



**CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE MONTHS ENDED MARCH 31, 2017 AND 2016**

**(UNAUDITED)**



Condensed Interim Consolidated Statements of Financial Position  
(Unaudited)

USD 000s	Note	As at March 31 2017 (note 3)	As at December 31 2016 (note 3)
<b>Assets</b>			
Current assets			
Cash and cash equivalents		5,941	4,071
Trade and other receivables		9,530	12,836
Inventory		1,647	1,432
Assets held for sale	6	819	1,265
Other current assets		556	465
		<b>18,493</b>	20,069
Property, plant and equipment	4	51,733	53,544
Exploration and evaluation assets	5	38,393	49,340
Other long-term assets	8	5,560	275
		<b>114,179</b>	123,228
<b>Liabilities</b>			
Current liabilities			
Refundable deposit		-	3,000
Current portion of long-term debt	7	-	1,619
Trade and other payables		8,913	15,098
Taxes payable		730	1,184
Decommissioning obligations	9	3,618	3,581
		<b>13,261</b>	24,482
Convertible debentures		1,168	1,143
Deferred income tax liability		4,674	8,394
Decommissioning obligations	9	18,223	16,813
Other long-term liabilities	5	5,937	2,138
		<b>43,263</b>	52,970
<b>Shareholders' Equity</b>			
Share capital	10	238,973	238,973
Contributed surplus		16,241	16,066
Equity component of convertible debenture		76	76
Accumulated other comprehensive loss		(26,994)	(27,157)
Deficit		(157,380)	(157,700)
		<b>70,916</b>	70,258
		<b>114,179</b>	123,228

Going Concern (note 2)

Commitments (note 14)

Subsequent Events (notes 6 and 18)

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



Condensed Interim Consolidated Statements of Income (Loss) and Comprehensive Income (Loss)  
(Unaudited)

USD 000s, except per share amounts	Note	Three months ended March 31	
		2017 (note 3)	2016 (note 3)
<b>Revenues</b>			
Oil and natural gas revenues		10,336	14,811
Royalties		(1,631)	(2,323)
		<b>8,705</b>	<b>12,488</b>
<b>Expenses</b>			
Operating	17	5,514	5,926
General and administrative	17	1,971	2,760
Finance (income) expenses	12	646	1,594
Share-based and long-term incentive compensation	11	228	460
Depletion and depreciation	4	3,761	5,924
Gain on disposal of assets	5, 6, 14	(4,047)	-
		<b>8,073</b>	<b>16,664</b>
<b>Income (Loss) before income taxes</b>		<b>632</b>	<b>(4,176)</b>
<b>Income tax recovery (expense)</b>			
Current		(4,032)	(353)
Deferred		3,720	(1,962)
		<b>(312)</b>	<b>(2,315)</b>
<b>Income (Loss) from continuing operations</b>		<b>320</b>	<b>(6,491)</b>
Net loss from discontinued operations	3	-	(343)
<b>Net Income (Loss)</b>		<b>320</b>	<b>(6,834)</b>
Foreign currency translation adjustment		163	1,419
Available for sale securities		-	(56)
<b>Comprehensive Income (Loss)</b>		<b>483</b>	<b>(5,471)</b>
<b>Net Income (Loss) per share</b>			
Basic and diluted - continuing	10	0.00	(0.01)
Basic and diluted - total	3, 10	0.00	(0.01)

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



Condensed Interim Consolidated Statements of Changes in Shareholders' Equity  
(Unaudited)

USD 000s	Share Capital (note 10)	Contributed Surplus	Equity Component of Convertible Debentures	Accumulated Other Comprehensive Loss	Deficit	Total Equity
<b>Balance at December 31, 2016</b>	<b>238,973</b>	<b>16,066</b>	<b>76</b>	<b>(27,157)</b>	<b>(157,700)</b>	<b>70,258</b>
Net Income	-	-	-	-	320	320
Foreign currency translation adjustment	-	-	-	163	-	163
Share-based compensation (note 11)	-	175	-	-	-	175
<b>Balance at March 31, 2017</b>	<b>238,973</b>	<b>16,241</b>	<b>76</b>	<b>(26,994)</b>	<b>(157,380)</b>	<b>70,916</b>
<b>Balance at December 31, 2015</b>	<b>238,758</b>	<b>14,520</b>	<b>-</b>	<b>(32,062)</b>	<b>(121,123)</b>	<b>100,093</b>
Net loss	-	-	-	-	(6,834)	(6,834)
Foreign currency translation adjustment	-	-	-	1,419	-	1,419
Share-based compensation (note 11)	-	601	-	-	-	601
Available for sale securities	-	-	-	(56)	-	(56)
<b>Balance at March 31, 2016</b>	<b>238,758</b>	<b>15,121</b>	<b>-</b>	<b>(30,699)</b>	<b>(127,957)</b>	<b>95,223</b>

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



Condensed Interim Consolidated Statements of Cash Flows  
(Unaudited)

USD 000s	Note	Three months ended March 31	
		2017 (note 3)	2016 (note 3)
<b>Cash provided by (used in):</b>			
<b>Operating</b>			
Net Income (Loss)		320	(6,834)
Items not affecting cash:			
Depletion and depreciation	3, 4	3,761	6,044
Accretion	3, 12	83	84
Fair value change on assets held for sale	6	140	-
Gain on disposal of assets	5, 6, 14	(4,047)	-
Share-based and long-term incentive compensation	3, 11	228	470
Deferred income tax expense (recovery)		(3,720)	1,962
Unrealized loss on foreign exchange	12	226	1,237
Lease commitment liability		(27)	-
Non-cash increase of contingent liability		38	-
Change in other long-term assets		(107)	(450)
Change in other long-term liabilities	5	3,700	-
Change in non-cash working capital	13	(5,080)	3,947
Cash flow from (used in) operating activities		(4,485)	6,460
<b>Investing</b>			
Property, plant and equipment additions	4	(511)	(1,181)
Evaluation and exploration assets additions	5	(154)	(3,680)
Proceeds on disposal of assets, net of transaction fees	5	9,544	-
Proceeds on disposal of assets held for sale, net of transaction fees	6	461	-
Change in non-cash working capital	13	(1,338)	443
Net cash from (used in) investing activities		8,002	(4,418)
<b>Financing</b>			
Bank loan repayment	7	(1,646)	(846)
Net cash used in financing activities		(1,646)	(846)
Change in cash and cash equivalents		1,871	1,196
Cash and cash equivalents, beginning of period		4,071	3,912
Impact of foreign exchange on cash balances		(1)	80
<b>Cash and cash equivalents, end of period</b>		<b>5,941</b>	<b>5,188</b>

See the accompanying Notes to the Condensed Interim Consolidated Financial Statements.



## Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

### 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 condensed interim consolidated financial statements include the results of the following wholly-owned subsidiaries:

- Madalena Petroleum Ltd. (Canada)
- Madalena Energy Argentina S.R.L. (Argentina) ("MEA")
- Madalena Petroleum Americas Limited (Barbados)
- 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 and Going Concern

These condensed interim consolidated financial statements have been prepared on the basis that the Company is a going concern and will continue to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. As at March 31, 2017, the Company has incurred year-to-date income of \$0.3 million, had working capital of approximately \$5.2 million and has significant future capital commitments to develop its properties. It is anticipated that currently available resources, in addition to forecasted cash flow from operating activities will not be sufficient to fund the 2017 and 2018 anticipated capital commitments as outlined in note 14.

The ability of the Company to continue as a going concern is dependent upon the Company's ability to access additional funding to meet its anticipated 2017 and 2018 capital commitments and/or opportunities to monetize its assets.

The need to access additional capital to fund the anticipated 2017 and 2018 capital commitments creates a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

These condensed interim consolidated financial statements do not reflect adjustments in the carrying values of the assets and liabilities, expenses and the condensed interim consolidated statements of financial position classifications that would be necessary if the going concern assumption were not appropriate. Such adjustments could be material.

Subsequent to March 31, 2017, the Company entered into a series of agreements to provide for a package of debt and mezzanine financing which, once completed, are expected to alleviate Madalena's liquidity challenges and permit the Company access to growth capital for drilling and investment activities. These agreements are described in note 18.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

**Statement of Compliance**

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34, “Interim Financial Reporting” and are presented in United States Dollars (“USD”), unless otherwise indicated. These condensed interim consolidated financial statements follow the same accounting policies and method of computation as the annual consolidated financial statements for the year ended December 31, 2016. The disclosures provided below are incremental to those included with the annual consolidated financial statements. Certain information and disclosures normally included in the notes to the annual consolidated financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, these condensed interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2016, which have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board (“IASB”).

The condensed interim consolidated financial statements were approved and authorized for issue by the Company’s Board of Directors on May 30, 2017.

**3. Discontinued Operations**

On June 28, 2016 and pursuant to a series of transactions, Madalena sold its Canadian petroleum and natural gas assets to Point Loma Resources Ltd. (“Point Loma”).

These assets consisted of the Canadian operating segment and are presented as discontinued operations. The comparative condensed interim consolidated statements of income (loss) and comprehensive income (loss) have been presented to show the discontinued operations as a single line item and are therefore separated from continuing operations in the comparative period. There was no resulting impact relating to discontinued operations for the three month period ended March 31, 2017 (2016 – net loss of \$0.3 million and (\$0.00) basic and diluted earnings per share).

The condensed interim consolidated statements of cash flows contain the Canadian operating segment in the comparative period. There was no resulting impact relating to discontinued operations for the three month period ended March 31, 2017 (2016 - \$38 thousand net cash used in operating activities).

**4. Property, Plant and Equipment (“PP&E”)**

USD 000s	Oil and Natural Gas Assets	Corporate	Total
<b>Cost</b>			
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	2,145	-	2,145
Effect of change in foreign exchange rates	-	7	7
<b>At March 31, 2017</b>	<b>141,680</b>	<b>2,066</b>	<b>143,746</b>



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars ("USD"), except per share amounts and as otherwise stated)

USD 000s	Oil and Natural Gas Assets	Corporate	Total
<b>Accumulated depreciation and depletion</b>			
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	(3,883)	(74)	(3,957)
Effect of change in foreign exchange rates	-	(6)	(6)
<b>At March 31, 2017</b>	<b>(90,817)</b>	<b>(1,196)</b>	<b>(92,013)</b>

USD 000s			
<b>Net book value</b>			
At December 31, 2016	52,601	943	53,544
<b>At March 31, 2017</b>	<b>50,863</b>	<b>870</b>	<b>51,733</b>

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

At March 31, 2017 and 2016, Madalena determined there were no triggers for impairment for any of its CGUs.

The depletion expense calculation for the three month period ended March 31, 2017 included as part of the depletable base, \$83.5 million for estimated future development costs associated with proved and probable reserves (March 31, 2016 - \$93.7 million).

During the three month period ended March 31, 2017, approximately \$0.2 million (2016 - \$0.4 million) of directly attributable general and administration costs were capitalized to property, plant and equipment. In addition, share-based compensation expense of nil was capitalized for the three month period ended March 31, 2017 (2016 - \$0.1 million).

**5. Exploration and Evaluation Assets ("E&E")**

USD 000s		
<b>Cost</b>		
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





Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

Additions	325
Disposals	(11,272)
<b>At March 31, 2017</b>	<b>38,393</b>

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.

During the period ended March 31, 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”), resulting in a reduction of \$11.3 million of E&E assets. Gross proceeds before transaction costs were \$15.6 million (note 14), resulting in a pre-tax gain on sale of \$3.9 million, which is recorded in gain on disposal of assets. The transaction resulted in an Argentine tax expense of \$3.7 million, payable in May 2018, which has been recorded in Other long-term liabilities in the condensed interim statements of financial position. This tax expense is calculated based on a 35% tax rate on the taxable gain from the sale of the 55% interest in CASE calculated pursuant to Argentine tax legislation. The accounting gain recognized in these condensed interim consolidated financial statements is based on calculations pursuant to IFRS. This has resulted in the significant current tax expense when compared to the accounting gain recognized. In addition, and as part of the sale, PAE carried \$0.4 million of E&E costs during the three months ended March 31, 2017, and will carry up to \$5.6 million over the course of the work program (“Work Program”) in the agreement (note 14). The carried amount of \$0.4 million incurred to March 31, 2017 is included in additions in the table above.

On June 28, 2016, the E&E assets associated with the Canadian operating segment amounting to \$2.5 million were disposed.

At March 31, 2017 and 2016, Madalena determined there were no triggers for impairment relating to E&E assets.

## 6. Assets Held For Sale

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.

During the three months ended March 31, 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.

In addition, and pursuant to a purchase and sale agreement dated April 21, 2017 with an arms-length third party, the Company sold 4.7 million escrowed common shares in Point Loma for gross cash proceeds of \$0.8 million with no resulting gain or loss on sale. Closing took place in two equal tranches. The first tranche was completed on April 24, 2017 and the second tranche was completed on May 25, 2017.

The fair value adjustment at March 31, 2017 amounted to a loss of \$0.1 million, and is recorded as part of finance (income) expenses.

## 7. Long-term Debt

The credit facility with Industrial and Commercial Bank of China (Argentina) S.A. 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.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

**8. Other Long-term Assets**

Included in other long-term assets is \$5.2 million of future carried capital costs by PAE (note 14). The remaining balance of \$0.4 million primarily relates to ARS denominated value added tax receivable of \$0.3 million (December 31, 2016 – \$2.2 million). The fair value of the future carried costs and long-term receivables approximate their carrying values.

**9. Decommissioning Obligations**

The total undiscounted amount of cash flows required to settle Madalena’s remaining decommissioning obligations at March 31, 2017 is approximately \$22.4 million (December 31, 2016 – \$22.9 million) with the majority of the costs to be incurred between 2026 and 2027.

At March 31, 2017, \$3.6 million of the decommissioning obligations are recorded as a current liability, given they are expected to be incurred in the coming twelve months.

At March 31, 2017, an inflation rate of 2.5% was used (December 31, 2016 – 1.5%) to value the liability. The risk free rate used to discount the liability at March 31, 2017 and December 31, 2016 was 2.8%. The impact of the change in inflation rate amounted to a \$1.8 million increase to decommissioning obligations during the three month period ended March 31, 2017.

The reduction in working interest in the CASE wells (notes 5 and 14) resulted in a decrease to decommissioning obligations of \$0.4 million for the three month period ended March 31, 2017.

**10. 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 March 31, 2017 or December 31, 2016. No dividends have been declared by the Company.

	Number of Shares 000s	Share Capital \$000s
Balance at December 31, 2015	542,083	238,758
Stock options exercised	1,697	215
<b>Balance at December 31, 2016 and March 31, 2017</b>	<b>543,780</b>	<b>238,973</b>

**Net Income (Loss) Per Share**

As at March 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:

	Three months ended March 31	
	2017	2016
Weighted average number of common shares - basic – 000s	543,780	542,083
Net Income (Loss) from continuing operations - USD 000s	320	(6,491)
Per share – basic & diluted - continuing operations (\$/share)	0.00	(0.01)



Notes to the Condensed Interim Consolidated Financial Statements  
 As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)  
 (Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

**11. Share-based and Long-term Incentive (“LTIP”) Compensation**

There were no share-based options exercised during the three months ended March 31, 2017 or 2016.

During the three month period ended March 31, 2017, no share-based options were granted to directors, officers, and employees of the Company (2016 – 8,650,000 granted at an exercise price of CAD \$0.27 per share).

During the three month period ended March 31, 2017, no share based compensation was capitalized (2016 - \$0.1 million).

The LTIP expense recorded as part of share-based and long-term incentive compensation for the three months ended March 31, 2017 was \$53 thousand.

**12. Finance (Income) Expenses**

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

USD 000s	Three months ended March 31	
	2017	2016
Bank charges	304	271
Foreign exchange loss	224	1,237
Decommissioning obligations accretion (note 9)	64	68
Accretion of debt portion of convertible debenture issued	19	-
Interest (income) and other expenses	(105)	18
Fair value change on convertible debentures held	140	-
	<b>646</b>	<b>1,594</b>

USD 000s	Three months ended March 31	
	2017	2016
Realized foreign exchange gains	(2)	-
Unrealized foreign exchange losses	226	1,237
Total	<b>224</b>	<b>1,237</b>
Currency exchange rate at period end:		
\$1 USD = CAD	<b>\$1.33</b>	\$1.30
\$1 USD = ARS	<b>15.39</b>	14.61



Notes to the Condensed Interim Consolidated Financial Statements  
 As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)  
 (Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

### 13. Supplemental Cash Flow Information

#### *Changes in non-cash working capital*

USD 000s	Three months ended March 31	
	2017	2016
Available for sale securities	-	4,737
Trade and other receivables	3,202	1,246
Other current assets, including inventory	(109)	(347)
Assets held for sale	306	-
Trade, tax and other payables	(9,640)	(121)
Impact of foreign exchange on working capital	(177)	(1,125)
Change in non-cash working capital <sup>(1)</sup>	(6,418)	4,390
Attributable to:		
Operating activities	(5,080)	3,947
Investing activities	(1,338)	443
	(6,418)	4,390

(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*

USD 000s	Three months ended March 31	
	2017	2016
Interest paid	105	486
Taxes paid	361	487

### 14. Commitments and Other Long-term Liabilities

#### *Development and Exploration Commitments*

##### Coirón Amargo (“CA”)

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 CASE, 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. The amounts due to Madalena from GyP are recorded on Madalena’s books as a receivable. Currently, exploitation and development phases are contained in CA-Norte, the northern part of CA, for which there are no current ongoing commitments.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

CASE (35% WI – non-operated – see details below)

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 Coirón Amargo 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, \$3 million in December 2016 and \$7 million on closing and sold a 55% WI to PAE, who became operator, thereby retaining a 35% non-operated WI in CASE. A 2017 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.

The resulting pre-tax gain on disposal of assets of the 55% WI of \$3.9 million has been recorded as part of gain on disposal of assets, in the condensed interim consolidated statements of income (loss) for the three month period ended March 31, 2017.

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 March 31, 2017.

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

USD 000s	2017 <sup>(1)</sup>	2018 <sup>(1)</sup>	Beyond
Concession commitments at CASE	1,950	-	1,950 <sup>(2)</sup>

<sup>(1)</sup> Committed values are reflected at Madalena’s 35% WI at March 31, 2017 plus Madalena’s proportionate share of GyP’s carry.

<sup>(2)</sup> 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 the partners will be eligible to enter into a development concession.

Curamhuele Block (90% WI-operated)

At Curamhuele, an exploration permit in the province of Neuquén, the Company is responsible for paying 100% of the costs during the exploration phase 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 Agrío shale. A performance bond of \$17.6 million relating to amounts committed under this exploration permit, is posted by the Company. The assets pertaining to MASA, a former subsidiary of the Company which was amalgamated into MEA effective January 1, 2017, are held as security for the bond.

On May 9, 2017, the Company was notified by the Province of Neuquén, subject to ratification by Provincial Decree, extending Curamhuele as an evaluation block for the term of thirty months starting on September 10,



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Three Months Ended March 31, 2017 and 2016 (Unaudited)

(Tabular amounts are stated in thousands of United States dollars (“USD”), except per share amounts and as otherwise stated)

2016. Work commitments pursuant to this evaluation block are \$8.2 million. The Company is waiting on a provincial certification that the \$17.6 million of work commitments have been fulfilled and a provincial decree on the new work commitments. Upon receipt of the provincial certification, the Company anticipates that the \$17.6 million performance bond will be cancelled and a new \$8.2 million performance bond will be posted.

Puesto Morales Block (100% WI-operated)

USD 000s	2017	2018	Beyond
Concession commitments	17,700	6,550	6,550

The Company is awaiting written provincial approval to transfer \$4.4 million of 2016 commitments to 2017 and has reflected this amount in the 2017 commitment.

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. An application has been submitted and negotiations continue and are currently ongoing with the province of Salta to reach a multi-year extension agreement.

El Chivil Block (100% WI – operated)

The concession’s one year extension expiry occurred on September 7, 2016 and during the last quarter of 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 May 30, 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 is awaiting further discussions.

**15. 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 update to risk exposures and explains how they are managed.

Liquidity risk

The Company’s liquidity risk is highlighted in note 2, which also outlines that subsequent to March 31, 2017, the Company entered into a series of agreements that are expected to substantially alleviate this risk. See note 18 for further details.

In early January 2017, the Company closed the sale of a 55% WI in the CASE exploration concession for \$10 million, of which \$3 million was received in December 2016 and \$7 million in January 2017. In addition, the Company sold 1.6 million common shares in Point Loma in January 2017 for net cash proceeds of approximately \$0.5 million.

Further, the Company sold 4.7 million escrowed common shares in Point Loma for gross cash proceeds of \$0.8 million. Closing took place in two equal tranches. The first tranche was completed on April 24, 2017 and the second tranche was completed on May 25, 2017.



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At March 31, 2017, the consolidated working capital of the Company was \$5.2 million (December 31, 2016 –\$4.4 million deficit), consisting of working capital of \$5.7 million (December 31, 2016 - \$3.4 million) in Argentina and a working capital deficiency of \$0.5 million (December 31, 2016 - \$1.0 million) in Canada.

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. Medanito crude oil averaged \$57.80 per barrel for the three months ended March 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, signed a 2017 Medanito crude oil pricing agreement (the "Agreement") allowing for convergence with international Brent pricing over the coming months. International Brent oil prices have been trading at approximately \$54.00 per barrel to date in 2017. The 2017 Medanito pricing therefore declines from \$59.40/bbl in January 2017 to \$55.00/bbl from July 2017 to December 2017. Should international Brent pricing be reached and remain higher than \$1.00 above the monthly Medanito floor price for 10 consecutive days, the Agreement will be suspended and international Brent pricing adopted. Should international Brent pricing fall below \$45.00 for 10 consecutive days, the Agreement will be reviewed. Although Medanito is set by the government, there can be no certainty that the official oil price will not be further adjusted, nor any assurance that the refiners will not further discount the amount paid.

Gas prices in Argentina are subject to seasonal demand and are negotiated between the producer and the buyer. For the period May to September 2017, which is the Argentine winter, the price was set at \$5.40/mmbtu. Winter prices in 2016 were \$5.35/mmbtu. Summer pricing for the period from October 2017 to April 2018 has been set at \$4.31/mmbtu (October 2016 - April 2017 - \$4.30/mmbtu).



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**16. 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 3), 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, which form a second segment. 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 Argentine operating segment.

As at and for the three months ended March 31, 2017				
USD 000s	Argentina	Corporate	Intersegment Eliminations	Total
Total assets	112,771	22,559	(21,151)	114,179
Total liabilities	60,579	3,835	(21,151)	43,263
Oil and natural gas revenues	10,336	-	-	10,336
Operating expenses	5,514	-	-	5,514
General & administrative expenses	1,343	628	-	1,971
Depletion and depreciation	3,752	9	-	3,761
Current income tax expense	4,032	-	-	4,032
Net income (loss) – continuing operations	1,215	(895)	-	320
Capital expenditures <sup>(1)</sup>	665	-	-	665

As at and for the three months ended March 31, 2016				
USD 000s	Argentina	Corporate <sup>(2)</sup>	Intersegment Eliminations	Total
Total assets	149,370	23,139	(22,349)	150,160
Total liabilities	79,972	1,017	(22,349)	58,640
Oil and natural gas revenues	14,811	-	-	14,811
Operating expenses	5,926	-	-	5,926
General & administrative expenses	1,170	1,590	-	2,760
Depletion and depreciation	5,870	54	-	5,924
Current income tax expense	353	-	-	353
Net loss – continuing operations	(3,421)	(3,070)	-	(6,491)
Capital expenditures <sup>(1)</sup>	4,861	-	-	4,861

(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 3).

Intersegment eliminations relate to intercompany loans between Canada and Argentina.





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**17. Supplemental disclosure**

Madalena's condensed interim consolidated statements of income (loss) and comprehensive income (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 on the condensed interim consolidated statements of income (loss) and comprehensive income (loss). The following table details the amount of total employee compensation costs included in the operating and general and administrative expense line items in the condensed interim consolidated statements of income (loss) and comprehensive income (loss).

USD 000s	Three months ended March 31	
	2017	2016
<b>Operating expenses</b>		
Compensation costs	1,005	1,077
Transportation and processing	1,987	1,581
Maintenance, workovers and other	2,522	3,268
	<b>5,514</b>	<b>5,926</b>
<b>General &amp; administrative expenses<sup>(1)</sup></b>		
Compensation costs	1,257	1,882
Other	714	878
	<b>1,971</b>	<b>2,760</b>

(1) Three months ended March 31, 2016 amounts include severance and retracted financing costs of \$1.0 million.

**18. Subsequent Event**

On May 8, 2017, Madalena entered into a series of agreements (the "Transactions") with Hispania, a private, family-owned Spanish energy company, which provide for a package of debt and mezzanine financing of up to \$23 million which, when completed, 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 Transactions are subject to certain regulatory and shareholder approvals. The Company expects to hold its annual and special meeting of shareholders in July 2017 to, among other things, approve the Capex Loan.

The Working Capital Loan is a multi-drawdown facility, which shall be used for general working capital purposes. Interest accrues at 7% 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% 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



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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 Rinconada-Puesto Morales concession.

In addition, a services agreement ("Services Agreement") was entered into for an initial term of one year, but may be extended. Pursuant to this agreement, Hispania's personnel will provide:

- technical, operational, strategic and financial advice, direction and assistance in relation to the operation of Madalena's oil and natural gas properties, undeveloped lands and related assets in Argentina;
- advice to Madalena's officers and the board of directors regarding the business of Madalena and such other services as requested by Madalena from time to time.

In association with the Services Agreement, Hispania will receive monthly service fees that will be no less than \$75 thousand and no more than \$150 thousand and Madalena will issue Warrants to Hispania in six consecutive monthly tranches of 4,758,333 Warrants. These Warrants will have an exercise price equal to the price of the Common Shares on the last trading day prior to issuance and will expire 18 months thereafter.

Pursuant to the Transactions entered into with Hispania, the Interim President and Chief Executive Officer and the Vice President, Exploration and New Ventures departed the Company on May 8, 2017. In addition, the Vice President, Finance and Chief Financial Officer of the Company will depart effective May 31, 2017. Resulting amounts owing by the Company as severance under their employment agreements are \$0.7 million.