Madalena Ventures Inc.

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Madalena Ventures Inc.

We have audited the accompanying consolidated financial statements of Madalena Ventures Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, the consolidated statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Madalena Ventures Inc. as at December 31, 2012 and December 31, 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

Calgary, Canada
April 26, 2013

Madalena Ventures Inc.

Consolidated Statements of Financial Position

$CDN **As at December 31,**	**Note**	**2012**	**2011**
Assets			
Current assets			
Cash and cash equivalents	16	**38,252,673**	16,439,077
Trade and other receivables	19	**2,255,860**	712,737
Prepaid expenses		**742,569**	212,913
Inventory	6	**151,527**	42,876
		41,402,629	17,407,603
Property, plant and equipment	7	**29,478,004**	7,120,404
Exploration and evaluation assets	8	**35,759,879**	17,338,614
Other non-current assets		**1,138,712**	231,166
		107,779,224	**42,097,787**
Liabilities			
Current liabilities			
Trade and other payables		**11,377,198**	2,964,693
Other long term liabilities		**61,660**	-
Decommissioning obligations	10	**3,954,732**	330,981
		15,393,590	3,295,674
Shareholders' Equity			
Share capital	11	**141,676,214**	77,862,747
Contributed surplus		**11,920,008**	10,073,672
Accumulated other comprehensive loss		**(8,373,278)**	(5,162,197)
Deficit		**(52,837,310)**	(43,972,109)
		92,385,634	38,802,113
		107,779,224	**42,097,787**

Commitments (Note 20)

Subsequent event (Note 22)

See the accompanying Notes to the Consolidated Financial Statements.

On behalf of the Board:

[signed] "Ray Smith"

Ray Smith
Chairman

[signed] "Keith Macdonald"

Keith Macdonald
Director

Consolidated Statements of Loss and Comprehensive Loss

$CDN **Years ended December 31,**	**Note**	**2012**	**2011**
Revenues			
Oil and natural gas revenues		5,545,294	2,598,503
Royalties		(884,649)	(521,037)
		4,660,645	2,077,466
Other income	14	632,052	290,928
		5,292,697	2,368,394
Expenses			
Operating		2,976,464	1,337,223
Business combination costs	5	509,680	-
General and administrative		4,163,593	3,479,141
Accretion of decommissioning obligation	10	72,822	56,534
Share-based compensation	12	1,944,753	2,832,288
Depletion and depreciation		1,723,337	453,231
Impairment	7	2,519,001	11,006,637
Foreign exchange loss		19,159	82,622
Gain on farm-out arrangement		-	(1,040,664)
		13,928,809	18,207,012
Loss before income taxes		(8,636,113)	(15,838,618)
Current income tax expense	15	(229,089)	(297,925)
Net loss		(8,865,201)	**(16,136,543)**
Foreign currency translation adjustment		(3,211,081)	(3,500,095)
Comprehensive loss		**(**12,076,282**)**	**(19,636,638)**
Loss per share			
Basic and diluted	18	(0.03)	(0.06)

See the accompanying Notes to the Consolidated Financial Statements.

Madalena Ventures Inc.

Consolidated Statements of Changes in Shareholders' Equity

$CDN	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total Equity
	(Note11)	(Note 12)			
Balance at January 1, 2011	75,403,123	7,932,605	(1,662,102)	(27,835,566)	53,838,060
Net loss	-	-	-	(16,136,543)	(16,136,543)
Other comprehensive loss	-	-	(3,500,095)	-	(3,500,095)
Stock options exercised	2,459,624	(790,113)	-	-	1,669,511
Share based payments	-	2,931,180	-	-	2,931,180
Balance at December 31, 2011	77,862,747	10,073,672	(5,162,197)	(43,972,109)	38,802,113
Net loss	-	-		(8,865,201)	(8,865,201)
Other comprehensive loss	-	-	(3,211,081)	-	(3,211,081)
Share issuance	67,500,000	-	-	-	67,500,000
Share issuance costs	(4,014,574)	-	-	-	(4,014,574)
Stock options exercised	328,041	(142,591)	-	-	185,450
Share based payments	-	1,988,927	-	-	1,988,927
Balance at December 31, 2012	**141,676,214**	**11,920,008**	**(8,373,278)**	**(52,837,310)**	**92,385,634**

See the accompanying Notes to the Consolidated Financial Statements.

Madalena Ventures Inc.

Consolidated Statements of Cash Flows

$CDN Years ended December 31,	Note	2012	2011
Cash provided by (used in):			
Operating			
Net loss		(8,865,201)	(16,136,543)
Items not affecting cash:			
Depletion and depreciation	7,8	1,723,337	453,231
Impairment		2,519,001	11,006,637
Gain on farm-out arrangement		-	(1,040,664)
Accretion		72,822	56,534
Share-based compensation	12	1,944,753	2,832,288
Decommissioning costs incurred	9	-	(78,472)
Change in other non-current assets		209,042	(1,429)
Change in non-cash working capital	17	(248,405)	415,212
Net cash used in operating activities		(2,644,651)	(2,493,206)
Investing			
Business combination	5	(16,090,000)	-
Development capital and corporate additions	7	(11,167,506)	(2,734,088)
Evaluation and exploration assets additions	8	(11,683,911)	(17,300,005)
Change in other non-current assets		(1,149,496)	-
Change in non-cash working capital	17	5,510,283	(2,111,723)
Net cash used in investing activities		(34,580,630)	(22,145,816)
Financing			
Issue of common shares	11	67,685,450	1,669,511
Share issuance costs	11	(4,014,574)	-
Repayment of demand bank loan		(4,420,000)	
Change in non-cash working capital	17	-	(3,880)
Net cash from financing activities		59,250,876	1,665,631
Change in cash and cash equivalents		22,025,595	(22,973,391)
Cash and cash equivalents, beginning of period		16,439,077	40,719,947
Impact of foreign exchange on cash balances		(211,999)	(1,307,479)
Cash and cash equivalents, end of period		**38,252,673**	**16,439,077**

See the accompanying Notes to the Consolidated Financial Statements.

1. Reporting Entity

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

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

- Madalena Austral S.A. (Argentina)
- Madalene Ventures International Holding Company Inc. (Barbados)
- Madalena Ventures International Inc. (Barbados)
- Online Energy Inc. (Canada)

2. Basis of Preparation

Future operations

These consolidated financial statements have been prepared on the basis that the Company is a going concern and will realize assets and discharge liabilities in the normal course of operations for the foreseeable future. Presently, Madalena has minimal production and limited cash flow from operating activities. The Company currently relies substantially 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.

Statement of Compliance

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

The consolidated financial statements were approved and authorized for issue by the Company's Board of Directors on April 26, 2013.

Basis of Measurement

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

Functional and Presentation Currency

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

Use of Estimates and Judgments

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

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

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

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

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

The Company's concessions may be subject to renewal extensions which require approvals for certain of its concessions and is currently awaiting renewals on others. As there is no indication that pending extensions will not be approved, management has used judgment to conclude that all extensions will be approved. If the Company fails to obtain extension renewals, the carrying value of the Company's exploration and evaluation assets may be negatively impacted.

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

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

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

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

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

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

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

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

3. Significant Accounting Policies

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

(a) Basis of Consolidation

i. Subsidiaries

These consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its 'subsidiaries'). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

ii. Jointly Controlled Operations and Assets

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

(b) Foreign Currency

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

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

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

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

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

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

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

(c) Financial Instruments

i. Financial assets

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

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

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

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

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

accumulated fair value adjustments recognized in other comprehensive income are included in profit or loss.

ii. Financial liabilities

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

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

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

(d) Cash and cash equivalents

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

(e) Inventories
Inventory of crude oil is valued at the lower of cost and net realizable value. Cost is determined on a first in - first out basis and relates to the cost of production.

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

i. Pre-license costs

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

ii. Exploration and evaluation assets

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

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

iii. Property, plant and equipment assets

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

iv. Subsequent costs

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

The gain or loss from the divestitures of PP&E under IFRS is recognized in profit or loss. In addition, risk-sharing agreements in which the Company cedes a portion of its working interest to a third-party are generally considered to be disposals of PP&E, potentially resulting in a gain or loss on disposition.

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

An asset within PP&E is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in profit or loss in the period in which the item is derecognized.

v. Depletion and depreciation

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

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

vi. Impairment

The carrying amounts of the Company's non-financial assets, other than E&E assets and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and other intangible assets that have indefinite lives or that are not yet available for use an impairment test is completed each year. E&E assets are assessed for impairment when they are reclassified to property, plant and equipment, as oil and natural gas interests, and also if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

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

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

The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to the CGU's that are expected to benefit from the synergies of the combination. E&E assets are allocated to related CGU's when they are assessed for impairment, both at the time of any triggering facts and circumstances as well as upon their eventual reclassification to producing assets (oil and natural gas interests in property, plant and equipment).

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

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

(g) Share Based Payments

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

(h) Decommissioning Obligations

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

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

(i) Revenue

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

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

(j) Income Taxes

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

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

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

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

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

(k) Share Capital

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

(l) Earnings Per Share

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

4. Changes in Accounting Policies

Future Accounting Changes

The following new or revised standards are effective beginning on or after January 1, 2013 and are not expected to have an impact on the Company's consolidated financial statements although the Company has not completed its evaluation.

- IFRS 10 *Consolidated Financial Statements* builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.
- IFRS 11 *Joint Arrangements* establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.
- IFRS 12 *Disclosure of Interest in Other Entities* provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.
- IFRS 13 *Fair Value Measurement* defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.
- IAS 1 *Presentation of Financial Statements* has been revised to require other comprehensive income ("OCI") be split into two parts, namely, OCI not reclassified and OCI reclassified, with related tax following the classification. The intent is to provide clarity around items that are expected to recycle through profit and loss and those that will not.
- IAS 27 *Separate Financial Statements* revises the existing standard which addresses the presentation of parent company financial statements that are not consolidated financial statements.
- IAS 28 *Investments in Associate and Joint Ventures* revises the existing standard and prescribes the accounting for investments and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

The following standards are new or revised, and are effective for annual periods as noted. Early adoption is permitted for each. Unless otherwise noted, the Company has not completed its evaluation of the effect of adopting these standards on its financial statements.

- IFRS 9 - Financial Instruments is intended to replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). IFRS 9 will be published in three phases, of which the first phase has been published. The first phase addresses the accounting for financial assets and financial liabilities. The second phase will address the impairment of financial instruments, and the third phase will address hedge accounting.

  For financial assets, IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, and replaces the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. For financial liabilities, although the classification criteria for financial liabilities will not change under IFRS 9, the approach to the fair value option for financial liabilities may require different accounting for changes to the fair value of a financial liability as a result of changes to an entity's own credit risk.

  IFRS 9 is effective for annual periods beginning on or after January 1, 2015 with different transitional arrangements depending on the date of initial application. The Company is currently evaluating the impact of adopting IFRS 9 on its consolidated financial statements.

5. Business Combination

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

Purchase price allocation

$CDN	
Net assets acquired	
Property, plant and equipment	16,530,204
Exploration and evaluation assets	8,455,000
Working capital deficiency	(1,160,162)
Demand bank loan	(4,420,000)
Decommissioning obligation	(3,315,042)
	16,090,000
Consideration	
Cash	16,090,000

The Company incurred transaction costs of $0.5 million in conjunction with the acquisition which have been which have been recorded as business combination costs in profit and loss. Had the transaction closed on January 1, 2012, the estimated incremental revenue and net loss that would have been reported by the Company was $4.1

million and $2.5 million, respectively. Revenues and net loss included in the Company's results for the period from the date of acquisitions, November 1, 2012 to December 31, 2012 was $1.6 million and $0.5 million, respectively. The fair value of receivables acquired was $0.9 million which is the same as their gross contractual flows since all receivables have a short maturity date. All acquired receivables have been collected or are expected to be collected.

6. Inventory

Inventory at December 31, 2012 of $151,527 (2011 - $42,876) consists of crude oil that has been produced but not yet sold.

7. Property, Plant and Equipment

$CDN	**Oil and Natural Gas Assets**	**Corporate**	**Total**
Cost			
At January 1, 2011	4,599,092	223,276	4,822,368
Development capital and corporate additions	3,542,118	10,080	3,552,198
Effect of change in foreign exchange rates	(651,404)	(6,049)	(657,453)
At December 31, 2011	7,489,806	227,307	7,717,113
Acquired on business combination (note 5)	16,488,711	41,493	16,530,204
Development capital and corporate additions	11,224,514	27,328	11,251,843
Effect of change in foreign exchange rates	(1,258,990)	(2,907)	(1,261,897)
December 31, 2012	33,944,041	293,221	34,237,263
Accumulated depreciation and depletion			
At January 1, 2011	(88,682)	(128,229)	(216,911)
Depreciation and depletion	(396,383)	(20,077)	(416,460)
Effect of change in foreign exchange rates	32,698	3,964	36,662
At December 31, 2011	(452,367)	(144,342)	(596,709)
Depreciation and depletion	(1,714,648)	(18,787)	(1,733,435)
Impairment	(2,519,001)	-	(2,519,001)
Effect of change in foreign exchange rates	87,742	2,145	89,887
At December 31, 2012	(4,598,274)	(160,984)	(4,759,258)
Net book value			
At December 31, 2011	7,037,439	82,965	7,120,404
At December 31, 2012	29,345,767	132,237	29,478,004

PP&E assets consist of costs less depletion, depreciation and impairment with respect to the Company's assets in Argentina and Canada. In Argentina, the carrying value of PP&E was written down to its estimated recoverable value resulting in an impairment charge of $2.5 million for the year ended December 31, 2012 (2011 – nil). The impairment was a result of lower proven plus probable reserves at December 31, 2012 as compared to December 31, 2011 which negatively affected the fair value of the year-end reserves. In Canada, the Company acquired Online Energy Inc. on November 1, 2012 for a total consideration of $16.1 million.

In July 2011, completion of a farm-out reduced the Company's interest in the Coiron Amargo block from 52.5% to 35% resulting in a gain of $1.0 million.

The amounts capitalized as PP&E assets in Argentina at December 31, 2012 includes $2.4 million of Value Added Tax ("VAT") (2011 - $0.8 million). VAT is payable on goods and services supplied to the Company and is not recoverable from the Government of Argentina, however the Company is allowed to retain VAT on any sales that it collects to the extent of the VAT recorded and paid on previous expenditures.

The depletion expense calculation for the year ended December 31, 2012 included $23.7 million (2011 – $12.2 million) for estimated future development costs associated with proved and probable reserves.

At December 31, 2012, the net book value of the Argentinean and Canadian PP&E assets were $10.9 million (2011 - $7.1 million) and $18.6 million (2011 - $nil), respectively.

8. Exploration and Evaluation Assets

$CDN	
Cost	
At January 1, 2011	12,829,447
Additions	17,431,140
Impairment	(11,006,637)
Effect of change in foreign exchange rates	(1,915,336)
At December 31, 2011	17,338,614
Acquired on business combination (note 5)	8,455,000
Additions	11,924,453
Effect of change in foreign exchange rates	(1,958,188)
At December 31, 2012	**35,579,879**

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.

In the second quarter of 2011, the Company completed drilling and subsequently abandoned an exploration well on the Curamhuele block and recorded an impairment loss of $11.0 million equal to the excess of the carrying value over the recoverable amount of the E&E impairment group to which that well belonged.

The amounts capitalized as Argentina E&E assets at December 31, 2012 before impairment losses include $5.6 million of VAT (2011 - $4.5 million). Included in impairment losses in 2011 is $1.9 million of VAT incurred during drilling of the Curamhuele exploration well. During the year ended December 31, 2012, share-based payments directly related to exploration and evaluation activities totaling $44,174 (2011 – $0.1 million) were capitalized.

At December 31, 2012, the net book value of the Argentinean and Canadian E&E assets were $25.2 million (2011 - $17.3 million) and $10.6 million (2011 - $nil), respectively.

9. Credit Facility

At December 31, the Company's wholly owned subsidiary, Online Energy had a credit facility with the National Bank of Canada consisting of a revolving operating demand loan to a maximum of $4.75 million with interest charged at the bank's prime rate plus 1.0% per annum. Security for this facility is provided by way of a charge over the petroleum and natural gas assets of Online and a guarantee by the Company. The facilities include a working capital ratio covenant, whereby the Company's working capital deficiency (excluding any unrealized hedging gains or losses) may not exceed $4.75 million. In addition, Online had an acquisition / development demand loan to a maximum of $1.25 million with interest charged at the bank's prime rate plus 1.25% per annum. Standby fees associated with both facilities are 0.25% per annum on the undrawn portion. The credit facility is subject to a periodic review by the bank, with the next review scheduled on or before May 1, 2013. The facility was unutilized at year-end.

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

10. Decommissioning Obligations

$CDN	December 31 2012	December 31 2011
Balance, beginning of year	330,981	602,366
Assumed in business combination (Note 5)	3,315,042	-
Incurred from development activities (Note 7)	197,912	-
Incurred from exploration activities (Note 8)	-	232,145
Accretion expense	72,822	56,534
Revision of estimates	82,780	(308,189)
Obligations settled	-	(78,472)
Dispositions	-	(122,967)
Effect of change in foreign exchange rates	(44,805)	(50,436)
Balance, end of year	**3,954,732**	**330,981**

The total undiscounted amount of cash flows required to settle its decommissioning obligations is approximately $7.0 million (2011 – $1.7 million) with the majority of the costs to be incurred between 2018 and 2030. The decommissioning obligations have been estimated using existing technology at current prices and discounted using discount rates that reflect current market assessments of the time value of money and the risks specific to each liability. Inflation rates of 10.8% and 2% were used to calculate the future value of the undiscounted decommissioning obligations in Argentina and Canada, respectively. The risk free rate used to discount the liability was 1.0 to 2.45% (2011 – 1.0 to 2.45%) in the fourth quarter for assets in Canada and 14.66% (2011 – 15.49%) in Argentina.

11. Share Capital

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

Share Capital

	Number of Shares	Share Capital $
Balance at January 1, 2011	257,285,885	75,403,123
Stock options exercised	2,734,632	2,459,624
Balance at December 31, 2011	260,020,517	77,862,747
Share issuance	54,000,000	67,500,000
Share issuance costs		(4,014,574)
Stock options exercised	286,668	328,041
Balance at December 31, 2012	**314,307,185**	**141,676,214**

12. Employee Compensation

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

The weighted average share price of the Company's common shares on the exercise date during the year ended December 31, 2012 was $1.21.

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

Number of share options

	Number of options	Weighted average exercise price $
Outstanding at January 1, 2011	16,565,000	0.57
Granted	2,480,000	0.76
Exercised	(2,734,632)	0.61
Forfeited	(333,334)	0.73
Expired	(2,000,000)	0.66
Outstanding at December 31, 2011	13,977,034	0.57
Granted	9,480,000	0.34
Exercised	(286,668)	0.65
Forfeited	(36,666)	0.74
Expired or cancelled	(800,001)	0.60
Outstanding at December 31, 2012	22,333,699	0.47
Exercisable at December 31, 2012	11,843,698	0.58

The range of exercise prices of the outstanding options

Exercise price ($)	Number of Options Outstanding	Weighted Average Contractual Life of options outstanding (years)	Number of outstanding options that are exercisable
0.105	405,366	0.91	405,366
0.125	200,000	1.41	200,000
0.210	3,816,667	2.08	2,533,336
0.290	6,010,000	4.92	-
0.320	300,000	2.55	200,000
0.405	30,000	0.8	30,000
0.420	3,470,000	4.47	1,156,665
0.570	50,000	1.75	16,666
0.690	1,275,000	3.92	841,664
0.790	5,860,000	2.97	5,860,000
0.800	316,666	2.90	200,001
0.960	600,000	3.12	400,000
	22,333,699	3.57	11,843,698

Fair value was estimated at the period end date using the Black-Scholes valuation model with weighted average assumptions as follows:

Inputs used to fair value options

Grant date	2012	2011
Fair value	$ 0.26	$ 0.60
Share price	$ 0.34	0.76
Exercise price	$ 0.34	0.76
Expected Volatility - %	116%	123%
Option life – years	4.32	3.96
Risk-free interest rate - %	1.22%	1.77%

Expected volatility is estimated by considering historic daily share price volatility. A 5.56% estimated forfeiture rate was used when recording share-based compensation for stock options. This estimate will be adjusted each period until the vesting date.

Share-based compensation expense arising from the issuance of stock options recognized in the year ended December 31, 2012 was $1,944,753 (2011 - $2,832,288) with an offsetting credit to contributed surplus.

Personnel expenses:

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

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

	Year ended December 31, 2012	**Year ended December 31, 2011**
Salaries and wages	1,150,175	1,209,350
Short-term employee benefits	50,092	35,226
Share-based payments[1]	1,999,033	2,896,404
	3,199,300	**4,140,980**

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

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

	Year ended December 31, 2012	**Year ended December 31, 2011**
Short-term employee benefits, including wages	794,755	846,533
Share-based payments	1,595,312	2,496,228
	2,390,067	**3,342,761**

13. Related Parties

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

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

A director of the Company is a partner of a law firm that provides legal services to the Company. During the year ended December 31, 2012, the Company was incurred fees of $0.4 million (2011 - $20,304) from this firm for legal fees.

A director of one of the Company's subsidiaries provides legal and consulting services to the Company. During the year ended December 31, 2012, the Company was incurred fees of $0.5 million (2011 - $0.1 million) for such services.

Transactions between the Company's subsidiaries, which are related parties, have been eliminated on consolidation

14. Other income

Other income consists primarily of interest income earned on cash deposits.

15. Income Taxes

The provision for income tax differs from the result that would be obtained by applying the combined Canadian federal and provincial tax rate of 25% (2011 - 26.5%) to the loss before taxes. The statutory tax rate decreased to 25.0% in 2012 from 26.5% in 2011 as a result of tax legislation enacted in 2007.The difference results from the following:

	Year ended December 31, 2012	Year ended December 31, 2011
Net loss before tax	(8,636,113)	(15,838,618)
Tax rate	25.0%	26.5%
Expected income tax recovery	(2,159,028)	(4,197,234)
Increase (decrease) resulting from:		
Effect of foreign tax rates	(364,472)	(930,471)
Share-based compensation	486,188	750,556
Unrecognized deferred tax benefit and other	1,992,650	4,280,134
Canadian tax rate adjustments	-	26,593
Non-taxable differences on foreign operations	53,636	62,219
Current equity tax expense	229,089	297,925
Other	(8,974)	8,203
Income tax expense	**229,089**	**297,925**

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

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

Canada	**December 31 2012**	**December 31 2011**
Decommissioning obligations	3,375,945	-
Share issue costs	5,727,990	1,323,399
Non-capital losses (expire 2026 to 2031)	15,307,509	13,880,712
Total temporary differences	**24,411,444**	**15,204,111**

Argentina	**December 31 2012**	**December 31 2011**
Non-capital losses (expire 2013 to 2016)	4,200,000	2,525,093
Total temporary differences	**4,200,000**	**2,525,093**

Barbados	**December 31 2012**	**December 31 2011**
Non-capital losses (expire 2017 to 2020)	425,000	378,012
Total temporary differences	**425,000**	**378,012**

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

	December 31 2012	December 31 2011
Foreign exchange	(349,737)	(350,807)
Property, plant and equipment	(1,551,011)	250,931
Non-capital losses	1,900,748	99,876
Unrecognized deferred tax asset	-	-

The Company has temporary differences associated with its investment in its foreign subsidiaries and branches. As at December 31, 2012 the Company has no deferred tax liabilities in respect of those temporary differences.

16. Cash and Cash Equivalents

	December 31 2012	December 31 2011
Bank balances	15,794,429	1,021,186
Guaranteed investment certificates	22,458,244	15,426,891
Cash and cash equivalents	**38,252,673**	**16,439,077**

17. Supplemental Cash Flow Information

Changes in non-cash working capital

	December 31 2012	December 31 2011
Trade and other receivables	(735,039)	184,765
Prepaid expenses and deposits	(373,576)	(95,970)
Inventory	(60,539)	126,824
Repayment of demand bank loan	4,420,000	-
Trade and other payable	2,011,032	(1,916,010)
Change in non-cash working capital	5,261,878	(1,700,391)
Attributable to:		
Operating activities	(248,405)	415,212
Financing activities	-	(3,880)
Investing activities	5,510,283	(2,111,723)
	5,261,878	(1,700,391)

18. Loss Per Share

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

Basic and diluted loss per share

	Year ended December 31, 2012	Year ended December 31, 2011
Net loss	(8,865,201)	(16,136,543)
Weighted average number of common shares:		
Basic and diluted	304,523,064	259,703,673

For the years ended December 31, 2012 and 2011, all share options were excluded from the calculation of diluted earnings per share as their effect is anti-dilutive.

19. Financial Instruments and Risk Management

The Company is exposed to various risks that arise from its business environment and the financial instruments it holds. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework, policies and procedures. The following outlines the Company's risk exposures and explains how these risks and its capital structure are managed.

Capital management

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying oil and natural gas assets. The Company considers its capital structure to include shareholders' equity, loans and borrowings and working capital. In order to maintain or adjust the capital structure, the Company may issue shares, adjust its capital spending to manage current and projected debt levels or farm-out existing opportunities.

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

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

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

Credit risk

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

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

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

The Company does not anticipate any default as it transacts with creditworthy customers and management does not expect any losses from non-performance by these customers. As such a provision for doubtful accounts has not been recorded at December 31, 2012 and December 31, 2011.

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

	December 31 2012	December 31 2011
Oil and natural gas marketing companies	**1,191,285**	201,475
Federal and provincial governments and other	**1,064,573**	511,262
Total trade and other receivables	**2,255,860**	712,737

Amounts due from oil and gas marketing companies were subsequently collected by the Company. Past due receivables are primarily related to taxes recoverable from the Argentinean government and the Company does not anticipate any recovery issues.

Aged trade and other receivables

In Canadian dollars	**December 31 2012**
Current (less than 90 days)	**1,492,790**
Past due (more than 90 days)	**392,815**
Total	**1,885,605**

Liquidity risk

Liquidity risk is the risk that the Company will not meet its financial obligations as they fall due. The Company manages its liquidity risk through management of its capital structure and annual budgeting of its revenues, expenditures and cash flow. The Company has a working capital surplus of $30.0 million at December 31, 2012 (December 31, 2011 - $14.4 million) and a $4.75 million credit facility with a Canadian chartered bank (see Note 9 for further details).

Market risk

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

Commodity price risk

Price fluctuations for both crude oil and natural gas are determined by world supply and demand factors. The Company has no influence over the pricing of oil and natural gas and has not attempted to mitigate commodity price risk through the use of financial derivatives. Currently all of the Company's oil and gas revenue is from an oil property in Argentina. Oil prices in Argentina are subject to domestic market discounts which result in prices significantly below benchmark prices.

Interest rate risk

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

Foreign currency exchange rate risk

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

The following table provides information on the foreign currency denominated working capital balances of the Company at December 31, 2012:

	Balance Denominated in US$	**Balance Denominated in ARS**	**Total CDN$ Equivalent**
Cash and cash equivalents	27,279	4,086,160	854,179
Trade and other receivables		5,678,723	1,149,403
Prepaid expenses		2,874,723	581,844
Inventory		748,651	151,527
Trade and other payables	29,400	20,207,111	4,089,919

A 10% change in ARS to Canadian dollar exchange rates on the working capital balances would have resulted in a $138,000 change in comprehensive loss at December 31, 2012 (2011- $87,000).

Fair value of financial instruments

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

20. Commitments

The Company has rental commitments (including estimated operating costs) relating to leased office premises as follows:

	December 31 2012 $	December 31 2011 $
2013	210,000	104,000
2014	143,000	46,000
2015	8,100	-
	361,100	150,000

Development & Exploration Commitments

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 US$4.1 million plus VAT.

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$ 4.9 million plus VAT remains outstanding). The exploration block (Coiron Amargo Sur) qualifies for an additional one year extension period at the end of the exploration period in the fourth quarter of 2013.

The initial exploration period for the Cortadera Block in the Province of Neuquén had an initial expiry of October 26, 2011. A new proposal was made by the joint venture to formalize an extension of the initial exploration period based on a proposed work plan for the block. As of December 31, 2012, the original proposal was yet to be finalized and discussions between the Province of Neuquen and the joint venture were recently reopened resulting in the decision to submit a new proposal. During the first quarter of 2013, the joint venture submitted a revised proposal and is currently working towards approval of an agreed upon work program for the block. As at December 31, 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.

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 $13.7 million plus VAT remains outstanding). The exploration block qualifies for an additional one year extension after November 13, 2013. In December 2012, Madalena initiated the process to qualify the Curamhuele block for an additional one year extension. Throughout the first quarter of 2013, the Company has made steady progress with respect to this application and is currently in the advanced stages of the approval process.

In 2012, Online, prior to its acquisition by the Company, issued a flow through share offering. Online renounced $462,450 to the flow-through share subscribers with an effective date of December 31, 2012 and recognized a flow-through share premium liability of $61,660. Online has until December 31, 2013 to expend the funds on qualified expenditures and as at December 31, 2012, no funds had been expended. The flow-through share premium liability is included in other long-term liabilities in the consolidated statement of financial position.

21. Segmented information

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

Year ended December 31, 2012	Canada $	Argentina $	Total $
Total assets	67,832,410	39,946,814	107,779,224
Total liabilities	(10,515,634)	(4,877,956)	(15,393,590)
Revenues	1,573,275	3,972,019	5,545,294
Loss	4,843,721	4,021,480	8,865,201
Depletion and depreciation	505,400	1,217,937	1,723,337
Impairment	-	2,519,001	2,519,001
Other Income	632,052	-	632,052
Foreign exchange loss	2,865	16,294	19,159
Acquired on business combination	24,985,204	-	24,985,204
Capital expenditures	4,570,067	18,281,350	22,851,417

Year ended December 31, 2011 CDN$	Canada	Argentina	Total
Total assets	15,628,299	26,469,488	42,097,787
Total liabilities	(219,280)	(3,076,394)	(3,295,674)
Revenues	-	2,598,503	2,598,503
Loss	(4,674,541)	(11,462,002)	(16,136,543)
Depletion and depreciation	9,956	433,275	453,231
Impairment	-	11,006,637	11,006,637
Other Income	290,604	324	290,928
Foreign exchange loss	-	82,622	82,622
Capital expenditures	6,437	20,027,656	20,034,093

22. Subsequent event

Subsequent to the year-end, the Company entered into the following physical natural gas and oil contracts:

Type	Period	Volume	Price Floor	Price Ceiling	Index
Natural gas fixed	April 1, 2013 to Oct. 31, 2013	300 GJ/d	$3.00 CDN	$3.00 CDN	AECO
Natural gas fixed	April 1, 2013 to Oct. 31, 2013	300 GJ/d	$3.20 CDN	$3.20 CDN	AECO
Natural gas fixed	April 1, 2013 to Oct. 31, 2013	300 GJ/d	$4.47CDN	$4.47 CDN	AECO
Crude oil call options	Jan. 1, 2014 to Dec. 31, 2014	50 bbl/d	-	$100.00 US	WTI