



CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Madalena Energy Inc.

Opinion

We have audited the consolidated financial statements of Madalena Energy Inc. and its subsidiaries (collectively the "Company"), which comprise the statements of financial position as at December 31, 2018 and 2017, and the statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant account policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018 and 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended, in accordance with International Financial Reporting Standards (IFRS).

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion & Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance 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.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' responsibility for the Audit of Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure, and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Ryan MacDonald.

Ernst & Young LLP

Calgary, Canada

April 9, 2019



Consolidated Statements of Financial Position

USD 000s	Note	As at December 31 2018	As at December 31 2017
Assets			
Current assets			
Cash and cash equivalents		778	1,202
Trade and other receivables	21	6,187	9,534
Inventory		1,167	1,585
Other current assets		361	461
		8,493	12,782
Property, plant and equipment	5	22,478	20,393
Exploration and evaluation assets	6	30,649	39,869
Other long-term assets	9	102	204
		61,722	73,248
Liabilities			
Current liabilities			
Convertible debentures	10	1,198	-
Current portion of long-term debt	8	52	-
Trade and other payables		7,935	9,522
Taxes payable		-	453
Decommissioning obligations	11	-	3,850
		9,185	13,825
Convertible debentures	10	-	1,274
Deferred income tax liability	18	488	1,352
Decommissioning obligations	11	15,621	17,821
Other long-term liabilities	20	1,182	1,977
		26,476	36,249
Shareholders' Equity			
Share capital	12	239,029	238,989
Contributed surplus		17,750	16,371
Equity component of convertible debentures	10	76	76
Accumulated other comprehensive loss		(26,941)	(26,941)
Deficit		(194,668)	(191,496)
		35,246	36,999
		61,722	73,248

Commitments and Other Long-term Liabilities (note 20)

See the accompanying Notes to the Consolidated Financial Statements

On behalf of the Board:

[signed] "Barry Larson"
Barry Larson
Director

[signed] "Alejandro Penafiel"
Alejandro Penafiel
Director



Consolidated Statements of Loss and Comprehensive Loss

USD 000s, except per share amounts	Note	Year ended December 31	
		2018	2017
Revenues			
Oil and natural gas revenues	23	36,171	38,187
Royalties		(5,764)	(6,332)
Other income	15, 23	480	78
		30,887	31,933
Expenses			
Operating	22	19,743	24,378
General and administrative	22	6,328	8,951
Restructuring	24	-	2,233
Finance (income) expenses	16	2,795	166
Share-based and long-term incentive compensation	13, 14	885	(633)
Warrants expenses	10	518	993
Depletion and depreciation	5	5,727	14,931
Gain on disposal of assets	5, 6	(33)	(405)
Impairment	5	(899)	22,206
		35,064	72,820
Loss before income taxes		(4,177)	(40,887)
Income tax recovery (expense)			
Current	18	-	52
Deferred	18	1,005	7,039
		1,005	7,091
Loss		(3,172)	(33,796)
Foreign currency translation adjustment		-	216
Other Comprehensive income, net of tax		-	216
Total Comprehensive loss		(3,172)	(33,580)
Loss per share			
Basic and diluted - continuing	12	(0.01)	(0.06)
Basic and diluted - total	12	(0.01)	(0.06)

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 10)	Accumulated Other Comprehensive Loss	Deficit	Total Equity
Balance at December 31, 2017	238,989	16,371	76	(26,941)	(191,496)	36,999
Net loss	-	-	-	-	(3,172)	(3,172)
Foreign currency translation adjustment	-	-	-	-	-	-
Share-based compensation (note 13)	-	861	-	-	-	861
Common shares issued (note 12)	40	-	-	-	-	40
Warrants (note 10)	-	518	-	-	-	518
Balance at December 31, 2018	239,029	17,750	76	(26,941)	(194,668)	35,246
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 13)	-	(688)	-	-	-	(688)
Common shares issued	-	-	-	-	-	16
Warrants (note 10)	-	993	-	-	-	993
Balance at December 31, 2017	238,989	16,371	76	(26,941)	(191,496)	36,999

See the accompanying Notes to the Consolidated Financial Statements



Consolidated Statements of Cash Flows

USD 000s	Note	Year ended December 31	
		2018	2017
Cash provided by (used in):			
Operating			
Net loss		(3,172)	(33,796)
Items not affecting cash:			
Depletion and depreciation	6	5,727	14,931
Impairment		(899)	22,206
Accretion	16	657	643
Fair value change on assets held for sale	7	-	150
Gain on disposal of assets	5, 6	(33)	(557)
Share-based and long-term incentive compensation	13, 14	885	(633)
Warrants expenses	10	518	993
Deferred income tax expense (recovery)		(1,005)	(7,039)
Unrealized gain on foreign exchange	16	1,459	833
Lease commitment liability accretion	20	(160)	(121)
Non-cash reduction of contingent liability		75	293
Change in other long-term assets		-	476
Change in non-cash working capital	19	(158)	(3,301)
Cash flow from operating activities		3,894	(4,922)
Investing			
Property, plant and equipment additions	5	(3,298)	(1,567)
Exploration and evaluation assets additions	6	(2,219)	(583)
Proceeds on disposal of PP&E and E&E assets, net of transaction fees	5, 6	-	7,373
Proceeds on disposal of assets held for sale, net of transaction fees	7	-	1,280
Change in non-cash working capital	19	1,199	(2,807)
Net cash used in investing activities		(4,318)	3,696
Financing			
Bank loan repayment	8	-	(1,646)
Net cash from (used in) financing activities		-	(1,646)
Change in cash and cash equivalents		(424)	(2,872)
Cash and cash equivalents, beginning of year		1,202	4,070
Impact of foreign exchange on cash balances		-	4
Cash and cash equivalents, end of year		778	1,202

See the accompanying Notes to the Consolidated Financial Statements



Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

Reporting Entity

Madalena Energy Inc. (the "Company" or "Madalena") is involved in the exploration, development and production of oil and natural gas in Argentina. Madalena's registered office is Suite 1600, 333 – 7th Avenue S.W., Calgary, Alberta, T2P 2Z1.

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 Inc. (Barbados)

On April 1, 2018, the business units of the Argentine branches of Madalena Petroleum Ltd ("MPL Argentina") and the Madalena Petroleum Americas Limited ("MPAL Argentina") were transferred to MEA.

On January 1, 2018, Pet-Ja S.A. (Argentina) amalgamated with MEA.

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

1. 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.

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 9, 2019.

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 functional and presentation currency is the USD.

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 indicators of impairment or reversals 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;



Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

- 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 all 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.
- A number of accounting policies and disclosures require that fair value measurements be determined, specifically, financial instruments. In determining fair value, the Company uses observable market data as much as possible. The fair value hierarchy used:

Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

- 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.

2. 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, 2018 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.



Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

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.

Foreign Currency

Madalena and each of its subsidiaries use US dollar as their functional currency. Foreign currency transactions are translated 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.

(b) Financial Instruments

Policy Applicable before January 1, 2018

i. Financial assets

Financial assets were 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 determined the classification of its financial assets at initial recognition.

A financial asset was assessed at each reporting date to determine whether there was any objective evidence that it was impaired. A financial asset was considered to be impaired if objective evidence indicated 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) were classified in this category if they were held for trading. Financial assets at fair value through profit or loss were 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.

Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

Loans and receivables

Loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. After initial measurement at fair value, such financial assets were subsequently measured at amortized cost less impairment. Loans and receivables were comprised of trade and other receivables. Impairments were 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 were non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management had the intention and ability to hold to maturity and include other long-term assets. These assets were measured at amortized cost. If there was objective evidence that the investment was impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset was measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, were recognized in profit or loss.

Available-for-sale financial assets

Non-derivative financial assets not included in the above categories were classified as available-for-sale. They were 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 was 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 were included in profit or loss.

ii. Financial liabilities

Financial liabilities were classified as financial liabilities at fair value through profit or loss and other financial liabilities, as appropriate. The Company determined 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 were 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 were recognized at amortized cost. Non-current liabilities were recorded at the amount at which they were expected to be settled or amortized cost, and includes long-term debt and convertible debentures.

Policy Applicable from January 1, 2018

IFRS 9

IFRS 9 provides guidance on the recognition and measurement, impairment and derecognition on financial instruments. The new standard was effective for annual periods beginning on or after January 1, 2018. The Company applied the new standard retrospectively and, in accordance with the transitional provisions, comparative figures have not been restated. On January 1, 2018, the Company adopted IFRS 9 which resulted in no material changes in the measurement and carrying value of the Company's financial instruments.

The following table outlines the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 as at January 1, 2018 for each class of the Company's financial assets and financial

Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

liabilities. The Company has no contract assets or debt investments measured at Fair Value Through Other Comprehensive Income.

Financial Instrument	IAS 39	IFRS 9
Cash and cash equivalents	Loans and receivables	Amortized Cost
Accounts receivable	Loans and receivables	Amortized Cost
Accounts payable and other payables	Other financial liabilities	Amortized Cost
Convertible debentures	Other financial liabilities	Amortized Cost

(c) 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.

(d) 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.

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.



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As of and for the years ended December 31, 2018 and 2017

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

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



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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.

Impairment losses related to PP&E can be reversed in future periods if the estimated recoverable amount of the asset exceeds the carrying value. The impairment recovery is limited to a maximum of the estimated depleted historical cost if the impairment had not been recognized. The reversal of the impairment loss is recognized in impairment.

(e) 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.

(f) 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.



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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.

(g) Revenue

Policy Applicable from January 1, 2018

Madalena recognizes crude oil and natural gas revenue when title passes from Madalena to the purchaser or, in the case of services, as contracted services are performed. Production revenues are determined pursuant to the terms outlined in contractual agreements and are based on fixed or variable price components. The transaction price for crude oil and natural gas is based on the commodity price in the month of production, adjusted for various factors including product quality and location. Commodity prices are based on monthly or daily market indices.

Performance obligations in the contract are fulfilled on the last day of the month.

The Company considers its performance obligations to be satisfied and control to be transferred when all of the following conditions are satisfied:

- Madalena has transferred title and physical possession of the commodity to the buyer;
- Madalena has transferred the significant risks and rewards of ownership of the commodity to the buyer; and
- Madalena has the present right to payment.

All of the Company's significant revenue streams are located in Argentina.

Policy Applicable before January 1, 2018

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.

(h) 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

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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.

(i) 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.

(j) 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.

(k) 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.

(l) New Accounting Policies

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.



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

(c) Hedge accounting

The Company not have 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.

The Company applied the new standard retrospectively and, in accordance with the transitional provisions, comparative figures have not been restated. On January 1, 2018, the Company adopted IFRS 9 which resulted in no material changes in the measurement and carrying value of the Company's financial instruments.

IFRS 15 Revenue from Contracts with Customers

The International Accounting Standards Board ("IASB") issued IFRS 15 "Revenue from Contracts with Customers" which replaces IAS 18 "Revenue". IFRS 15 specifies revenue recognition criteria and expanded disclosures for revenue. The new standard was effective for annual periods beginning on or after January 1, 2018. The Company adopted IFRS 15 on January 1, 2018 using the modified retrospective method. IFRS 15 was applied retrospectively only to contracts that were not completed at the date of initial application. The Company completed an assessment of its revenue streams and major contracts following the guidance outlined in IFRS 15. Based on this review, there were no material changes to the timing of the Company's previous revenue recognition.

As a result of the adoption of IFRS 15, no cumulative effect adjustment to retained earnings was required.

3. Future accounting pronouncements

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



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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.

Transition to IFRS 16

The Company plans to adopt the standard using the modified retrospective approach by recognizing the cumulative adjustment in opening retained earnings at the date of adoption. Madalena is currently completing a detailed review of its contracts to determine which contracts are in scope under IFRS 16 and their associated financial statement impact. The Company anticipates that the standard will impact its consolidated financial statements with increases in the assets and liabilities reported on the consolidated Balance Sheets. The Company's leases that will be recognized on its balance sheet at January 1, 2019 include leases of real estate, however the full extent of the impact has not yet been finalized. As part of this review, the Company is also assessing potential changes to its processes, policies and internal controls. The impacts of IFRS 16 disclosed herein are subject to change in future periods pending updates to individual contract terms, assumptions, and other facts and circumstances arising subsequent to the date of these financial statements.



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

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Cost			
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
Additions	3,142	156	3,298
Disposals	(1,188)	-	(1,188)
Change in decommissioning liabilities	(5,847)	-	(5,847)
Transfers from E&E assets	10,650	-	10,650
At December 31, 2018	150,158	2,277	152,435

USD 000s	Oil and Natural Gas Assets	Corporate	Total
Accumulated depreciation and depletion			
At December 31, 2017	(86,934)	(1,116)	(88,050)
Depreciation and depletion	(14,582)	(326)	(14,908)
Impairment	-	34	34
Disposals	(22,206)	-	(22,206)
Effect of change in foreign exchange rates	-	1	1
At December 31, 2017	(123,722)	(1,407)	(125,129)
Depreciation and depletion	(5,535)	(192)	(5,727)
Disposals	-	-	-
Impairment	1,222	(323)	899
At December 31, 2018	(128,035)	(1,922)	(129,957)

USD 000s			
Net book value			
At December 31, 2017	19,679	714	20,393
At December 31, 2018	22,131	347	22,478

At December 31, 2018, Madalena determined that indicators of impairment existed in each of its Argentine CGUs. These indicators of impairment were as result of fluctuation in interest rate.

As a result of the transferr of MPAL and MPL business units to MEA, management determined a change is justified. In 2018 the CGUs were redefined by management into MEA North and MEA South as a result of D&P concessions which are similar due to geography basin, prices,oil quality and managed as a portfolio.

As a result, impairment tests were performed over each CGU and one of them, MEA North, was deemed to be impaired as it's estimated recoverable amount was lower than the carrying amount by \$0.8 million. For MEA South the recoverable amount was higher than it carrying amount by \$1.7 million. The combined recoverable amounts,



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calculated as \$22.5 million, resulted in pre-tax impairment reversal of \$0.9 million (2017 – impairment of \$22.2 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, 2018 reserve report using a discount rate of 17.1% for MEA North and of 19% for MEA South, and the following forecast benchmark commodity price estimates:

Year	Brent Oil Price ⁽¹⁾ (USD/bbl)	Argentina Domestic Gas Price ⁽¹⁾ (USD/mmbtu)
2019	65.92	4.90
2020	69.47	4.90
2021	71.65	5.00
2022	73.72	5.10
2023	75.58	5.20
2024	77.39	5.30
2025	79.27	5.41
2026	81.27	5.52
2027	82.88	5.63
2028	84.54	5.74
2028+	+2%/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 \$1.9 million would have resulted for the year ended December 31, 2018.

An additional \$1 decrease in the price deck would have resulted in further impairment charges of \$3.3 million for the year ended December 31, 2018.

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. 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.

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, 2017 reserve report using a discount rate of 17% and the forecast benchmark commodity price estimates ranging from \$62.33/bbl - \$82.75/bbl for oil and \$4.40 - \$5.16/mmbtu for natural gas.

During the first quarter of 2018 the Company determined that the use of proved producing and developed non-producing reserves would be more appropriate than proved and probable reserves for the depletion reserves basis. The change is considered a change of the estimation technique, and the effect is recognized prospectively.

The depletion expense calculation for the year ended December 31, 2018 included as part of the depletable base, \$5.5 million for estimated future development costs associated proved developed non-producing reserves in



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Argentina. (December 31, 2017 – \$93.9 million for estimated future development costs associated with proved and probable reserves).

During the year ended December 31, 2018, approximately \$0.6 million (2017 - \$0.7 million) of directly attributable general and administration costs were capitalized to property, plant and equipment in Argentina.

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

USD 000s	
Cost	
At December 31, 2016	49,340
Additions	529
Disposals	(10,000)
At December 31, 2017	39,869
Additions	2,219
Disposals	-
Change in decommissioning liabilities	(711)
Transfers to PP&E assets	10,650
At December 31, 2018	30,727

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 September 2018, Coiron Amargo Sur Este ("CASE") block in Neuquen, Argentina, was converted in an unconventional exploitation concession with a 35-year term and its assets for \$10.6 million was transferred to PP&E assets. 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 did not exceed the fair value.

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).

At December 31, 2018 and 2017, Madalena determined that no impairment triggers existed relating to its Argentine E&E assets.

6. Assets Held for Sale and Investments

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.



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7. 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. On August 11, 2017, the Capex Loan was assigned to KD Energy International Capital Limited ("KD Energy"), a British Virgin Islands company wholly-owned by Mr. Jose David Penafiel and Mr. Alejandro Penafiel.

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, 2018, neither loan has been drawn. The Company has no bank debt at December 31, 2018 and 2017.

8. 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 \$0.1 million (December 31, 2017 – \$0.2 million).



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9. Convertible Debentures and Warrants

The 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.

On April 7, 2019 the Company entered into an amended and restated convertible loan agreement (the "Amended and Restated Loan Agreement") with KD Energy and Hispania, and has extended the term of the Working Capital Loan agreement (the "Working Capital Loan Agreement"). Key amendments include an extension of the expiry date from May 8, 2020 to May 8, 2023, a change in the conversion price to CAD 0.225 (subject to adjustment), the right of KD Energy to designate Jose David Penafiel and one additional representative to the board of directors during the term of the Amended and Restated Loan Agreement, and an expansion to the purposes for which the Company can draw on the loan to include acquisitions of oil and gas assets, subject to consent of KD Energy. The expiry date of the Working Capital Loan Agreement which is in the aggregate amount of \$6.5 million and carries an interest rate of 7% per annum has also been extended to May 8, 2023.

In conjunction with the Transactions entered into with Hispania, the Company entered into a services agreement which required the Company to issue six monthly tranches of share purchase warrants to Hispania commencing June 2017 (see notes 7 and 13). Each monthly tranche included 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 services agreement with Hispania Petroleum, S.A. ("Hispania") terminated on March 31, 2019.

The Company expensed \$0.5 million for the twelve months periods ended December 31, 2018 in relation to these warrants (2017 – \$1 million).

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

	Number of options 000s	Weighted average exercise price
Outstanding at December 31, 2016	-	-
Granted	28,550	0.168
Outstanding at December 31, 2017	28,550	0.168
Outstanding at December 31, 2018	28,850	0.168
Exercisable at December 31, 2018	4,758	0.145

The range of exercise prices of the outstanding warrants



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

Exercise price (CAD)	Number of Options Outstanding 000s	Weighted Average Contractual Life of options outstanding (years)	Number of outstanding options that are exercisable 000s
0.145	4,758	0.02	4,748
0.165	4,758	0.02	-
0.17	9,517	0.23	-
0.18	9,517	0.02	-
	28,850	0.12	4,758

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, 2018 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, 2017	1,274	76	1,350
Accretion (note 17)	67	-	67
Converted debentures (note 13)	(40)	-	(40)
Impact of foreign exchange	(103)	-	(103)
At December 31, 2018	1,198	76	1,274

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

10. Decommissioning Obligations

USD 000s	Year ended December 31	
	2018	2017



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

Balance, beginning of year	21,671	20,394
Disposals	-	(485)
Additions from development activities	-	351
Accretion expense (note 5a, 17)	589	575
Revision of estimates	(6,639)	836
Balance, end of year	15,621	21,671
Current	-	3,850
Long-term	15,621	17,821
Total	15,621	21,671

The total undiscounted amount of cash flows required to settle Madalena's decommissioning obligations in Argentina only at December 31, 2018 is approximately \$17.1 million (December 31, 2017 – \$22.7 million) with the majority of the costs to be incurred between 2026 and 2027. 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, 2018 an inflation rate of 1.9% was used (December 31, 2017 – 2.1%). The risk free rate used to discount the liability at December 31, 2018 was 2.87% (December 31, 2017 – 2.65%). 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 decreased decommissioning liabilities by \$6.6 million for the year ended December 31, 2018 (2017 - \$0.8 million) is comprised of a decrease of \$6.1 million (2017 – increase of \$0.1 million) for changes in well cost estimates, a decrease of \$0.2 million (2017 - \$1 million) relating to a change in the discount and inflation rate and a decrease of \$0.3 million (2017 – 0.1 million) relating to reserve life changes.

11. 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, 2018 or 2017. No dividends have been declared by the Company for the years ended December 31, 2018 or 2017.

	Number of Shares 000s	Share Capital 000s
Balance at December 31, 2016	543,780	238,973
Common shares issued	80	16
Balance at December 31, 2017	543,860	238,989
Common shares issued	200	40
Balance at December 31, 2018	544,060	239,029

2018

On January 17, 2018, 200,000 common shares were issued at a price of CAD \$0.25 pursuant to the exercise of convertible debenture option of \$40 thousand.

2017

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 \$16 thousand.



Notes to the Consolidated Financial Statements

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

Net Loss Per Share

As at December 31, 2018, 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	
	2018	2017
Weighted average number of common shares - basic and diluted – 000s	544,051	543,860
Net loss from continuing operations - USD 000s	(3,172)	(33,796)
Per share – basic - continuing operations (\$/share)	(0.01)	(0.06)

The number of incremental shares included in diluted earnings per share is computed using the average volume-weighted market price of shares for the period, and are shares that could be issued under the option plan, convertible debentures and warrants.

	Year ended December 31	
	2018	2017
Weighted average number of common shares - diluted – 000s	579,362	561,032
Net loss diluted - USD 000s	(2,431)	(32,575)
Per share – diluted (\$/share)	(0.00)	(0.06)

12. 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, 2018, 11,400,000 (2017 – 3,000,000) options were granted to directors, officers, and employees of the Company, at an exercise price of CAD \$0.22 per share (2017 – CAD \$0.17).

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, 2016	34,125	0.34
Granted	3,000	0.17
Forfeited	(9,851)	0.31
Expired or cancelled	(20,926)	0.34



Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

Outstanding at December 31, 2017	6,348	0.27
Granted	11,400	0.22
Forfeited	(107)	0.31
Expired or cancelled	(758)	0.34
Outstanding at December 31, 2018	16,883	0.23
Exercisable at December 31, 2018	7,116	0.26

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	3.50	1,000
0.22	11,400	4.28	3,800
0.27	500	2.04	333
0.30	1,100	1.67	1,100
0.50	883	0.53	883
	16,883	2.40	7,116

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 \$0.12 (2017 – CAD \$0.10) with weighed average assumptions as follows:

Inputs used to fair value share options granted

	Year ended December 31	
	2018	2017
Share price (CAD \$)	0.22	0.17
Exercise price (CAD \$)	0.22	0.17
Expected Volatility (%)	72	75
Forfeiture rate (%)	9.8	9.8
Option life (years)	4.19	4.35
Risk-free interest rate (%)	1.97	0.85

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, 2018 was \$0.9 million (2017 - \$64 thousand). No share-based compensation expense was capitalized during the year (2017 - nil).

Share-based compensation recovery arising from the forfeitures of stock options recognized for the year ended December 31, 2018 was \$12 thousand (2017 – 0.7 million).



Notes to the Consolidated Financial Statements

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

13. 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, 2018 was \$24 thousand (2017 – expense of \$20 thousand) and is revalued at the end of each reporting period.

At December 31, 2018 the LTIP liability was \$24 thousand (2017 - \$49 thousand).

14. Other Income

Other income relates primarily to oil storage services in CA-Norte rendered to three Joint ventures operated by O&G Developments Ltd S.A. of \$0.5 million.

In the comparative period other income of \$78 thousand, relates primarily to the same oil reception services in CA-Norte explained previously.

Other income are made up of the following:

USD 000s	Year ended December 31	
	2018	2017
Oil storage services in CA-Norte	480	78
	480	78

15. Finance (Income) Expenses

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

USD 000s	Year ended December 31	
	2018	2017
Bank charges and fees	802	1,084
Foreign exchange loss	1,459	833
Decommissioning liability accretion (note 11)	590	163
Accretion of debt component of convertible debentures issued (note 10)	67	69
Recovery of allowance for doubtful account, interest and other expenses	(123)	(2,458)
Fair value change on assets held for sale (note 8)	-	150
	2,795	(159)

Year ended December 31



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As of and for the years ended December 31, 2018 and 2017

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

USD 000s	2018	2017
Realized foreign exchange losses	-	(2)
Unrealized foreign exchange gains	1,459	835
Total	1,459	833
Currency exchange rate at period end:		
\$1 USD = CAD	\$1.36	\$1.25
\$1 USD = ARS	\$37.70	\$18.65

16. 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, 2018, the Company did not incur fees (2017 - \$0.3 million of which \$0.1 million was included in trade and other payables at December 31, 2017) from this firm for legal services. 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 \$1.8 million during the year ended December 31, 2017 (2017 – 1.1 million).

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, as amended by the Amended and Restated Loan Agreement. At December 31, 2018, there were no disbursements.

A director of the Company in Argentina provides professional services to the Company. During the year ended December 31, 2018, the Company incurred professional fees for \$6 thousand (2017 - nil).

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. In addition, current directors and officers of the Corporation as a group own, directly or indirectly, or control or exercise direction over 122 Convertible Debentures, representing 7% of the issued and outstanding Convertible Debentures.

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.

17. 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% (2017 – 27%) to the income (loss) before taxes. The difference results from the following:

	Year ended December 31	
	2018	2017
Income (Loss) before income tax – continuing operations	(4,177)	(40,887)
Tax rate	27%	27%



Notes to the Consolidated Financial Statements

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

Expected income tax recovery (expense)	1,128	11,039
Recovery (expense) resulting from:		
Effect of foreign tax rates	(952)	2,623
Share-based compensation	(239)	171
Share-based compensation - warrants	(137)	(268)
Unrecognized deferred tax benefit and other	1,282	(3,455)
Canadian tax rate adjustments	-	-
Argentina tax rate adjustments	(277)	(2,867)
Non-taxable portion of capital loss	-	-
Non-taxable differences on foreign operation	283	-
Minimum presumed foreign income tax	-	-
Other	(83)	(152)
Total income tax (recovery) expense	1,005	7,091
Attributable to:		
Current tax (recovery) expense	-	52
Deferred tax (recovery) expense	1,005	7,039
Total income tax (recovery) expense	1,005	7,091

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:

	Year ended December 31	
	2018	2017
Canada		
Property, plant and equipment	17,398	25,203
Share issue costs	1,339	1,214
Capital losses	24,253	25,641
Non-capital losses (expire 2026 to 2036)	77,828	94,978
Foreign tax credits	42,905	44,443
Other	766	(3,113)
Total unrecognized temporary differences	164,489	188,366
Argentina		
Decommissioning obligations	-	11,922
Non-capital losses (expire 2018 to 2020)	-	7,495
Property, plant and equipment	-	2,298
Accruals & Other	-	5,776
Total unrecognized temporary differences	-	27,491
Barbados		
Non-capital losses (expire 2018 to 2023)	4,658	677
Total unrecognized temporary differences	4,658	677



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

	Year ended December 31					
	2016	Recognized in statement of loss	2017	Recognized in statement of loss	Other	2018
Foreign exchange	(774)	774	-	-	-	-
Property, plant and equipment	(12,773)	9,157	(3,616)	(3,471)	-	(7,087)
Decommissioning obligations	3,541	(1,681)	1,860	2,044	-	3,904
Non-capital losses	1,370	(1,370)	-	932	-	932
Accruals and other	242	162	404	1,499	-	1,905
Minimum tax credits	-	-	-	-	(142)	(142)
	(8,394)	7,042	(1,352)	1,005	(142)	(488)

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.

18. Supplemental Cash Flow Information

Changes in non-cash working capital

USD 000s	Year ended December 31	
	2018	2017
Trade and other receivables	3,374	1,409
Other current assets, including inventory	1,342	(86)
Assets held for sale (note 8)	-	1,116
Trade, tax and other payables	(3,470)	(7,866)
Impact of foreign exchange on working capital	(205)	(681)
Change in non-cash working capital	1,041	(6,108)
Attributable to:		
Operating activities	(158)	(3,301)
Investing activities	1,199	(2,807)
Financing activities	-	-
	1,041	(6,108)

Other cash flow information- continuing operations

USD 000s	Year ended December 31	
	2018	2017
Interest paid	43	77
Interest received	-	4
Taxes paid	32	1,257



Notes to the Consolidated Financial Statements

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19. Commitments and Other Long-term Liabilities

Consolidated undiscounted Commitments table

USD 000s	Under negotiations	2019	2020	2021	2022	2023	Thereafter	Total
Development and Exploration Commitments	4,515	31,803	33,585	10,238	10,238	-	1,470	91,848
Office lease	-	58	31	-	-	-	-	89
Total	4,515	31,861	33,616	10,238	10,238	-	1,470	91,937

Coirón Amarqo 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. 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.

Coirón Amarqo Sur Este (CASE - 35% WI)

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. There was a loan draw down of \$2.5 million fully repaid as of December 31, 2018 (2017 no draw down of the loan has occurred).

On September 18, 2018 CASE block was converted in an unconventional exploitation concession with a 35-year term. The concession was awarded after the CASE block successfully completed the evaluation phase.

As part of the terms and conditions for the award of an Unconventional Exploitation Concession, Madalena work commitments at CASE were amended as follows:

USD 000s	2019 ⁽²⁾	2020 ⁽²⁾	Beyond ⁽³⁾
Concession commitments at CASE ⁽¹⁾	21,778	5,445	19,445

(1) Committed values are reflected at Madalena's 35% WI at December 31, 2018 plus Madalena's proportionate share of GyP's carry.

(2) Phase I includes the drilling of five horizontal multfrac wells targeting the Vaca Muerta, the construction of early production facilities, investment for infrastructure improvement and social responsibility commitments.

(3) Subject to the results on Phase I in 2019, three additional wells will be drilled over the following two-year period (Phase II).

Curamhuele Block (90% WI-operated)



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USD 000s	2019	2020
Concession commitments	8,703	-

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.

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 provincial government notified the Company that it had been approved 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.

On December 14, 2018, the company proposed to GyP, in its character of concessioner of the block, a new program consisting in one vertical well in a new location. This new proposal was accepted and approved by GyP, and both parties, requested a 2 years extension of the evaluation period.

Puesto Morales Block (100% WI-operated)

USD 000s	2019	2020	Beyond
Concession commitments	1,800	28,140	2,500

On January 4, 2019 the Company received the approval from the provincial authority for a re-schedule and conversion of the last 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 \$4.037 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. In November, 2017 an application was 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 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. The Company is in discussions with the province of Formosa.

El Vinalar Block (100% WI – operated)

On September 18, 2018 the Company signed an agreement assigning Madalena's entire interest in the non-core and non-producing El Vinalar concession to a private Argentine oil and gas company. The assignment was presented to Salta province on December 20, 2018, and the approval is still pending.

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



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contract income expected over the period of the lease term, results in an onerous contract and a liability has been recognized of approximately \$0.7 million (2017 - \$0.8 million), of which \$0.2 million (2017 - \$0.2 million) is recorded as part of Trade and other payables and \$0.5 million (2017 - \$0.6 million) is recorded as part of Other long-term liabilities in the consolidated statements of financial position at December 31, 2018.

Other long-term liabilities

A continuity relating to these liabilities is as follows:

USD 000s	Year ended December 31	
	2018	2017
Balance, beginning of year	1,977	2,138
Lease liability ⁽¹⁾	(164)	(120)
LTIP liability	24	(20)
New contingencies	71	-
Updated contingencies	(43)	156
Settled through negotiation	-	-
Effect of change in foreign exchange rates	(683)	(177)
Balance, end of year	1,182	1,977

(1) Relates to "Other Commitments"

20. 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 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, 2018, the consolidated working capital deficit of the Company was \$0.3 million (December 31, 2017 -\$1 million deficit), consisting of positive working capital of \$1.8 million (December 31, 2017 – positive



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working capital of \$0.6 million) in Argentina and a working capital deficiency of \$2 million (December 31, 2017- \$1.6 million working capital deficiency) in Canada.

Liquidity risk

At December 31, 2018, cash and cash equivalents of \$0.6 million was deposited with banks in Argentina (December 31, 2017 - \$1.2 million), and is held in ARS. Cash and cash equivalents of \$0.2 million was deposited with banks in Canada and Barbados, and \$190 thousand is held in USD and \$10 thousand is held in CAD.

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 2018, \$4.4 million (2017 - \$5.3 million) was repatriated from Argentina. The Company didn't increase its investment in its Argentine subsidiaries (2017 - \$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 2018, a provision for doubtful accounts of \$77 thousand has been recorded (2017 - \$6 thousand).



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

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

USD 000s	Year Ended December 31	
	2018	2017
Oil and natural gas marketing companies	5,450	4,489
Other trade receivables	441	540
Total trade receivables	5,891	5,029
Taxes receivable	296	4,505
Total trade and other receivables	6,187	9,534

Amounts due from oil and gas marketing companies were subsequently collected by the Company, with the exception of \$0.5 million, which is deemed collectible. Of the \$0.4 million recorded in other trade receivables, \$0.3 million has been collected subsequent to year end, with the remaining balance deemed to be collectible.

Aged trade and other receivables

USD 000s	Year Ended December 31	
	2018	2017
Current (less than 90 days)	5,614	4,391
Past due (more than 90 days)	277	638
Total	5,891	5,029

Amounts totaling \$0.3 million over 90 days were not provided for and \$0.1 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 \$56.27 per barrel for the three months ended December 31, 2018 (2017 - \$53.41). 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. Since August 2018, due to the Argentinean peso devaluation, domestic price is agreed upon between refiners and producers. Such a price considers the impact of the export withholding imposed by the government during this quarter and the possibility to increase the fuel to the final consumers.



Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

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 2018 to April 2019 was set at \$4.10/mmbtu. (October 2017 - April 2018 - \$4.30/mmbtu). For the winter season from May to September 2019, the price has been set at \$5.30/mmbtu (May to September 2018 - \$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, 2018 would have changed the unrealized foreign exchange gain recorded in the consolidated statements of loss by \$0.2 million for the year ended December 31, 2018.

21. 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.

USD 000s	Year ended December 31	
	2018	2017
Operating expenses		
Compensation costs	4,020	4,419
Transportation and processing	5,234	7,910
Maintenance, workovers and others	10,489	12,049
	19,743	24,378
General & Administrative expenses		
Compensation costs	1,611	3,264
Other	4,717	5,687
	6,328	8,951



Notes to the Consolidated Financial Statements

As of and for the years ended December 31, 2018 and 2017

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

- b) Key management personnel of the Company consist of its directors and executive officers. As at December 31, 2018, the Company had 7 directors and 2 officers (2017 – 8 directors and 2 officers). The table below summarizes all key management personnel net compensation paid and payable during the years ended December 31, 2018 and 2017.

USD 000s	Year ended December 31	
	2018	2017
Short-term employee benefits, including wages and management fees	682	910
Severance payments	-	629
Share-based compensation	628	(281)
	1,310	1,258

22. Revenue from contracts with customers

Madalena generally recognizes oil and natural gas revenue when title passes from Madalena to the purchaser or, in the case of services, as contracted services are performed. Production revenues are pursuant to the terms outlined in contractual agreements and are based on fixed or variable price components. The transaction price for crude oil and natural gas is based on the commodity price in the month of production, adjusted for various factors including product quality and location. Commodity prices are based on monthly or daily market indices.

Disaggregated revenue information

All of the Company's significant revenue streams are located in Argentina and include the following:

USD 000s	Three months ended December 31		Twelve months ended December 31	
	2018	2017	2018	2017
Crude Oil	7,822	7,803	33,337	34,334
Natural gas	667	797	2,834	3,853
Oil and natural gas sales	8,488	8,601	36,171	38,187

USD 000s	Three months ended December 31		Twelve months ended December 31	
	2018	2017	2018	2017
Oil storage services in CA-Norte	165	78	480	78
Other income	165	78	480	78

23. Restructuring

For the year ended December 31, 2018, the incurred restructuring costs was nil (2017 – \$2.2 million).