CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Madalena Energy Inc.

We have audited the accompanying consolidated financial statements of Madalena Energy Inc., which comprise the consolidated statements of financial position as at December 31, 2014 and December 31, 2013, the consolidated statements of loss and comprehensive loss, changes in 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 Energy Inc. as at December 31, 2014 and December 31, 2013, 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

April 16, 2015
Calgary, Canada

Consolidated Statements of Financial Position

Canadian $000s	Note	**As at December 31 2014**	As at December 31 2013
Assets			
Current assets			
Cash and cash equivalents	15	**13,425**	14,835
Trade and other receivables		**19,861**	4,057
Inventory		**2,875**	271
Other current assets		**1,183**	804
		37,344	19,967
Property, plant and equipment	5, 6	**113,084**	39,062
Exploration and evaluation assets	5, 7	**43,879**	35,745
Other non-current assets		**2,357**	1,512
		196,664	96,286
Liabilities			
Current liabilities			
Trade and other payables		**21,761**	11,951
Taxes payable		**3,806**	-
Flow-through share liability	10	**-**	385
		25,567	12,336
Other long-term liabilities	5, 17	**4,984**	-
Deferred income tax liability	14	**5,004**	-
Decommissioning obligations	5, 9	**25,357**	4,947
		60,912	17,283
Shareholders' Equity			
Share capital	10	**249,717**	159,574
Contributed surplus		**14,303**	12,645
Accumulated other comprehensive loss		**(16,142)**	(17,094)
Deficit		**(112,126)**	(76,122)
		135,752	79,003
		196,664	96,286

Commitments and Contingencies (Note 17)
Subsequent Events (Note 17 and 19)

See the accompanying Notes to the Consolidated Financial Statements.

On behalf of the Board:

[signed] "Steven Sharpe"

Steven Sharpe
Chairman

[signed] "Keith Macdonald"

Keith Macdonald
Director

Consolidated Statements of Loss and Comprehensive Loss

Canadian $000s, except per share amounts	Note	Year ended December 31 2014	2013
Revenues			
Oil and natural gas revenues		**72,945**	17,960
Royalties		**(10,233)**	(2,375)
		62,712	15,585
Gain on commodity contracts	19	**111**	43
		62,823	15,628
Expenses			
Operating		**29,785**	9,536
General and administrative		**10,651**	5,365
Finance income and expenses	12	**93**	(3,285)
Business combination expenses		**1,896**	-
Share-based compensation	11	**1,675**	1,234
Depletion and depreciation	6	**21,620**	6,638
Impairment	6, 7	**31,208**	19,719
		96,928	39,207
Loss before income taxes		**(34,105)**	(23,579)
Income tax expense			
Current income tax expense	14	**(3,101)**	(319)
Deferred income tax recovery	14	**1,202**	613
Total tax (expense)/ recovery		**(1,899)**	294
Net loss		**(36,004)**	(23,285)
Foreign currency translation adjustment		**952**	(8,721)
Comprehensive loss		**(35,052)**	(32,006)
Loss per share			
Basic and diluted	18	**(0.08)**	(0.07)

See the accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Changes in Equity

Canadian $000s	Share Capital (Note 10)	Contributed Surplus	Accumulated Other Comprehensive Income (Loss)	Deficit	Total Equity
Balance at December 31, 2013	**159,574**	**12,645**	**(17,094)**	**(76,122)**	**79,003**
Net loss	-	-	-	(36,004)	(36,004)
Other comprehensive income	-	-	952	-	952
Gross proceeds from financings	80,536	-	-	-	80,536
Share issue costs	(5,661)	-	-	-	(5,661)
Issued on business combination	15,214	-	-	-	15,214
Stock options exercised	54	(24)	-	-	30
Share-based compensation	-	1,682	-	-	1,682
Balance at December 31, 2014	**249,717**	**14,303**	**(16,142)**	**(112,126)**	**135,752**
Balance at December 31, 2012	141,676	11,920	(8,373)	(52,837)	92,386
Net loss	-	-	-	(23,285)	(23,285)
Other comprehensive loss	-	-	(8,721)	-	(8,721)
Gross proceeds from financings	19,454	-	-	-	19,454
Share issue costs	(1,766)	-	-	-	(1,766)
Flow-through share liability	(936)	-	-	-	(936)
Stock options exercised	1,146	(515)	-	-	631
Share-based compensation	-	1,240	-	-	1,240
Balance at December 31, 2013	159,574	12,645	(17,094)	(76,122)	79,003

See the accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Canadian $000s	Note	Year ended December 31 2014	2013
Cash provided by (used in):			
Operating			
Net loss		**(36,004)**	(23,285)
Items not affecting cash:			
Depletion and depreciation	6	**21,620**	6,638
Impairment	6, 7	**31,208**	19,719
Accretion	9	**281**	137
Unrealized loss (gain) on commodity contracts	19	**(279)**	90
Share-based compensation	11	**1,675**	1,234
Deferred income tax expense (recovery)	14	**(1,202)**	(613)
Unrealized loss on foreign exchange	12	**422**	-
Change in non-cash working capital	16	**7,214**	(1,860)
Decommissioning costs incurred	9	**(229)**	(92)
Cash flow from operating activities		**24,706**	1,968
Investing			
Business combination, net of cash acquired	5	**(48,020)**	-
Property, plant and equipment additions	6	**(23,709)**	(22,751)
Evaluation and exploration assets additions	7	**(16,828)**	(20,545)
Change in other non-current assets		**(836)**	(631)
Change in non-cash working capital	16	**(12,966)**	613
Net cash used in investing activities		**(102,359)**	(43,314)
Financing			
Issue of common shares	10	**80,536**	20,085
Share issue costs	10	**(5,661)**	(1,765)
Change in non-cash working capital	16	**486**	-
Net cash from financing activities		**75,361**	18,320
Change in cash and cash equivalents		**(2,292)**	(23,026)
Cash and cash equivalents, beginning of year		**14,835**	38,253
Impact of foreign exchange on cash balances		**882**	(392)
Cash and cash equivalents, end of year	15	**13,425**	14,835

See the accompanying Notes to the Consolidated Financial Statements.

1. Reporting Entity

Madalena Energy Inc. (the "Company" or "Madalena") is involved in the exploration, development and production of oil and natural gas in Argentina and in Alberta, Canada and its principal place of business is Suite 3200, 500 – 4th Avenue S.W., Calgary, Alberta, T2P 2V6.

Prior to June 25, 2014, the consolidated financial statements were comprised of the results of the Company and the following wholly-owned subsidiaries in the indicated legal jurisdictions:

- Madalena Austral S.A. (Argentina)
- Madalena Ventures International Holding Company Inc. (Barbados)
- Madalena Ventures International Inc. (Barbados)

On June 25, 2014, the Company acquired the Argentine business unit of Gran Tierra Energy Inc. and the consolidated financial statements at December 31, 2014 include, in addition to the full year of results of those subsidiaries listed above, the results from June 25, 2014 to December 31, 2014 of the following wholly-owned subsidiaries:

- Madalena Petroleum Ltd. (formerly "Petrolifera Petroleum Ltd.") (Canada)
- Madalena Petroleum Holdings Limited (formerly "Petrolifera Petroleum Holdings Limited") (Barbados)
- Madalena Petroleum Americas Limited (formerly "Petrolifera Petroleum Americas Limited") (Barbados)
- Madalena Energy Argentina S.R.L (formerly "Gran Tierra Energy Argentina S.R.L.") (Argentina)
- Pet-Ja S.A. (Argentina)

2. Basis of Preparation

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. Although the Company has generated significant cash flow from operations and is debt free, the Company's ability to pay for exploration and development activity is dependent on the price of oil worldwide, the regulated oil and gas prices in Argentina and its ability to access capital from time to time, either through debt or equity, on terms acceptable to the Company. Further, the Company's ability to continue operations is dependent on identifying commercial oil and gas reserves or resources, generating profitable operations for reinvestment and accessing sufficient capital to complete planned exploration and development activities while satisfying block commitments in Argentina. 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') as issued by the International Accounting Standards Board ('IASB'). These consolidated financial statements follow the same accounting policies and methods of computation for all periods presented as outlined in Note 3.

The consolidated financial statements were approved and authorized for issue by the Company's Board of Directors on April 16, 2015.

Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis, except for commodity contracts which are recorded at fair value through profit or loss.

Comparative Information
Certain numbers in the comparative year have been reclassified to conform with current year presentation.

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 was the functional currency of Madalena Austral S.A. up to June 30, 2014, at which time it was changed to the United States Dollar ("US$"). See Note 4 for further detail. The US$ is the functional currency of all subsidiaries.

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 change is identified, and prospectively in future periods.

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 is based on management's judgment in regard to shared infrastructure, geographical proximity of properties, commodity and/or petroleum type and similar exposure to market risk.

  Judgment is required when assessing if impairment indicators exist and therefore 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 in Argentina are, from time to time, subject to renewal which requires approval from regulatory authorities. As there is no indication that pending extensions will not be approved or revised contracts will not be entered into, management has used judgment to conclude that all extensions or a revised form of a block contract will be approved. If the Company fails to obtain block contract renewals, the carrying value of the Company's property, plant and equipment and exploration and evaluation assets could 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 or commercial resources have been found.

- In establishing the functional currency, an analysis of several factors is required, including which currency principally affects expenses incurred, sales prices of products sold by the Company, in which currency the

Company keeps it receipts from operating activities, and in which currency the Company has received financing.

The determination of the Company's Argentine operation's functional currency requires assessing several factors, including the dominant currency used in transactions such as the settlement of revenues and operational and capital expenditures. Management used its judgment to assess these factors and concluded its functional currency was the US$. See Note 4 for further detail.

- Management has exercised judgment in concluding that joint arrangements are subject to joint control. Specifically, judgment has been used in determining that decisions concerning the relevant activities of each arrangement require the specified parties must act together even though our interests in these arrangements may not be the same as the other parties to the arrangement. Madalena has classified and accounted for its interests in joint arrangements, both in Canada and Argentina, as joint operations.

- 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 the assumptions made by management affecting the measurement of balances and transaction in these consolidated financial statements.

- Estimation of recoverable quantities of proven and probable 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. These estimates are reviewed at least annually, through the engagement of qualified independent reserves evaluators. 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, if applicable, 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 obligation settlements.

- 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 and probable and/or contingent reserves being acquired. These estimates impact the potential for recognizing goodwill or a bargain purchase gain, future depletion and impairment.

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

- A number of accounting policies and disclosures require that fair value measurements be determined, specifically, business combinations and financial instruments. In determining fair value, the Company uses observable market data as much as possible. The fair value hierarchy used:
    a) Level 1 – quoted prices in active markets for identical assets or liabilities;
    b) Level 2 – observable prices for similar assets or liabilities, either directly or indirectly determined;
    c) Level 3 – unobservable input sources.

3. Significant Accounting Policies

(a) Basis of Consolidation

i. Subsidiaries

Subsidiaries are entities controlled by Madalena. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

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 related revenue and related costs.

Madalena has 14 concessions in Argentina. Operations for these concessions are conducted by way of a Union Transitoria de Empresas ("UTE"), which is an agreement entered into between two or more parties with the purpose of gathering human, technological and economic resources temporarily, in order to develop or execute a project, render a service or provide a specific supply. The UTE parties maintain at all times their legal and economic independence. The UTE is not a separate legal entity and no separate legal entities are established by the parties of the UTE to conduct business on behalf of the UTE.

In Canada, Madalena's core area of operations is located in the Greater Paddle River area of west-central Alberta. There are no unusual terms or conditions attached to any of the joint operating agreements associated with these properties. Madalena contributes to exploration and development projects in accordance with its proportionate working interest in the wells and is allocated revenue and operating costs in accordance with its working interest.

(b) Foreign Currency

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 of CAD are translated into CAD 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, the proportionate share of the cumulative exchange differences previously recognized in equity would be recognized in the statement of loss, as part of the gain or loss on sale.

(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
Financial assets or liabilities (including our derivative assets) are 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. See also financial liabilities, Fair value through profit or loss, below.

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 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.

The Company enters into certain financial derivative contracts in order to manage exposure to market risks from fluctuations in commodity prices. These instruments are not used for trading or speculative purposes. The Company has not designated its financial derivative contracts as effective accounting hedges, and thus has not applied hedge accounting. As a result, all financial derivative contracts are classified as fair value through profit or loss and are recorded on the balance sheet at fair value. Proceeds and costs realized from holding the derivative contracts are recognized in net income at the time each transaction under a contract is settled. The fair value of derivative contracts is based on an approximation of the amounts that would be received or paid to settle these instruments at the end of the period, with reference to forward commodity prices using remaining contracted volumes discounted at a credit adjusted rate.

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 held 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) Business combinations

Business combinations are accounted for using the acquisition method. The identifiable assets acquired and liabilities and contingent liabilities assumed are measured at their fair values at the acquisition date. The cost of an acquisition is measured as the aggregate consideration transferred, measured at the acquisition date fair value. If the cost of the acquisition is less than the fair value of the net assets acquired, the difference is recognized immediately in net profit. If the cost of the acquisition is more than the fair value of the net assets acquired, the difference is recognized on the balance sheet as goodwill. Acquisition costs incurred are expensed.

(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 and all associated value added tax ("VAT") 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. Upon determination of technical feasibility and commercial viability, E&E assets are first tested for impairment and then reclassified from E&E assets to Property, plant and equipment. 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. If the cost of the asset is greater than the fair value, then the excess is written off.

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 net 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.

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 proven and/or probable reserves and bringing in or enhancing production from such reserves, and are accumulated on a field or geotechnical area basis. VAT incurred on development and production assets are recorded as a receivable and are not recognized as part of PP&E. 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.

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.

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.

v. *Depletion and depreciation*

Depletion of oil and natural gas properties and depreciation of production equipment are calculated based on the establishment of depletable components, using the unit-of-production method. Components are generally determined at a field level. The component's volumes of total proven and probable oil and natural gas reserves and production before royalties, as determined by independent petroleum reservoir engineers is the unit basis for calculating depletion. 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 proven and probable undeveloped reserves.

VAT that is included in PP&E as a result of being transferred from E&E are not amortized. VAT collected on revenue from resale of oil and natural gas is applied directly against the amounts capitalized.

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 is depreciated at rates ranging from 10 to 33%.

vi. *Impairment*

The carrying amounts of the Company's PP&E and E&E 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. In addition, E&E assets are assessed for impairment when they are reclassified to property, plant and equipment 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 smallest 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 of disposal.

In assessing the recoverable amount, 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. The recoverable amount 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.

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 PP&PE.

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, should it exist, 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.

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 Compensation

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

Obligations for dismantling, decommissioning and site disturbance remediation may arise as a result of the Company's activities. Once it is determined that an obligation exists, a decommissioning obligation is recorded for the estimated cost of site restoration, with the offset capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of the expected expenditures, including their timing, that are required to remediate the property. The decommissioning obligation reflects current market assessments of the time value of money and the risks specific to the liability. The discount and inflation rates used to present value the obligation is based on the risk free rate associated with the currency in which payment is expected to be made. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time, changes in the estimated future cash flows underlying the obligation, and for changes in discount and inflation rates as required. These changes are accounted for prospectively. The increase in the decommissioning obligation due to the passage of time is recognized as finance costs (accretion) 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. Should the asset to which the obligation is related to, be disposed of, the decommissioning obligation associated with it is derecognized.

The Company does not recognize decommissioning obligations on facilities in Argentina where it has determined that there is no legal or constructive obligation to perform such activities

(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 and when collection is reasonably assured. This is generally at the time product enters the pipeline or is shipped.

(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.

(m) Inventory

Inventory consists of oil in tanks and third party pipelines, as well as supplies, and is valued at the lower of cost or market value. The cost of inventory is determined using the weighted average method. Oil inventories include expenditures incurred to produce, upgrade and transport the product to the storage facilities and include operating, depletion and depreciation expenses and cash royalties. Allocated to inventory is its relevant share of operating, royalty expense and depletion. Depending on inventory levels, this could increase or decrease inventory otherwise recorded.

(n) Value-added tax

Madalena capitalizes value-added tax ("VAT") incurred in Argentina when there is uncertainty regarding recovery during the evaluation and exploration phase. If these amounts are transferred to property, plant and equipment, VAT collected on sales to customers are initially credited to the asset to the extent of the amounts previously capitalized. VAT incurred during production are recorded as receivables. VAT collected on sales is applied against the receivable until the Company is in a net payable position, at which time it must remit the amounts collected to the government. Madalena monitors its receivables for impairment, as VAT receivables do not expire.

4. Accounting Changes

(i) Change in Functional Currency

Effective July 1, 2014, the functional currency of one of Madalena's subsidiaries, Madalena Austral S.A., changed from the Argentine Peso ("ARS") to the US$. The change coincides with the Acquisition (see Note 5) along with the evolving business activities in this subsidiary and the economic environment in Argentina that has become more influenced by the US$ over time. This change in accounting treatment is applied prospectively. The assets, liabilities and equity of the Madalena Austral S.A. were translated from ARS to US$ at the exchange rate on the date of change into the new functional currency, the US$.

(ii) New and Amended Standards and Interpretations Adopted

The International Accounting Standards Board ("IASB") issued International Financial Reporting Interpretations Committee Interpretation ("IFRIC") 21, "Levies" which was adopted by the Company on January 1, 2014. The IFRIC clarifies that an entity should recognize a liability for a levy when the activity that triggers payment occurs. The adoption of this interpretation did not impact the consolidated financial statements.

Effective January 1, 2014, the Company adopted, as required, amendments to IAS 32, "Financial Instruments: Presentation" ("IAS 32"). The amendments clarify that the right to offset financial assets and liabilities must be available on the current date and cannot be contingent on a future event. IAS 32 did not impact the consolidated financial statements.

(iii) Future Accounting Pronouncements

Certain new standards, interpretations, amendments and improvements to existing standards have been issued by the IASB or IFRIC and are effective for accounting periods beginning on or after January 1, 2015. These standards have not been applied in preparing the consolidated financial statements, and the Company is currently evaluation the impact that these standards will have. Those which may be relevant to Madalena are described below:

i. IFRS 15: Revenues and Contracts with Customers

In May 2014, the IASB issued IFRS 15, Revenues from Contracts with Customers, which provides a single, principles based five-step model to be applied to revenue recognition from all contracts with customers, and applies to an annual reporting period beginning on or after 1 January 2017.

ii. IFRS 9: Financial Instruments

In July 2014, the IASB issued IFRS 9, Financial Instruments, which is effective January 1, 2018 and is available for early adoption.

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

5. Business Combination

On June 25, 2014, the Company acquired all of the outstanding shares of the Argentine business unit of Gran Tierra Energy Inc. ("Gran Tierra") for cash consideration of $59.2 million (US$55.4 million), including acquired cash of $11.2 million, and 29,831,537 common shares, at a fair value of $0.51 per common share (the "Acquisition"). The fair value of oil and natural gas interests acquired was estimated with reference to the discounted cash flows expected to be derived from the oil and natural gas production in Argentina based on externally prepared reserve reports dated December 31, 2013 based on escalating price forecasts on proven plus probable reserves discounted at 20% and updated internally. The operations from the Acquisition have been included in the results of Madalena commencing June 25, 2014. The business combination was accounted for using the acquisition method, based on initial fair values, and subsequently adjusted as at December 31, 2014 as follows:

	As originally disclosed	Adjustments	Revised fair values
Net assets acquired			
Property, plant and equipment	98,628	(10,148)	88,480
Exploration and evaluation assets	2,037	1,097	3,134
Working capital	5,097	6,287	11,384
Other long-term assets	2,877	(2,877)	-
Other long-term liabilities (Note 17)	-	(5,341)	(5,341)
Deferred tax liability	(6,265)	912	(5,353)
Decommissioning liabilities	(27,968)	10,070	(17,898)
	74,406	**-**	**74,406**
Consideration			
Cash	59,192		59,192
Common shares	15,214		15,214
	74,406		**74,406**

The most significant adjustment to the original purchase price related to a $10 million reduction of decommissioning liabilities associated with the removal of certain facilities estimates from the calculation of this provision that were determined to have no retirement liability. Working capital increased mainly due to the reclassification of $6.1 million of liabilities from current to long term, the movement of $2.9 million of assets from long term to current, net of under-accrued income taxes of $1.3 million, and the write-off of uncollectible receivables of $1.0 million. All other changes to working capital were not individually or collectively significant. The addition to Exploration and Evaluation assets is the result of the allocation of associated deferred income taxes.

Amendments are allowed up to one year from the date of the Acquisition, however further updates are not anticipated.

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

The Acquisition resulted in the addition of 11 concessions located in the NorOeste Basin in northern Argentina and the Neuquén Basin in central Argentina, with working interests ranging between 14 – 100%. These arrangements are accounted for as joint operations, in the same manner as the Company's pre-existing Argentine concessions.

The fair value of exploration and evaluation assets is based on prices estimated for similar items.

The fair value of receivables acquired was $24.4 million which approximates their gross contractual flows. The revised fair values of acquired receivables have been collected or are expected to be collected.

The Company incurred transaction costs of $1.9 million in conjunction with the Acquisition which have been recorded as business combination costs in the consolidated statement of loss. Had the transaction closed on January 1, 2014, the estimated revenue and net income that would have been reported by the Company for the year ending December 31, 2014 would have been $87.7 million and $0.8 million, respectively. Actual revenues and net income included in the Company's results for the period from the date of acquisition June 25, 2014 to December 31, 2014 were $47.1 million and $0.4 million, respectively.

6. Property, Plant and Equipment

	Oil and Natural Gas Assets	Corporate	Total
Cost			
At December 31, 2012	35,181	292	35,473
Additions	22,643	(15)	22,628
Effect of change in foreign exchange rates	(3,674)	(7)	(3,681)
At December 31, 2013	54,150	270	54,420
Additions	23,465	679	24,144
Transferred from E&E assets (Note 7)	4,215	-	4,215
Acquired on business combination (Note 5)	87,944	536	88,480
Effect of change in foreign exchange rates	5,020	37	5,057
At December 31, 2014	**174,794**	**1,522**	**176,316**

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

	Oil and Natural Gas Assets	Corporate	Total
Accumulated depreciation, depletion and impairment			
At December 31, 2012	(4,598)	(161)	(4,759)
Depreciation and depletion	(6,647)	(25)	(6,672)
Impairment	(5,000)	-	(5,000)
Effect of change in foreign exchange rates	1,067	6	1,073
At December 31, 2013	(15,178)	(180)	(15,358)
Depletion and depreciation	(21,485)	(135)	(21,620)
Impairment	(26,000)	-	(26,000)
Effect of change in foreign exchange rates	(258)	4	(254)
At December 31, 2014	**(62,921)**	**(311)**	**(63,232)**
Net book value			
At December 31, 2013	38,972	90	39,062
At December 31, 2014	**111,873**	**1,211**	**113,084**

In assessing its Canadian CGU for impairment at December 31, 2014, the Company concluded that triggers for impairment existed due to the recent decline in current and forward commodity prices for oil and natural gas together with disappointing results from two wells that were completed in the fourth quarter. The Company's testing of its Canadian CGU recoverable value, established as value in use, relative to its carrying value, revealed an impairment charge of $26 million (2013- $5.0 million). The impairment test was based on proven plus probable reserves, using a discount rate of 15% and forward commodity price estimates. The impairment test used the following adjusted benchmark prices from McDaniel & Associates Consultants Ltd. price forecast, effective January 1, 2015.

Year	Oil Price (CAD/bbl)	Natural Gas Price (CAD/mcf)
2015	60.98	3.55
2016	73.53	4.02
2017	78.36	4.26
2018	83.10	4.53
2019	87.45	4.75
2020	91.70	5.07
2021	93.64	5.38
2022	95.51	5.59
2023	97.33	5.79
2024	99.24	6.00

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

Year	Oil Price (CAD/bbl)	Natural Gas Price (CAD/mcf)
2025	101.23	6.08
2026	103.19	6.18
2027	105.27	6.35
2028	107.39	6.35
2029	109.49	6.61
Thereafter	+2%/yr	+2%/yr

At December 31, 2014 and 2013, Madalena determined that no impairment triggers existed for its Argentine CGUs.

At December 31, 2013, the Company observed triggers for impairment that included a decrease in the long term forward Canadian natural gas prices as at December 31, 2013, reserve revisions on certain of the mature producing assets, increases in operating costs and significant facility upgrades on the Company's older facilities. The Company's testing of its Canadian CGU recoverable value, determined to be value in use, relative to its carrying value revealed an impairment charge of $5.0 million. The impairment test was based on proved plus probable reserves, using a discount rate of 10% and forward commodity price estimates.

At December 31, 2014, the net book value of the Argentine and Canadian PP&E assets were $100.4 million (December 31, 2013 - $12.0 million) and $12.7 million (December 31, 2013 - $27.1 million), respectively.

The depletion expense calculation for the year ended December 31, 2014 included $97.9 million (December 31, 2013 – $30.6 million) for estimated future development costs associated with proven and probable reserves.

During the year ended December 31, 2014, approximately $0.6 million (2013 - $nil) of directly attributable general and administration costs were capitalized to property, plant, and equipment.

The amounts capitalized as PP&E assets in Argentina at December 31, 2014 includes $2.7 million of VAT (December 31, 2013 - $3.3 million). VAT is payable on goods and services supplied and the Company retains VAT on any sales that it collects to the extent of the VAT recorded and paid on previous expenditures.

7. Exploration and Evaluation Assets

Cost	
At December 31, 2012	35,760
Additions	20,491
Impairment	(14,719)
Effect of change in foreign exchange rates	(5,787)
At December 31, 2013	35,745
Additions	17,510
Acquired on business combination (Note 5)	3,134

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

Transfer to PP&E assets (Note 6)	(4,215)
Impairment	(5,208)
Effect of change in foreign exchange rates	(3,087)
At December 31, 2014	**43,879**

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

At December 31, 2014, the net book value of the Argentine and Canadian E&E assets were $38.1 million (December 31, 2013 - $28.6 million) and $5.8 million (December 31, 2013 - $7.1 million), respectively.

The Company has recorded an impairment charge of $5.2 million (2013 - $14.7 million) on its Canadian exploration and evaluation assets at December 31, 2014, primarily resulting from unsuccessful exploration drilling and expiries in both years.

The amounts capitalized as Argentina E&E assets at December 31, 2014 included $7.4 million of VAT (December 31, 2013 - $6.4 million).

8. Credit Facility

At December 31, 2014, Madalena had a credit facility in place against its Canadian based assets. There were no credit facilities in place in Argentina, where the majority of the Company's reserves and production are located.

At December 31, 2014, the Company had available to it, a Canadian revolving operating demand loan credit facility with the National Bank of Canada up to a maximum of $10 million with interest charged at the bank's prime rate plus 1.0% per annum which is secured by the Company's Canadian assets. When drawn, security for this facility is provided by way of a charge over the Canadian petroleum and natural gas assets of the Company.

The facility includes a working capital ratio covenant, whereby the working capital deficiency (excluding working capital from any of its Argentina subsidiaries and any unrealized hedging gains or losses) may not exceed $10 million. At December 31, 2014, the consolidated working capital position of the Company was $11.8 million (2013 - $7.6 million), consisting of working capital of $12.5 million (2013 – working capital deficiency of $1.1 million) in Argentina and a working capital deficiency of $0.7 million (2013 – working capital of $8.7 million) in Canada.

The facility is restricted to activity in Canada only and is not available for funding of its Argentine operations. Standby fees associated with the facility are 0.25% per annum on the undrawn portion.

In addition, the Company has available a Canadian acquisition/development demand loan credit facility with the National Bank of Canada, up to a maximum of $3 million, with interest charged at the bank's prime rate plus 1.5% per annum.

Subsequent to the year-end, in conjunction with the annual review, the operating demand loan credit facility was reduced to $7 million, of which the maximum draw is currently limited to $3.5 million. The acquisition/development demand loan credit facility remains available to a maximum of $3 million. Both facilities are subject to a periodic review by the bank and the next review is scheduled for June 30, 2015.

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

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 any outstanding indebtedness.

9. Decommissioning Obligations

	Year ended December 31	
	2014	**2013**
Balance, beginning of year	**4,947**	5,191
Assumed in business combination (Note 5)	**17,898**	-
Incurred from development activities (Note 6)	**359**	210
Incurred from exploration activities (Note 7)	**156**	50
Accretion expense (Note 12)	**281**	137
Revision of estimates	**602**	(448)
Obligations settled	**(229)**	(92)
Effect of change in foreign exchange rates	**1,343**	(101)
Balance, end of year	**25,357**	4,947

The total undiscounted amount of cash flows at December 31, 2014 required to settle Madalena's decommissioning obligations is approximately $31.7 million (December 31, 2013 – $8.7 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 reflective of the functional currency used to account for the obligations of 1% and 2% were used to calculate the future value of the undiscounted decommissioning obligations in Argentina and Canada, respectively (December 31, 2013 – 10.9% and 2% for Argentina and Canada, respectively. The risk free rates used to discount the liability, which are based on the functional currency used to account for the obligations, were 2.5% (December 31, 2013 – 17.2%) in Argentina and 2.5% (December 31, 2013 – 2%) in Canada. The reason for the higher inflation and discount rates used in 2013 is due to the fact that at December 31, 2013, the functional currency of the Argentine operations was in the Argentine Peso. At December 31, 2014, all Argentine operations are being accounted for using the functional currency of the United States Dollar. The discount rates and inflation rates were therefore adjusted in 2014 to reflect the currency in which the obligations are expected to be settled and accounted for.

Included in the decommissioning obligation increase for revision of estimates of $0.6 million is $0.9 million for changes associated with cost increases, offset by $0.3 million relating to changes in discount and inflation rates.

10. 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. No preference shares are outstanding at December 31, 2014 or 2013.

Share Capital – Common Shares

	Number of Shares 000s	Share Capital $000s
Balance at December 31, 2012	314,307	141,676
Shares issued on financing	46,763	19,454
Share issue costs	-	(1,766)
Flow-through share liability	-	(936)
Stock options exercised	2,959	1,146
Balance at December 31, 2013	364,029	159,574
Shares issued on financing	145,672	80,536
Share issue costs	-	(5,661)
Issued on business combination (Note 5)	29,832	15,214
Stock options exercised/share-based compensation	250	54
Balance at December 31, 2014	**539,783**	**249,717**

2014

On February 11, 2014, the Company closed a bought deal financing of 32,857,225 common shares at a price of $0.70 per common share, including 4,285,725 common shares issued pursuant to the exercise of the over-allotment option in full by the Underwriters, for aggregate gross proceeds of $23.0 million.

On June 24, 2014, the Company closed a bought deal financing of 98,100,000 common shares at a price of $0.51 per common share, for aggregate gross proceeds of $50.0 million.

On June 25, 2014, in connection with the Acquisition, the Company issued 29,831,537 common shares to Gran Tierra at a price of $0.51 per common share for partial consideration in the Acquisition totaling $15.2 million.

On July 7, 2014, the Company closed the over-allotment option in full of the $50 million bought deal described above, issuing 14,715,000 common shares of the Company at a price of $0.51 per common share for gross proceeds of $7.5 million.

2013

On July 11, 2013, the Company raised approximately $7.25 million through the issuance of 11,765,000 common shares issued as CEE flow-through shares at a price of $0.34 by way of a bought deal private placement and 200,000 common shares at a price of $0.31 per share, 4,780,000 common shares issued as CDE flow-through shares at a price of $0.32 per share and 4,886,765 common shares issued as CEE flow-through shares at a price of $0.34 per share by way of a Private Placement. A flow-through share liability in the amount of $936,000 was recorded to recognize the difference between the flow-through share price and the price of the common shares. Certain directors and officers of the Company acquired an aggregate of 200,000 common shares and 400,000 CEE "flow-through" shares under the non-brokered Private Placement.

On November 21, 2013, the Company issued 5,555,556 common shares, issued as “flow-through shares” (“CDE Flow-Through Shares”) within the meaning of the Income Tax Act (Canada) at a price of $0.54 per CDE Flow-Through

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

Share, for gross proceeds of $3 million pursuant to a Private Placement.

On December 5, 2013, the Company closed a bought deal financing of 19,575,300 common shares at a price of $0.47 per common share, including 2,553,300 common shares issued pursuant to the exercise of the over-allotment option in full by the underwriters, for aggregate gross proceeds of $9.2 million.

11. 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 for those options exercised during the year ended December 31, 2014 was $0.61 (December 31, 2013 - $0.40).

During the period ended December 31, 2014, 7,000,000 options (December 31, 2013 – 7,260,000) were granted to certain employees, consultants and directors of the Corporation and its subsidiaries, of which 5,000,000 were granted to employees in Argentina as a result of the Acquisition, 1,300,000 were granted to employees in Canada and 700,000 were granted to two new directors who were added to the board of directors during 2014.

Fair value was estimated at the period end date using the Black-Scholes valuation model, resulting in a per option fair value of $0.30 (2013 - $0.26) with weighted average assumptions as follows:

Inputs used to fair value share options

	Year ended December 31	
	2014	**2013**
Share price ($)	0.46	0.36
Exercise price ($)	0.46	0.36
Expected Volatility (%)	86	96
Forfeiture rate (%)	9.8	9.8
Option life (years)	4.85	4.35
Risk-free interest rate (%)	1.48	1.25

Expected volatility is estimated by considering historic daily share price volatility. The forfeiture 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, 2014 was $1.7 million (2013 - $1.2 million) with an offsetting credit to contributed surplus.

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 000s	Weighted average exercise price CDN$
Outstanding at December 31, 2012	22,334	0.47
Granted	7,260	0.36
Exercised	(2,959)	0.21
Forfeited	(1,842)	0.42
Expired or cancelled	(5,263)	0.76
Outstanding at December 31, 2013	19,530	0.40
Granted	7,000	0.47
Exercised	(250)	0.13
Forfeited	(353)	0.50
Expired or cancelled	(47)	0.11
Outstanding at December 31, 2014	**25,880**	**0.42**
Exercisable at December 31, 2014	**12,494**	**0.43**

The range of exercise prices of the outstanding options

Exercise price ($)	Number of Options Outstanding 000s	Weighted Average Contractual Life of options outstanding (years)	Number of outstanding options that are exercisable 000s
0.21	1,117	0.08	1,117
0.29	6,610	3.77	3,873
0.32	300	0.55	300
0.35	6,000	3.66	1,904
0.41	1,060	3.18	353
0.42	2,020	2.47	2,020
0.44	150	4.71	-
0.46	700	4.73	-
0.50	4,997	4.53	-
0.69	450	1.92	450
0.79	1,860	0.97	1,860
0.80	316	0.90	317
0.96	300	1.12	300
	25,880	**3.30**	**12,494**

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

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, executive management and directors included in operating and general and administrative expenses comprises:

	Year ended December 31	
	2014	**2013**
Salaries and wages	5,240	2,232
Short-term employee benefits	241	70
	5,481	**2,302**

Key management personnel are persons who have the authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly. Key management includes all directors and executives of the Company. The table below summarizes all key management personnel compensation paid during the years ended December 31, 2014 and 2013.

	Year ended December 31	
	2014	**2013**
Short-term employee benefits, including wages	2,686	1,924
Share-based compensation	1,199	1,048
	3,885	**2,972**

12. Finance Income and Expenses

Finance Income and Expenses are made up of the following:

	Year ended December 31	
	2014	**2013**
Bank charges	1,675	632
Foreign exchange (gain)/loss	(1,642)	(3,586)
Accretion (Note 9)	281	137
Interest expense (other income)	(221)	(468)
	93	(3,285)

Foreign Exchange Gain / (Loss)

	For the year ended December 31	
$000s CDN	**2014**	**2013**
Realized foreign exchange (gains)/losses	(2,064)	(3,586)
Unrealized foreign exchange (gains)/losses	422	-
Total	(1,642)	(3,586)
Currency exchange rate at period end:		
$1 Canadian = $ United States	$0.86	$0.94
$1 Canadian = Argentine Peso	7.29	6.13

13. Related Parties

A former director and current Secretary of the Company is a partner of a law firm that provides legal services to the Company. During the year ended December 31, 2014, the Company incurred fees of $604,000 (2013 - $551,000), from this firm for legal services of which $67,000 (2013 – $35,000) is included in accounts payable and accrued liabilities at December 31, 2014. The costs were expensed in general and administrative and business combination costs in the Statement of Loss and Comprehensive Loss.

A director of one of the Company's subsidiaries provides legal and consulting services to the Company. During the year ended December 31, 2013, the Company incurred fees of $41,000 (2013 - $261,000), for these services which related to concession extensions and other legal matters, of which $35,000 (2013 - $22,000) was included in accounts payable and accrued liabilities at December 31, 2014. The costs related to the concession extensions were incurred in 2013 and were recorded in PP&E and E&E assets and the costs related to other legal matters were expensed in general and administrative expenses in profit and loss.

The transactions arose during the normal course of business and have been recorded at the exchange amounts, which are the amounts agreed upon by the related parties.

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

14. 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% (2013 - 25%) to the loss before taxes. The difference results from the following:

	Year ended December 31	
	2014	2013
Loss before income tax	(34,105)	(23,579)
Tax rate	25%	25%
Expected income tax recovery	(8,527)	(5,895)
Increase (decrease) resulting from:		
Effect of foreign tax rates	1,538	(354)
Share-based compensation	419	309
Non-deductible transaction costs	474	-
Unrecognized deferred tax benefit and other	6,999	4,919
Flow-through shares	-	1,587
Canadian tax rate adjustments	-	(300)
Non-taxable differences on foreign operation	641	(461)
Minimum presumed (foreign) income tax	639	427
Other	101	87
Income tax expense	2,284	320
Flow through share premium	(385)	(613)
Total income tax expense (recovery)	**1,899**	(294)

Current tax expense	3,101	319
Deferred tax expense (recovery)	(1,202)	(613)
Total income tax expense (recovery)	**1,899**	(294)

The current income tax expense relates to current income tax and minimum income tax incurred in Argentina.

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

	Year ended December 31	
Canada	**2014**	**2013**
Property, plant and equipment	24,404	5,651
Decommissioning obligations	5,131	3,988
Share issue costs	7,553	4,830
Capital losses	2,257	-
Non-capital losses (expire 2026 to 2034)	63,031	30,431
Foreign tax credits	14,601	-
Total unrecognized temporary differences	**116,977**	44,900

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

Argentina	Year ended December 31 2014	2013
Property, plant and equipment	11,595	-
Decommissioning obligations	8,387	430
Non-capital losses (expire 2015 to 2019)	25,585	2,931
Accruals & Other	9,714	-
Minimum Tax Credits	1,949	-
Total unrecognized temporary differences	**57,230**	3,361

Barbados	Year ended December 31 2014	2013
Non-capital losses (expire 2017 to 2022)	497	493
Total unrecognized temporary differences	**497**	493

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

	Year ended December 31						
	2012	**Recognized in statement of income**	**2013**	**Acquired balances**	**Recognized in Statement of income**	**OCI**	**2014**
Foreign exchange	(350)	350	-	-	(320)	-	(320)
Property, plant and equipment	(543)	(271)	(814)	(9,012)	(810)	(791)	(11,427)
Decommissioning obligations	-	151	151	3,466	223	306	4,146
Non-capital losses (expire 2026 to 2031)	893	(230)	663	-	1,133	-	1,796
Accruals and other	-	-	-	193	156	17	366
Minimum tax credits	-	-	-	-	435	-	435
	-	-	-	(5,353)	817	(468)	**(5,004)**

No deferred tax liability has been recognized for temporary differences associated with investments in subsidiaries and joint ventures as the Company is in a position to control the entities and it is considered probable that these timing differences will not reverse in the foreseeable future.

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

15. Cash and Cash Equivalents

	Year ended December 31	
	2014	**2013**
Bank balances	13,425	13,605
Guaranteed investment certificates	-	1,230
Cash and cash equivalents	**13,425**	**14,835**

16. Supplemental Cash Flow Information

Changes in non-cash working capital

	Year ended December 31	
	2014	**2013**
Trade and other receivables	(15,568)	(2,128)
Other current assets	(2,495)	(310)
Inventory	(226)	-
Trade and other payable	13,100	1,191
Impact of foreign exchange on working capital	(77)	-
Change in non-cash working capital	**(5,266)**	(1,247)
Attributable to:		
Operating activities	7,214	(1,860)
Investing activities	(12,966)	613
Financing activities	486	-
	(5,266)	(1,247)

17. Commitments and Contingencies

Development & Exploration Commitments

Coiron Amargo Block (35% working interest)

In October 2013 the exploration period for Coiron Amargo Sur was extended until November 8, 2014 based on a work commitment program for the southern portion of the block. The Company drilled a vertical Vaca Muerta shale well in late 2014 which satisfied the last of the work commitments prior to entering into a new contract phase.

On April 16, 2015, the Company received a three year evaluation phase contract from the Province of Neuquén for Coiron Amargo Sur. The Company's share of the work commitment is US$17.5 million and must be incurred by November 8, 2017. Following this three year evaluation phase contract, Madalena is eligible to enter into a further exploitation (development) concession and/or enter into additional evaluation phase periods to further explore and appraise the Coiron Amargo Sur block.

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

Curamhuele Block (90% working interest)

The Curamhuele Block is operated by Madalena. In September 2013 the first exploration period was extended until November 8, 2014 by the Province of Neuquén. On December 19, 2014, the Province officially granted an extension to September 2015 to satisfy the remaining work commitments on the block.

At December 31, 2014, Madalena's remaining share of future work commitments associated with the Curamhuele block is approximately US$12.0 million plus VAT. To satisfy this remaining work commitment, Madalena is preparing to conduct a 2 well re-entry program prior to September 2015.

After satisfying these remaining work commitments, Madalena expects to either convert certain areas of the acreage into an exploitation (development) concession and/or enter into a new exploration period(s) or unconventional evaluation phase to further appraise the Curamhuele block. The Company has posted a performance bond for amounts committed under this concession agreement. The assets of Madalena Austral S.A., a subsidiary of the Company, are held as security for the bond.

Cortadera Block (37.8% working interest)

On January 15, 2014, Madalena and its working interest partners signed an amended contract agreement to formalize a multi-year agreement for the extension of the initial exploration period and inclusion of subsequent exploration periods.

In 2014, Madalena and its working interest partners satisfied all of its remaining commitments related to the first exploration period on the Cortadera block and now have the option to enter into a second exploration period extending to October 25, 2018 and a third exploration period extending to October 25, 2021, or extend acreage at Cortadera through potential further evaluation and/or exploitation phases. As of April 2015, Madalena is taking steps with its partners and the Province to move officially into a second exploration period.

Puesto Morales Block (100% working interest)

The Corporation acquired its interest in the 31,254 acre block in the Neuquén Basin as part of the Acquisition. The block produces oil and natural gas from the Sierras Blancas and Loma Montosa formations. The exploitation permit expires on Jan 22, 2016. An application for block extension has been submitted to the Province of Rio Negro and the Company expects an approval for a ten year extension to be granted in 2015.

Santa Victoria Block (100% working interest)

This block was part of the recent Acquisition and includes a 100% working interest operated property covering 516,846 gross acres in the NorOeste Basin. The contract is currently in the second of three exploration phases. This phase requires a minimum commitment of US$3.8 million plus VAT to be conducted by April 2015. Madalena is currently in discussions with the Province to obtain an extension for the current commitment on the block.

Leased office premises

The Company is responsible for the following:

	2015	2016	2017	2018	2019
Leased office premises	854	853	623	470	480

Other long-term liabilities

Other long-term liabilities primarily relate to a number of contingencies acquired with the Acquisition, which are considered by management to be in the normal course of business. The expected timeline for resolution is not known at this time, although all are expected to take more than one year to settle. All but one has been outstanding for over one year. As new information is obtained, amounts are adjusted to reflect management's best estimate of the amounts to be settled. The outcome of outstanding, pending or future proceedings cannot be predicted with certainty and their outcome could have a significant effect on the Company's assets, liabilities, business, financial condition and results of operations.

18. Loss Per Share

There is no dilutive impact to the weighted average number of common shares at December 31, 2014 or 2013. All share options were excluded from the calculation of diluted earnings per share as their effect is anti-dilutive. The following table provides the weighted average number of common shares used in the per share calculations:

	Year ended December 31	
	2014	**2013**
Weighted average number of common shares:		
Basic and diluted – '000s	467,361	328,771

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. As disclosed in Note 8, the Company has an existing credit facility with the National Bank of Canada. This facility is for its Canadian operations and the funds may not be used to funds any of its Argentine activities. The Company does not currently have an Argentine credit facility.

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, existing credit facilities 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.

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

The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the next twelve months.

Argentine Foreign Currency Restrictions

Prior to the fourth quarter of 2014, Madalena had never repatriated funds from Argentina as the Company did not generate sufficient funds from operations to support its ongoing capital requirements. As a result of the Acquisition, depending on the amount of inflows and outflows of cash, the Company may have surplus funds on hand in Argentina.

As part of the Company's cash management, during the fourth quarter and to date in 2015, the Company repatriated US$2.7 million and US$1.8 million, respectively. The Company's ability to repatriate funds from Argentina is controlled by the Argentina government through the Central Bank. There are currently a number of monetary and currency exchange control measures in Argentina that include restrictions on the free disposition of funds deposited with banks and tight restrictions on transferring funds abroad. While the Company has repatriated funds successfully as described above, future repatriation of cash is dependent on approvals obtained from the Argentina Central Bank.

At December 31, 2014, $9.0 million, or 67%, of Madalena's cash and cash equivalents was deposited with banks in Argentina.

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, 2014 and December 31, 2013.

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

	Year Ended December 31	
$000s CDN	**2014**	2013
Oil and natural gas marketing companies	**15,278**	2,120
Federal and provincial governments and other	**4,583**	1,937
Total trade and other receivables	**19,861**	4,057

Amounts due from oil and gas marketing companies were subsequently collected by the Company.

Aged trade and other receivables

$000s CDN	Year Ended December 31
Current (less than 90 days)	**17,111**
Past due (more than 90 days)	**2,750**
Total	**19,861**

Liquidity risk

Liquidity risk is the risk that the Company will not meet its financial obligations as they fall due. The Company has both capital and operating obligations in 2015. The Company manages its liquidity risk through 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, existing credit facilities and working capital.

The Company's 2015 capital expenditure budget is 100% allocated to Argentina. This budget is reviewed monthly and updated as necessary depending on varying factors including current and forecast prices, actual capital deployment and general industry conditions. Funding for the Company's 2015 capital budget is expected to come from existing working capital, funds generated from operations in 2015 and a combination of new credit facilities and/or equity, if available to the Company on terms acceptable to the Company. An adverse outcome of obtaining new financing on a timely basis could result in a failure to comply with certain spending requirements under the terms of an existing concession agreement (see note 17). While the Company believes that it will be able to obtain the necessary financing to meet these commitments, this outcome cannot be guaranteed. The net book value of E&E assets of approximately $16.4 million are subject to these uncertainties.

As a result of shut in production and the low commodity price environment in Canada, the Company anticipates a reduction in funds generated from operations in Canada. This reduction may require that alternative sources of funds be accessed to enable the Company to meet all of its 2015 Canadian operating obligations. As disclosed in Note 8, the Company has borrowing availability of $3.5 million on a credit facility with a Canadian chartered bank that is available to support the Canadian operations. This facility is subject to a renewal in June 2015 and there are no assurances that the borrowing capacity will continue beyond this time. The Company also has access to repatriate cash generated from operations in Argentina to Canada in order to fund its Canadian working capital deficiency. As described in the "Argentine Foreign Currency Restriction" section, future repatriation of funds is subject to approvals from the Argentine Central Bank. The Company recognizes that the timing and amounts to be approved for repatriation are ultimately controlled by the Argentine Central Bank, which could impact the Company's ability to meet its future Canadian obligations.

Market risk

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

Commodity price risk

The Government of Argentina sets the benchmark (Medanito) price for oil. Over the last few years world prices (WTI and Brent) increased sharply while the Argentina prices did not keep pace. Conversely, when world prices fell sharply in the latter half of 2014, Argentina prices remain relatively stable. Although currently Argentina prices are approximately 30% higher than Brent pricing, there can be no assurances that prices in Argentina will remain above Brent and/or WTI.

(Tabular amounts are stated in thousands of Canadian dollars, except per share amounts and as otherwise stated)

Gas prices in Argentina are fixed by the Government regulator in US$/mmbtu. Summer prices have been set at US$4.10/mmbtu October 2014 to April 2015. For the period May to September 2015, which is the Argentine winter, the price generally increases. Last winter it was US$5.20/mmbtu.

The Company had the following physical natural gas and oil contracts in place at December 31, 2014:

Type	Period	Volume	Price Floor	Price Ceiling	Index
Natural gas fixed	Nov. 1, 2014 to Oct. 31, 2015	500 GJ/d	$3.52CDN	$3.52 CDN	AECO
Crude oil call options	Jan. 1, 2015 to Dec. 31, 2015	50 bbl/d	-	$95 US	WTI

The fair value of commodity contracts is determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes. The fair value of commodity contracts for the year ended December 31, 2014 was a net receivable of $189,000 (December 31, 2013 – net liability of $90,000). Realized losses for the year ended December 31, 2014 were $168,000 (December 31, 2013 – realized gain $133,000) and are included in gain on commodity contracts on the statement of loss and comprehensive loss. The commodity contracts are classified as level 2 within the fair value hierarchy.

Effective April 1, 2015, the Company unwound its natural gas contract for a gain of $92,000.

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. This exposure is not material.

Foreign currency exchange rate risk

The majority of the Company's exploration and development activities are conducted in Argentina and a portion of the Company's cash and cash equivalents are denominated in 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.

A 10% change in exchange rates to the Canadian dollar would have changed AOCI by $7.4 million for the year.

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 at December 31, 2014.

20. 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, 2014 and December 31, 2013.

	As at and for year ended December 31, 2014		
$000s CDN	**Canada**	**Argentina**	**Total**
Total assets	22,960	173,704	196,664
Total liabilities	(12,138)	(48,774)	(60,912)
Revenues	15,473	57,472	72,945
Loss	(35,589)	(415)	(36,004)
Capital expenditures	19,954	20,583	40,537

	As at and for year ended December 31, 2013		
	Canada	**Argentina**	**Total**
Total assets	50,881	45,405	96,286
Total liabilities	(12,384)	(4,899)	(17,283)
Revenues	12,723	5,237	17,960
Loss	(20,792)	(2,493)	(23,285)
Capital expenditures	28,286	15,010	43,296