CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

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 statements of financial position as at December 31, 2017, and the statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the year then ended, and 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 as issued by the International Accounting Standards Board, 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 audit. We conducted our audit 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 financial statements. The procedures selected depend on the auditors' 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, the auditors 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 financial statements present fairly, in all material respects, the financial position of Madalena Energy Inc. as at December 31, 2017, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Other Matters

The consolidated financial statements of Madalena Energy Inc. for the year ended December 31, 2016, were audited by another auditor who expressed an unmodified opinion on those statements on May 1, 2017.

Ernst & Young LLP

Calgary, Canada
April 10, 2018

Chartered Professional Accountants

Consolidated Statements of Financial Position

USD 000s	Note	As at December 31 2017	As at December 31 2016
Assets			
Current assets			
Cash and cash equivalents		**1,202**	4,071
Trade and other receivables	22	**9,534**	12,836
Inventory		**1,585**	1,432
Assets held for sale	8	**-**	1,265
Other current assets		**461**	465
		12,782	20,069
Property, plant and equipment	6	**20,393**	53,544
Exploration and evaluation assets	7	**39,869**	49,340
Other long-term assets	10	**204**	275
		73,248	123,228
Liabilities			
Current liabilities			
Refundable deposit	21	**-**	3,000
Current portion of long-term debt	9	**-**	1,619
Trade and other payables		**9,522**	15,098
Taxes payable		**453**	1,184
Decommissioning obligations	12	**3,850**	3,581
		13,825	24,482
Convertible debentures	11	**1,274**	1,143
Deferred income tax liability	19	**1,352**	8,394
Decommissioning obligations	12	**17,821**	16,813
Other long-term liabilities	15, 21	**1,977**	2,138
		36,249	52,970
Shareholders' Equity			
Share capital	13	**238,989**	238,973
Contributed surplus		**16,371**	16,066
Equity component of convertible debentures	11	**76**	76
Accumulated other comprehensive loss		**(26,941)**	(27,157)
Deficit		**(191,496)**	(157,700)
		36,999	70,258
		73,248	123,228

Commitments and Other Long-term Liabilities (note 21)

See the accompanying Notes to the Consolidated Financial Statements

On behalf of the Board:

[signed] "Eric Mark"
Eric Mark
Director

[signed] "Leonardo Madcur "
Leonardo Madcur
Director

Consolidated Statements of Loss and Comprehensive Loss

USD 000s, except per share amounts	Note	Year ended December 31 2017	2016
Revenues			
Oil and natural gas revenues		**38,187**	50,152
Royalties		**(6,332)**	(8,039)
Other income	16	**78**	390
		31,933	42,503
Expenses			
Operating	24	**24,378**	23,567
General and administrative	24	**8,951**	9,858
Restructuring	25	**2,233**	-
Finance (income) expenses	17	**166**	3,122
Share-based and long-term incentive compensation	14, 15	**(633)**	1,549
Warrants expenses	11	**993**	-
Depletion and depreciation	6	**14,931**	19,805
Gain on disposal of assets	6, 7, 8	**(405)**	(2,227)
Impairment	6, 7	**22,206**	18,238
		72,820	73,912
Income (Loss) before income taxes		**(40,887)**	(31,409)
Income tax recovery (expense)			
Current	19	**52**	(2,203)
Deferred	19	**7,039**	1,512
		7,091	(691)
Loss from continuing operations		**(33,796)**	(32,100)
Net loss from discontinued operations	5	-	(4,477)
Net loss		**(33,796)**	(36,577)
Items that are or may be subsequently reclassified to net profit (loss)			
Foreign currency translation adjustment		**216**	820
Available for sale securities		**-**	(68)
Other Comprehensive income, net of tax		**216**	752
Total Comprehensive loss		**(33,580)**	(35,825)
Loss per share			
Basic and diluted - continuing	13	**(0.06)**	(0.06)
Basic and diluted - total	5, 13	**(0.06)**	(0.07)

See the accompanying Notes to the Consolidated Financial Statements

Consolidated Statements of Changes in Shareholders' Equity

USD 000s	Share Capital (note 13)	Contributed Surplus	Equity Component of Convertible Debentures (note 11)	Accumulated Other Comprehensive Loss	Deficit	Total Equity
Balance at December 31, 2016	**238,973**	**16,066**	**76**	**(27,157)**	**(157,700)**	**70,258**
Net loss	-	-	-	-	(33,796)	(33,796)
Foreign currency translation adjustment	-	-	-	216	-	216
Share-based compensation (note 14)	-	(688)	-	-	-	(688)
Common shares issued	16	-	-	-	-	16
Warrants (note 11)	-	993	-	-	-	993
Balance at December 31, 2017	**238,989**	**16,371**	**76**	**(26,941)**	**(191,496)**	**36,999**

USD 000s	Share Capital (note 13)	Contributed Surplus	Equity Component of Convertible Debentures (note 11)	Accumulated Other Comprehensive Loss	Deficit	Total Equity
Balance at December 31, 2015	238,758	14,520	-	(32,062)	(121,123)	100,093
Net loss	-	-	-	-	(36,577)	(36,577)
Recycle of other comprehensive loss due to discontinued operations (note 5a)	-	-	-	4,153	-	4,153
Foreign currency translation adjustment	-	-	-	820	-	820
Share-based compensation (note 14)	-	1,546	-	-	-	1,546
Common shares issued	215	-	-	-	-	215
Equity component of convertible debentures		-	76	-	-	76
Available for sale securities (note 16)	-	-	-	(68)	-	(68)
Balance at December 31, 2016	238,973	16,066	76	(27,157)	(157,700)	70,258

See the accompanying Notes to the Consolidated Financial Statements

Consolidated Statements of Cash Flows

		Year ended December 31	
USD 000s	Note	2017	2016
Cash provided by (used in):			
Operating			
Net loss		**(33,796)**	(36,577)
Items not affecting cash:			
Depletion and depreciation	6	**14,931**	19,968
Impairment		**22,206**	18,238
Accretion	17	**643**	255
Fair value change on convertible debentures held		**-**	190
Fair value change on assets held for sale	8	**150**	(14)
Equity loss pick up		**-**	614
Gain on disposal of assets	6, 7, 8, 21	**(557)**	(2,227)
Share-based and long-term incentive compensation	14, 15	**(633)**	1,570
Warrants expenses	11	**993**	
Deferred income tax expense (recovery)		**(7,039)**	(1,512)
Unrealized gain on foreign exchange	17	**833**	(161)
Lease commitment liability	21	**(121)**	908
Non-cash reduction of contingent liability		**293**	(29)
Realized other comprehensive loss	3	**-**	4,153
Loss on sale of discontinued operations	3	**-**	18
Change in other long-term assets		**476**	(718)
Change in non-cash working capital	20	**(3,301)**	8,178
Cash flow from operating activities		**(4,922)**	12,854
Investing			
Property, plant and equipment additions	6	**(1,567)**	(2,482)
Evaluation and exploration assets additions	7	**(583)**	(3,857)
Proceeds on sale of assets		**-**	54
Proceeds on disposal of PP&E and E&E assets, net of transaction fees	6, 7	**7,373**	-
Proceeds on disposal of assets held for sale, net of transaction fees	8	**1,280**	-
Change in non-cash working capital	14	**(2,807)**	(4,766)
Net cash used in investing activities		**3,696**	(11,051)
Financing			
Convertible debenture proceeds, net of fees			1,241
Investment disposal proceeds, net of fees			525
Bank loan repayment	9	**(1,646)**	(3,500)
Net cash from (used in) financing activities		**(1,646)**	(1,734)
Change in cash and cash equivalents		**(2,872)**	69
Cash and cash equivalents, beginning of year		**4,070**	3,912
Impact of foreign exchange on cash balances		**4**	90
Cash and cash equivalents, end of year		**1,202**	4,071

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 its principal place of business is Suite 200, 707 – 7th Avenue S.W., Calgary, Alberta, T2P 3H6.

The consolidated financial statements include the results of the following wholly-owned subsidiaries:

- Madalena Petroleum Ltd. (Canada) ("MPL")
- Madalena Energy Argentina S.R.L. (Argentina) ("MEA")
- Madalena Petroleum Americas Limited (Barbados) ("MPAL")
- Madalena Petroleum Holdings Limited (Barbados)
- Madalena Ventures International Holding Company Inc. (Barbados)
- Madalena Ventures International Inc. (Barbados)
- Pet-Ja S.A. (Argentina)

On January 1, 2017, Madalena Austral S.A. (Argentina) (“MASA”) and MEA were amalgamated into one legal entity, continuing under the name of MEA.

2. Basis of Preparation

The financial statements have been prepared in accordance with IFRS applicable to a going concern, which contemplate the realization of assets and the settlement of liabilities in the normal course of business as they become due. Continuing as a going concern is dependent upon the Company’s ability to amend capital commitments outlined in Note 21, which is expected to be achieved through negotiations with the provincial authorities. Failure to amend the commitments could result in insufficient sources to fund anticipated capital commitments. The Company’s ability to continue as a going concern and discharge its obligations would be dependent on obtaining alternative equity, debt financing, and/or proceeds from asset sales which could be challenging.

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"), and are presented in United States Dollars ("USD") unless otherwise indicated.

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 10, 2018.

Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis, except as described in the accompanying notes.

Functional and Presentation Currency

The presentation currency is the USD. The functional currency of the parent Company is the Canadian dollar (“CAD”). The USD 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 whether 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. Further, commitments entered into for concessions are based on the agreement signed at the time of concession entry, extension or renewal. To the extent that commitments have not been fulfilled by the expiry date, the Company may enter into negotiations to extend or renew. Should the concession not be extended or renewed, the Company may be responsible for any outstanding commitments.

- 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.

- 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 that the specified parties must act together even though the Company's 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 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.

- Determination of Functional Currency:

  Judgments made by management in determining the appropriate functional currency include an analysis of primary and secondary indicators, as follows:

  (1) Primary indicators of functional currency included the review of the currency that mainly influences sales prices; the currency whose competitive forces and regulations mainly determine sales price; and the currency that mainly influences labour, material and other costs. Specific relevant factors that management considered included:

- the government of Argentina sets the benchmark price for oil in USD per barrel and although the benchmark prices do not always follow world oil price changes in a predictable manner, the government is aware of and takes into consideration world prices when establishing the benchmark;
- although settled in the Argentina peso ("ARS"), all oil and gas sales are invoiced in USD and various credits and incentives that the Company is entitled to through the government of Argentina are expected to be denominated in USD;
- the Company's budget is prepared and managed in USD; and
- the majority of anticipated spending in the next 3 – 5 years is expected to be weighted to USD denominated expenditures, mainly as a result of the anticipated capital spending budgets in Argentina, although influenced as well by USD denominated operating costs. The size of the expenditures being made will result in the engagement of international companies that will require USD as the invoicing currency.

(2) Secondary indicators of functional currency determination include the currency in which funds from financing are generated; the currency in which funds from operations are retained; the degree of autonomy of the foreign operation; the frequency of the transactions with the reporting entity; the cash flow impact on the reporting entity and the ability of the foreign operation to finance its own activities. Relevant indicators considered in management's assessment included:

- as the expectation of growth existed, the anticipated financing currency was and continues to be the USD. Although ARS loans are available, given the Company's planned growth, any financing of significance is expected to be USD denominated; and
- funds retained in Argentina are in ARS.

While the above noted factors are mixed in support of both the USD and ARS, Management concludes that when considered collectively, it is appropriate to continue the conclusion that the USD is the appropriate functional currency for the Argentine subsidiaries.

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. 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, the extent of reclamation activities required, the engineering methodology for estimating cost, inflation estimates, 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.
- 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:
  - Level 1 – Quoted prices in active markets for identical assets or liabilities. Cash and cash equivalents, and the refundable deposit are Level 1 financial instruments.
  - Level 2 – Observable prices for similar assets or liabilities, either directly or indirectly determined. Long-term debt is a Level 2 financial instrument.
  - Level 3 – Unobservable input sources. Convertible debentures issued and the convertible debenture asset are Level 3 financial instruments.

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, unless IFRS indicates otherwise.

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 currently has 11 concessions in Argentina. Of the concessions owned by Madalena in Argentina, five are governed by 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. The Company has determined these agreements to result in joint operations, and accounts for these operations in accordance with its proportionate working interest ("WI").

The Company's WI at December 31, 2017 in the UTEs is as follows:

- Surubi - (85%)
- Palmar Largo - (14%)
- Coirón Amargo-Norte – (35%)
- Coirón Amargo-Sur Este – (35%)
- Curamhuele (90%)

The other 6 concessions are operated by the Company with a 100% WI.

iii. Associated companies

Associated companies are entities over which the Company has significant influence, but not control, generally accompanied by a shareholding giving rise to voting rights of 20% and above but not exceeding 50%. Investments in associated companies are accounted for in the consolidated financial statements using the equity method of accounting less impairment losses, if any.

Investments in associated companies are initially recognized at cost. The cost of an acquisition is measured at the fair value of the assets given, equity instruments issued or liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

In applying the equity method of accounting, Madalena's share of its associated companies' post-acquisition profits or losses are recognized in profit or loss and its share of post-acquisition other comprehensive income is recognized in other comprehensive income. These post-acquisition movements and distributions received from the associated companies are adjusted against the carrying amount of the investment. When Madalena's share of losses in an associated company equals or exceeds its interest in the associated company, including any other unsecured non-current receivables, Madalena does not recognize further losses, unless it has obligations or has made payments on behalf of the associated company.

Unrealized gains on transactions between the Company and its associated companies are eliminated to the extent of Madalena's interest in the associated companies. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of associated companies have been changed where necessary to ensure consistency with the accounting policies adopted by the Company.

Gains and losses arising from partial disposals or dilutions in investments in associated companies are recognized in profit or loss.

Investments in associated companies are derecognized when the Company loses significant influence. Any retained interest in the entity is remeasured at its fair value. The difference between the carrying amount of the retained investment at the date when significant influence is lost and its fair value is recognized in profit or loss.

(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 the parent company is translated into USD for presentation purposes as follows:

i. assets and liabilities for each statement of financial position presented are translated at the period end 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 on the dates of the transactions); and
iii. all resulting exchange differences are recognized as a foreign currency translation adjustment in a separate component of equity called 'accumulated other comprehensive loss'.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign currency gains and losses arising from such items are considered to form part of a net investment in the foreign operation and are recognized in other comprehensive income, and are presented in the foreign currency translation adjustment in equity. Where these are not considered to form part of the net investment, these foreign currency gains and losses are recognized as part of finance (income) expenses in the consolidated statements of loss.

When an operation with a functional currency other than the USD 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.

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

Fair value through profit or loss
Financial assets or liabilities (including derivative assets) are classified in this category if they are 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. Impairments are determined through review and assessment of collectability of the amounts, given the counterparty in question, aging and other relevant factors in the circumstances.

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 intention and ability to hold to maturity and include other long-term assets. 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 and include available for sale securities. 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 profit or loss. 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 and taxes payable, which are recognized at amortized cost. Non-current liabilities are recorded at the amount at which they are expected to be settled or amortized cost, and includes long-term debt and convertible debentures. . Convertible debentures are separated into their liability and equity components. The liability component accretes to the principal balance at maturity using the effective interest rate method. The equity component will be reclassified to share capital upon conversion. Any balance in equity that remains after the settlement of the liability is transferred to contributed surplus. The equity portion is recognized net of deferred income taxes and deferred issuance costs.

(d) Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash held at banks and short-term deposits with an original maturity of three months or less. For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of any 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 profit and loss. If the cost of the acquisition is more than the fair value of the net assets acquired, the difference is recognized on the statement of financial position as goodwill. Acquisition costs incurred are expensed.

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 E&E 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.

Initial wells on an E&E property that are drilled for the purpose of proving the technical feasibility and commercial viability of a reserve are capitalized and the property remains in the E&E phase pending a decision to fully develop the property. Multiple wells may need to be drilled to determine whether the E&E property

will be developed. A review of each exploration area is carried out to ascertain whether technical feasibility and commercial viability has been established 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 the project by incurring the future capital costs attributed to them. Upon determination of technical feasibility and commercial viability, E&E assets attributable to those reserves, in that particular area, are first tested for impairment and then reclassified from E&E assets to property, plant and equipment. If the cost of the asset is greater than the fair value, then the excess is written off in profit or loss.

During the quarter ended June 30, 2017, management reviewed their accounting policy for E&E transactions. The Company's new accounting policy for E&E dispositions where it retains an economic interest in the asset or concession is to reduce the carrying value of the assets in the particular concession by the proceeds of the transaction with no gain or loss being recorded. If the proceeds received on a partial disposition are in excess of the Company's carrying value then a pre-tax gain will be recognized by the amount of the excess. For transaction whereby the Company disposes of its interest in E&E assets that result in no on-going ownership or involvement with a concession, the Company recognizes gains and losses based on the difference in the carrying value of the assets being disposed and the net proceeds of disposition. In accordance with the requirements of IFRS, the Company believes that the accounting policy provides more relevant and no less relevant information about the transaction. The Company believes that recognizing a gain on E&E asset sales while retaining an economic interest in the E&E assets might imply to users that there is less risk associated with the recovery of the Company's retained interest. By their nature, the recovery of E&E assets are inherently risky and by reducing the carrying value of the asset and treating the proceeds as a recovery of costs incurred, the Company believes it is taking a more balanced approach to recognizing the transaction.

iii. Property, plant and equipment assets ("PP&E")

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 PP&E 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. 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 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 profit and loss.

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.

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 an indication of impairment exists. 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 PP&E 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 recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

Fair value less costs to sell is determined as the amount that would be obtained for the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. Fair value less costs to sell of a CGU can also be determined by using assumptions that an independent market participant may take into account. This evaluation could use discounted future net cash flows of proved and probable reserves using forecast prices and costs including the development of prospective lands.

Madalena's management determines value in use for each CGU by estimating the present value of estimated future net cash flows from continued production through exploitation of its proved and probable reserves. Management applies a present value to these cash flows using a pre-tax discount rate range depending on the category of reserves being discounted. The discount rates reflect current market assessments and the risks specific to the assets.

E&E assets are allocated to related CGUs 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&E.

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.

(f) Share Based Compensation and Long-term Incentive Plan

i. Share based compensation

The grant date fair value of equity settled options granted to employees and directors is recognized as share-based 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 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.

ii. Long-term incentive plan

For cash based incentive plans, units issued are recorded at fair value and recognized over the requisite service period. Changes in fair value each period are recognized in the statement of loss.

(g) 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 the timing, that is 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 by which payment is most influenced. 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 and amortized based on the methodology that is consistent with the asset to which it is 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, 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.

(h) 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.

(i) 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. Current tax also includes the amounts paid or accrued for minimal presumed income tax, which is an Argentine tax on net assets, levied on those companies with no taxable income.

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.

(j) Earnings (Loss) Per Share

The Company presents basic and diluted earnings (loss) 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. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares.

(k) 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 a relevant share of operating, royalty expense and depletion. Depending on inventory levels, this could increase or decrease inventory otherwise recorded.

(l) Assets held for sale

Non-current assets are classified as held for sale if it is highly probable that they will be recovered primarily through sale rather than through continuing use. Such assets are generally measured at the lower of their carrying amount and fair value less costs to sell. Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognized in profit or loss.

(m) Value added tax ("VAT")

VAT on purchases is applied against VAT on sales to reduce the amount paid to the Argentine government. VAT is recorded as a receivable when it is expected that it will be recovered through future sales. To the extent that

amounts are expected to be recovered over a period greater than a year, the amount is discounted. VAT does not expire and may be carried forward indefinitely.

4. Accounting Changes

Future Accounting Pronouncements
IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments that replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9.

IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions.

(a) Classification and measurement
The Company does not expect a significant impact on its balance sheet or equity on applying the classification and measurement requirements of IFRS 9. It expects to continue measuring at fair value all financial assets currently held at fair value.

b) Impairment
IFRS 9 requires the Company to record expected credit losses on all of its debt securities, loans and trade receivables, either on a 12-month or lifetime basis.

The Company will apply the simplified approach and record lifetime expected losses on all trade receivables.

(c) Hedge accounting
The Company does not expect any impact for hedge accounting under IFRS 9.

(d) Other adjustments
In addition to the adjustments described above, on adoption of IFRS 9, other items of the primary financial statements such as deferred taxes, assets held for sale and liabilities associated with them, investments in the associate and joint venture, will be adjusted as necessary. The exchange differences on translation of foreign operations will also be adjusted.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014, and amended in April 2016, and establishes a five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The new revenue standard will supersede all current revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application is required for annual periods beginning on or after 1 January 2018. Early adoption is permitted. Madalena has elected to apply IFRS 15 prospectively from January 1, 2018 and no material impacts to the financial results of Tervita were identified as a result of the adoption of IFRS 15.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset.

Lessees will be also required to remeasure the lease liability upon the occurrence of certain events (e.g., a change in the lease term, a change in future lease payments resulting from a change in an index or rate used to determine those payments). The lessee will generally recognise the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset.

Lessor accounting under IFRS 16 is substantially unchanged from today's accounting under IAS 17. Lessors will continue to classify all leases using the same classification principle as in IAS 17 and distinguish between two types of leases: operating and finance leases.

IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies IFRS 15. A lessee can choose to apply the standard using either a full retrospective or a modified retrospective approach. The standard's transition provisions permit certain reliefs. . Madalena is evaluating the impact this standard may have on Madalena's consolidated financial statements.

5. Discontinued Operations

On June 28, 2016 and pursuant to a series of transactions, Madalena sold its Canadian petroleum and natural gas assets in exchange for 6,244,814 escrowed common shares of Point Loma Resources Ltd. ("Point Loma"), with a fair value of $1.9 million and a five-year $2.4 million subordinated secured convertible debenture, bearing interest at 3% per annum, plus an origination fee of 3% of the principal remaining on maturity, payable at the end of the debenture term. Madalena can convert all or part of the debenture plus accrued interest and origination fee into common shares, at Madalena's election, at a fixed price of CAD $0.50 per common share (note 8). The fair value of the convertible debenture at June 28, 2016 was $2.4 million, which included the fair value of the conversion feature, valued at $0.6 million.

These assets consist of the Canadian operating segment and are presented as discontinued operations. The consolidated statements of loss and comprehensive loss have been presented to show the discontinued operations as a single line item, and are therefore separated from continuing operations in the current and comparative periods. The consolidated statements of financial position reflect the disposition of the Canadian operating segment as at June 28, 2016, although the comparatives still contain the Canadian operating segment, as required under IFRS. The consolidated statements of cash flows contain the Canadian operating segment in the current and comparative period, with the cash flow results of the discontinued operation disclosed in note 5c.

a. Net loss from discontinued operations

USD 000s	For the years ended December 31 2017	2016
Revenues		
Oil and natural gas revenues	-	430
Royalties	-	(7)
	-	423
Expenses (recoveries)		
Operating	-	395
General and administrative	-	127
Finance (income) and expenses	-	23
Share-based compensation	-	21
Depletion and depreciation	-	163
Impairment	-	-
	-	729
Loss from operating activities of discontinued operations	-	(306)
Loss on sale of discontinued operations (note 5b)	-	(18)
Realized accumulated other comprehensive loss on disposition of Canadian operations[1]	-	(4,153)
Net loss from discontinued operations	-	(4,477)
Basic and Diluted EPS	-	(0.01)

(1) This is the cumulative translation adjustment on the sale of the Canadian assets that is recycled through the statement of loss on disposition.

Current and deferred taxes were not impacted by the disposal of the Canadian operating segment as no assets had previously been recognized on the Canadian tax pools.

b. Loss on sale of discontinued operations

USD 000s	2017	2016
Proceeds (note 8):		
Common shares – Point Loma	-	1,918
Debenture including conversion feature	-	2,351
	-	4,269
Property, plant and equipment disposed of	-	(6,336)
Exploration and evaluation assets disposed of	-	(2,419)
Decommissioning liabilities disposed of	-	4,682
Transaction costs attributable to disposal	-	(214)
	-	(4,287)
Loss on sale of discontinued operation – June 28, 2016	-	(18)

c. Cash flows from (used in) discontinued operations

USD 000s	For the years ended December 31 2017	2016
Net cash used in operating activities	-	(41)
Net cash from (used in) investing activities	-	12
Net cash flow for period	-	(29)

6. Property, Plant and Equipment ("PP&E")

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Cost			
At December 31, 2015	173,934	1,992	175,926
Additions	5,162	46	5,208
Disposals	(42,018)	-	(42,018)
Effect of change in foreign exchange rates	2,457	21	2,478
At December 31, 2016	139,535	2,059	141,594
Additions	3,866	54	3,920
Disposals	-	(34)	(34)
Effect of change in foreign exchange rates	-	42	42
At December 31, 2017	**143,401**	**2,121**	**145,522**

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Accumulated depreciation and depletion			
At December 31, 2015	(85,951)	(610)	(86,561)
Depreciation and depletion	(18,934)	(498)	(19,432)
Impairment	(15,500)	-	(15,500)
Disposals	35,511	-	35,511
Effect of change in foreign exchange rates	(2,060)	(8)	(2,068)
At December 31, 2016	**(86,934)**	**(1,116)**	**(88,050)**
Depreciation and depletion	(14,582)	(326)	(14,906)
Disposals	-	34	34
Impairment	(22,206)	-	(22,206)
Effect of change in foreign exchange rates	-	1	1
At December 31, 2017	**(123,722)**	**(1,407)**	**(125,127)**

USD 000s			
Net book value			
At December 31, 2016	52,601	943	53,544
At December 31, 2017	**19,679**	**714**	**20,395**

On June 28, 2016 (note 5b), the net book value of PP&E assets associated with the Canadian operating segment amounting to $6.3 million were disposed.

At December 31, 2017, Madalena determined that indicators of impairment existed in each of its Argentine CGUs. These indicators of impairment were a result of lower netbacks in these CGUs. CGUs at December 31, 2016 were defined at the legal entity level and aggregated up to the concession level for the Argentine branches of Madalena Petroleum Ltd. (Canada) ("MPL") and Madalena Petroleum Americas Limited (Barbados) ("MPAL").

However, effective January 1, 2017 Madalena amalgamated legal entities MEA and MASA into one legal entity. In fiscal 2016 these two legal entities were considered their own CGUs. Because these two legal entities hold concessions in different parts of the country, where independent cash flows exist due to different economic circumstances and different processing arrangements, management concludes that the concessions in the North (originally MEA) and the concessions in the South (originally MASA) will continue to maintain their own CGU.

As a result, impairment tests were performed over each CGU and all of them were deemed to be impaired as their estimated recoverable amounts were lower than their carrying amounts. The recoverable amounts, calculated as $20.3 million, resulted in pre-tax impairment charges of $22.2 million (2016 - $18.2 million).

The impaired CGU's recoverable values were estimated using value in use calculations based on future net cash flows expected to be derived from the CGU's proven plus probable reserves from the externally prepared December 31, 2017 reserve report using adiscount rate of 17% and the following forecast benchmark commodity price estimates:

Year	Brent Oil Price [(1)] (USD/bbl)	Argentina Domestic Gas Price [(1)] (USD/mmbtu)
2018	62.33	4.40
2019	63.93	4.40
2020	66.13	4.49
2021	70.37	4.58
2022	73.23	4.67
2023	75.21	4.76
2024	77.23	4.86
2025	79.26	4.96
2026	81.15	5.05
2027	82.75	5.16
2027+	+2.0%/yr	+2%/yr

(1) The forecast benchmark commodity prices listed above are adjusted for quality differentials, heat content, distance to market and other factors in performing our impairment tests.

Had the discount rate used been 1% higher for the discount rate used, additional impairment charges of $1.3 million would have resulted for the year ended December 31, 2017.

An additional $1 decrease in the price deck would have resulted in further impairment charges of $1.1 million for the year ended December 31, 2017.

At December 31, 2016, Madalena determined that indicators of impairment existed in each of its Argentine CGUs due to pricing reductions associated with Argentine oil benchmarks moving toward world prices. As a result, impairment tests were performed over each CGU and two (Madalena Austral S.A. (Argentina) ("MASA") and the Argentine branches of MPL/MPAL) were deemed to be impaired as their estimated recoverable amounts were lower than their carrying amounts. The recoverable amounts, calculated as $12.8 million and $5.0 million, resulted

in pre-tax impairment charges of $3 million and $3.2 million for the two CGUs, respectively, for the Quarter (Q4-2015 - $8.4 million) and $17.4 million YTD (YTD-2015 - $8.4 million).

The impaired CGU's recoverable amounts were estimated using value in use calculations based on future net cash flows expected to be derived from the CGU's proven plus probable reserves from the externally prepared December 31, 2016 reserve report using a pre-tax discount rate ranging from 22% to 28% depending on the category of reserves and the forecast benchmark commodity price estimates ranging from $57.00/bbl - $89.64/bbl for oil and $4.95 - $5.80/mmbtu for natural gas.

The depletion expense calculation for the year ended December, 2017 included as part of the depletable base, $93.9 million (December 31, 2016 – $83.5 million) for estimated future development costs associated with proved and probable reserves in Argentina.

During the year ended December 31, 2017, approximately $0.7 million (2016 - $1.3 million) of directly attributable general and administration costs were capitalized to property, plant and equipment in Argentina. No share-based compensation expense was capitalized for the year ended December 31, 2017 (2016 - $40 thousand).

7. Exploration and Evaluation Assets ("E&E")

USD 000s	
Cost	
At December 31, 2015	43,767
Additions	10,622
Impairment	(2,738)
Disposals	(2,450)
Effect of change in foreign exchange rates	139
At December 31, 2016	49,340
Additions	529
Disposals	(10,000)
At December 31, 2017	**39,869**

E&E assets consist of the Company's intangible exploration projects in Argentina 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.

In January 2017, the Company sold 55% of its previously held 90% working interest ("WI") in Coirón Amargo Sur-Este ("CASE") to Pan American Energy LLC, Sucursal Argentina ("PAE"). Gross proceeds before transaction costs were $10 million and PAE agreed to carry Madalena share of capital cost up to $5.6 million over the course of an agreed upon work program ("Work Program") (note 21).

In October 2016, Madalena closed a transaction that was entered into in July 2016, whereby certain E&E land positions in the southwestern region of Coirón Amargo ("CA"), CA-Sur Oeste ("CASO"), which had no accounting value assigned to them, were exchanged for an increase in WI in the existing E&E property in the southeastern region of CA, CA-Sur Este ("CASE"). This non-cash transaction was evaluated to have commercial substance and the fair value of the land acquired of $5.6 million was recorded as an addition to E&E.

On June 28, 2016 (note 5b), the E&E assets associated with the Canadian operating segment amounting to $2.4 million were disposed.

At December 31, 2017, Madalena determined that no impairment triggers existed relating to its Argentine E&E assets.

At December 31, 2016, Madalena determined that no impairment triggers existed relating to its Argentine E&E assets. The Cortadera concession was officially relinquished to the Province of Neuquén in October 2016, prior to the release of the Company's Q3-16 results. Accordingly, the net book value of the Cortadera E&E assets of $2.7 million was written off and recorded as part of Impairment in the consolidated statements of loss during Q3-16, and is included in Impairment for the year ended December 31, 2016.

8. Assets Held for Sale and Investments

As a result of the disposal of the non-core Canadian assets on June 28, 2016 (note 3), the Company received as part of the proceeds, 6.2 million common shares of Point Loma, which were recorded as an equity accounted investment at that date. At December 31, 2016, and given the liquidity challenges faced by the Company and the intention to sell all of the common share investment in Point Loma, these common shares were no longer accounted for as an equity investment, but as assets held for sale ("AHFS") and recorded at fair value amounting to $1.3 million.

In January 2017, the Company sold 1.5 million of the Point Loma common shares for net cash proceeds of approximately $0.5 million, and realized a gain on sale of approximately $0.1 million which is recorded as part of gain on disposal of assets for the twelve months period ended December 31, 2017.

In addition, and pursuant to a purchase and sale agreement dated April 21, 2017 with an arms-length third party, the Company sold the remaining 4.7 million common shares in Point Loma for gross cash proceeds of $0.8 million with no resulting gain or loss on sale.

9. Long-term Debt and facility availability

Argentina

The credit facility with Industrial and Commercial Bank of China (Argentina) S.A. of $1.6 million was fully repaid on February 3, 2017. The loan incurred interest at the variable rate of BADLAR plus approximately 8.8%, resulting in borrowing rate of 32.6% at the time it was paid out.

Canada

On May 8, 2017, Madalena entered into a series of agreements (the "Transactions") with Hispania Petroleum S.A., ("Hispania"), a private, family-owned Spanish energy Company and a related party of the Company, where José Peñafiel is director, which provides for a package of debt and mezzanine financing of up to $23 million which are expected to alleviate Madalena's liquidity challenges through a Working Capital Loan of up to $6.5 million and provide the Company access to growth capital for drilling and investment activities through a Capex Loan of up to $16.5 million.

The Working Capital Loan is a multi-drawdown facility, which is available to be used for general working capital purposes. Interest accrues at 7% per annum. Principal and interest on each drawdown will be repayable thirty-six months after an advance of funds.

The Capex Loan is a multi-drawdown convertible loan. The loan similarly accrues interest at 7% per annum, with each drawdown and accrued interest repayable thirty-six months after drawdown. The Capex Loan is convertible into units of the Company ("Units") with each Unit comprised of one common share ("Common Share") and 0.22 of a Common Share purchase warrant ("Warrant"), with each Warrant entitling the holder to purchase an additional Common Share. The Capex Loan is convertible based on a conversion price equal to a 5% premium to the 20-day volume weighted average price ("VWAP") of the Common Shares on the last trading date prior to a

particular drawdown (“Conversion Price”) in respect of the Common Shares comprising the Units. The exercise price of the Warrants issued upon conversion is also at a 5% premium to that 20-day VWAP. These Warrants expire 18 months after the date of issuance. Both Hispania and Madalena have the right to convert the whole or part of the principal and interest owing hereunder into Units on or before repayment, although Madalena’s right to compel conversion is limited in some circumstances.

Both loans are secured, limited to the Company’s interests in the Puesto Morales concession.

On September 13, 2017, the shareholders of the Company passed an ordinary resolution approving KD Energy International Capital Limited as a new "Control Person" (as such term is defined in the TSX Venture Exchange Corporate Finance Manual) of the Company. In connection therewith, the convertible loan agreement dated May 8, 2017 for an amount up to $16.5 million is now available to be drawn upon by the Company in accordance with the terms thereof.

As a December 31, 2017, neither loan has been drawn. The Company has no bank debt in Canada at December 31, 2017 and 2016.

10. Other Long-term Assets

Other long-term assets are comprised of long-term receivables for which the fair value approximates the carrying value. The long-term receivables primarily relate to ARS denominated taxes receivable of $0.2 million (December 31, 2016 – $0.3 million).

11. Convertible Debentures and Warrants

The Hispania Capex Loan will be convertible into units of the Company ("Units") with each Unit comprised of one common share ("Common Share") and 0.22 of a Common Share purchase warrant ("Warrant"), with each Warrant entitling the holder to purchase an additional Common Share. The Capex Loan will be convertible based on a conversion price equal to a 5% premium to the 20-day volume weighted average price ("VWAP") of the Common Shares on the last trading date prior to a particular drawdown ("Conversion Price") in respect of the Common Shares comprising the Units. The exercise price of the Warrants issued upon conversion will be at a 5% premium to that 20-day VWAP. These Warrants will expire 18 months after the date of issuance. Both Hispania and Madalena will have the right to convert the whole or part of the principal and interest owing hereunder into Units on or before repayment, although Madalena's right to compel conversion is limited in some circumstances.

In conjunction with the Transactions entered into with Hispania, the Company entered into a services agreement which requires the Company to issue six monthly tranches of share purchase warrants to Hispania commencing June 2017 (see notes 7 and 13). Each monthly tranche will include 4,758,333 warrants that are exercisable after 6 months from the date of issuance. Each tranche will expire 18 months from the date of issuance. Each warrant entitles the holder to purchase one common share of the Company. The exercise price for the six tranches of 4,758,333 warrants issued was $0.145/share, $0.165/share, $0.18/share, $0.17/share, $0.17/share and $0.18/share respectively.

The Company expensed $1 million for the twelve months periods ended December 31, 2017 in relation to these warrants (2016 – nil).

On July 13, 2016, the Company completed a private placement of $1.2 million (CAD $1.6 million) 12% secured convertible debentures, net of fees, primarily to insiders or existing shareholders, with a June 30, 2019 maturity date. The debentures are convertible into common shares of the Company at a conversion price of CAD $0.25 per common share, any time after January 13, 2017. Interest on the debentures is payable semi-annually, in arrears, on December 31 and June 30. Interest accrued to December 31, 2017 amounting to $0.1 million was fully paid at year end. The Company may, at its option and upon providing notice to the debenture holders, repay the

outstanding indebtedness. Such repayments involve premiums that reduce as the date to maturity approaches. Although insiders participated in the private placement, the terms and conditions were the same as those available to third parties.

These debentures are a level III financial liability with an embedded conversion feature. As a result, the equity and debt components must be bifurcated. The value assigned to the liability on July 13, 2016 was the present value of the contractually determined stream of future cash flows discounted at 15%, being the rate estimated to be equivalent to that which the market would apply to an instrument with comparable credit status and provide substantially the same cash flows, on the same terms, but without the conversion option. From the date of issuance, the liability component accretes up to its principal value using the effective interest method, with the charge recorded in finance (income) expenses in the consolidated statements of loss.

The following table reconciles the principal amount, liability and equity components of the convertible debentures:

USD 000s	Liability Component	Equity Component	Total
At December 31, 2016	1,143	76	1,219
Accretion (note 17)	69	-	69
Converted debentures (note 13)	(16)	-	(16)
Impact of foreign exchange	78	-	78
At December 31, 2017	**1,274**	**76**	**1,350**

Transaction costs totaling $0.1 million were deducted from the amounts issued, on a pro-rata basis between the liability and equity components.

12. Decommissioning Obligations

USD 000s	Year ended December 31 2017	2016
Balance, beginning of year	**20,394**	**20,641**
Disposals	**(485)**	**(4,902)**
Additions from development activities	**351**	**381**
Additions from exploration activities	**-**	**475**
Accretion expense (note 5a, 17)	**575**	**203**
Revision of estimates	**836**	**3,302**
Obligations settled	**-**	**-**
Effect of change in foreign exchange rates	**-**	**294**
Balance, end of year	**21,671**	**20,394**
Current	**3,850**	**3,581**
Long-term	**17,821**	**16,813**
Total	**21,671**	**20,394**

The total undiscounted amount of cash flows required to settle Madalena's decommissioning obligations in Argentina only at December 31, 2017 is approximately $22.7 million (December 31, 2016 – $22.9 million) with the majority of the costs to be incurred between 2026 and 2027. At December 31, 2017, $3.9 million of the decommissioning obligations are recorded as a current liability and the remainder of $17.8 million as a long-term liability, given that the current obligations are expected to be incurred by December 31, 2017. 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.

At December 31, 2017 an inflation rate of 2.1% was used (December 31, 2016 – 1.5%). The risk free rate used to discount the liability at December 31, 2017 was 2.65% (December 31, 2016 – 2.8%). The majority of the Argentine decommissioning obligations are expected to be invoiced in USD and settled through payments in ARS.

The revision of estimates which increased decommissioning liabilities by $0.8 million for the year ended December 31, 2017 (2016 - $3.3 million) is comprised of a decrease of $0.1 million (2016 – increase of $2.8 million) for changes in well cost estimates, and an increase of $1 million (2016 - $0.5 million) relating to a change in the discount and inflation rate and a decrease of $0.1 million (2016 - nil) relating to reserve life changes.

13. Share Capital

The Company is authorized to issue an unlimited number of common shares and preferred 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 preferred shares were outstanding at December 31, 2017 or 2016. No dividends have been declared by the Company for the years ended December 31, 2017 or 2016.

	Number of Shares 000s	Share Capital 000s
Balance at December 31, 2015	542,083	238,758
Common shares issued	1,697	215
Balance at December 31, 2016	543,780	238,973
Common shares issued	80	16
Balance at December 31, 2017	**543,860**	**238,989**

<u>2017</u>
On October 30, 2017, 80,000 common shares were issued at a price of CAD $0.25 pursuant to the exercise of convertible debenture option of $20 thousand.

2016
On July 21, 2016, 1,696,970 common shares were issued at a price of CAD $0.165 pursuant to a settlement agreement with a former employee, reducing the contractual severance liability owed by $0.2 million.

Net Loss Per Share
As at December 31, 2017, there is no resulting dilutive impact of the convertible debentures or share options. The following table provides the weighted average number of common shares used in the per share calculations:

	Year ended December 31	
	2017	**2016**
Weighted average number of common shares - basic and diluted – 000s	**543,860**	542,880
Net loss from continuing operations - USD 000s	**(33,796)**	(32,100)
Per share – basic & diluted - continuing operations ($/share)	**(0.06)**	(0.06)

14. Share-based 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 vest 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.

During the year ended December 31, 2016, 3,000,000 (2016 – 8,650,000) options were granted to directors, officers, and employees of the Company, at an exercise price of CAD $0.17 per share (2016 – CAD $0.27).

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

	Number of options 000s	Weighted average exercise price
Outstanding at December 31, 2015	34,819	0.35
Granted	8,650	0.27
Forfeited	(7,329)	0.30
Expired or cancelled	(2,015)	0.53
Outstanding at December 31, 2016	34,125	0.34
Granted	3,000	0.17
Forfeited	(20,926)	0.34
Expired or cancelled	(9,851)	0.31
Outstanding at December 31, 2017	**6,348**	**0.27**
Exercisable at December 31, 2017	**2,452**	**0.38**

The range of exercise prices of the outstanding options

Exercise price (CAD)	Number of Options Outstanding 000s	Weighted Average Contractual Life of options outstanding (years)	Number of outstanding options that are exercisable 000s
0.17	3,000	4.50	-
0.27	575	3.04	192
0.30	1,250	2.67	833
0.35	612	0.65	516
0.50	911	1.53	911
	6,348	3.21	2,452

The fair value of options granted was estimated at the period end date using the Black-Scholes valuation model, resulting in a per option fair value of CAD $0.10 (2016 – CAD $0.15) with weighed average assumptions as follows:

Inputs used to fair value share options granted

	Year ended December 31	
	2017	**2016**
Share price (CAD $)	**0.17**	0.27
Exercise price (CAD $)	**0.17**	0.27
Expected Volatility (%)	**75**	75
Forfeiture rate (%)	**9.8**	9.8
Option life (years)	**4.35**	4.05
Risk-free interest rate (%)	**0.85**	0.61

Expected volatility is estimated by considering historic daily share price volatility. The forfeiture estimate is adjusted each period until the vesting date.

Share-based compensation expense arising from the issuance of stock options recognized for the year ended December 31, 2017 was $64 thousand (2016 - $1.5 million). No share-based compensation expense was capitalized during the year (2016 - $40 thousand capitalized).

Share-based compensation recovery arising from the forfeitures of stock options recognized for the year ended December 31, 2017 was $0.7 million (2016 - nil).

15. Long-term Incentive Plan

On August 25, 2016, the Board of Directors approved a long-term cash incentive plan ("LTIP"), whereby certain Argentine employees of the Company are provided an opportunity to benefit as a result of appreciation of the trading price of Madalena's common shares from the issue date, through the payment of cash upon vesting.

On August 26, 2016, 6,505,000 LTIP units (the "Units") were issued to Argentine personnel at an exercise price of CAD $0.145 per common share. The Units vest one-third on each of the first, second and third anniversary dates and are exercisable for a period no later than:

i) December 1 of the third year in which the Units vest; and
ii) Five years from the date of the grant of the Units.

The LTIP recovery arising from the forfeitures of units net of LTIP expense, recorded as part of share-based and long-term incentive compensation expense in the consolidated statements of loss for the year ended December 31, 2017 was $20 thousand (2016 – expense of $64 thousand) and is revalued at the end of each reporting period.

At December 31, 2017 the LTIP liability was $49 thousand (2016 - $64 thousand).

16. Other Income

Other income relates primarily to oil reception services in CA-Norte rendered to two Joint ventures operated by O&G Developments Ltd S.A. of $78 thousand.

In the comparative period other income of $0.4 million, other income relates primarily to miscellaneous equipment sales.

17. Finance (Income) Expenses

Finance (Income) and Expenses are made up of the following:

	Year ended December 31	
USD 000s	**2017**	**2016**
Bank charges and fees	**1,084**	1,229
Foreign exchange gain	**833**	(145)
Decommissioning liability accretion (note 5a, 12)	**163**	203
Accretion of debt component of convertible debentures issued (note 11)	**69**	29
Recovery of allowance for doubtful account, interest and other expenses	**(2,458)**	948
Equity loss pick up (note 8)	**-**	614
Fair value change on convertible debentures held (note 11)	**-**	190
Fair value change on assets held for sale (note 8)	**150**	(14)
Available for sale securities	**-**	68
	(159)	3,122

	Year ended December 31	
USD 000s	**2017**	**2016**
Realized foreign exchange losses	**(2)**	16
Unrealized foreign exchange gains	**835**	(161)
Total	**833**	(145)
Currency exchange rate at period end:		
$1 USD = CAD	**$1.25**	$1.34
$1 USD = ARS	**$18.65**	15.89

18. Related Parties

An ex-director of the Company was a partner of a law firm that provided legal services to the Company. During the year ended December 31, 2017, the Company incurred fees of $0.3 million (2016 - $0.8 million) from this firm for legal services, of which $0.1 million (2016 – $0.8 million) is included in trade and other payables at December 31, 2017. The costs were expensed in general and administrative costs in the consolidated statements of loss.

In association with the Services Agreement with Hispania, the Company incurred fees of $1.1 during the year ended December 31, 2017 (2016 – nil).

On September 13, 2017, the shareholders of the Company passed an ordinary resolution approving KD Energy International Capital Limited as a new "Control Person" (as such term is defined in the TSX Venture Exchange Corporate Finance Manual) of the Company. In connection therewith, the convertible loan agreement dated May 8, 2017 for an amount up to USD $16.5 million is now available to be drawn upon by the Company in accordance with the terms thereof. At December 31, 2017, there were no disbursements.

A director of two of the Company's subsidiaries provides professional services to the Company. During the year ended December 31, 2017, the Company did not incur fees (2016 - $45 thousand), for professional fees. The $45 thousand was included in trade and other payables at December 31, 2016.

Of the convertible debentures issued by Madalena in July 2016 (note 11), certain directors and officers of the Company subscribed to 18% of the total issuance.

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. The terms and conditions of these transactions were no more favourable than those available, or which might reasonably be expected to be available in similar transactions with arm's length third parties.

19. 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 27% (2016 – 27%) to the income (loss) before taxes. The difference results from the following:

	Year ended December 31	
	2017	**2016**
Income (Loss) before income tax – continuing operations	**(40,887)**	(31,409)
Tax rate	**27%**	27%
Expected income tax recovery (expense)	**11,039**	8,480
Recovery (expense) resulting from:		
Effect of foreign tax rates	**2,623**	(1,130)
Share-based compensation	**(97)**	(441)
Unrecognized deferred tax benefit and other	**(3,455)**	(6,476)
Effect of tax rate adjustments	**(2,867)**	-
Non-taxable portion of capital loss	**-**	(234)
Non-taxable differences on foreign operation	**-**	(729)
Minimum presumed foreign income tax	**-**	(197)
Other	**(152)**	36
Total income tax expense	**7,091**	(691)
Attributable to:		
Current tax expense	**52**	(2,203)
Deferred tax recovery (expense)	**7,039**	1,512
Total income tax expense	**7,052**	(691)

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

Deferred tax assets have not been recognized on the following temporary differences and credits:

Canada	Year ended December 31 2017	2016
Property, plant and equipment	**25,203**	21,785
Decommissioning obligations	**-**	-
Share issue costs	**1,214**	2,011
Capital losses	**25,641**	24,405
Non-capital losses (expire 2026 to 2036)	**94,978**	66,581
Foreign tax credits	**44,443**	40,485
Minimun tax credits	**-**	-
Other	**(3,113)**	1,503
Total unrecognized temporary differences	**188,366**	156,770

Argentina	Year ended December 31 2017	2016
Decommissioning obligations	**11,922**	10,278
Non-capital losses (expire 2017 to 2020)	**7,495**	4,820
Property, plant and equipment	**2,298**	-
Accruals & Other	**5,776**	7,471
Minimum tax credits	**-**	3,368
Total unrecognized temporary differences	**27,491**	25,937
Barbados		
Non-capital losses (expire 2017 to 2023)	**677**	706
Total unrecognized temporary differences	**677**	706

The following table summarizes the movements of the deferred income tax liability during the year:

	Year ended December 31				
	2015	Recognized in statement of loss	2016	Recognized in statement of loss	2017
Foreign exchange	(846)	**72**	(774)	**774**	**-**
Property, plant and equipment	(15,099)	**2,326**	(12,773)	**9,157**	**(3,616)**
Decommissioning obligations	3,057	**484**	3,541	**(1,681)**	**1,860**
Non-capital losses	2,040	**(670)**	1,370	**(1,370)**	**-**
Accruals and other	942	**(700)**	242	**162**	**404**
Minimum tax credits	-	**-**	-	**-**	**-**
	(9,906)	**1,512**	(8,394)	**7,042**	**(1,352)**

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.

20. Supplemental Cash Flow Information

Changes in non-cash working capital

	Year ended December 31	
USD 000s	**2017**	**2016**
Available for sale securities	**-**	5,361
Trade and other receivables	**1,409**	6,226
Other current assets, including inventory	**(86)**	648
Assets held for sale (note 8)	**1,116**	(1,265)
Trade, tax and other payables	**(7,866)**	(5,390)
Impact of foreign exchange on working capital	**(681)**	(2,168)
Change in non-cash working capital[1]	**(6,108)**	3,412
Attributable to:		
Operating activities	**(3,301)**	8,178
Investing activities	**(2,807)**	(4,766)
	(6,108)	3,412

(1) Change in non-cash working capital excludes the current portion of long-term debt, as this is considered part of financing activities.

Other cash flow information- continuing operations

	Year ended December 31	
USD 000s	**2017**	**2016**
Interest paid	**77**	1,621
Interest received	**4**	120
Taxes paid	**1,257**	3,788

21. Commitments and Other Long-term Liabilities

Development and Exploration Commitments

Coirón Amargo Norte ("CA-Norte")

Madalena and its partners at the CA concession in the province of Neuquén are responsible for paying 100% of the costs during the exploration and evaluation phase, with Gas y Petróleo del Neuquén S.A. (“GyP”), a provincial government entity, receiving a 10% carry whereby all other partners, including Madalena, are responsible for paying their proportionate share of GyP’s WI. Currently, exploration and evaluation phases are contained in CA-Sur, in the southern portion of CA.

In an exploitation or development phase, GyP is responsible for its 10% interest of the incurred capital costs through an assignment of GyP’s 10% interest in future production revenue streams to Madalena and its partners. Currently, exploitation and development phases are contained in CA-Norte, in the northern portion of CA, for which there are no current work commitments.

Coirón Amargo Sur Este (CASE - 35% WI)

Prior to July 11, 2016, Madalena held a 35% WI in the entire CA-Sur exploration and evaluation concession. Pursuant to a series of agreements dated July 11, 2016 and subject to government approvals and an Executive Decree, which were subsequently obtained in October 2016, CA-Sur was divided into two evaluation lots – CASE and CoirónAmargo-Sur Oeste (“CASO”). Madalena sold its’ interest in CASO in return for an additional 55% WI in CASE and became operator.

On December 7, 2016, the Company entered into agreements with PAE relating to the Company’s 90% WI at CASE, which closed on January 10, 2017. Pursuant to these agreements, Madalena received cash payments of an aggregate of $10 million, an advance of $3 million in December 2016, disclosed as refundable deposits, and $7 million on closing and sold a 55% WI and operatorship to PAE, thereby retaining a 35% non-operated WI in CASE. A 2017 work program (“Work Program”) will be comprised of two well re-entries, which will be undertaken by PAE as the new operator of CASE. Madalena will be carried for the first $5.6 million in carried costs through this Work Program. GyP retains their 10% WI in CASE. To the extent that Madalena’s share of the Work Program extends beyond $5.6 million, Madalena will be required to fund this incremental amount.

Concurrently, PAE agreed, subject to certain conditions, to provide Madalena with a loan of up to $40 million, on a limited recourse basis, to be drawn-down as required to fund certain CASE capital expenditures. This limited recourse loan would bear interest at 7% per annum and is repayable in five years from the net revenue generated from the capital expenditure program. Transaction fees of $0.5 million were incurred to complete this agreement. No draw down of the loan has occurred as of December 31 2017.

Pursuant to the new arrangements, Madalena work commitments at CASE were amended as follows:

USD 000s	2018	2019[(1)]
Concession commitments at CASE	-	1,787[(2)]

(1) Committed values are reflected at Madalena’s 35% WI at December 31, 2017 plus Madalena’s proportionate share of GyP’s carry.
On November 13, 2017 the company received the provincial approval due to the re-entry of well Cas.x-15 for $2.1 million.
(2) Subject to the results in 2017 to be completed, before November 8, 2019.

The new exploration and evaluation permit for CASE expires on November 8, 2019, following which Madalena will be eligible to enter into a development concession.

Curamhuele Block (90% WI-operated)

USD 000s	2018	2019
Concession commitments	-	8,225

At Curamhuele, a concession in the province of Neuquén, the Company is responsible for paying 100% of the costs during the exploration phase of a concession to maintain its 90% WI.

In December 2015, Madalena ratified an extension of its second exploration and evaluation term with the Province of Neuquén to September 9, 2016, after which a further extension was available. During the first quarter of 2016, the remaining work commitment relating to the block concession agreement was fulfilled by completing the

Yapai.x 1001 well in the Mulichinco and Lower Agrio shale. The 17.6 million performance bond submitted for such commitment was returned by the Provincial Authorities once the work commitment was certified by them.

The Company has proposed a horizontal multi-frac re-entry in CH.x-1 for $8.2 million to be incurred by March 9, 2019 under the Evaluation Lot Period. On May 5th, 2017, by means of Resolution 119/17, the Province finally notified the approval to enter into the Evaluation Lot Period. Once this commitment is completed, the company has the option to extend this period for another 2 years or to enter into the Exploitation Period.

Puesto Morales Block (100% WI-operated)

USD 000s	2018	2019	Beyond
Concession commitments	24,700	7,000	0,600

The Company is in discussions with the provincial authority for a re-schedule and conversion of the present commitments in a new exploration plan.

Santa Victoria Block (100% WI - operated)

The contract can contain up to three exploration and evaluation phases, of which the second expired in April 2015. The second phase required additional work commitments of $4.0 million for which no qualifying expenditures have been made. A performance bond of $3.6 million is in place over the commitments under this exploration and evaluation permit. On November, 2017 an application has been submitted and negotiations continue and are currently ongoing with the province of Salta for reconversion of the Exploration Area into a non-conventional exploration permit.

El Chivil Block (100% WI – operated)

The concession's one year extension expiry occurred on September 7, 2016. The province of Formosa granted a further six month extension to negotiate a 10-year development period extension, which expired on May 1, 2017. At November 2017, the Company remains in discussions with the province of Formosa.

El Vinalar Block (100% WI – operated)

Salta province granted a block extension to file an investment plan, which expired on November 11, 2016. The Company has requested a further extension from the province of Salta and the Company remains in discussions with the province of Salta.

Other Commitments

In November 2016, Madalena sub-leased its former corporate office premises to the end of 2018, with the expectation of further renewals or alternative sub-lease arrangements to the end of the head lease term of September 2022. The difference between the head lease payments under the existing contract and the sub-lease contract income expected over the period of the lease term, results in an onerous contract and a liability has been recognized of approximately $0.8 million, of which $0.2 million is recorded as part of Trade and other payables and $0.6 million is recorded as part of Other long-term liabilities in the consolidated statements of financial position at December 31, 2017.

Other long-term liabilities

A continuity relating to these liabilities is as follows:

	Year ended December 31	
USD 000s	**2017**	**2016**
Balance, beginning of year	**2,138**	1,575
Lease liability [1]	**(120)**	786
LTIP liability	**(20)**	64
New contingencies	**-**	19
Updated contingencies	**156**	-
Settled through negotiation	**-**	(29)
Effect of change in foreign exchange rates	**(164)**	(277)
Balance, end of year	**1,990**	2,138

(1) Relates to "Other Commitments"

22. 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 objective has been to maintain its 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, as it is able to, in 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 and working capital. In order to maintain or adjust the capital structure, the Company may obtain issue shares, adjust its capital spending to manage current and projected debt levels, sell non-core assets, farm-out existing opportunities or attempt to obtain new credit facilities.

In order to facilitate the management of its capital structure, the Company prepares annual capital expenditure budgets, which are updated throughout the year depending on varying factors including current and forecast prices, actual capital deployment and general industry conditions, if necessary. The focus of the Company throughout 2017 was to access additional capital to enable continuation of the Company.

The Company has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the next twelve months and there are no external restrictions on the Company's capital structure.

At December 31, 2017, the consolidated working capital deficit of the Company was $1 million (December 31, 2016 -$4.4 million deficit), consisting of positive working capital of $0.6 million (December 31, 2016 - working capital deficiency of $3.4 million) in Argentina and a working capital deficiency of $1.6 million (December 31, 2016- $1 million) in Canada.

Liquidity risk

The Company's liquidity risk is highlighted in note 2, which also outlines in May 2017, the Company entered into a series of agreements that are expected to substantially alleviate this risk.

At December 31, 2017, all of Madalena's cash and cash equivalents of $1.2 million was deposited with banks in Argentina (December 31, 2016 - $4.1 million), and is held in ARS.

Repatriation of Funds to Canada

Madalena's corporate office is in Canada. Funds are required to enable the Company to maintain its Canadian corporate office and manage the regulatory, reporting, audit, legal and tax requirements of a TSX-V listed company.

During 2017, $5.3 million (2016 - $0.2 million) was repatriated from Argentina. The Company increased its investment in one of its Argentine subsidiaries by nil (2016 - $0.8 million).

Credit risk

The Company's primary operations are conducted in Argentina. The Company is exposed to credit risk in relation to its cash and cash equivalents, trade and other receivables, and other long-term assets.

Cash and cash equivalents are held in local short term investments, and therefore the Company does not believe these financial instruments are subject to material credit risk.

Other long-term assets relate to amounts due from various governments in Argentina primarily as it relates to VAT and is collected as revenue is earned. Although collection is slow, it is expected.

In Argentina, the majority of the Company's oil production is sold to the Argentine subsidiaries of major international oil and gas companies. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers.

During 2017, a provision for doubtful accounts of $6 thousand has been recorded (2016 - $0.2 million).

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

	Year Ended December 31	
USD 000s	**2017**	**2016**
Oil and natural gas marketing companies	**4,489**	5,505
Other trade receivables	**540**	2,458
Total trade receivables	**5,029**	7,963
Taxes receivable	**4,505**	4,873
Total trade and other receivables	**9,534**	12,836

Amounts due from oil and gas marketing companies were subsequently collected by the Company, with the exception of $0.2 million, which is deemed collectible. Of the $0.5 million recorded in other trade receivables, $0.3 million has been collected subsequent to year end, with the remaining balance deemed to be collectible. The taxes receivable balance of $4.5 million relates to current amounts owed from various governments in Argentina for VAT. These are collectible on future revenue.

Aged trade and other receivables

	Year Ended December 31	
USD 000s	**2017**	**2016**
Current (less than 90 days)	**4,391**	6,984
Past due (more than 90 days)	**638**	979
Total	**5,029**	7,963

Amounts totaling $0.6 million over 90 days were not provided for and $0.4 million has been collected subsequent to year end. The remaining $0.2 million is deemed to be collectible.

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. Although the Argentine refiners used by the Company have paid an average unofficial crude oil price of $52.79 per barrel for the year ended December 31, 2017 (2016 - $60.09), official Medanito crude oil averaged $52.22 per barrel for the year ended December 31, 2017 (2016 - $67.50). In January 2017, Madalena was advised that a majority of producers and refiners in Argentina, at the request of the government, have signed a 2017 Medanito crude oil pricing agreement (the "Agreement") allowing for convergence with international Brent pricing over the coming months. Such agreement stated that in case international Brent pricing reached and remained above the monthly Medanito floor price for 10 consecutive days, the Agreement would be suspended. And, in case international Brent pricing fell below $45.00 for 10 consecutive days, the Agreement would be reviewed. On September 13, 2017 the above suspension condition was reached and the agreement finalized in October, 2017. As from October, market prices were agreed upon between refiners and producers considering the international Brent price as a reference.

Gas prices in Argentina are subject to seasonal demand and are negotiated between the producer and the buyer. Summer pricing for the period from October 2017 to April 2018 was set at $4.30/mmbtu. (October 2016 - April 2017 - $4.30/mmbtu). For the winter season from May to September 2018, the price has been set at $5.40/mmbtu (May to September 2017 - $5.40/mmbtu).

Interest rate risk

The Company entered into a series of agreements with Hispania Petroleum S.A..

The Working Capital Loan is a multi-drawdown facility, which shall be used for general working capital purposes. Interest accrues at 7% in USD per annum. Principal and interest on each drawdown is repayable thirty-six months after an advance of funds.

The Capex Loan is a multi-drawdown convertible loan. The loan similarly accrues interest at 7% in USD per annum, with each drawdown and accrued interest repayable thirty-six months after drawdown.

There is not risk associated with interest rate as a result of the interest fixed in USD at 7% per annum.

Foreign currency exchange risk

The majority of the Company's exploration and development activities are conducted in Argentina and the majority of the Company's cash and cash equivalents are denominated in ARS. The Company is exposed to currency risk to the extent that revenue, expenses and monetary assets and liabilities are denominated in currencies that differ from the functional currency of the respective entity within the Company. The company has all its revenue nominated in USD. This mitigate most of the effect associated with foreign currency behaviors.

The impact of a 10% change in foreign exchange rates on gains and losses recorded on financial instruments, when translating from ARS and/or CAD to USD at December 31, 2017 would have changed the unrealized foreign exchange gain recorded in the consolidated statements of loss by $0.3 million for the year ended December 31, 2017. The amount recorded as foreign currency translation adjustment in comprehensive income in the consolidated statements of comprehensive loss would have changed by $0.5 million for the year ended December 31, 2016 as it relates to loans owed from Argentina that are not considered part of the net investment in the subsidiaries.

Fair value of financial instruments

The Company's financial instruments include cash and cash equivalents, trade and other receivables, other long-term assets, refundable deposit, current portion of long-term debt, trade and other payables, taxes payable, convertible debentures issued and long-term debt, the carrying values of which approximate their fair values due to their short-term nature with the exception of: (i) long-term debt, which approximates fair value as a result of its variable interest rate; (ii) convertible debentures issued, which relates to the debt component of these instruments and is accreted up to their principal value over the term of the debenture using the effective interest rate method; (iii) available for sale securities which are recorded at fair value through the statement of other comprehensive loss, and recycled into the statements of loss and comprehensive loss when sold; and (iv) other long-term assets whose calculated fair value approximates its carrying value.

23. Segmented information

The Company is engaged in the exploration and development of oil and gas. With the disposition of the Canadian operating segment on June 28, 2016 (note 5), Madalena's continuing operations are represented by its Argentine petroleum and natural gas producing assets which form one reportable segment and its corporate costs in Canada t. The Company does not have separate operations in Barbados. Barbados entities hold a direct interest in the Argentine businesses and the chief operating decision maker views Barbados as an extension of the Argentine operations. Together they collectively comprise the Argentina operating segment.

	As at and for the year ended December 31, 2017			
USD 000s	Argentina	Corporate	Eliminations	Total
Total assets	72,861	2,179	-1,792	73,248
Total liabilities	34,085	3,956	-1,792	36,249
Oil and natural gas revenues	38,187	-	-	38,187
Operating expenses	24,378	-	-	24,378
General & administrative expenses	4,355	4,596	-	8,951
Restructuring expenses	1,402	831	-	2,233
Depletion and depreciation	14,807	124	-	14,931
Impairment	22,206	-	-	22,206
Current income tax expense	(52)	-	-	(52)
Net loss – continuing operations	28,186	5,610	-	33,796
Capital expenditures[1]	3,748	-	-	3,748

	As at and for the year ended December 31, 2016			
USD 000s	**Argentina**	**Corporate[2]**	**Eliminations**	**Total**
Total assets	121,520	24,307	(22,599)	123,228
Total liabilities	70,996	4,573	(22,599)	52,970
Oil and natural gas revenues	50,152	-	-	50,152
Operating expenses	23,567	-	-	23,567
General & administrative expenses	4,906	4,952	-	9,858
Depletion and depreciation	19,574	231	-	19,805
Impairment	18,238	-	-	18,238
Current income tax expense	2,203	-	-	2,203
Net loss – continuing operations	22,725	9,375	-	32,100
Capital expenditures[1]	6,339	-	-	6,339

(1) Capital expenditures include cash additions to PP&E and E&E.
(2) For comparative purposes, the Canadian operations have been removed from these amounts (note 5).

For the year ended December 31, 2017, three customers within the Argentine operating segment individually accounted for more than 77% of oil and natural gas revenues, and amounted to $14.1 million, $10.4 million and $4.2 million. For the year ended December 31, 2016, three customers within the Argentina operating segment each individually accounted for more than 70% of oil and natural gas revenues and amounted to $20.1 million, $8.4 million and $6.8 million.

Intersegment eliminations relate to intercompany loans between Canada and Argentina.

24. Supplemental disclosure

(a) Madalena's consolidated statements of loss and comprehensive loss are prepared primarily by nature of expenses, with the exception of employee compensation costs which are included in both the operating and general and administrative expense line items in the consolidated statements of loss and comprehensive loss. The following table details the amount of total employee compensation costs included in the operating and general and administrative expenses line items in the consolidated statements of loss and comprehensive loss.

	Year ended December 31	
USD 000s	**2017**	**2016**
Operating expenses		
Compensation costs	**4,419**	4,067
Transportation and processing	**7,910**	7,474
Maintenance, workovers and others	**12,049**	12,026
	24,378	23,567
General & Administrative expenses		
Compensation costs	**3,264**	5,221
Other	**5,687**	4,637
	8,951	9,858

(b) Key management personnel of the Company consist of its directors and executive officers. As at December 31, 2017, the Company had eight directors and two officers (2016 – 7 directors and 3 officers). The table below summarizes all key management personnel compensation paid and payable during the years ended December 31, 2017 and 2016.

USD 000s	Year ended December 31 2017	2016
Short-term employee benefits, including wages and management fees	**910**	884
Severance payments	**629**	774
Share-based compensation	**(281)**	1,236
	1,258	2,894

25. Restructuring

For the year ended December 31, 2017, the Company incurred restructuring costs of $2.2 million (2016 – nil) primarily associated with severance that are recorded as Restructuring expenses.