balances denominated in US dollars and Argentine pesos. For the year ended December 31, 2010 the Company experienced a foreign exchange loss of \$181,065 compared to a foreign exchange loss of \$556,300 in 2009. The Company incurred higher foreign exchange losses in 2009 as a result of significant fluctuations that year between the Canadian dollar and the US dollar and Argentina peso. Foreign exchange losses increased to \$125,239 in the fourth quarter of 2010 compared to \$18,422 in the fourth quarter of 2009 due to greater cash balances in Argentina in the period. Currently, the Company does not hedge its exposure to foreign currency fluctuations.

### Depletion, depreciation and accretion expense

Depletion, depreciation and accretion expense for the year ended December 31, 2010 totaled \$126,231 compared to \$60,371 in 2009. Accretion expense increased in 2010 as a result of accruing additional asset retirement obligations on wells drilled in Argentina during the year. Depletion, depreciation and accretion expense increased in the fourth quarter of 2010 to \$88,463 compared to \$25,109 in the fourth quarter of 2009 due to depletion expense recorded on production from the Coiron Amargo Block in the period.

### Income taxes

Future income tax assets and liabilities arise due to the difference between the tax basis of assets and their respective accounting carrying cost. The Company has tax losses and other cumulative tax deductions in excess of net book values, but to date, has not recognized the income tax benefit of these future tax assets as their recoverability is uncertain at this time.

### Net loss from continuing operations

The Company realized a net loss from continuing operations of \$4,420,272 for the year ended December 31, 2010, compared to a net loss of \$2,832,223 in 2009. Net loss from continuing operations increased due to higher general and administrative expenses and stock-based compensation expense, partially offset by oil revenue from the Coiron Amargo Block, higher interest income on cash balances and lower foreign exchange losses.

Net loss from continuing operations increased in the fourth quarter of 2010 to \$2,150,275 compared to \$610,556 in the fourth quarter of 2009 due to higher general and administrative expenses, stock based compensation and foreign exchange losses partially offset by oil revenue from the Coiron Amargo Block and higher interest income on cash balances.

#### Net loss and other comprehensive loss

The Company realized a net loss of \$4,038,752 for the year ended December 31, 2010, compared to a net loss of \$6,363,349 in 2009. Net loss decreased in 2010 primarily due to a write-down in 2009 of the carrying value of the Tunisia cost center at December 31, 2009 by \$2,110,666 and cost adjustments recorded in 2010. See "Results from Discontinued Operations". Higher general and administrative expenses and stock based compensation expense in 2010 was partially offset by oil revenue in 2010 from the Coiron Amargo Block, higher interest income and lower foreign exchange losses in the year.

#### Funds used in operations

Funds used in operations increased to \$2,740,701 for the year ended December 31, 2010, compared to funds used in operations of \$2,371,173 in 2009. Funds used in operations increased as a result of higher general and administrative expenses partially offset by oil revenue from the Coiron Amargo Block, higher interest income on cash balances and lower foreign exchange losses.

Funds used in operations increased in the fourth quarter to \$751,700 compared to \$452,596 in the fourth quarter of 2009 due to higher general and administrative expenses and foreign exchange losses partially offset by oil revenue from the Coiron Amargo Block and higher interest income on cash balances.

#### Capital expenditures

	<u>Three months ended December 31,</u>		<u>Twelve months ended December 31,</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
<b>Argentina:</b>				
Geological and geophysical	\$ 35,935	\$ 72,808	\$ 212,057	\$ 377,627
Land	905,347	-	963,740	74,809
Drilling and completion	5,385,840	163,126	5,540,855	2,837,334
Well equipment and facilities	-	35,349	21,512	1,019,540
Other	581,083	(34,530)	718,562	908,250
	<u>6,908,205</u>	<u>236,753</u>	<u>7,456,726</u>	<u>5,217,560</u>
<b>Tunisia:</b>				
Geological and geophysical	(223,161)	(33,595)	(189,878)	435,446
Drilling and completion	(82,414)	(1,620)	(79,814)	298,108
Other	(4,283)	(65,825)	(17,743)	(187,623)
	<u>(309,858)</u>	<u>(101,040)</u>	<u>(287,435)</u>	<u>545,931</u>
<b>Canada:</b>				
Other	2,164	-	5,613	24,821
	<u>2,164</u>	<u>-</u>	<u>5,613</u>	<u>24,821</u>
<b>Total Capital Expenditures</b>	<b>\$ 6,600,511</b>	<b>\$ 135,713</b>	<b>\$ 7,174,904</b>	<b>\$ 5,788,312</b>

Prior to completion of the CAN X-3 and CAN X-1 exploration wells drilled in August and September, 2010, respectively, all test production revenues, operating costs, and royalties was capitalized for accounting purposes and therefore excluded from production and revenue information. In 2010, net operating revenue of \$19,540 (2009 – costs of \$250,042) was credited to Argentina pre-production costs.

In the year ended December 31, 2010, the Company incurred capital expenditures on petroleum and natural gas properties and office furniture and fixtures totaling \$7,174,904 compared to \$5,788,312 in 2009. Capital expenditures increased in 2010 as the Company acquired its partner's interest in the Curamhuele Block and commenced drilling the Curamhuele X-1001 exploration well on the block. Drilling and completion expenditures in 2009 were primarily related to drilling the CAN X-2 exploration well on the Coiron Amargo Block. Under the terms of a previous farm-out of the Coiron Amargo Block, the Company did not incur any capital costs in 2010 associated with drilling the CAN X-3 and CAN X-1 wells.

## RESULTS FROM DISCONTINUED OPERATIONS

In August 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 comparative figures associated with the Tunisia property as separate assets and liabilities on the balance sheet. The Company also recorded a write-down and reduced the carrying value of the Tunisia cost center at December 31, 2009 by \$2,110,666.

The Company recorded income from discontinued operations of \$381,520 for the year ended December 31, 2010 compared to a loss from discontinued operations of \$3,531,126 in 2009. Income from discontinued operations increased as the Company recorded write-downs of its Canadian oil and gas properties and Tunisia cost center in 2009 and recorded cost adjustments in 2010.

The following table provides information on the results recorded as income (loss) from discontinued operations for the three and twelve months ended December 31, 2010:

	Three months ended December 31,		Twelve months ended December 31,	
	2010	2009	2010	2009
Canada:				
Petroleum and natural gas revenues	\$ -	\$ (269)	\$ -	\$ 244,786
Royalties	8	(885)	42,330	(31,322)
Operating costs	(1,028)	667	(2,703)	(85,485)
Depletion	-	-	-	(1,576,147)
Gain on sale of property and equipment	-	-	-	27,708
	(1,020)	(487)	39,627	(1,420,460)
Writedown of Tunisia pre-production costs	-	(2,110,666)	-	(2,110,666)
Gain on sale of Tunisia property and equipment	309,861	-	341,893	-
Income (loss) from discontinued operations	\$ 308,841	\$ (2,111,153)	\$ 381,520	\$ (3,531,126)

The following table provides information on the gain on sale of property and equipment used in discontinued operations for the year ended December 31, 2010:

Gain on sale for the year ended December 31	2010	2009
Cash proceeds	\$ 4,084,400	\$ 554,000
Asset retirement obligations	50,968	100,656
Working capital adjustments	202,860	14,056
Net book value of property and equipment	(3,996,335)	(641,004)
Gain on sale of property and equipment	\$ 341,893	\$ 27,708



## **LIQUIDITY AND CAPITAL RESOURCES**

At December 31, 2010 Madalena had working capital of \$37,033,741 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, completion of an equity offering in November 2010 for gross proceeds to Madalena of \$26,503,750 and the exercise of warrants.

The Company had negative funds from operations in the fourth quarter and year ended December 31, 2010 totaling \$751,700 (2009 – \$452,596) and \$2,740,701 (2009 – \$2,371,173), respectively. Negative funds from operations increased in 2010 as a result of higher general and administrative expenses partially offset by oil revenue from the Coiron Amargo Block, higher interest income on cash balances and 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 successfully producing economic quantities of petroleum and natural gas from its exploration properties in Argentina, raising sufficient capital to complete planned exploration and development activities, properly managing its existing cash resources, identifying additional commercial oil and gas reserves, and generating profitable operations. The Company has no outstanding debt.

## **TRANSACTIONS WITH RELATED PARTIES**

In 2010, the Company incurred fees of \$132,161 (2009 - \$156,931) payable to a law firm in which a director of the Company is a partner.

## **SHARE INFORMATION**

At December 31, 2010, the Company had 257,285,885 common shares and 16,565,000 stock options outstanding. On April 28, 2011, the Company had 259,995,517 common shares and 12,455,368 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 economic uncertainty;
- Risks associated with operating in foreign jurisdictions;
- Competition with more established companies and the availability of services;
- 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;
- Uncertainty as to the nature of evolving environmental legislation that is likely to result in stricter standards and enforcement; 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;
- Working with established industry partners; 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

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 and uncertain global markets may impair the Company's ability to access 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 December 31, 2010, including operating costs, are approximately \$437,000.

On acquisition of the Argentina 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 December 31, 2010, the Company has met its share of the amount to be spent to satisfy the total dollar value of the initial work programs.

The Company has 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. The subsequent new two year exploration periods for Coiron Amargo and Curamhuele will require additional gross work commitments the equivalent of US\$3.1 million and US\$2.0 million, respectively, which will include the drilling of at least one well on each block. These drilling commitments will be fulfilled by Madalena's current drilling programs on the blocks.

On the Cortadera Block, the Company received an extension of the exploration period commencing on October 26, 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. The extension requires an additional gross work commitment the equivalent of US\$6.0 million which may be fulfilled through conducting additional seismic or the drilling of a well. Drilling of the CorS x-1 well planned for the second quarter of 2011 is expected to fulfill the new work commitment.

There will be no requirement to relinquish non-commercial or non-prospective acreage on any of the blocks until the end of the one year continuation. 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**

Recent extensions to the exploration period of all three exploration blocks in Argentina combined with proceeds from the Company's November 2010 equity financing allows the Company to move forward with its exploration and development plans.

The amount of capital deployed in 2011 amongst the Company's three blocks will be dependent on a number of factors including the success of the Coiron Amargo and Cortadera farm-out wells, drilling operations on the Curamhuele Block, agreement amongst the joint venture parties regarding future exploration and or appraisal drilling programs and rig availability. While the Company will no longer have a majority interest in the Coiron Amargo and Cortadera Blocks after completion of the farm-outs, the Company takes an active role in the future development of the blocks in order to plan for future capital commitments and maximize cash flow from the blocks.

As the Company's current blocks mature, the Company will look to acquire new, underexplored acreage within its regional geographic area as well as evaluate other acquisition opportunities as they arise.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Significant accounting policies used by Madalena are disclosed in note 2 to the December 31, 2010 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 twelve month periods ended December 31, 2010.

## NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

### 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. The adoption of IFRS requires the restatement, for comparative purposes, of amounts reported by Madalena for the year ended December 31, 2010, including the opening balance sheet as at January 1, 2010.

Madalena commenced its IFRS convergence project in 2008 and is currently executing a specific convergence plan which includes assessing and quantifying anticipated impacts, determining appropriate changes to accounting policies and disclosures, identifying and implementing associated changes to processes and information systems, updating and ensuring compliance with internal controls and educating staff and other stakeholders.

Management has identified key areas of impact related to the conversion to IFRS, the most significant of which is property and equipment (“PP&E”), the differences for which are as follows:

- First time adoption exemption – IFRS 1, First-time Adoption of International Financial Reporting Standards, generally requires first-time adopters to retrospectively apply IFRS. However, the standard does provide certain optional exemptions from the retrospective application of IFRS, including the full cost exemption that allows full cost oil and gas companies to elect, at the date of transition to IFRS, to measure exploration and evaluation (“E&E”) assets at the amount determined under Canadian GAAP. The Company will use this exemption.
- Re-classification of E&E expenditures from PP&E on the consolidated balance sheet – under IFRS, E&E expenditures are those that are incurred after the right to explore is obtained and before technical feasibility and commercial viability is demonstrable. E&E expenditures are capitalized and classified separately on the balance sheet. All of Madalena’s oil and gas assets at the IFRS opening balance sheet date are in the E&E phase, and as a result, the Company will utilize the full cost exemption discussed above and re-classify approximately \$17.2 million of book value at January 1, 2010 from PP&E to E&E. Under Canadian GAAP E&E assets are excluded from the depletion calculation and are assessed for impairment on an annual basis. Under IFRS, E&E assets will not be depleted and must be assessed for impairment when indicators suggest the possibility of impairment. When an area or project is determined to be technically feasible and commercially viable, it enters the development and production phase and the associated E&E costs will be transferred to PP&E. Unrecoverable E&E costs associated with an area or project will be expensed.
- Impairment of PP&E assets – Under IFRS, impairment tests of PP&E must be performed at the cash generating unit (CGU) level as opposed to under Canadian GAAP where the entire PP&E balance attributed to the country cost center is subject to the full cost ceiling test. Impairment calculations will be performed at the CGU level based on discounted cash flows using either total proven or proven plus probable reserves. Impairments recognized under Canadian GAAP are not reversed, however under IFRS impairment can be reversed in future periods if there are indicators of reversal. The Company does not anticipate an impairment of PP&E assets upon conversion to IFRS.
- Calculation of future depletion expense for PP&E – Under IFRS, the Company has the option to use either proved reserves or proved plus probable reserves in the depletion calculation. The Company anticipates that it will use proved plus probable reserves in determining future depletion expense for PP&E.

- Asset retirement obligation (ARO) – The major difference between current Canadian GAAP and IFRS is the discount rate used to measure ARO. Under current Canadian GAAP, a credit adjusted risk free rate is used, whereas IFRS allows the use of a risk free rate when the estimated cash flows are risked. The Company has made a preliminary decision to use a risk free interest rate. Under Canadian GAAP, existing liabilities are not re-measured using current discount rates, whereas under IFRS ARO is remeasured at each reporting date using the best estimate of expenditure to be incurred and current discount rates. As a result of the change in discount rates, the ARO is estimated to decrease by approximately \$0.1 million at January 1, 2010, with the offsetting amount being charged to deficit.

Other key differences identified by the Company that may impact the financial statements include stock-based compensation and foreign currency translation. With respect to stock-based compensation, the Company must estimate a forfeiture rate at grant date as opposed to recognizing the impact of forfeitures when they occur. In addition, stock-based compensation will be expensed using a graded vesting schedule rather than the straight-line method utilized by the Company. At this time the Company does not anticipate the impact of the stock-based compensation differences, on transition, to be material.

The Company's 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 Company anticipates that its Argentina and Barbados subsidiaries will have a functional currency change. Converting the subsidiaries' financial statements into the Company's presentation currency (Canadian dollars) will result in a cumulative translation difference. The Company will elect to utilize the first time adoption exemption available in IFRS 1 and thus set the cumulative translation difference to zero at the transition balance sheet date with the difference recorded directly to retained earnings. The estimated charge to retained earnings at January 1, 2010 is approximately \$2.0 million.

Any changes in accounting policies required to address reporting and first-time adoption of IFRS will be made in consideration of the integrity of internal control over financial reporting and disclosure controls and procedures. However, the Company does not expect that any material changes in control procedures will be required as a result of the transition to IFRS.

At this time, the impact on the Company's financial position and results of operations for the accounting policy differences previously identified are not finalized. The Company anticipates completing assessing accounting policy alternatives, finalizing the opening and interim 2010 results under IFRS and making any necessary system changes in the second quarter of 2011.

## QUARTERLY FINANCIAL INFORMATION

	Net Revenue	Net Loss	Net Loss Per Share
<b>2010</b>			
Fourth quarter	\$ 247,721	\$ (1,747,547)	\$ (0.01)
Third quarter	13,487	(670,368)	-
Second quarter	17,492	(733,878)	-
First quarter	28,373	(886,959)	(0.02)
<b>Total</b>	<b>\$ 307,073</b>	<b>\$ (4,038,752)</b>	<b>\$ (0.03)</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>

## SELECTED ANNUAL INFORMATION

Years ended December 31	2010	2009	2008
Net revenue	\$ 307,073	\$ 9,412	\$ 264,478
Net loss and other comprehensive loss	(4,038,752)	(6,363,349)	(1,833,791)
Net loss and other comprehensive loss per share	(0.02)	(0.06)	(0.02)
Total assets	63,104,062	27,697,901	23,874,947
Working capital	37,033,741	8,871,993	7,243,361
Capital expenditures	7,174,904	5,788,312	8,425,954
Debt	-	-	-

**DIRECTORS**

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**REGISTRAR AND TRANSFER AGENT**

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**STOCK EXCHANGE LISTING**

TSX Venture Exchange  
Trading Symbol: "MVN"