CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTHS ENDED JUNE 30, 2015 AND 2014

(UNAUDITED)

Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

Canadian $000s	Note	As at June 30 2015	As at December 31 2014
Assets			
Current assets			
Cash and cash equivalents		**15,301**	13,425
Trade and other receivables		**25,888**	19,861
Inventory		**3,082**	2,875
Other current assets		**1,373**	1,183
		45,644	37,344
Property, plant and equipment	4	**116,182**	113,084
Exploration and evaluation assets	5	**48,515**	43,879
Other non-current assets		**1,650**	2,357
		211,991	196,664
Liabilities			
Current liabilities			
Operating loan	6	**1,750**	-
Current portion of long-term debt	6	**5,354**	-
Trade and other payables		**22,551**	21,761
Taxes payable		**1,781**	3,806
		31,436	25,567
Long-term debt	6	**7,068**	-
Other long-term liabilities	13	**3,791**	4,984
Deferred income tax liability		**6,194**	5,004
Decommissioning obligations	7	**25,348**	25,357
		73,837	60,912
Shareholders' Equity			
Share capital	8	**250,210**	249,717
Contributed surplus		**14,765**	14,303
Accumulated other comprehensive loss		**(6,053)**	(16,142)
Deficit		**(120,768)**	(112,126)
		138,154	135,752
		211,991	196,664

Commitments and Contingencies (Note 13)

Subsequent Events (Note 18)

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

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

		Three months ended June 30		Six months ended June 30	
Canadian $000s (except per share amounts)	Note	2015	2014	2015	2014
			(Note 3)		(Note 3)
Revenues					
Oil and natural gas revenues		**30,365**	9,144	**54,500**	15,450
Royalties		**(6,133)**	(1,199)	**(9,458)**	(1,963)
		24,232	7,945	**45,042**	13,487
Gain (loss) on commodity contracts	15	**2**	4	**-**	(348)
		24,234	7,949	**45,042**	13,139
Expenses					
Operating		**11,802**	2,931	**21,904**	5,431
General and administrative		**3,864**	2,171	**6,883**	3,022
Business combination expenses		**-**	1,724	**-**	1,724
Finance (income) and expenses	10	**1,173**	8	**1,759**	(1,389)
Share-based compensation	9	**256**	344	**497**	693
Depletion and depreciation	4	**8,643**	2,648	**16,383**	4,565
Impairment	4, 5	**2,400**	1,907	**2,400**	2,565
		28,138	11,733	**49,826**	16,611
Loss before income taxes		**(3,904)**	(3,784)	**(4,784)**	(3,472)
Current income tax expense		**(1,654)**	(115)	**(3,068)**	(182)
Deferred tax (expense) recovery		**(1,312)**	167	**(790)**	220
Total Tax		**(2,966)**	**52**	**(3,858)**	38
Net Loss		**(6,870)**	(3,732)	**(8,642)**	(3,434)
Foreign currency translation adjustment		**(1,891)**	(2,390)	**10,089**	(8,970)
Comprehensive Income (Loss)		**(8,761)**	(6,122)	**1,447**	(12,404)
Loss per share					
Basic and diluted	14	**(0.01)**	(0.01)	**(0.02)**	(0.01)

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

Condensed Interim Consolidated Statements of Equity
(Unaudited)

Canadian $000s	**Share Capital**	**Contributed Surplus**	**Accumulated Other Comprehensive Income**	**Deficit**	**Total Equity**
	(Note 8)				
Balance at December 31, 2014	**249,717**	**14,303**	**(16,142)**	**(112,126)**	**135,752**
Net loss	**-**	**-**	**-**	**(8,642)**	**(8,642)**
Foreign currency translation adjustment	**-**	**-**	**10,089**	**-**	**10,089**
Stock options exercised	**493**	**(112)**	**-**	**-**	**381**
Share-based compensation	**-**	**574**	**-**	**-**	**574**
Balance at June 30, 2015	**250,210**	**14,765**	**(6,053)**	**(120,768)**	**138,154**
Balance at December 31, 2013	159,574	12,645	(17,094)	(76,122)	79,003
Net loss (Note 3)	-	-	-	(3,434)	(3,434)
Foreign currency translation adjustment	-	-	(8,970)	-	(8,970)
Gross proceeds from financings	73,031	-	-	-	73,031
Share issue costs	(5,196)	-	-	-	(5,196)
Issued on business combination	15,214				15,214
Stock options exercised	52	(24)			28
Share-based compensation	-	699	-	-	699
Balance at June 30, 2014	242,675	13,320	(26,064)	(79,556)	150,375

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

Condensed Interim Consolidated Statements of Cash Flows
(Unaudited)

		Three months ended June 30		Six months ended June 30	
Canadian $000s	Note	2015	2014	2015	2014
			(Note 3)		(Note 3)
Cash provided by (used in):					
Operating					
Net loss		**(6,870)**	(3,732)	**(8,642)**	(3,434)
Items not affecting cash:					
Depletion and depreciation	4	**8,643**	2,647	**16,383**	4,565
Impairment	4, 5	**2,400**	1,907	**2,400**	2,565
Accretion	7	**95**	52	**203**	99
Unrealized (gain) loss on commodity contracts	15	**(2)**	(4)	**189**	348
Share-based compensation	9	**256**	344	**497**	693
Deferred income tax (recovery) expense		**1,312**	(168)	**790**	(220)
Unrealized loss on foreign exchange	10	**(260)**	-	**(242)**	-
Non-cash reduction of contingent liability	13	**(1,303)**	-	**(1,303)**	-
Change in other non-current assets		**27**	-	**(882)**	-
Change in non-cash working capital	12	**(9,330)**	(2,589)	**(5,860)**	(3,648)
Decommissioning costs incurred	7	**-**	-	**-**	(23)
Cash flow from operating activities		**(5,032)**	(1,543)	**3,533**	945
Investing					
Property, plant and equipment additions	4	**(1,026)**	(2,113)	**(15,144)**	(5,857)
Evaluation and exploration assets additions	5	**(2,020)**	(51)	**(2,471)**	(8,855)
Business combination, net of cash acquired		**-**	(48,114)	**-**	(48,114)
Change in other non-current assets		**2,334**	24	**1,737**	(612)
Change in non-cash working capital	12	**(4,532)**	(4,453)	**(1,278)**	(3,318)
Net cash used in investing activities		**(5,244)**	(54,707)	**(17,156)**	(66,756)
Financing					
Issue of common shares	8	**226**	48,311	**381**	73,059
Bank loan proceeds		**12,284**		**12,284**	
Share issue costs		**-**	(1,724)	**-**	(5,196)
Change in non-cash working capital	12	**-**	306	**-**	306
Net cash from financing activities		**12,510**	46,893	**12,665**	68,169
Change in cash and cash equivalents		**2,234**	(9,357)	**(958)**	2,358
Cash and cash equivalents, beginning of period		**11,499**	26,248	**13,425**	14,835
Impact of foreign exchange on cash balances		**(182)**	(37)	**1,084**	(339)
Cash and cash equivalents, end of period[(1)]		**13,551**	16,854	**13,551**	16,854

(1) Cash and cash equivalents net of Canadian operating loan

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

1. Reporting Entity

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

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

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

On June 25, 2014, the Company acquired the Argentine business unit of Gran Tierra Energy Inc. (the "Acquisition") and the condensed interim consolidated financial statements include the results from June 25, 2014 of the following wholly-owned subsidiaries:

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

2. Basis of Preparation

These condensed interim consolidated financial statements have been prepared on the basis that the Company is a going concern and will realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. Although the Company has generated significant cash flow from operations, the Company's ability to pay for exploration and development activity is dependent on the price of oil worldwide, the regulated oil and gas prices in Argentina and its ability to access capital from time to time, either through debt or equity, on terms acceptable to the Company. Further, the Company's ability to continue operations is dependent on identifying commercial oil and gas reserves or resources, generating profitable operations for reinvestment and accessing sufficient capital to complete planned exploration and development activities while satisfying block commitments in Argentina. The outcome of these matters cannot be predicted at this time.

Statement of Compliance

These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting" and are presented in Canadian Dollars, 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, 2014. 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, 2014, which have been prepared in accordance with International Financial Reporting Standards.

The condensed interim consolidated financial statements were approved and authorized for issue by the Company's Board of Directors on August 26, 2015.

Change in Functional Currency

On July 1, 2014, the Company changed the functional currency for one of its subsidiaries, Madalena Austral S.A. ("MASA"), from the Argentine Peso ("AR$") to the United States Dollar ("US$"), as disclosed in the December 31, 2014 financial statements. Judgements made by management in determining the appropriate functional currency included analysis of the following factors:

(a) Support for a change in functional currency to US$ included:
- The government of Argentina sets the benchmark price for oil and natural gas in US$ per barrel;
- All oil and gas sales are initially denominated in US$;
- Various credits that the Company is entitled to through the government of Argentina are denominated in US$;
- The Company's budget is prepared and managed in US$; and
- Significant amount of expenses are denominated in US$

(b) Factors that could result in either an AR$ or US$ functional currency included:
- Payables are settled in AR$, regardless of the currency in which they are invoiced

Management concluded that once the above factors were collectively considered, together with the fact that MASA had evolved from an exploration company with no oil and gas production, to a company with significant oil and gas revenue for the six months ended June 30, 2014, including the expectation of continued growth as well as the integration of MASA with those entities acquired in the Acquisition on June 25, 2014, that it was appropriate to change the functional currency of MASA on July 1, 2014.

Jointly Controlled Operations and Assets

Of the concessions owned by Madalena in Argentina, six 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's working interest in the UTEs are as follows:
- Surubi (85%)
- Valle Morado (97%)
- Palmar Largo (14%)
- Coiron Amargo (35%)
- Curamhuele (90%)
- Cortadera (38%)

Comparative Information

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

3. Business Combination

As outlined in Note 5 of the Company's December 31, 2014 consolidated financial statements, the initial Gran Tierra purchase price equation on June 25, 2014 was adjusted in the fourth quarter of 2014 to reflect the final determination of fair value of the assets acquired and liabilities assumed in the business acquisition. The June 30, 2014 comparative figures in these interim financial statements have been changed from those previously filed to reflect these adjustments as though they had been recorded at June 25, 2014. For the three and six month periods ending June 30, 2014, net loss increased by $0.2 million, compared to amounts previously filed. The adjustment related primarily to depletion and accretion.

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

Canadian $000s	Oil and Natural Gas Assets	Corporate	Total
Cost			
At December 31, 2013	54,150	270	54,420
Additions	23,465	679	24,144
Transferred from E&E assets (Note 4)	4,215	-	4,215
Acquired on business combination	87,944	536	88,480
Effect of change in foreign exchange rates	5,020	37	5,057
At December 31, 2014	174,794	1,522	176,316
Additions	12,877	557	13,434
Effect of change in foreign exchange rates	9,467	59	9,526
At June 30, 2015	**197,138**	**2,138**	**199,276**

Canadian $000s	Oil and Natural Gas Assets	Corporate	Total
Accumulated depreciation and depletion			
At December 31, 2013	(15,178)	(180)	(15,358)
Depreciation and depletion	(21,485)	(135)	(21,620)
Impairment	(26,000)	-	(26,000)
Effect of change in foreign exchange rates	(258)	4	(254)
At December 31, 2014	(62,921)	(311)	(63,232)
Depreciation and depletion	(16,122)	(228)	(16,350)
Impairment	(1,650)	-	(1,650)
Effect of change in foreign exchange rates	(1,878)	16	(1,862)
At June 30, 2015	**(82,571)**	**(523)**	**(83,094)**

Canadian $000s			
Net book value			
At December 31, 2014	111,873	1,211	113,084
At June 30, 2015	**114,567**	**1,615**	**116,182**

At June 30, 2015, the Company's Canadian CGU was assessed for impairment, and it was concluded that triggers for impairment existed due to the continued decline in current and forward commodity prices for oil and natural gas. The Company's testing of its Canadian CGU recoverable value, established as fair value less costs of disposal, relative to its carrying value, amounting to $8.0 million**,** resulted in an impairment charge of $1.7 million for the three month and six month period ended June 30, 2015. The carrying value of the Canadian CGU amounted to $9.7 million prior to this impairment charge. The recoverable value was determined through the analysis of updated price deck data, which indicated that prices have softened by 10% since December 31, 2014.

The impairment test recoverable value was based on proven plus probable reserves, using a discount rate of 15% and forward commodity price estimates. The following benchmark prices were utilized, adjusted for Company differentials and transportation, from McDaniel & Associates Consultants Ltd. price forecast, effective July 1, 2015.

Year	Oil Price (CAD/bbl)	Natural Gas Price (CAD/mcf)
2015	62.22	3.04
2016	66.55	3.42
2017	70.87	3.71
2018	74.84	3.93
2019	79.11	4.14
2020	83.38	4.41
2021	87.95	4.77
2022	89.73	5.08
2023	91.38	5.28
2024	93.12	5.39
2025	95.02	5.47
2026	96.89	5.57
2027	98.89	5.69
2028	100.83	5.70
2029	102.76	5.95
Thereafter	+2%/yr	+2%/yr

For the three and six months ended June 30, 2015, Madalena determined that no impairment triggers existed for its Argentine CGUs. At June 30, 2014, no impairment was recorded for the Canadian or Argentine CGU's for either three or six months then ended.

At June 30, 2015, the net book value of the Argentine and Canadian PP&E assets were $105.2 million (December 31, 2014 - $100.4 million) and $11 million (December 31, 2014 - $12.7 million), respectively.

The depletion expense calculation for the three and six months ended June 30, 2015 included $102.3 million (December 31, 2014 - $97.9 million) for estimated future development costs associated with proved and probable reserves. Similar future development costs for the three and six months ended June 30, 2014 were $66.2 million.

During the three and six months ended June 30, 2015, approximately $0.2 and $0.5 million (2014 - $nil) of directly attributable general and administration costs were capitalized to property, plant and equipment in Argentina.

The amounts capitalized as PP&E assets in Argentina at June 30, 2015 includes $0.3 million of Value Added Tax ("VAT") (December 31, 2014 - $1.5 million). VAT is payable on goods and services supplied and the Company retains VAT on any sales that it collects to the extent of the VAT recorded and paid on previous expenditures.

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

Canadian $000s	
Cost	
At December 31, 2013	35,745
Additions	17,510
Acquired on business combination	3,134
Transfer to PP&E assets (Note 3)	(4,215)
Impairment	(5,208)
Effect of change in foreign exchange rates	(3,087)
At December 31, 2014	43,879
Additions	2,436
Impairment	(750)
Effect of change in foreign exchange rates	2,950
At June 30, 2015	**48,515**

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

At June 30, 2015, the net book value of the Argentine and Canadian E&E assets were $43.4 million (December 31, 2014 - $38.1 million) and $5.1 million (December 31, 2014 - $5.8 million), respectively.

Amounts capitalized as Argentina E&E assets at June 30, 2015 included $4.9 million of VAT (December 31, 2014 - $4.9 million).

The Company recorded an impairment charge of $0.7 million on its Canadian E&E assets for the three and six months of 2015. The Canadian E&E assets at December 31, 2014 were comprised of drilling and completion costs on one exploratory well that has yet to be transferred to PP&E, pending tie-in and further proof of concept and undeveloped exploration acreage. The impairment charge was a result of the analysis of updated price deck data, which indicated that prices have softened by 10% since December 31, 2014.

During 2014, the Company recorded impairment charges of $1.9 million and $2.6 million for the three and six months ended June 30.

6. Operating Loan and Long-Term Debt

Canadian $000s	June 30 2015	December 31 2014
Argentina		
Long-term debt - ICBC loan	**12,422**	-
Canada		
Operating loan - National Bank	**1,750**	-
	14,172	-
Current	**7,104**	-
Long-term	**7,068**	-
	14,172	-

Argentina

On May 28, 2015, Madalena Energy Argentina S.R.L (Argentina) ("MEA"), obtained an AR$ 90 million (June 30, 2015 - $12.4 million) credit facility with Industrial and Commercial Bank of China (Argentina) S.A. ("ICBC"). These funds will be utilized on an as needed basis to provide Madalena's Argentine business unit the necessary liquidity to execute its 2015 capital budget. The loan bears interest at the variable rate of the Buenos Aires Deposits of Large Amount Rate ("BADLAR") plus approximately 8%, resulting in a current rate of approximately 29%. Surplus funds from the ICBC facility are invested in Argentina by Madalena in short-term deposits that currently are yielding approximately 22% in Argentina. The loan is repayable in seven equal quarterly instalments of AR$ 12.9 million ($1.78 million), starting on November 30, 2015.

Security for this loan is provided by the assignment of MEA's receivables that arise from the sale of crude oil. The facility includes a quarterly financial covenant, whereby MEA's ratio of debt to earnings before income taxes, depletion, interest and other non-cash items must be equal to or less than 1:1. At June 30, 2015, MEA was in compliance with this covenant.

Canada

At June 30, 2015, Madalena had a credit facility in place against its Canadian based assets that includes an operating demand loan and an acquisition/development demand loan. The facility is restricted to activity in Canada only and is not available for funding any of its Argentine operations. The operating demand loan credit facility is currently $7 million, of which the maximum draw is limited to $3.5 million, with interest charged at the bank's prime rate plus 1% per annum. The acquisition/development demand loan credit facility is available to a maximum of $3 million, with interest charged at the bank's prime rate plus 1.5% per annum. Both facilities are subject to a periodic review by the bank and the next review is scheduled on or before September 15, 2015. As of June 30, 2015, the Company had utilized $1.75 million (December 31, 2014 - $nil) of the operating demand loan credit facility. The acquisition/development demand loan credit facility was unutilized at June 30, 2015 and December 31, 2014.

The operating demand facility includes a working capital ratio covenant, whereby the working capital deficiency (excluding working capital from any of its Argentina subsidiaries and any unrealized hedging gains or losses) may not exceed $3.5 million. At June 30, 2015, the Company was in compliance with this covenant.

The operating demand credit facility is a demand loan and may be called at any time. There is no assurance that the credit facility will be renewed when the next scheduled review is completed. In addition, as a result of the low commodity price environment in Canada, the Company has experienced a reduction in funds generated from operations in Canada and expects this to continue until prices recover. Consequently, the Company may require access to alternative sources of funds.

7. Decommissioning Liabilities

Canadian $000s	Six months ended June 30 2015	Year ended December 31 2014
Balance, beginning of period	**25,357**	4,947
Assumed in business combination	**-**	17,898
Incurred from development activities (Note 4)	**55**	359
Incurred from exploration activities (Note 5)	**-**	156
Accretion expense (Note 10)	**203**	281
Revision of estimates	**(1,800)**	602
Obligations settled	**-**	(229)
Effect of change in foreign exchange rates	**1,533**	1,343
Balance, end of period	**25,348**	25,357

The total undiscounted and inflated amount of cash flows required to settle Madalena's decommissioning obligations at June 30, 2015 is approximately $32.8 million (December 31, 2014 – $31.7 million) with the majority of the costs to be incurred between 2018 and 2030. The decommissioning obligations have been estimated using existing technology at current prices and discounted using discount rates that reflect current market assessments of the time value of money and the risks specific to each liability.

At June 30, 2015, inflation rates of 1% and 2% were used in Argentina and Canada, respectively (December 31, 2014 – 1% and 2% for Argentina and Canada, respectively). The risk free rate used to discount the liability at June 30, 2015 was 2.9% (December 31, 2014 – 2.5%) in Argentina and 2.4% (December 31, 2014 - 2.5%) in Canada. The Argentina liability is expected to be settled through payments in US$.

8. Share Capital

The Company is authorized to issue an unlimited number of common shares. The holders of common shares are entitled to receive dividends as declared by the Company and are entitled to one vote per share.

Share Capital

	Number of Shares 000s	Share Capital $000s
Balance at December 31, 2013	364,029	159,574
Shares issued pursuant to financing	145,672	80,536
Share issue costs	-	(5,661)
Flow through share liability	29,832	15,214
Stock options exercised	250	54
Balance at December 31, 2014	539,783	249,717
Stock options exercised	1,250	493
Balance at June 30, 2015	**541,033**	**250,210**

2015

On March 13, 2015, 533,333 common shares were issued at a price of $0.29 per common share pursuant to the exercise of options for cash proceeds of $0.2 million. On April 16, 250,000 common shares were issued at a price of $0.35 per share pursuant to the exercise of options for cash proceeds of $0.1 million. On May 22, 2015, 400,000 and 66,666 common shares were issued at a price of $0.29 and $0.35, respectively, pursuant to the exercise of options for cash proceeds of $0.1 million.

2014

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

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

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

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

9. 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 may vest immediately or over three years on each anniversary of the grant date. Options expire three to five years from the grant date. There are no cash settlement alternatives for employees under the Company's stock option plan.

The weighted average share price of the Company's common shares on the exercise date for those options exercised during the six months ended June 30, 2015 was $0.39.

During the period ended June 30, 2015, no options were granted to any officers, employees, consultants or directors of the Company and its subsidiaries. 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 CDN$
Outstanding at December 31, 2013	19,530	0.40
Granted	7,000	0.47
Exercised	(250)	0.13
Forfeited	(353)	0.50
Expired or cancelled	(47)	0.11
Outstanding at December 31, 2014	25,880	0.42
Exercised	(1,250)	0.31
Forfeited	(1,532)	0.36
Expired or cancelled	(16)	0.35
Outstanding at June 30, 2015	**23,082**	**0.44**
Exercisable at June 30, 2015	**10,465**	**0.47**

Share-based compensation expense arising from the issuance of stock options recognized for the three and six months ended June 30, 2015 was $0.3 and $0.5 million (2014 - $0.3 and $0.7 million) with an offsetting credit to contributed surplus.

10. Finance Income and Expenses

Finance Income and Expenses are made up of the following:

	Three months ended June 30		Six months ended June 30	
Canadian $000s	**2015**	**2014**	**2015**	**2014**
Bank charges	**783**	339	**1,304**	518
Foreign exchange loss (gain)	**18**	(438)	**(117)**	(2,031)
Accretion (Note 7)	**95**	52	**203**	99
Interest and other expense (income)	**277**	(57)	**369**	(105)
	1,173	(104)	**1,759**	(1,519)

Foreign Exchange Gain / (Loss)

Canadian $000s	Three months ended June 30 2015	Three months ended June 30 2014	Six months ended June 30 2015	Six months ended June 30 2014
Realized foreign exchange (gains)/losses	**278**	(438)	**125**	(2,031)
Unrealized foreign exchange (gains)/losses	**(260)**	-	**(242)**	-
Total	**18**	(438)	**(117)**	(2,031)
Currency exchange rate at period end:				
$1 Canadian = US$	**$0.80**	$0.94	**$0.80**	$0.94
$1 Canadian = Argentine Peso	**7.29**	7.62	**7.29**	7.62

11. Related Parties

A director of the Company is a partner of a law firm that provides legal services to the Company. During the three and six months ended June 30, 2015, the Company incurred fees of $0.1 million and $0.2 million (2014 - $0.5 million for three months ended June 30, 2014 and $0.6 million for six months ended June 30, 2014) from this firm for legal services of which $0.1 million (2014 – $0.1 million) is included in accounts payable and accrued liabilities at June 30, 2015. All legal fees from this firm are included in general and administrative costs in the statement of loss and comprehensive loss.

12. Supplemental Cash Flow

Changes in non-cash working capital

Canadian $000s	Three months ended June 30 2015	Three months ended June 30 2014	Six months ended June 30 2015	Six months ended June 30 2014
Trade and other receivables	**(7,238)**	1,640	**(7,549)**	1,558
Other current assets, including inventory	**25**	(6,166)	**(681)**	(504)
Trade, tax and other payables	**(7,406)**	(2,943)	**150**	(7,945)
Impact of foreign exchange on working capital	**757**	733	**942**	231
Change in non-cash working capital(1)	**(13,862)**	(6,736)	**(7,138)**	(6,660)
Attributable to:				
Operating activities	**(9,330)**	(2,589)	**(5,860)**	(3,648)
Investing activities	**(4,532)**	(4,453)	**(1,278)**	(3,318)
Financing activities	**-**	306	**-**	306
	(13,862)	(6,736)	**(7,138)**	(6,660)

(1) Change in non-cash working capital excludes the current portion of long-term debt, as the proceeds of this debt are shown as a cash inflow in the financing section of the Consolidated Statements of Cash Flows

13. Commitments and Contingencies

Development and Exploration Commitments

Coiron Amargo Block (35% working interest)
In October 2013 the exploration period for Coiron Amargo Sur was extended until November 8, 2014 based on a work commitment program for the southern portion of the block. The Company drilled a vertical Vaca Muerta shale well in late 2014 which satisfied the last of the work commitments prior to entering into a new contract phase.

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

Curamhuele Block (90% working interest)
The Curamhuele Block is operated by Madalena. In September 2013 the first exploration period was extended until November 8, 2014 by the Province of Neuquén. On December 19, 2014, the Province officially granted an extension to September 2015 to satisfy the remaining work commitments on the block.

At June 30, 2015, Madalena's remaining share of future work commitments associated with the Curamhuele block is approximately US$10.5 million plus VAT.

In late July 2015, Madalena reviewed the planned work activities to satisfy the remaining commitments on the block with the Province of Neuquén and its partner Gas y Petroleo ("GyP"). The plan is to re-enter an existing wellbore on the block and drill approximately 600 additional meters to the intended target depth. Following the drilling operations, the plan is to evaluate the drilling results and plan a two zone, dual completion and fracture stimulation program to evaluate and test both the Mulichinco liquids rich gas resource play and the strategic Agrio shale play (oil) on the block. Drilling activities will commence prior to the September 2015 block commitment date and the activities outlined above are expected to satisfy the remaining commitment on the block.

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

Cortadera Block (38% working interest)
On January 15, 2014, Madalena and its working interest partners signed an amended contract agreement to formalize a multi-year agreement for the extension of the initial exploration period and inclusion of subsequent exploration periods.

In 2014, Madalena and its working interest partners satisfied all of its remaining commitments related to the first exploration period on the Cortadera block and now have the option to enter into a second exploration period extending to October 25, 2018 and a third exploration period extending to October 25, 2021, or extend acreage at Cortadera through potential further evaluation and/or exploitation phases. As of June 30, 2015, Madalena is taking steps with its partners and the Province to move officially into a second exploration period.

Puesto Morales Block (100% working interest)

The Company acquired its interest in the 31,254 acre block in the Neuquén Basin as part of the Acquisition. The block produces oil and natural gas from the Sierras Blancas and Loma Montosa formations. The exploitation permit expires on January 22, 2016 and Madalena has taken steps over the past 10 months to enter into a formal negotiations and multi-step approval process with the Province of Rio Negro related to a new ten year contract term / block extension to allow Madalena to continue to exploit, develop and explore the Puesto Morales area.

In June 2015 Madalena signed a new 10 year exploitation concession for the Puesto Morales area after reaching an agreement with the Province of Rio Negro. Further to the signing of this agreement, the 10 year extension agreement was subject to receiving an official decree followed by Madalena proceeding through a formal public hearing and a Parliamentary vote. Since reaching an agreement on the block, Madalena has received an official decree from the Province of Rio Negro formalizing the agreement which was signed subject to Parliamentary ratification. In early August 2015, Madalena successfully proceeded through a formal public hearing and as a result a parliamentary vote was held and passed on August 21, 2015 to officially ratify and formalize the 10 year exploitation agreement.

As part of the terms and conditions of the 10 year extension, the Company has agreed to firm commitments of US$49.3 million in activities on the block over the next 10 year period. As of June 30, 2015, Madalena estimates that approximately US$5.5 million of the Company's capital spending has already qualified towards this firm commitment.

The Puesto Morales block is the Company's largest producing concession representing approximately 40% of the Madalena's current production in Argentina and is a core area of focus for Madalena. The drilling and completion activities which are included in the USD $49.3 million commitment on the block are largely focused on horizontal development wells in the Loma Montosa over the new 10 year exploitation term.

Santa Victoria Block (100% working interest)

This block was part of the Acquisition and includes a 100% working interest operated property in the Noroeste Basin. The contract is currently in the second of three exploration phases, with the second exploration phase expiring in April 2015, unless extended by both parties. As at June 30, 2015, the second exploration phase required additional work commitments of US$3.75 million plus VAT. In March 2015, the Company submitted an application for a three year extension. Negotiations are currently ongoing with the Province.

Other Commitments and Contingencies

Leased office premises

The Company is responsible for the following rental commitments:

Canadian $000s	**2015**	**2016**	**2017**	**2018**	**2019**
Leased office premises	446	883	635	470	480

Other long-term liabilities

Other long-term liabilities primarily relate to a number of contingencies acquired with the Acquisition, which are considered by management to be in the normal course of business. The expected timeline for resolution is not known at this time, although all are expected to take more than one year to settle. All but one has been outstanding for over one year. As new information is obtained, amounts are adjusted to reflect management's best estimate of the amounts to be settled. During the three months ended June 30, 2015, other long-term liabilities were reduced by $1.3 million as a result of the settlement of a contingency.

14. Net Loss Per Share

The following table reconciles the weighted average number of common shares used in the basic and diluted net loss per share calculations:

Basic and diluted loss per share

	Three months ended June 30		Six months ended June 30	
Canadian $000s	**2015**	**2014**	**2015**	**2014**
Weighted average number of common shares				
Basic and Diluted – 000s	**540,730**	406,401	**540,314**	394,227

For the three and six months ended June 30, 2015 all share options were excluded from the calculation of diluted earnings per share, as their effect is anti-dilutive.

15. Financial Instruments and Risk Management

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

<u>Capital management</u>
The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying oil and natural gas assets. The Company considers its capital structure to include shareholders' equity, existing credit facilities (see Note 6) and working capital. In order to maintain or adjust the capital structure, the Company may obtain new credit facilities, adjust its capital spending to manage current and projected debt levels, farm-out existing opportunities or issue shares.

<u>Liquidity risk</u>
Liquidity risk is the risk that the Company will not meet its financial obligations as they fall due. The Company has both capital and operating obligations in 2015. The Company's 2015 capital expenditure budget is 100% allocated to Argentina, where the majority of the Company's reserves and production are located (see Note 13). This budget is reviewed monthly and updated as necessary depending on varying factors including current and forecast prices, actual capital deployment and general industry conditions.

At June 30, 2015, $15.1 million, or 99%, of Madalena's cash and cash equivalents was deposited with banks in Argentina (December 31, 2014 - $9.0 million, 67%).

At June 30, 2015, the consolidated working capital position of the Company was $14.2 million (December 31, 2014 - $11.8 million), consisting of working capital of $16.9 million (December 31, 2014 - $12.5 million) in Argentina and a working capital deficiency of $2.7 million (December 31, 2014 – working capital deficiency of $0.7 million) in Canada.

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

Argentine Foreign Currency Restrictions

Depending on the amount of inflows and outflows of cash, the Company may have surplus funds on hand in Argentina. As part of the Company's cash management, these surplus funds may be repatriated to Canada. The Company's ability to repatriate funds from Argentina is controlled by the Argentina government through the Central Bank. There are currently a number of monetary and currency exchange control measures in Argentina that include restrictions on the free disposition of funds deposited with banks and tight restrictions on transferring funds abroad.

During the first half of 2015, the Company repatriated $2.7 million. The Company anticipates additional repatriation of funds in the second half of 2015, subject to Central Bank approvals and availability of funds in the Argentine business unit.

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. Prior to the fourth quarter of 2014, world prices (WTI and Brent) increased sharply while the Argentina prices did not keep pace. Conversely, when world prices fell sharply in the latter half of 2014, Argentina prices remained relatively stable. As the government currently changes posted benchmark oil prices on a month to month basis, there is no certainty that oil prices will remain at current levels.

Gas prices in Argentina are fixed by the Government regulator in US$/mmbtu. For the period May to September 2015, which is the Argentine winter, prices have been set at US$5.30/mmbtu (2014 – US$5.20/mmbtu). Prices for the summer from October 2015 to April 2016 have been set at US$4.20/mmbtu (2014 – 2015 - US$4.10/mmbtu).

As of June 30, 2015, the Company has the following physical oil contract in place:

Type	Period	Volume	Price Floor	Price Ceiling	Index
Crude oil call options	Jan. 1, 2015 to Dec. 31, 2015	50 bbl/d	-	$95.00 US	WTI

The fair value of commodity contracts is determined by discounting the difference between the contracted price and published forward price curves as at the balance sheet date, using the remaining contracted petroleum and natural gas volumes. The fair value of commodity contracts for the period ended June 30, 2015 was a net payable of $nil (December 31, 2014 – net receivable of $0.2 million). Realized gains for the three and six month period ended June 30, 2015 were $nil and $0.2 million (three and six months ended June 30, 2014 - $0.1 million realized loss) and are included in loss on commodity contracts on the statement of loss and comprehensive loss. The commodity contracts are classified as level 2 within the fair value hierarchy.

Foreign currency exchange rate 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 AR$. Consequently, the Company is exposed to foreign currency exchange risk on a substantial portion of its financial assets. The Company has not entered into derivative exchange rate contracts to mitigate this risk.

A 10% change in exchange rates to the Canadian dollar at June 30, 2015 would have changed Foreign Currency Translation Adjustment by $13.7 million for the quarter and on a year to date basis (Q2-2014 - $4.6 million).

16. Segmented information

Madalena is engaged primarily in the exploration and development of oil and gas. The Company's reportable segments are based on geographic areas and comprise Canada and Argentina. The Company does not have separate operations in Barbados. Barbados entities hold direct interest in the Argentine businesses and the chief operating decision maker views Barbados as an extension of the Argentine operations. Together they collectively comprise the Argentina operating segment.

	As at and for six months ended June 30, 2015		
Canadian $000s	Canada	Argentina	Total
Total assets	17,078	194,913	211,991
Total liabilities	(8,878)	(64,959)	(73,837)
Revenues	1,403	53,097	54,500
Depletion, depreciation and impairment	2,937	15,846	18,783
Operating expenses	2,043	19,861	21,904
General & administrative expenses	2,991	3,892	6,883
Net loss	6,436	2,206	8,642
Capital expenditures(1)	543	17,072	17,615

	As at and for six months ended June 30, 2014		
Canadian $000s	Canada	Argentina	Total
Total assets	48,432	173,469	221,901
Total liabilities	(14,756)	(56,770)	(71,526)
Revenues	9,078	6,372	15,450
Depletion, depreciation and impairment	2,326	2,239	4,565
Operating expenses	3,407	2,024	5,431
General & administrative expenses	2,260	762	3,022
Net (income) loss	(3,655)	221	(3,434)
Capital expenditures(1)	6,282	8,430	14,712

(1) Capital expenditures include cash additions to PP&E and E&E.

17. Supplemental disclosure

Madalena's statement of loss is prepared primarily by nature of expense, with the exception of employee compensation costs which are included in both the operating and general and administrative expense line items on 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 expense line items in the consolidated statements of loss and comprehensive loss.

	Three months ended June 30		Six months ended June 30	
Canadian $000s	**2015**	**2014**	**2015**	**2014**
Operating	**1,710**	95	**3,034**	116
General and administrative	**2,331**	1,385	**4,345**	1,784
Total employee compensation	**4,041**	1,480	**7,379**	1,900

18. Subsequent events

US$3.00 per barrel oil incentive

On February 2, 2015 the Government of Argentina announced a new oil incentive program, effective January 1, 2015, to replace the Petroleum Plus Incentive Program. This new program is effective for all of 2015 and may be extended. To stimulate production, the Government of Argentina has set a US$3.00 per barrel royalty-free bonus payment to be paid on all oil production for each company that increases its oil production or maintains it at greater than 95% of Q4-2014 volumes. This US$3.00 per barrel incentive is incremental to the regulated oil price per barrel received in Argentina's domestic oil market.

The Company has included $1.9 million in crude oil revenue for the three and six months ended June 30, 2015 pursuant to this incentive program, all of which has been received since June 30, 2015.

Petroleum Plus Program

Subsequent to the quarter, the Company was notified by the Argentina Secretary of Energy that Madalena will receive US$11.1 million in publicly traded government bonds for settlement of past Petroleum Plus incentive credits. Prior to September 13, 2015, Madalena must elect from the following bond options:

- A minimum of 20% and a maximum of 100% of government bonds linked to the AR$ ("BONAD 2018"), bearing interest at 2.4%, maturing in 2018 and no selling restrictions; and
- Up to 80% of government bonds in US$ 2024 ("BONAR 2024"), bearing interest at 8.75% and maturing in 2024. Until December 31, 2016, a maximum of 2% per month of the total received in BONAR 2024 may be sold, after which no selling restrictions apply.

Revenue recognition will occur upon receipt of the bonds. Madalena cautions that it is currently assessing the terms and conditions of the bonds, including the marketability of the bonds. Although the bonds are publicly traded, no assurance can be given as to the cash proceeds that Madalena would receive if and when the bonds are monetized. The Company expects to receive the bonds prior to September 30, 2015 and, if and when Madalena sells the bonds, it intends to use the net proceeds for general working capital purposes.