Madalena Ventures Inc.

Quarterly Report

For the Three and Nine Months Ended September 30, 2012
(unaudited)

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"), as at and for the three and nine month periods ended September 30, 2012 and 2011. This MD&A should be read in conjunction with the Company's condensed consolidated unaudited financial statements for the three and nine month periods ended September 30, 2012. The interim consolidated unaudited financial statements of the Company have been prepared in accordance with International Accounting Standards ("IAS") 34 Interim Financial Reporting. The Company's financial statements and other public disclosure documents, including its annual information form ("AIF"), are filed on SEDAR at www.sedar.com. The commentary in this MD&A is based on information available to November 23, 2012. 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 reserves and resources described can be profitably produced in the future.

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

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 September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Cash flow used in operating activities	$ (1,021,582)	$ (478,183)	$ (3,158,931)	$ (2,107,111)
Change in non-cash working capital	941,815	(145,991)	1,226,180	(123,247)
Funds used in operations	$ (79,767)	$ (624,174)	$ (1,932,751)	$ (2,230,358)

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 oil and natural gas revenue less royalties and operating expenses. Additional information on operating netbacks is provided in "Netbacks".

HIGHLIGHTS

Highlights in the nine months ended September 30, 2012 include:

- Strategic acquisition (closed November 1, 2012) of Canadian oil and gas assets securing access to a large inventory of horizontal drilling locations and diversifying country risk;
- Extension of the Company's large acreage position in the Neuquen Basin and conversion of the northern 108 km^2 of the 404 km^2 Coiron Amargo Block to a 25 year exploitation concession;
- Successful drilling and completion of 2 development wells and 2 exploration wells on the Coiron Amargo Block;
- With its partner Apache, drilled a Vaca Muerta shale test at the CorS X-1 deep gas exploration well on the Cortadera Block penetrating the Vaca Muerta formation and additional zones of interest in the Quintuco, Mulichinco, and Agrio formations; and
- Generated in Argentina in Q3 positive funds from operations(2) on higher production volumes and maintained strong working capital position exiting the period with working capital of $58.7 million.

OVERVIEW

Madalena is an independent, Canadian-based, domestic and international upstream oil and gas company whose main business activities include exploration, development and production of crude oil, natural gas liquids and natural gas.

<u>Corporate</u>

On November 1, 2012 the Company acquired all of the common shares of Online Energy Inc. ("Online") for a total purchase price of approximately $20.6 million which includes the assumption of Online's debt in the amount of approximately $4.5 million excluding transaction and severance costs.

Online's assets include 153 net sections of land (197 gross sections at 77.9% average working interest) in the greater Paddle River area of central Alberta across multiple light oil and liquids-rich gas resource plays.

The acquisition of Online is expected to have the following benefits for Madalena:

- Provides entry into the domestic E&P space with the opportunity to ramp production and cash flow while continuing to develop and grow its international assets & business plan
- High working interest ownership and operatorship of a sizeable domestic land base with a large inventory of potential oil and liquids-rich natural gas locations

- Increases critical mass for continuing operations and the opportunity to transfer North America technology and engineering techniques to other international resource plays
- Increases total proved reserves of Madalena by 124% from 874 MBOE to 1,955 MBOE(1)
- Increases total proved plus probable reserves of Madalena by 92% from 1,565 MBOE to 3,001 MBOE(1)

Online's average daily production in the third quarter of 2012 was 389 boepd (40% oil and liquids), with Online's current production approximately 650 boepd (51% oil & liquids) with the recent start-up of the Ostracod 1-5 horizontal well. Average Q3 production from the Company's combined Argentina and Canadian assets would have been 700 boepd (59% oil & liquids).

Argentina - Coiron Amargo Block (35% working interest)

On Coiron Amargo Sur, in February 2012 the Company drilled and cased the CAS X-4 well approximately nine kilometers south east of the CAS X-1 discovery well drilled in 2011 and in March 2012 drilled and cased to TD the CAS X-2 vertical exploration well in the center of the block. At CAS X-4 a full diameter core was taken through most of the Vaca Muerta shale formation interval which will be used to optimize future wells in the Vaca Muerta formation.

In March 2012 an application by the Coiron Amargo joint venture to convert the northern 108 km^2 of the 404 km^2 block to a 25 year exploitation concession (Coiron Amargo Norte) was approved by the Province of Neuquén. In addition, the exploration period for the remainder of the block (Coiron Amargo Sur) was extended to November 8, 2013. Madalena's remaining share of future development commitments associated with Coiron Amargo Norte to December 31, 2013 is approximately $5.5 million plus VAT.

On Coiron Amargo Norte, in May 2012 the Company completed drilling the CAN 5 development well located within the CAN X-1 Sierras Blancas structure and in June 2012 the Company completed drilling the CAN 7 development well located within the CAN X-3 Sierras Blancas structure. With the addition of these wells, the Company's share of production in the third quarter of 2012 from Coiron Amargo Norte and Sur was 331 boepd (268 bopd).

In November 2012, the Company commenced drilling the CAN 8 development well located approximately 800 metres south east of the CAN 7 well. The vertical well is scheduled to be drilled to approximately 10,430 feet depth with the primary objective horizon in the Sierras Blancas formation and the Vaca Muerta horizon above.

The extension of Coiron Amargo Sur to November 8, 2013 required additional work commitments of US$ 33.5 million (Madalena share – US$ 13.0 million of which approximately US$ 9.3 million plus VAT remains outstanding). The exploration block qualifies for an additional one year extension period at the end of the exploration period in the fourth quarter of 2013.

Argentina - Cortadera Block (40% working interest)

In March 2012 Apache completed a two stage hydraulic fracture stimulation of the Vaca Muerta formation in the CorS X-1 vertical exploration well. Further work to assess the Vaca Muerta and/or uphole formations (i.e. Quintuco, Mulichinco, and Agrio zones) is required to fully evaluate this deep exploration test.

Also in March 2012, a resolution was passed approving Apache's application to qualify the Cortadera exploration block for Gas Plus pricing. The Gas Plus program was launched at the end of 2008 to stimulate investments in and production of natural gas and oil through providing incentives for new production of natural gas or oil.

Notes:

1. Based on the addition of Online's proved and proved plus probable reserves effective as of December 31, 2011 as set forth in the McDaniel Report to Madalena's proved and proved plus probable reserves evaluated by InSite Petroleum Consultants effective as of December 31, 2011. Reserves are "gross reserves", being each company's working interest share of reserves before the deduction of royalties owned by others and without including royalty interests of each company.
2. See "*Non-GAAP measurements*" above.

The Company has agreed a work program with provincial authorities to extend the initial exploration period of the Cortadera Block beyond the initial expiry date of October 26, 2011 and despite delays in formalizing this extension, the Company believes that formal approval of the extension remains forthcoming.

Argentina - Curamhuele Block (90% working interest)

At the Cur X-1 well the Company mobilized a service rig in the second quarter of 2012 for its planned three stage fracture stimulation of the Lower Agrio shale formation. At this time operations on the CurX-1 well remain suspended after attempts to remove certain down-hole equipment in order to install casing for the fracture stimulation were unsuccessful.

In March 2012 the exploration period for the block was extended to November 8, 2013. The extension of the block required additional work commitments of US$ 17.6 million (Madalena share – US$ 17.6 million of which approximately US $15.1 million plus VAT remains outstanding). The exploration block qualifies for an additional one year extension period at the end of the exploration period in the fourth quarter of 2013.

Financial and Operating Results

	Three months ended September 30,		Nine months ended September 30,	
	2012	**2011**	**2012**	**2011**
Financial Information (1)				
Oil and gas revenue	$ 1,761,983	$ 619,178	$ 2,533,490	$ 1,989,163
Funds used in operations (2)	(79,767)	(624,174)	(1,932,751)	(2,230,358)
Funds used in operations per share (2)	-	-	(0.01)	(0.01)
Cash flow from (used in) operating activities	(1,021,582)	(478,183)	(3,158,931)	(2,107,111)
Cash flow from (used in) operating activities per share	-	-	(0.01)	(0.01)
Net loss	(916,185)	(315,915)	(3,931,534)	(14,551,023)
Net loss per share	-	-	(0.01)	(0.06)
Total assets	102,103,537	45,426,540	102,103,537	45,426,540
Working capital	58,752,469	19,730,619	58,752,469	19,730,619
Capital expenditures	3,632,703	3,011,513	16,541,896	15,951,447
Debt	-	-	-	-
Production				
Oil production (barrels per day)	251	103	127	116
Gas production (mcf per day)	380	-	128	-
Total production (boe per day)	314	103	148	116

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

RESULTS OF OPERATIONS

The following paragraphs provide information about the results of Madalena's operations for the three and nine month periods ended September 30, 2012.

Oil and gas revenue

Oil and gas revenue in the third quarter of 2012 was $1,761,983 compared to $619,178 in the third quarter of 2011. Oil and gas revenue increased to $2,533,490 for the nine months ended September 30, 2012 compared to $1,989,163 for the corresponding period in 2011. The Company's share of oil production from Coiron Amargo Norte in the three and nine month periods ended September 30, 2012 was 23,127 barrels (251 barrels per day) and 34,745 barrels (127 barrels per day), respectively. The Company's share of oil production from Coiron Amargo Norte in the three and nine month periods ended September 30, 2011 was 9,462 barrels (103 barrels per day) and 31,741 barrels (116 barrels per day), respectively. Net production increased from the corresponding period in 2011 due to production from the CAN 5 and CAN 7 wells drilled in May and June 2012 partially offset by a reduction in the Company's working interest in the block from 52.5% to 35%. The Company's share of oil revenue, operating costs and royalty expenses related to production from Coiron Amargo Sur is capitalized for accounting purposes and therefore excluded from production and revenue information.

Royalties

Royalty expense totaled $273,751 in the third quarter of 2012 compared to $129,099 in the third quarter of 2011. Royalty expense increased to $400,287 for the nine months ended September 30, 2012 compared to $378,446 for the corresponding period in 2011. Royalty expense increased due to higher production volumes partially offset by a lower royalty rate. In 2011 production from the Coiron Amargo Block was subject to a 15% provincial royalty rate. With conversion of the northern portion of the block into a 25 year exploitation concession, production from Coiron Amargo Norte is subject to a 12% provincial royalty payable to the Province of Neuquén. Royalty expense also includes a 3% provincial turnover tax on sales.

Operating costs

Operating costs increased to $634,133 in the third quarter of 2012 compared to $366,695 in the third quarter of 2011. Operating costs increased to $1,235,497 for the nine months ended September 30, 2012 compared to $984,760 for the corresponding period in 2011. Operating costs increased primarily due to higher production volumes and unscheduled maintenance at CAN X-2, completion of necessary road works, adjustment to surface rental rates payable to private land owners and higher transportation costs.

Netbacks

Oil and gas sales increased to 24,297 boe (264 boepd) in the third quarter of 2012 compared to 9,592 boe (104 boepd) in the third quarter of 2011. Total oil and gas sales increased to 34,327 boe (125 boepd) compared to 34,094 boe (125 boepd) for the corresponding period in 2011.

	Three months ended September 30, 2012		Nine months ended September 30, 2012	
	Amount	Per boe	Amount	Per boe
Oil and gas revenues	$ 1,761,983	$ 72.52	$ 2,533,490	$ 73.81
Royalties	(273,751)	(11.27)	(400,287)	(11.66)
Operating costs	(634,133)	(26.10)	(1,235,497)	(35.99)
Operating netback (1)	$ 854,099	$ 35.15	$ 897,706	$ 26.16

	Three months ended September 30, 2011		Nine months ended September 30, 2011	
	Amount	Per boe	Amount	Per boe
Oil and gas revenues	$ 619,178	$ 64.55	$ 1,989,163	$ 58.34
Royalties	(129,099)	(13.46)	(378,446)	(11.10)
Operating costs	(366,695)	(38.23)	(984,760)	(28.88)
Operating netback (1)	$ 123,384	$ 12.86	$ 625,957	$ 18.36

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

The Company realized an operating netback of $35.15/boe and $26.16/boe in the three and nine month periods ended September 30, 2012, respectively, compared to $12.86/boe and $18.36/boe for the corresponding periods in 2011. Operating netbacks per boe increased due to higher sales prices, higher production volumes and certain cost adjustments in the quarter partially offset by unscheduled maintenance costs and higher fixed and variable operating costs compared to the corresponding period in 2011.

The average oil sales price increased to US $74.75 per barrel in the third quarter of 2012 compared to US $64.02 in the third quarter of 2011. The average gas price received in the third quarter of 2012 was $4.25/mcf. During the summer months in Argentina, Coiron Amargo Norte gas production is expected to be sold at a price of US $3.80/mcf.

General and administrative ("G&A") expenses

G&A expenses totaled $975,067 in the third quarter of 2012 compared to $671,126 in the third quarter of 2011. G&A expenses increased as a result of higher professional fees associated with the acquisition of Online Energy Inc. G&A expenses increased to $2,923,334 for the nine months ended September 30, 2012 compared to $2,642,086 for the corresponding period in 2011 due to higher professional fees and travel costs.

A breakdown of general and administrative expenses is as follows:

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Compensation	$ 200,551	$ 244,248	$ 802,992	$ 1,011,796
Office and administration	244,267	240,841	804,491	871,736
Professional fees	459,706	120,867	1,041,204	591,093
Travel	70,543	65,170	274,647	167,461
	$ 975,067	$ 671,126	$ 2,923,334	$ 2,642,086

Share-based payments ("SBP") expense

SBP expense totaled $407,071 in the third quarter of 2012 compared to $605,261 in the third quarter of 2011. SBP expense decreased to $1,386,471 for the nine months ended September 30, 2012 compared to $2,056,226 for the corresponding period in 2011 as option grants in 2012 have been at a lower exercise price compared to option grants in 2011 and there were fewer option grants in 2011 compared to 2010.

At September 30, 2012, the Company has approximately $1.2 million (December 31, 2011 - $1.45 million) of unamortized SBP that will be charged to income over the remaining vesting period of the outstanding options.

Depletion and depreciation expense

Depletion and depreciation expense totaled $436,197 in the third quarter of 2012 compared to $111,329 in the third quarter of 2011. Depletion and depreciation expense totaled $591,562 for the nine months ended September 30, 2012 compared to $334,752 for the corresponding period in 2011. Depletion and depreciation expense increased due to higher production from Coiron Amargo Norte. Depletion expense for the three months ended September 30, 2012 was $17.77 per boe compared to $11.08 per boe for the corresponding period in 2011.

Interest Income

Interest income totaled $203,831 in the third quarter of 2012 compared to $62,652 in the third quarter of 2011. Interest income for the nine months ended September 30, 2012 totaled $499,238 compared to $239,958 for the corresponding period in 2011. Interest income increased in the periods due to higher cash balances.

Foreign exchange loss

The Company recorded a foreign exchange gain of $386 in the third quarter of 2012 compared to a loss of $25,658 in the third quarter of 2011. Foreign exchange loss for the nine months ended September 30, 2012 totaled $10,564 compared to $74,985 for the corresponding period in 2011. In accordance with IFRS, foreign currency transactions are translated into the respective functional currencies of Madalena and its subsidiaries using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

Finance costs

Finance costs consist of accretion of decommissioning obligations. Finance costs increased to $16,975 in the third quarter of 2012 compared to $15,813 in the third quarter of 2011. Finance costs for the nine months ended September 30, 2012 totaled $46,006 compared to $43,685 for the corresponding period in 2011. Finance costs increased as a result of an increase in the number of wells in which the Company has a working interest offset by a decrease in the Company's working interest in the Coiron Amargo and Cortadera blocks.

Income tax expense

Income tax expense in the third quarter of 2012 totaled $139,191 compared to $113,428 in the third quarter of 2011. Income tax expense for the nine months ended September 30, 2012 totaled $370,541 compared to $299,231 for the corresponding period in 2011. Current income tax expense relates to minimum taxes based on the book value of assets in Argentina.

Net loss and other comprehensive loss

The Company realized a net loss of $916,185 in the third quarter of 2012 compared to $315,915 in the third quarter of 2011. Net loss increased as the third quarter of 2011 included a gain of $1,040,664 associated with the 2011 farm-out of the Coiron Amargo Block which reduced the Company's interest in the block from 52.5% to 35%. Net loss decreased to $3,931,534 for the nine months ended September 30, 2012 compared to $14,551,023 for the corresponding period in 2011. Net loss decreased primarily due to an impairment loss recorded in the second quarter of 2011 with respect to drilling the Curamhuele X-1001 exploration well. Total comprehensive loss decreased to $3,705,154 in the third quarter of 2012 compared to comprehensive income of $375,579 in the third quarter of 2011. Total comprehensive loss for the nine months ended September 30, 2012 totaled $5,856,774 compared to a loss of $15,763,243 for the corresponding period in 2011. Total comprehensive loss decreased due to the decrease in net loss above partially offset by a higher loss on translation of foreign operations. Exchange differences on translation of foreign operations resulted in a loss of $2,788,969 in the third quarter of 2012 compared to a gain of $691,494 in the third quarter of 2011 as a result of a decrease in the third quarter of 2012 in the value of the Argentina peso relative to the Canadian dollar.

Funds used in operations

Funds used in operations decreased to $79,767 in the third quarter of 2012 compared to $624,174 in the third quarter of 2011. Funds used in operations decreased to $1,932,751 for the nine months ended September 30, 2012 compared to $2,230,358 for the corresponding period in 2011. Funds used in operations decreased as a result of a higher operating netbacks and higher interest income in 2012.

Capital expenditures

	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Argentina:				
Geological and geophysical	$ 113,461	$ 121,527	$ 422,613	$ 136,581
Land	-	-	577,493	(6,305)
Drilling and completion	2,843,187	2,475,246	10,455,242	13,215,912
Well equipment and facilities	(1,974)	-	2,391,334	22,724
Other	678,029	412,009	2,683,570	2,576,098
	3,632,703	3,008,782	16,530,252	15,945,010
Canada:				
Other	-	2,731	11,644	6,437
	-	2,731	11,644	6,437
Total Capital Expenditures	$ 3,632,703	$ 3,011,513	$ 16,541,896	$ 15,951,447

Capital expenditures increased to $3,632,703 in the third quarter of 2012 compared to $3,011,513 in the third quarter of 2011. Capital expenditures increased slightly to $16,541,896 for the nine months ended September 30, 2012 compared to $15,951,447 for the corresponding period in 2011. Capital expenditures in 2012 consisted primarily of costs associated with drilling on the Coiron Amargo Block the CAS X-4 and CAS X-2 exploration wells, the CAN 5 and CAN 7 development wells and completion of the pipeline to the Loma Jarillosa Este gas processing facility and costs associated with the planned fracture stimulation of the Lower Agrio formation on the Curamhuele Block.

LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2012 Madalena had working capital of $58,752,469 compared to $14,442,910 at December 31, 2011. Working capital increased as the Company issued 54,000,000 common shares at an issue price of $1.25 per share for gross proceeds to Madalena of $67,500,000.

The Company had negative funds from operations in the three and nine month periods ended September 30, 2012 totaling $79,767 (2011 - $624,174) and $1,932,751 (2011 – $2,230,258), respectively. Funds used in operations decreased as a result of higher oil revenue.

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. At September 30, 2012 the Company had no outstanding debt.

TRANSACTIONS WITH RELATED PARTIES

In the three and nine month periods ended September 30, 2012, the Company incurred fees of $243,587 (2011 - $1,845) and $338,342 (2011 – $18,406), respectively, payable to a law firm in which a director of the Company is a partner.

SHARE INFORMATION

At September 30, 2012 the Company had 314,307,185 common shares and 16,323,699 stock options outstanding. At November 23, 2012, the Company had 314,307,185 common shares and 16,323,699 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

Prior to the acquisition of Online on November 1, 2012 all of the Company's oil and gas operations were 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.

On May 3, 2012, Law No. 26,741 was passed by the Argentine Congress and, on May 7, it was published in the Official Gazette of the Republic of Argentina. The law declared achieving self-sufficiency in the supply of hydrocarbons as well as in the exploitation, industrialization, transportation and sale of hydrocarbons, a national public interest and a priority for Argentina. In addition, its stated goal is to guarantee socially equitable economic development, the creation of jobs, the increase of the competitiveness of various economic sectors and the equitable and sustainable growth of the Argentine provinces and regions. On July 27, 2012 the Federal Government published Decree 1277/12 (the "Decree") in the Official Gazette, regulating Law No. 26741 which introduced a tighter regime on investments and commercialization of hydrocarbons in Argentina. Although there has been no change to the fiscal regime, the Company continues to evaluate what impact the Decree may have on the Company's business, financial condition, results of operations and prospects. Future regulatory changes could have a material adverse effect on the Company's business, financial condition, results of operations and prospects.

Expiration of licences and leases

The Company's properties in Argentina are held in the form of licences and leases and working interests in licences and leases. If the Company or the holder of the licence or lease fails to meet the specific requirement of a licence or lease, the licence or lease may terminate or expire. There can be no assurance that any of the obligations required to maintain each licence or lease will be met. The termination or expiration of the Company's licences or leases or the working interests relating to a licence or lease may result in an impairment of the costs incurred with respect to this block.

In response to declining oil and gas production volumes in Argentina, the federal and various provincial governments in Argentina are calling for oil and gas companies operating in the country to increase investment. Any federal changes to the licencing regime or changes to the provincial licencing regime in Neuquen Province, Argentina where the Company's acreage is located could have a material adverse effect on the Company.

The Company has agreed a work program with provincial authorities to extend the initial exploration period of the Cortadera Block beyond the initial expiry date of October 26, 2011 and despite delays in formalizing this extension, the Company believes that formal approval of the extension remains forthcoming. A delay or rejection of the extension terms may have a material adverse effect on the Company.

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.

CONTRACTUAL OBLIGATIONS

The Company has lease commitments for office space and rental accommodations in Canada and Argentina. The total estimated remaining lease payments at September 30, 2012, including operating costs, are approximately $274,000 through 2015.

In March 2012 the northern 108 km^2 of the 404 km^2 Coiron Amargo Block (Coiron Amargo Norte) was converted to a 25 year exploitation concession by the Province of Neuquén. In addition, the exploration period for the remainder of the Coiron Amargo Block (Coiron Amargo Sur) and the Curamhuele Block was extended to November 8, 2013. Madalena's remaining share of future development commitments associated with Coiron Amargo Norte to December 31, 2013 is approximately $5.5 million plus VAT. The extension of the Coiron Amargo Sur and Curamhuele blocks required additional work commitments of US$ 51.1 million (Madalena share – US$ 30.6 million of which approximately US$ 24.4 million plus VAT remains outstanding). Both exploration blocks qualify for an additional one year extension period at the end of their exploration periods in the fourth quarter of 2013.

The initial exploration period on the Cortadera Block in the Province of Neuquén expired on October 26, 2011. The joint venture has agreed a work plan with provincial authorities which will require additional work commitments and is currently working with provincial authorities to formalize the extension of the initial exploration period.

OUTLOOK

The Company is monitoring steps being taken by the Argentina federal and provincial governments to encourage investment in the country as well as continuing to work with its industry and provincial partners to both progress development of the hydrocarbon sector in general and continue further exploration and development of its blocks.

In November 2012 the Company made a strategic acquisition in the Canadian oil and gas sector by acquiring all of the common shares of Online Energy Inc. for approximately $20.6 million excluding transaction and severance costs. Its assets include 153 net sections of land (197 gross sections at 77.9% average working interest) in the greater Paddle River area of central Alberta across multiple light oil and liquids-rich gas resource plays. Online's resource plays are highlighted by the Ostracod light oil project (54 net sections) and the Nordegg light oil and liquids-rich gas project (144 net sections), and are complemented by the Rock Creek, Notikewin, Wilrich and Duvernay oil and liquids-rich gas plays.

This strategic acquisition positions Madalena to obtain a domestic source of cash flow from production along with access to a large inventory of horizontal drilling locations. The acquisition also allows Madalena the ability to re-deploy capital, where required, as international and domestic economic conditions evolve in its core operating areas.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Significant accounting policies used by Madalena are disclosed in note 3 to the December 31, 2011 consolidated financial statements. Preparing financial statements in accordance with IFRS 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 months ended September 30, 2012.

Following are the accounting policies subject to such judgments and the key sources of estimation uncertainty that the Company believes could have the most significant impact on the reported results and financial position:

Reserves

The estimate of petroleum and natural gas reserves is integral to the calculation of the amount of depletion charged to the statement of operations and is also a key determinant in assessing whether the carrying value of any of the Company's development and production assets has been impaired. Changes in reported reserves can impact asset carrying values and the decommissioning provision due to changes in expected future cash flows.

The Company's reserves are evaluated and reported on by independent reserve engineers at least annually in accordance with Canadian Securities Administrators' National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities. Reserve estimation is based on a variety of factors including engineering data, geological and geophysical data, projected future rates of production, commodity pricing and timing of future expenditures, all of which are subject to significant judgment and interpretation. Changes in market and regulatory conditions and assumptions can materially impact the estimation of net reserves.

Carrying value of development and production and exploration and evaluation assets

The Company assesses at each reporting date whether there is an indication that an asset or cash generating unit ("CGU") may be impaired. A CGU is defined as the lowest grouping of assets that generate identifiable cash inflows that are largely independent of cash inflows of other assets or groups of assets. The allocation of assets into CGU's requires significant judgment and interpretations with respect to the way in which management monitors operations.

If any indication exists that an asset or CGU may be impaired, the Company estimates the recoverable amount. The recoverable amounts of individual assets and CGU's have been determined based on the higher of value-in-use calculations and fair value less costs to sell. These calculations require the use of estimates and assumptions, such as estimates of proved plus probable reserves, future production rates, oil and natural gas prices, future costs and other relevant assumptions, all of which are subject to change. A material adjustment to the carrying value of the Company's development and production and exploration and evaluation assets may be required as a result of changes to these estimates and assumptions.

Decommissioning obligations

Amounts recorded for decommissioning obligations require the use of management's best estimates of future decommissioning expenditures, expected timing of expenditures and future inflation rates. The estimates are based on internal and third party information and calculations and are subject to change over time and may have a material impact on profit and loss or financial position.

Share-based payments

The Company measures the cost of its share-based payments to directors, officers and employees by reference to the fair value of the equity instruments at the date at which they are granted. The assumptions used in determining fair value include: expected lives of options, risk-free rates of return and stock price volatility. These assumptions, by their nature, are subject to measurement uncertainty.

Deferred tax

Deferred tax is recorded, using the balance sheet method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations from multiple jurisdictions. Rates are also affected by legislative changes. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded in the financial statements.

Legal, environmental remediation and other contingent matters

In respect of these matters, the Company is required to determine both whether a loss is probable based on judgment and interpretation of laws and regulations and if such a loss can reasonably be estimated. When any such loss is determined, it is charged to net income (loss). Management continually monitors known and potential contingent matters and makes appropriate provisions by charges to net income (loss) when warranted by circumstances.

NEW ACCOUNTING STANDARDS AND PRONOUNCEMENTS

Unless otherwise noted, the following pronouncements and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company is in the process of evaluating the impact of adopting these standards.

IFRS 9 - Financial Instruments applies to the classification and measurement of financial assets and liabilities as defined in IAS 39. It is effective for annual periods beginning on or after January 1, 2015.

IFRS 10 - Consolidated Financial Statements was issued in May 2011 and establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 replaces SIC-12 *Consolidation—Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statement.*

IFRS 11 - Joint Arrangements focuses on the rights and obligations of a joint arrangement, rather than its legal form (as is currently the case). To address reporting inconsistencies, the standard requires a single method to account for interests in jointly controlled entities. IFRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers.*

IFRS 12 - Disclosure of Interests in Other Entities applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity.

IFRS 13 - Fair Value Measurements defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value measurements.

IAS 27 - Separate Financial Statements addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements.

IAS 28 - Investments in Associates and Joint Ventures has been amended to included joint ventures in its scope and to address the changes in IFRS 10 - 13.

IAS 1 - Presentation of Financial Statements has been amended to require components of other comprehensive income to be separately presented between those that may be reclassified to income and those that will not. The amendments are effective for annual periods beginning on or after July 1, 2012.

IAS 32 - Financial Instruments has been amended to provide clarification on the application of offsetting rules. The amendments are effective for annual periods beginning on or after July 1, 2012.

QUARTERLY FINANCIAL INFORMATION

		Oil and Gas Revenue		Net Loss		Net Loss Per Share (1)
2012						
Third quarter	**$**	**1,761,983**	**$**	**(916,185)**	**$**	**-**
Second quarter		374,734		(1,847,984)		(0.01)
First quarter		396,773		(1,167,365)		-
Total	$	2,533,490	$	(3,931,534)	$	(0.01)
2011						
Fourth quarter	$	609,340	$	(1,585,520)	$	(0.01)
Third quarter		619,178		(315,915)		-
Second quarter		807,497		(12,490,603)		(0.05)
First quarter		562,488		(1,744,505)		(0.01)
Total	$	2,598,503	$	(16,136,543)	$	(0.07)
2010						
Fourth quarter	$	244,235	$	(1,719,762)	$	(0.01)
Third quarter		-		(624,144)		-
Second quarter		-		(757,919)		-
First quarter		-		(784,240)		(0.01)
Total	$	244,235	$	(3,886,065)	$	(0.02)

(1) Basic and diluted amounts per common share.

Condensed Consolidated Interim Financial Statements of

MADALENA VENTURES INC.

As at and for the three and nine month period ended September 30, 2012 (unaudited)

MADALENA VENTURES INC.

Condensed Consolidated Balance Sheets (unaudited)

As at	Note	September 30, 2012	December 31, 2011
Assets			
Current assets			
Cash and cash equivalents		**$ 59,685,000**	$ 16,439,077
Trade and other receivables		**1,936,706**	712,737
Prepaid expenses		**536,093**	212,913
Inventory		**127,705**	42,876
		62,285,504	17,407,603
Non-current assets			
Property and equipment	3	**13,093,117**	7,120,404
Exploration and evaluation assets	4	**25,715,462**	17,338,614
Other non-current assets		**1,009,454**	231,166
		39,818,033	24,690,184
		$ 102,103,537	$ 42,097,787
Liabilities			
Current liabilities			
Trade and other payables		**$ 3,533,035**	$ 2,964,693
Decommissioning provisions	5	**534,506**	330,981
		4,067,541	3,295,674
Shareholders' equity			
Share capital	6	**141,676,214**	77,862,747
Contributed surplus		**11,350,862**	10,073,672
Accumulated other comprehensive loss		**(7,087,437)**	(5,162,197)
Deficit		**(47,903,643)**	(43,972,109)
		98,035,996	38,802,113
		$ 102,103,537	$ 42,097,787

Commitments (note 9)
Subsequent event (note 12)

See accompanying notes to the condensed consolidated interim financial statements

MADALENA VENTURES INC.

Condensed Consolidated Statements of Loss and Comprehensive Income (Loss) (unaudited)

		Three months ended September 30,		Nine months ended September 30,	
		2012	**2011**	**2012**	**2011**
	Note				
Revenue					
Oil and gas		**$ 1,761,983**	$ 619,178	**$ 2,533,490**	$ 1,989,163
Royalties		**(273,751)**	(129,099)	**(400,287)**	(378,446)
		1,488,232	490,079	**2,133,203**	1,610,717
Expenses					
Operating		**634,133**	366,695	**1,235,497**	984,760
General and administrative		**975,067**	671,126	**2,923,334**	2,642,086
Share-based payments	6	**407,071**	605,261	**1,386,471**	2,056,226
Depletion and depreciation	3	**436,197**	111,329	**591,562**	334,752
Impairment of exploration and evaluation assets	4	**-**	-	**-**	11,006,637
Gain on farm-out arrangement		**-**	(1,040,664)	**-**	(1,040,664)
		2,452,468	713,747	**6,136,864**	15,983,797
Operating loss		**(964,236)**	(223,668)	**(4,003,661)**	(14,373,080)
Other income (expenses)					
Interest and other income		**203,831**	62,652	**499,238**	239,958
Foreign exchange gain (loss)		**386**	(25,658)	**(10,564)**	(74,985)
Finance cost	5	**(16,975)**	(15,813)	**(46,006)**	(43,685)
		187,242	21,181	**442,668**	121,288
Loss before tax		**(776,994)**	(202,487)	**(3,560,993)**	(14,251,792)
Current income tax expense		**(139,191)**	(113,428)	**(370,541)**	(299,231)
Net loss for the period		**(916,185)**	(315,915)	**(3,931,534)**	(14,551,023)
Exchange differences on translation of foreign operations		**(2,788,969)**	691,494	**(1,925,240)**	(1,212,220)
Total comprehensive income (loss) for the period		**$ (3,705,154)**	$ 375,579	**$ (5,856,774)**	$ (15,763,243)
Weighted average number of shares:					
Basic and diluted	6	**314,307,185**	260,001,767	**301,237,885**	259,596,893
Net loss per share:					
Basic and diluted		**$ -**	$ -	**$ (0.01)**	$ (0.06)

See accompanying notes to the condensed consolidated interim financial statements

MADALENA VENTURES INC.

Condensed Consolidated Statements of Cash Flows (unaudited)

	Note	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Cash provided by (used in):					
Operating activities					
Net loss for the period		**$ (916,185)**	$ (315,915)	**$ (3,931,534)**	$ (14,551,023)
Items not involving cash:					
Share-based payments		**407,071**	605,261	**1,386,471**	2,056,226
Depletion and depreciation		**436,197**	111,329	**591,562**	334,752
Impairment of exploration and evaluation assets	4	**-**	-	**-**	11,006,637
Gain on farm-out arrangement		**-**	(1,040,664)	**-**	(1,040,664)
Accretion on provisions		**16,975**	15,813	**46,006**	43,685
Abandonment expenditures	5	**-**	-	**-**	(78,472)
Change in other non-current assets		**(23,825)**	2	**(25,256)**	(1,499)
		(79,767)	(624,174)	**(1,932,751)**	(2,230,358)
Change in non-cash working capital items	8	**(941,815)**	145,991	**(1,226,180)**	123,247
		(1,021,582)	(478,183)	**(3,158,931)**	(2,107,111)
Financing activities					
Issue of common shares		**-**	8,000	**67,685,450**	1,669,511
Share issue costs		**-**	-	**(4,014,574)**	-
Change in non-cash working capital items	8	**-**	-	**-**	(3,880)
		-	8,000	**63,670,876**	1,665,631
Investing activities					
Additions to exploration and evaluation assets		**(3,065,026)**	(2,463,716)	**(9,267,278)**	(15,285,226)
Additions to property and equipment		**(567,677)**	(547,797)	**(7,274,618)**	(666,221)
Change in other non-current assets		**(782,564)**	-	**(782,564)**	-
Change in non-cash working capital items	8	**375,608**	(1,170,094)	**210,225**	(2,026,712)
		(4,039,659)	(4,181,607)	**(17,114,235)**	(17,978,159)
Change in cash and cash equivalents		**(5,061,241)**	(4,651,790)	**43,397,710**	(18,419,639)
Cash and cash equivalents, beginning of the period		**64,849,788**	26,261,219	**16,439,077**	40,719,947
Impact of foreign exchange on cash balances		**(103,547)**	(182,585)	**(151,787)**	(873,464)
Cash and cash equivalents, end of the period		**$ 59,685,000**	$ 21,426,844	**$ 59,685,000**	$ 21,426,844

See accompanying notes to the condensed consolidated interim financial statements

MADALENA VENTURES INC.

Condensed Consolidated Statements of Changes in Equity (unaudited)

	Share Capital						Accumulated Other Comprehensive				Total
	Number		Amount		Contributed Surplus		Income		Deficit		Equity
Balance at December 31, 2010	**257,285,885**	**$**	**75,403,123**	**$**	**7,932,605**	**$**	**(1,662,102)**	**$**	**(27,835,566)**	**$**	**53,838,060**
Loss for the period									(14,551,023)		(14,551,023)
Exercise of stock options	2,734,632		2,459,624		(790,113)		-		-		1,669,511
Share-based payments	-		-		2,120,474		-		-		2,120,474
Comprehensive loss for the period	-		-		-		(1,212,220)		-		(1,212,220)
Balance at September 30, 2011	**260,020,517**	**$**	**77,862,747**	**$**	**9,262,966**	**$**	**(2,874,322)**	**$**	**(42,386,589)**	**$**	**41,864,802**
Loss for the period									(1,585,520)		(1,585,520)
Exercise of stock options	-		-		-		-		-		-
Share-based payments	-		-		810,706		-		-		810,706
Comprehensive loss for the period	-		-		-		(2,287,875)		-		(2,287,875)
Balance at December 31, 2011	**260,020,517**	**$**	**77,862,747**	**$**	**10,073,672**	**$**	**(5,162,197)**	**$**	**(43,972,109)**	**$**	**38,802,113**
Loss for the period									(3,931,534)		(3,931,534)
Public offering	54,000,000		63,485,426		-		-		-		63,485,426
Exercise of stock options	286,668		328,041		(142,591)		-		-		185,450
Share-based payments	-		-		1,419,781		-		-		1,419,781
Comprehensive loss for the period	-		-		-		(1,925,240)		-		(1,925,240)
Balance at September 30, 2012	**314,307,185**	**$**	**141,676,214**	**$**	**11,350,862**	**$**	**(7,087,437)**	**$**	**(47,903,643)**	**$**	**98,035,996**

See accompanying notes to the condensed consolidated interim financial statements

1. Corporate Information

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.

2. Basis of Preparation

a) Future operations

These condensed consolidated interim 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.

b) Statement of compliance

The Company prepares its financial statements in accordance with International Accounting Standards ("IAS") 34 *Interim Financial Reporting*. These interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements of the Company for the year ended December 31, 2011. The disclosures below are incremental to those included with the annual consolidated financial statements and certain disclosures, which are normally required to be included in the notes to the annual consolidated financial statements, have been condensed or omitted.

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company's annual filings for the year ended December 31, 2011. The interim consolidated financial statements were authorized for issuance by the Board of Directors on November 23, 2012.

c) Basis of measurement

These consolidated interim financial statements have been prepared on a historical cost basis. The Company's presentation currency is Canadian dollars ($).

d) Use of estimates, judgments and estimation uncertainty

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

Significant estimates and judgment used in the preparation of the financial statements are described in the Company's consolidated annual financial statements for the year ended December 31, 2011.

3. Property and equipment

	Development and Production Assets $	Furniture and Fixtures $	Total $
Cost			
At December 31, 2010	4,599,092	223,276	4,822,368
Additions	3,542,118	10,080	3,552,198
Effect of movement in exchange rates	(651,404)	(6,049)	(657,453)
At December 31, 2011	7,489,806	227,307	7,717,113
Additions	7,298,852	13,016	7,311,868
Effect of movement in exchange rates	(746,474)	(1,247)	(747,721)
At September 30, 2012	14,042,184	239,076	14,281,260
Depletion and depreciation			
At December 31, 2010	88,682	128,229	216,911
Depletion and depreciation charge	396,383	20,077	416,460
Effect of movement in exchange rates	(32,698)	(3,964)	(36,662)
At December 31, 2011	452,367	144,342	596,709
Depletion and depreciation charge	616,611	14,387	630,998
Effect of movement in exchange rates	(38,586)	(978)	(39,564)
At September 30, 2012	1,030,392	157,751	1,188,143
Net book value			
At December 31, 2010	4,510,410	95,047	4,605,457
At December 31, 2011	7,037,439	82,965	7,120,404
At September 30, 2012	13,011,792	81,325	13,093,117

Development and production assets consist of costs less depletion and depreciation with respect to the northern portion of the Company's Coiron Amargo Block. The amounts capitalized as development and production ("D&P") assets in Argentina at September 30, 2012 includes $1,967,934 of Value Added Tax ("VAT") (December 31, 2011 - $822,157). 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.

The depletion expense calculation for the three month period ended September 30, 2012 included $9.4 million (2011 – $11.1 million) for estimated future development costs associated with proved and probable reserves in Argentina.

4. Exploration and evaluation assets

	$
Cost	
At December 31, 2010	12,829,447
Additions	17,431,140
Effect of movement in exchange rates	(2,511,468)
At December 31, 2011	27,749,119
Additions	9,447,900
Effect of movement in exchange rates	(1,323,076)
At September 30, 2012	35,873,943
Depletion, depreciation and impairment losses	
At December 31, 2010	-
Impairment losses	11,006,637
Effect of movement in exchange rates	(596,132)
At December 31, 2011	10,410,505
Effect of movement in exchange rates	(252,024)
At September 30, 2012	10,158,481
Net book value	
At December 31, 2010	12,829,447
At December 31, 2011	17,338,614
At September 30, 2012	25,715,462

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

The amounts capitalized as Argentina E&E assets at September 30, 2012 before impairment losses include $5,311,872 of VAT (December 31, 2011 - $4,164,832). During the nine month period ended September 30, 2012, share-based payments directly related to exploration and evaluation activities totaling $33,310 (2011 - $64,248) were capitalized.

5. Decommissioning provisions

The Company's decommissioning obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. At September 30, 2012, the Company estimates the total undiscounted inflation-adjusted amount of cash flows required to settle its decommissioning obligations to be approximately $2.1 million (December 31, 2011 - $1.7 million). The costs are expected to be incurred in the period between 2023 and 2025. The decommissioning obligations have been estimated using existing technology at current prices and discounted using discount rates that reflect current market assessments of the time value of money and the risks specific to each liability. A non-credit risk adjusted rate for Argentina of 13.39% (December 31, 2011 – 15.49%) was used to calculate the fair value of the decommissioning obligations.

A reconciliation of the decommissioning obligations is provided below:

	September 30, 2012	December 31, 2011
Balance, beginning of period	$ 330,981	$ 602,366
Additions	79,873	232,145
Revisions in interest rates	103,741	(308,189)
Accretion	46,006	56,534
Costs incurred	-	(78,472)
Disposition	-	(122,967)
Effect of movement in exchange rates	(26,095)	(50,436)
Balance, end of period	$ 534,506	$ 330,981

6. 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 common share activity

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

b) Share-based payments

Employee stock option plan

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

As at and for the period ended	September 30, 2012		December 31, 2011	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding - beginning of period	13,977,034	$ 0.57	16,565,000	$ 0.57
Granted	3,470,000	0.42	2,480,000	0.76
Exercised	(286,668)	0.65	(2,734,632)	0.61
Forfeited	(36,666)	0.74	(333,334)	0.73
Expired / cancelled	(800,001)	0.60	(2,000,000)	0.66
Outstanding - end of period	16,323,699	$ 0.54	13,977,034	$ 0.57
Exercisable - end of period	9,340,368	$ 0.53	7,570,372	$ 0.61

The Company recognized share-based payment expense related to stock options of $1,386,471 for the nine month period ended September 30, 2012 (2011 – $2,056,226).

c) Per share information

The diluted weighted average number of shares outstanding for the nine month period ended September 30, 2012 was 301,237,885 (2011 – 259,596,893). For the nine month period ended September 30, 2012 and 2011, all share options were excluded from the calculation of diluted weighted average shares outstanding as they were anti-dilutive.

7. Segmented information

The Company's segmented information is reported by geographical area. The Company has two segments, Canada (representing corporate functions) and Argentina. The segments are based on the information that is internally provided to the Chief Executive Officer, who is the Company's chief operating decision maker. No operating segments have been aggregated to form the reportable segments.

Financial information pertaining to the reportable segments is presented in the following tables:

As at and for the nine months ended September 30, 2012

	Canada	Argentina	Total
Total assets	$ 59,337,367	$ 42,766,170	$ 102,103,537
Total liabilities	(402,081)	(3,665,460)	(4,067,541)
Revenue	-	2,533,490	2,533,490
Loss	(2,799,676)	(1,131,858)	(3,931,534)
Depletion and depreciation	8,700	582,862	591,562
Other income (expenses)	502,423	(59,755)	442,668
Capital expenditures	11,644	16,530,252	16,541,896

As at and for the nine months ended September 30, 2011

	Canada	Argentina	Total
Total assets	$ 20,295,687	$ 25,130,853	$ 45,426,540
Total liabilities	(117,675)	(3,444,063)	(3,561,738)
Revenue	-	1,989,163	1,989,163
Loss	(3,456,907)	(11,094,116)	(14,551,023)
Depletion and depreciation	7,455	327,297	334,752
Other income (expenses)	239,930	(118,642)	121,288
Capital expenditures	6,437	15,945,010	15,951,447

8. Supplemental cash flow information

Decrease (increase) in non-cash working capital	Three months ended September 30, 2012	2011	Nine months ended September 30, 2012	2011
Trade and other receivables	$ (1,227,061)	$ (173,520)	$ (1,274,003)	$ 110,828
Prepaid expenses	(6,730)	(17,597)	(356,999)	(60,211)
Inventory	74,635	54,004	(57,362)	75,861
Trade and other payables	592,949	(886,990)	672,409	(2,033,823)
Change in non-cash working capital	$ (566,207)	$ (1,024,103)	$ (1,015,955)	$ (1,907,345)
Attributable to:				
Operating activities	$ (941,815)	$ 145,991	$ (1,226,180)	$ 123,247
Financing activities	-	-	-	(3,880)
Investing activities	375,608	(1,170,094)	210,225	(2,026,712)
Change in non-cash working capital	$ (566,207)	$ (1,024,103)	$ (1,015,955)	$ (1,907,345)

9. Commitments

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

Year	Amount
2012	$ 40,000
2013	139,000
2014	81,000
2015	14,000

In March 2012 the northern 108 km^2 of the 404 km^2 Coiron Amargo Block (Coiron Amargo Norte) was converted to a 25 year exploitation concession by the Province of Neuquén. In addition, the exploration period for the remainder of the Coiron Amargo Block (Coiron Amargo Sur) and the Curamhuele Block was extended to November 8, 2013. Madalena's remaining share of future development commitments associated with Coiron Amargo Norte to December 31, 2013 is approximately $5.5 million plus VAT. The extension of the Coiron Amargo Sur and Curamhuele blocks required additional work commitments of US$ 51.1 million (Madalena share – US$ 30.6 million of which approximately US$ 24.4 million plus VAT remains outstanding). Both exploration blocks qualify for an additional one year extension period at the end of their exploration periods in the fourth quarter of 2013.

The initial exploration period on the Cortadera Block in the Province of Neuquén expired on October 26, 2011. The joint venture has agreed a work plan with provincial authorities which will require additional work commitments and is currently working with provincial authorities to formalize the extension of the initial exploration period. As at September 30, 2012 the Company had incurred cumulative costs of approximately $2.4 million with respect to this block. A delay or rejection of the extension terms may result in an impairment of these costs.

10. Capital management and financial risk

<u>Capital management</u>

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.

In order to maintain a strong capital position 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; or
- 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.

Foreign currency exchange rate risk

Substantially all 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 Argentina Pesos (ARS). Consequently, the Company is exposed to foreign currency exchange risk on a substantial portion of its financial assets. The Company has not entered into derivative exchange rate contracts to mitigate this risk.

The following table provides information on the foreign currency denominated working capital balances of the Company at September 30, 2012:

	Balance denominated in		Total CAD
	USD	ARS	equivalent
Cash and cash equivalents	39,712	2,568,956	$ 577,498
Trade and other receivables	443,704	6,555,156	1,810,211
Prepaid expenses	-	2,475,714	518,910
Inventory	-	609,279	127,705
Trade and other payables	2,376,115	3,883,817	$ 3,150,244

11. Related party transactions

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

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

Transactions between the Company's subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. During the nine month period ended September 30, 2012, the Company incurred fees of $338,342 (2011 - $18,406) payable to a law firm in which a director of the Company is a partner.

The personnel expenses of key management personnel, including directors, were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Salaries and short-term benefits	$ 134,669	$ 141,724	$ 574,940	$ 724,049
Share-based payments	333,981	540,186	1,146,772	1,807,660
	$ 468,650	$ 681,910	$ 1,721,712	$ 2,531,709

12. Subsequent event

On November 1, 2012, the Company acquired all of the issued and outstanding common shares of Online Energy Inc. (“Online”), a junior Canadian oil and gas company, for cash consideration of $16,090,000 plus assumption of Online’s working capital deficiency at November 1, 2012 estimated to be approximately $4,534,000 excluding transaction and severance costs. The acquisition has been accounted for as a business combination. The acquisition accounting will be finalized after all actual results have been obtained and the final fair values of the assets and liabilities have been determined.

The Company incurred estimated transaction costs of $550,000 in conjunction with the acquisition which have been expensed as incurred. Had the transaction closed on January 1, 2012, the estimated incremental revenue and net loss that would have been reported by the Company are $4.0 million and $1.7 million, respectively.

DIRECTORS
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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,
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Ving Y. Woo
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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"