



**CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017**

**(UNAUDITED)**



Condensed Interim Consolidated Statements of Financial Position  
(Unaudited)

USD 000s	Note	As at September 30 2018	As at December 31 2017
<b>Assets</b>			
Current assets			
Cash and cash equivalents		310	1,202
Trade and other receivables		7,484	9,534
Inventory		1,338	1,585
Other current assets		426	461
		<b>9,558</b>	12,782
Property, plant and equipment	3	23,973	20,393
Exploration and evaluation assets	4	30,711	39,869
Other long-term assets	7	124	204
		<b>64,366</b>	73,248
<b>Liabilities</b>			
Current liabilities			
Current portion of long term debt		896	-
Trade and other payables		7,872	9,522
Taxes payable		-	453
Decommissioning obligations	9	4,053	3,850
		<b>12,821</b>	13,825
Convertible debentures	8	1,246	1,274
Deferred income tax liability		5,059	1,352
Decommissioning obligations	9	12,030	17,821
Other long-term liabilities		1,339	1,977
		<b>32,495</b>	36,249
<b>Shareholders' Equity</b>			
Share capital	10	239,029	238,989
Contributed surplus		17,611	16,371
Equity component of convertible debenture	8	76	76
Accumulated other comprehensive loss		(26,941)	(26,941)
Deficit		(197,904)	(191,496)
		<b>31,871</b>	36,999
		<b>64,366</b>	73,248

Commitments and Other Long-term Liabilities (note 15)

See the accompanying Notes to the Consolidated Financial Statements



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

USD 000s, except per share amounts	Note	Three months ended September 30		Nine months ended September 30	
		2018	2017	2018	2017
<b>Revenues</b>					
Oil and natural gas revenues	18	8,269	9,893	27,683	29,587
Royalties		(1,305)	(1,667)	(4,391)	(4,974)
Other Income		120	-	319	-
		<b>7,084</b>	<b>8,226</b>	<b>23,611</b>	<b>24,613</b>
<b>Expenses</b>					
Operating	17	4,321	6,455	14,012	18,159
General and Administrative	17	1,603	1,996	4,593	6,919
Restructuring		-	(33)	-	2,169
Finance (income) expenses	13	(267)	426	1,271	1,461
Share-based and long-term incentive compensation	11,12	165	(113)	778	(551)
Warrants expenses	8	4	438	518	465
Depletion and depreciation	3	1,369	4,211	4,961	11,630
Gain on disposal of assets		-	2	(33)	(558)
		<b>7,195</b>	<b>13,382</b>	<b>26,100</b>	<b>39,694</b>
<b>Loss before income taxes</b>		<b>(111)</b>	<b>(5,156)</b>	<b>(2,489)</b>	<b>(15,081)</b>
<b>Income tax recovery (expense)</b>					
Current		(139)	161	(139)	(1,040)
Deferred		(2,022)	(707)	(3,780)	1,698
		<b>(2,161)</b>	<b>(546)</b>	<b>(3,919)</b>	<b>658</b>
<b>Loss</b>		<b>(2,272)</b>	<b>(5,702)</b>	<b>(6,408)</b>	<b>(14,423)</b>
Foreign currency translation adjustment		-	18	-	240
<b>Comprehensive Loss</b>		<b>(2,272)</b>	<b>(5,684)</b>	<b>(6,408)</b>	<b>(14,183)</b>
<b>Net Loss per share</b>					
Basic and diluted – continuing	10	(0.00)	(0.01)	(0.01)	(0.03)
Basic and diluted – total	10	(0.00)	(0.01)	(0.01)	(0.02)

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

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

USD 000s	Share Capital (note 10)	Contributed Surplus	Equity		Accumulated Other Comprehensive Loss	Deficit	Total Equity
			Component of Convertible Debentures (note 8)				
<b>Balance at December 31, 2017</b>	<b>238,989</b>	<b>16,371</b>	<b>76</b>		<b>(26,941)</b>	<b>(191,496)</b>	<b>36,999</b>
Net Loss	-	-	-		-	(6,408)	(6,408)
Share-based compensation (note 11)	-	722	-		-	-	722
Common shares issue – Convert debentures	40	-	-		-	-	40
Warrants (note 8)	-	518	-		-	-	518
<b>Balance at September 30, 2018</b>	<b>239,029</b>	<b>17,611</b>	<b>76</b>		<b>(26,941)</b>	<b>(197,904)</b>	<b>31,871</b>
<b>Balance at December 31, 2016</b>	<b>238,973</b>	<b>16,066</b>	<b>76</b>		<b>(27,157)</b>	<b>(157,700)</b>	<b>70,258</b>
Net loss	-	-	-		-	(14,423)	(14,423)
Foreign currency translation adjustment	-	-	-		240	-	240
Share-based compensation (note 11)	-	(593)	-		-	-	(593)
Warrants (note 11)	-	465	-		-	-	465
<b>Balance at September 30, 2017</b>	<b>238,973</b>	<b>15,938</b>	<b>76</b>		<b>(26,917)</b>	<b>(172,123)</b>	<b>55,947</b>

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



Condensed Interim Consolidated Statements of Cash Flows  
(Unaudited)

USD 000s	Note	Three months ended		Nine months ended	
		September 30 2018	September 30 2017	September 30 2018	September 30 2017
<b>Cash provided by (used in):</b>					
<b>Operating</b>					
Net Loss		(2,272)	(5,702)	(6,408)	(14,423)
Items not affecting cash:					
Depletion and depreciation	3	1,369	4,211	4,961	11,630
Accretion	13	41	40	94	189
Fair value change on assets held for sale	5	-	-	-	150
Gain on disposal of assets	3,4,5	-	2	(33)	(558)
Share-based and long-term incentive compensation	11,12	165	(113)	778	(551)
Warrants expenses	8	4	438	520	465
Deferred income tax expense (recovery)		2,022	707	3,780	(1,698)
Unrealized (gain) loss on foreign exchange	13	(551)	427	560	864
Lease commitment liability		(36)	(34)	(109)	(87)
Non-cash increase of contingent liability		19	65	103	280
Change in other long-term assets		-	-	-	479
Change in non-cash working capital	14	96	(798)	(1,917)	(3,640)
<b>Cash flow from (used in) operating activities</b>		<b>857</b>	<b>(757)</b>	<b>2,329</b>	<b>(6,901)</b>
<b>Investing</b>					
Property, plant and equipment additions	3	(2,331)	(299)	(2,634)	(981)
Evaluation and exploration assets additions	4	91	(10)	(2,206)	(165)
Proceeds on disposal of PP&E and E&E assets, net of transaction fees	4	-	-	-	7,373
Proceeds on disposal of assets held for sale, net of transaction fees	5	-	-	-	1,280
Change in non-cash working capital	14	11	(36)	5	(1,189)
<b>Net cash from (used in) investing activities</b>		<b>(2,229)</b>	<b>(345)</b>	<b>(4,835)</b>	<b>6,318</b>
<b>Financing</b>					
Bank loan repayment	6	-	-	-	(1,646)
Change in non-cash working capital	14	414	-	1,614	-
<b>Net cash used in financing activities</b>		<b>414</b>	<b>-</b>	<b>1,614</b>	<b>(1,646)</b>
Change in cash and cash equivalents		(958)	(1,102)	(892)	(2,229)
Cash and cash equivalents, beginning of period		1,268	2,942	1,202	4,070
Impact of foreign exchange on cash balances		-	4	-	3
<b>Cash and cash equivalents, end of period</b>		<b>310</b>	<b>1,844</b>	<b>310</b>	<b>1,844</b>

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



## Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

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### 1. Reporting Entity

Madalena Energy Inc. (the "Company" or "Madalena") is involved in the exploration, development and production of oil and natural gas in Argentina. The Company's head office is located at Maipú 1300, 23rd Floor, Buenos Aires, Argentina, 1006ACT, and its registered office is Suite 1600 Dome Tower, 333 – 7th Avenue S.W., Calgary, Alberta, T2P 2Z1.

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

- Madalena Petroleum Ltd. (Canada)
- Madalena Energy Argentina S.R.L. (Argentina) ("MEA")
- Madalena Petroleum Americas Limited (Barbados)
- Madalena Petroleum Holdings Limited (Barbados)
- Madalena Ventures International Inc. (Barbados)

### 2. Basis of Preparation

These condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to a going concern, which contemplate the realization of assets and the settlement of liabilities in the normal course of business as they become due. Continuing as a going concern is dependent upon the Company's ability to amend capital commitments outlined in Note 15, which is expected to be achieved through negotiations with the provincial authorities. Failure to amend the commitments could result in insufficient sources to fund anticipated capital commitments. The Company's ability to continue as a going concern and discharge its obligations would be dependent on obtaining alternative equity, debt financing, and/or proceeds from asset sales which could be challenging.

#### Statement of Compliance

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" and are presented in United States Dollars ("USD"), unless otherwise indicated. These condensed interim consolidated financial statements follow the same accounting policies and method of computation as the annual consolidated financial statements for the year ended December 31, 2017. The disclosures provided below are incremental to those included with the annual consolidated financial statements. Certain information and disclosures normally included in the notes to the annual consolidated financial statements have been condensed or have been disclosed on an annual basis only. Accordingly, these condensed interim consolidated financial statements should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2017, which have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board ("IASB"). These consolidated financial statements follow the same accounting policies and methods of computation for all periods presented as outlined in note 3. The condensed interim consolidated financial statements were approved and authorized for issue by the Company's Board of Directors on November 15, 2018.

#### Significant accounting policies



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

*IFRS 15*

The 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 that were not completed at the date of initial application, thus prior years’ financial statements have not been restated. 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.

*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. 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 16*

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

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

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

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

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

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

USD 000s	Oil and Natural	Corporate	Total
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Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

<b>Gas Assets</b>			
<b>Cost</b>			
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	2,476	156	2,632
Effect of change in ARO	(4,919)	-	(4,919)
Transfers from E&E assets	10,650	-	10,650
Effect of change in foreign exchange rates	-	2	2
<b>At September 30, 2018</b>	<b>151,608</b>	<b>2,279</b>	<b>153,887</b>

USD 000s	<b>Oil and Natural Gas Assets</b>	<b>Corporate</b>	<b>Total</b>
<b>Accumulated depreciation and depletion</b>			
At December 31, 2016	(86,934)	(1,116)	(88,050)
Depreciation and depletion	(14,582)	(326)	(14,908)
Disposals	-	34	34
Impairment	(22,206)	-	(22,206)
Effect of change in foreign exchange rates	-	1	1
At December 31, 2017	(123,722)	(1,407)	(125,129)
Depreciation and depletion	(4,649)	(136)	(4,785)
<b>At September 30, 2018</b>	<b>(128,371)</b>	<b>(1,543)</b>	<b>(129,914)</b>

USD 000s			
<b>Net book value</b>			
At December 31, 2017	19,679	714	20,393
<b>At September 30, 2018</b>	<b>23,237</b>	<b>736</b>	<b>23,973</b>

At September 30, 2018 and 2017, Madalena determined there were no impairment indicators for any of its CGUs.

The depletion expense calculation for the three and nine months period ended September 30, 2018 included as part of the depletable base, \$3.2 million for estimated future development costs associated with proved developed non-producing reserves (Sept 30, 2017 - \$83.5 million for estimated future development costs associated with proved and probable reserves).

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.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

During the three and nine months period ended September 30, 2018, approximately \$0.1 million and \$0.4 (2017 - \$0.2 million and \$0.6 million) of directly attributable general and administration costs were capitalized to property, plant and equipment.

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

USD 000s	
<b>Cost</b>	
At December 31, 2016	49,340
Additions	529
Disposals	(10,000)
At December 31, 2017	39,869
Additions	2,205
Effect of change in ARO	(713)
Transfers to PP&E assets	(10,650)
<b>At September 30, 2018</b>	<b>30,711</b>

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

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 15).

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.

At September 30, 2018 and 2017, Madalena determined there were no impairment indicators relating to E&E assets.

**5. Assets Held for Sale and Investments**

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

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



## Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

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.

### 6. Long-term Debt and facility availability

#### Argentina

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

#### Canada

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

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

The Capex Loan is a multi-drawdown convertible loan. The loan similarly accrues interest at 7% per annum, with each drawdown and accrued interest repayable thirty-six months after drawdown. The Capex Loan is convertible into units of the Company ("Units") with each Unit comprised of one common share ("Common Share") and 0.22 of a Common Share purchase warrant ("Warrant"), with each Warrant entitling the holder to purchase an additional Common Share. The Capex Loan is convertible based on a conversion price equal to a 5% premium to the 20-day volume weighted average price ("VWAP") of the Common Shares on the last trading date prior to a particular drawdown ("Conversion Price") in respect of the Common Shares comprising the Units. The exercise price of the Warrants issued upon conversion is also at a 5% premium to that 20-day VWAP. These Warrants expire 18 months after the date of issuance. Both Hispania and Madalena have the right to convert the whole or part of the principal and interest owing hereunder into Units on or before repayment, although Madalena's right to compel conversion is limited in some circumstances.

Both loans are secured, limited to the Company's interests in the Puesto Morales concession. On August 11, 2017, Hispania assigned the Capex Loan Agreement to KD Energy International Capital Limited ("KD Energy"), a company wholly-owned by family trusts of Jose D. Penafiel and Alejandro Penafiel.

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 September 30, 2018, neither loan has been drawn. The Company has no bank debt in Canada at September 30, 2018 and 2017.



## Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

### 7. 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).

### 8. 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.

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 Company expensed \$4 thousand for the three months periods ended September 30, 2018 in relation to these warrants (2017 – \$0.4 million). On a YTD basis, the Company expensed \$0.5 million (2017 – \$0.5 million).

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

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

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



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

USD 000s	Liability Component	Equity Component	Total
At December 31, 2017	1,274	76	1,350
Accretion (note 13)	51	-	51
Converted debentures (note 10)	(40)	-	(40)
Impact of foreign exchange	(39)	-	(39)
<b>At September 30, 2018</b>	<b>1,246</b>	<b>76</b>	<b>1,322</b>

### 9. Decommissioning Obligations

The total undiscounted amount of cash flows required to settle Madalena's decommissioning obligations in Argentina only at September 30, 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. At September 30, 2018, \$4.1 million of the decommissioning obligations are recorded as a current liability and the remainder of \$12 million as a long-term liability, given that the current obligations are expected to be incurred by December 31, 2018. 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 September 30, 2018 an inflation rate of 2.3% was used (December 31, 2017 – 2.1%). The risk free rate used to discount the liability at September 30, 2018 was 3.13% (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.

### 10. Share Capital

The Company is authorized to issue an unlimited number of common shares and preferred shares. The holders of common shares are entitled to receive dividends as declared by the Company and are entitled to one vote per share. No preferred shares were outstanding at September 30, 2018 or December 31, 2017. No dividends have been declared by the Company.

	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
<b>Balance at September 30, 2018</b>	<b>544,060</b>	<b>239,029</b>

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.

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.

### Net Income (Loss) Per Share



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

As at September 30, 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:

	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Weighted average number of common shares - basic – 000s	543,860	543,780	544,048	543,780
Weighted average number of common shares - diluted – 000s	36,302	-	35,651	-
Net Loss from continuing operations - USD 000s	(2,272)	(5,702)	(6,408)	(14,423)
Per share – basic & diluted - continuing operations (\$/share)	(0.00)	(0.01)	(0.01)	(0.03)

**11. Share-based Compensation**

No options were granted in Q3-2018. During the nine months ended September 30, 2018, 11,400,000 options were issued to directors, officers, and employees of the Company. 8,650,000 options were granted during Q3-2017 and YTD-2017.

During the three month and nine months periods ended September 30, 2018, no share based compensation was capitalized (2017 - nil).

**12. Long-term Incentive Plan**

The LTIP expense recorded as part of share-based and long-term incentive compensation expense in the consolidated statements of loss for the three and nine months ended September 30, 2018 was \$1 thousand and \$56 thousand, respectively (2017 – recover of \$25 thousand and \$8 thousand) and is revalued at the end of each reporting period.

At September 30, 2018 the LTIP liability was \$131 thousand (December 31, 2017 - \$49 thousand).



Notes to the Condensed Interim 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. Finance (Income) Expenses**

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

USD 000s	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Bank charges	316	248	654	789
Foreign exchange loss (gain)	(551)	427	560	862
Decommissioning obligations accretion (note 9)	24	23	44	137
Accretion of debt portion of convertible debenture issued (note 8)	17	17	50	52
Interest (income) and other expenses	(73)	(289)	(37)	(519)
Fair value change on convertible debentures held	-	-	-	140
	(267)	426	1,271	1,461

USD 000s	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Realized foreign exchange loss (gain)	-	-		(2)
Unrealized foreign exchange loss (gain)	(551)	427	560	864
Total	(551)	427	560	862
Currency exchange rate at period end:				
\$1 USD = CAD			\$1.29	\$1.25
\$1 USD = ARS			\$41.25	\$17.31

**14. Supplemental Cash Flow Information**

*Changes in non-cash working capital*

USD 000s	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Trade and other receivables	851	73	2,054	1,999
Other current assets, including inventory	(419)	752	458	(88)
Assets held for sale	-	-	-	1,116
Trade, tax and other payables	89	(1,236)	(2,810)	(7,146)
Impact of foreign exchange on working capital	-	(423)	-	(710)



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

Change in non-cash working capital <sup>1</sup>	<b>521</b>	(834)	<b>(298)</b>	(4,829)
Attributable to:				
Operating activities	<b>96</b>	(798)	<b>(1,917)</b>	(3,640)
Investing activities	<b>11</b>	(36)	<b>5</b>	(1,189)
Financing activities	<b>414</b>	-	<b>1,614</b>	-
	<b>521</b>	(834)	<b>(298)</b>	(4,829)

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

*Other cash flow information*

USD 000s	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Interest paid (income)	-	-	-	57
Interest received (income)	-	-	-	-
Taxes paid	-	213	<b>32</b>	1,221

**15. Commitments and Other Long-term Liabilities**

*Development and Exploration Commitments*

*Consolidated undiscounted Commitments table*

USD 000s	2018	2017
Under negotiations	<b>36,955</b>	36,955
Within one year	<b>35,448</b>	10,012
After one year but not more than three years	<b>19,445</b>	-
More than three years	-	-
Total	<b>91,848</b>	46,966

*Coirón Amarqo Norte ("CA-Norte"- 35% WI)*

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.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

Coirón Amargo 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 \$2.6 million and a repayment of \$1.7 million as of September 30, 2018.

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 <sup>(2)</sup>	2020 <sup>(3)</sup>
Concession commitments at CASE <sup>(1)</sup>	27,223	19,445

(1) Committed values are reflected at Madalena's 35% WI at December 31, 2017 plus Madalena's proportionate share of GYP's carry.

(2) Phase I includes the drilling of five horizontal multistage fracture 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)

USD 000s	2018	2019
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 5<sup>th</sup>, 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.

Puesto Morales Block (100% WI-operated)

USD 000s	2018	2019	Beyond
Concession commitments	24,700	7,000	740

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

Santa Victoria Block (100% WI - operated)

The contract can contain up to three exploration and evaluation phases, of which the second expired in April 2015. The second phase required additional work commitments of \$4.037 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



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

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)*

Salta province granted a block extension to file an investment plan, which expired on November 11, 2016. On January, 2018 the Company notified the province of Salta that it is not interested in a contract extension. El Vinalar facilities and wells have been mothballed.

**16. Financial Instruments and Risk Management**

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

**Foreign Exchange Fluctuations**

The table below provides various exchange rates that illustrate the quarterly foreign exchange fluctuations between the USD, the Argentine Peso ("ARS"), and the Canadian dollar ("CAD"). The table illustrates the impact of both the ARS and CAD changes relative to the USD in the three and nine months ended September 30, 2018 compared to the three and nine months ended September 30, 2017. Foreign exchange changes in CAD and ARS impact the unrealized foreign exchange gains and losses recorded in the condensed interim consolidated statements of income (loss).

USD	Three months ended			Nine months ended		
	September 30 2018	September 30 2017	% Change <sup>(1)</sup>	September 30 2018	September 30 2017	% Change <sup>(1)</sup>
Average CAD to USD	<b>0.765</b>	0.798	<b>4.2%</b>	<b>0.777</b>	0.765	<b>-1.5%</b>
Average ARS to USD	<b>0.031</b>	0.058	<b>45.9%</b>	<b>0.040</b>	0.062	<b>35.2%</b>
Period end CAD to USD	<b>0.772</b>	0.801	<b>3.6%</b>	<b>0.772</b>	0.801	<b>3.6%</b>
Period end ARS to USD	<b>0.024</b>	0.058	<b>58.0%</b>	<b>0.024</b>	0.058	<b>58.0%</b>

**Liquidity risk**

The Company's liquidity risk is highlighted in note 2.

At September 30, 2018, cash and cash equivalents of \$0.1 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 \$162 thousand is held in USD and \$6 thousand is held in CAD.



Notes to the Condensed Interim Consolidated Financial Statements

As of and for the Six Months Ended June 30, 2018 and 2017 (Unaudited)

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

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**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 \$59.60 per barrel for the three months ended September 30, 2018 (2017 - \$49.85), official Medanito crude oil averaged \$73.97 per barrel for the three months ended September 30, 2018 (2017 - \$49.74). 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.

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 2018, the price has been set at \$5.30/mmbtu (May to September 2017 - \$5.40/mmbtu).

**Interest rate risk**

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

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

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

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

**Foreign currency exchange risk**

The majority of the Company's exploration and development activities are conducted in Argentina and the majority of the Company's cash and cash equivalents are denominated in ARS. The Company is exposed to currency risk to the extent that revenue, expenses and monetary assets and liabilities are denominated in currencies that differ from the functional currency of the respective entity within the Company. The Company has all its revenue nominated in USD. This mitigates 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 September 30, 2018 would have changed the unrealized foreign exchange gain recorded in the consolidated statements of gain by \$59 thousand at September 30, 2018.



Notes to the Condensed Interim 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)

**17. Supplemental disclosure**

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

USD 000s	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
<b>Operating expenses</b>				
Compensation costs	861	1,049	2,927	3,094
Processing	1,004	1,949	3,726	5,893
Maintenance, workovers and other	2,456	3,457	7,359	9,172
	<b>4,321</b>	6,455	<b>14,012</b>	18,159
<b>General &amp; administrative expenses</b>				
Compensation costs	359	603	1,189	2,632
Other	1,244	1,393	3,404	4,287
	<b>1,603</b>	1,996	<b>4,593</b>	6,919

**18. Revenue**

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.

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

USD 000s	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Crude Oil	7,580	8,852	25,515	26,531
Natural gas	689	1,041	2,168	3,056
Oil and natural gas sales	<b>8,269</b>	9,893	<b>27,683</b>	29,587