

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management Discussion and Analysis ("MD&A") is provided by the management of Madalena Ventures Inc. ("Madalena" or the "Company"), for the three and nine months ended September 30, 2007 with comparative information for the corresponding period in the prior year. This MD&A should be read in conjunction with the Company's MD&A and audited financial statements for the year ended December 31, 2006. The Company's audited financial statements and other public disclosure documents are filed on SEDAR at [www.sedar.com](http://www.sedar.com). The commentary in this MD&A is based on information available to November 21, 2007. Unless otherwise stated, all dollar amounts are expressed in Canadian dollars.

In this MD&A, all calculations converting natural gas to barrels of oil equivalent ("boe") have been made using a conversion ratio of six thousand cubic feet (six "Mcf") of natural gas to one barrel of oil, unless otherwise stated. The use of boe's may be misleading, particularly if used in isolation, as the conversion ratio of six Mcf of natural gas to one barrel of oil, is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

### Forward-looking Statements

This MD&A contains forward-looking statements within the meaning of applicable securities legislation. Forward-looking statements are based on current expectations, estimates, and projections that involve numerous risks and uncertainties, many of which are beyond the Company's and management's control. These risks and uncertainties could cause actual results to differ materially from those anticipated by the Company and described in this MD&A. These risks and uncertainties include, but are not limited to, the impact of general economic conditions, industry conditions, fluctuation of commodity prices, fluctuation of foreign exchange rates, imperfection of reserve estimates, environmental risks, industry competition, availability of qualified personnel and management, stock market volatility, and timely and cost-effective access to sufficient capital from internal and external sources. The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change except as required by law.

### Non-GAAP Measurements

This MD&A contains the terms "funds from operations", "funds from operations per share", "netback", and "operating netback", which are not defined under Generally Accepted Accounting Principles ("GAAP"), and may not be comparable to similar measures reported by other companies. Management considers these measures to be useful supplementary information for investors. Funds from operations, is defined as cash flow from operating activities before changes in non-cash working capital items, as shown in the following table:

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Cash flow from operating activities	\$ (272,707)	\$ (3,962)	\$ (257,812)	\$ (472,267)
Change in non-cash working capital	(129,350)	173,958	(75,424)	20,085
	\$ (143,357)	\$ (177,920)	\$ (182,388)	\$ (492,352)

Operating netbacks are calculated as total petroleum and natural gas revenue less royalties, operating expenses, and transportation expenses and is shown in the table under results of operations.

## **Disclosure Controls and Procedures**

Disclosure controls and procedures (“DC&P”) are designed to provide reasonable assurance, that information required to be disclosed by the Company in its annual and interim filings or other reports filed or submitted under various securities legislation, are recorded, processed, summarized, and reported within the time limits specified by the particular securities legislation, and include controls and procedures designed to ensure that information to be disclosed by the Company is accumulated and communicated to management to allow timely decisions regarding the required disclosure. The Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) of the Company are responsible for designing DC&P, or causing them to be designed under their supervision, to provide reasonable assurance that material information related to the Company is made known to them by others within the organization.

The CEO and CFO have evaluated the effectiveness of the Company’s DC&P as of September 30, 2007 and have concluded that the DC&P provide a reasonable level of assurance that material information related to the Company is recorded, processed, summarized, and reported in a timely fashion and that material information is made known to them by others within the organization except as described below.

## **Internal Controls over Financial Reporting**

Internal controls over financial reporting (“ICFR”) is a process designed by, or under the supervision of, the CEO and CFO, and effected by the Company’s board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP, and includes those policies and procedures that:

- (a) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and disposition of the assets of the Company;
- (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Canadian GAAP, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors; and
- (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company’s assets, that could have a material affect on the annual or interim financial statements.

ICFR have been designed under the supervision of the CEO and CFO of Madalena to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP, however in designing the ICFR, management has identified the following significant weaknesses inherent in the system:

- A lack of segregation of incompatible duties within the accounting and reporting function.
- The lack of sufficient financial reporting personnel with enough technical accounting knowledge in all areas to address all complex and non-routine accounting transactions that may arise.
- A lack of sufficient information system controls with respect to access and documentation of spreadsheet information.

Management is of the view that the size of the Company and cost of correcting these inherent weaknesses does not justify the additional assurance remediation will provide, and therefore does not plan to remediate these weaknesses at this time. Management believes that the small size of the Company, allows the board of directors and management to possess significant knowledge of all events occurring in the Company which mitigates the possibility of a material error from taking place.

There were no changes in the Company’s ICFR during the three and nine months ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect the Company’s ICFR.

## HIGHLIGHTS

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006 Restated *
<i>Financial</i>				
Gross petroleum and natural gas revenues	\$ 200,514	\$ 67,475	\$ 687,260	\$ 118,816
Interest income	164,981	94,762	532,911	138,585
Funds from operations	(143,357)	(177,920)	(182,388)	(492,352)
Funds from operations per common share - basic and diluted	(0.00)	(0.00)	(0.00)	(0.01)
Net loss for the period	(462,486)	(405,633)	(2,408,779)	(1,766,071)
Net loss per common share - basic and diluted	(0.00)	(0.01)	(0.02)	(0.03)
Capital expenditures	\$ 147,716	\$ 5,437,133	\$ 3,348,804	\$ 8,356,586
<i>Operations</i>				
Daily production				
Oil (bbls/d)	8.1	-	12.2	-
Natural gas (Mcf/d)	179.6	109.4	165.1	88.7
Natural gas liquids (bbls/d)	7.0	1.8	7.0	1.8
Oil equivalent (boe/d)	45.0	20.0	46.7	16.6
Average sales price				
Oil (\$/bbl)	78.66	-	73.04	-
Natural gas (\$/mcf)	6.04	5.75	7.39	6.06
Natural gas liquids (\$/bbl)	65.26	62.47	58.45	64.07
Netback per boe (6:1)				
Petroleum and natural gas	\$ 48.38	\$ 37.01	\$ 53.93	\$ 39.38
Royalties	7.60	-	6.73	3.17
Operating expenses	15.40	4.44	14.53	5.53
Operating netback	\$ 25.38	\$ 32.57	\$ 32.67	\$ 30.68

\* The nine months ended September 30, 2006 has been restated to correct an error in the calculation of stock based compensation.

### Highlights of the quarter include:

- Tunisian seismic results prompt Madalena to announce its intention to elect to drill a first test well in the Remada Sud area.
- Continued activities on numerous prospects in South America result in the announcement of three significant prospects in the Nequen province of Argentina.
- Production revenues from Alberta operations stabilize.

## OVERVIEW

In the second and third quarters of 2007 Madalena continued the process of evaluation of seismic information on its Tunisian interests and advanced \$2,286,000 in the second quarter to its joint venture partner to complete 3D seismic programs on the Remada Sud and Hammamet blocks in Tunisia. Evaluation of the initial 2D seismic on Remada Sud led to an announcement in July that Madalena would participate in the drilling of an exploratory well on the Remada Sud onshore exploration block containing over 1.2 million acres in the Ghadames basin of southern Tunisia. The results of the 3D seismic program will be evaluated in conjunction with the operator to determine a suitable drilling location. The operator has contracted with a drilling company operating in the area to drill the first test well. Madalena anticipates drilling to start in the first quarter of 2008.

Madalena spent a significant amount of time in the second and third quarters evaluating additional exploration and development opportunities in South America, resulting in announcements in October of a joint venture and operating agreement with Hidrocarburos del Neuquén Sociedad Anónima, ("HIDENESA"), the Neuquén Provincial Hydrocarbon Company, and Estrella Servicios Petroleros SA (Estrella) to explore for hydrocarbons on the Cortadera Block in the Province of Neuquen, Argentina. On November 14, 2007 the Company announced the completion of a joint venture and operating agreement with HIDENESA to pursue exploration activities on two additional exploration blocks in the Province of Neuquen, Argentina, known as Curamhuele and Coiron Amargo.

In Alberta, the Company spent approximately \$116,000 for its share of a re-completion of the 10-18-45-11 W5 Brazeau area well into the Notikewan zone, resulting in initial production increases from this well of approximately 40 Mcf/d, our share. Production from our share of the Brazeau area 9-32-46-13 W5 well, declined in the third quarter after higher initial start up production volumes in April and May to stabilize corporate production, and offset the production increases from the re-completion of the 10-18-45-11 W5 well.

## RESULTS OF OPERATIONS

### Production

Madalena's daily production volumes averaged 45 boe/d for the three months ended September 30, 2007, and 46.7 boe/d for the nine months ended September 30, 2007, compared to 20 and 16.1 boe/d for the comparable periods in 2006. Increases in production rates over 2006 reflect the early stage of development of the Company in the first nine months of 2006 and additional volumes brought on stream in 2007. By the end of September of 2007 the Company has completed most of its drilling and completion activities on its joint venture programs in the Edson and Brazeau areas.

### Production Revenue

Madalena received an average of \$78.66/bbl and \$73.04/bbl for its oil production for the three and nine months ended September 30, 2007. Edmonton light crude oil averaged \$73.00/bbl for the nine months ended September 30, 2007. The Company received an average of \$6.04/Mcf and \$7.39/Mcf for its gas production for the three and nine months ended September 30, 2007 compared to \$5.75/Mcf and \$6.06/Mcf for the three and nine month periods ended September 30, 2006. Alberta average plant gate prices for the nine months ended September 30, 2007 were \$6.40/MMBtu. Gas produced from the Edson and Brazeau areas has a higher heat energy value which reflects the slightly higher prices received by the Company. The Company received \$65.26/bbl and \$58.45/bbl for its natural gas liquids for the three and nine months ended September 30, compared to \$62.47/bbl and \$64.07/bbl for the three and nine months ended September 30, 2006. Edmonton butane and NGL mix prices trended downward in 2007 with butanes averaging \$48.15/bbl, and NGL mix prices averaging 51.60/bbl for the nine months ended September 30, 2007.

Gross revenue for the three months ended September 30, 2007 were \$58,379 (29%) for oil, \$99,859 (50%) for natural gas, and \$42,278 (21%) for natural gas liquids, while gross revenues for the nine months ended September 30, 2007 were \$242,538 (36%) for oil, \$332,967 (48%) for natural gas, and \$111,762 (16%) for natural gas liquids. Gross revenues for the three months ended September 30, 2006 were \$nil for oil, \$57,258 (85%) for gas, and \$10,216 (15%) and for the nine months ended September 30, 2006 were \$nil for oil, \$97,862 (82%) for gas and \$20,953 (18%) for natural gas liquids. The Company received a higher percentage of its revenue from oil production after the 9-32 Brazeau well started producing in the second quarter of 2007.

The Company did not have any commodity pricing contracts in place at September 30, 2007.

#### Interest Income

Interest income for the three and nine months ended September 30, 2007 amounted to \$164,981 and \$532,911 respectively compared to \$94,762 and \$138,585 for the comparative periods in 2006. Interest income has increased in 2007 which reflects the Company's investment of funds it received from its private placement in November 2006 in low risk short term interest bearing securities. At the start of the year the Company had investments in low risk bank supported asset backed securities. As a result of market risk increases from defaults in the non bank supported asset backed securities, the Company took steps to move its investments into discount notes issued by financial institutions and bankers acceptance, which follows the Companies objective of earning a reasonable rate of return without a significant risk on the cash it has raised for exploration and development opportunities.

#### Royalties

Production royalties including crown royalties and gross overriding royalties were \$31,498 (\$7.60/boe) for the three months ended, and \$85,706 (\$6.73/boe) for the nine months ended September 30, 2007 compared to \$nil for the three months ended, and \$9,562 (\$3.17/boe) for the nine months ended September 30, 2006. The somewhat low royalty rates reflect reduced royalty rates under the deep well royalty holiday program, and reduced royalties on low productivity wells.

#### Operating expenses

Production expenses for the three and nine months ended September 30, 2007 amounted to \$63,831 and \$185,305 or \$11.99 and \$11.95 per boe compared to \$8,088 and \$16,670 or \$3.91 and \$5.06 per boe for the three and nine months ended September 30, 2006. Higher production expenses reflect higher industry operating costs in Western Canada and additional costs as more of the Company's wells came on-stream in 2007.

Transportation costs amounted to \$14,134 and \$32,836, or \$3.41 and \$2.58 per boe for the three and nine months ended September 30, 2007 compared to \$821 or \$0.69 per boe and \$1398 or \$0.47 per boe for the three and nine months ended September 30, 2006. Higher transportation costs reflect the higher cost of trucking oil from the 9-32 well compared to gas transportation costs from low production gas wells in 2006.

## Operating netbacks

Madalena realized the following operating netbacks from oil and gas operations:

	Three months ended		Nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Netback per boe (6:1)				
Petroleum and natural gas revenues	\$ 48.38	\$ 37.01	\$ 53.93	\$ 39.38
Royalties	7.60	-	6.73	3.17
Production expenses	11.99	3.91	11.95	5.06
Transportation costs	3.41	0.53	2.58	0.47
Operating netback	\$ 25.38	\$ 32.57	\$ 32.67	\$ 30.68

Although average netbacks for the nine months ended September 30, 2007 have remained comparable to the three and nine months ended September 30, 2006 they have fallen for the three months ended September 30, 2007. In 2006 the Company's production was all from natural gas and natural gas liquids resulting in a lower sales price. However production and transportation costs averaged around ten percent of the production value. In 2007 the Company received higher prices as the 9-32 oil well started producing at initially high volumes and then declined in the third quarter. As the proportion of sales received from oil declined in the three months ended September 30, 2007 so did the average sales price received compared to the average sales price for the nine months ended September 30, 2007. Also in 2007 production and transportation costs as a percentage of the average price received doubled over 2006.

## General and administrative costs

General and administrative ("G&A") costs of \$301,998, and \$1,020,023 were incurred for the three and nine months ended September 30, 2007 compared to \$332,069 and \$723,521 for the three and nine months ended September 30, 2006. G&A for Q3 2007 is comparable to G&A for Q3 2006. G&A for the nine months ended September 30, 2007 has increased by approximately 40% over the same period in 2006. The increased total G&A for 2007 is a result of: more expenses incurred for travel to South America to evaluate exploration and development prospects there; a full nine months of salaries and benefits for employees of the Company who were not employed for a full year in 2006; and a full nine months of office rent, and insurance costs.

The Company capitalized \$84,637 and \$163,945 of G&A associated with a consulting geologist and a consulting lawyer in the Argentina and Tunisia cost centers for the three and nine months ended September 30, 2007. There was no G&A capitalized in the comparative periods for 2006.

### Stock-based compensation

Stock-based compensation ("SBC") expense amounted to \$158,692 and \$1,429,644 for the three and nine months ended September 30, 2007 compared to \$136,698 and \$1,181,212 for the three and nine months ended September 30, 2006. SBC expenses in 2007 include additional expenses for options granted June 18, 2007, and a one time charge for options transferred from one director to two other directors in the first quarter of 2007. Accounting standards view this transaction as forfeiture by the transferor, and the grant of new options for the transferees. As a result the SBC for the transferred options is left in contributed surplus as an expense, and a new expense is recorded for the grant of the new options.

The comparative numbers for the third quarter of 2006 have been restated to reflect a revision to the calculation of SBC to amortize the expense over the correct vesting period. The Company increased SBC for the nine months ended September 30, 2006 from \$730,389 to \$1,181,212, an increase of \$450,823. The Company capitalized \$24,626 and \$36,934 of SBC to the Argentine and Tunisian foreign cost centers in the three and nine months ended September 30, 2007. There was no SBC capitalized in the comparative periods for 2006. The SBC capitalized reflects the estimated cost of options granted to the Company's geological and legal consultants for evaluating exploration opportunities in the foreign cost centers. At September 30, 2007, the Company has approximately \$1,191,000 of unamortized SBC costs that will be charged to income over the remaining vesting period of the options outstanding.

### Depletion, depreciation and accretion

Depletion expense for the three and nine months ended September 30, 2007 was \$155,000 and \$780,000 respectively compared to \$40,000 and \$66,000 for the three and nine months ended September 30, 2006. The increase in depletion reflects increased production from the Canadian properties in 2007 and a reduction in the carrying value of the Canadian oil and gas properties in the second quarter of 2007 as described below.

Depletion was not recorded in Argentina or Tunisia. These cost centers are considered to be in the pre-production stage where all costs reasonably attributable to exploration are capitalized to the cost center. Management feels that the costs capitalized to date will be recoverable from future business activities in the area.

Depreciation for the three and nine months ended September 30, 2007 was \$4,120 and \$12,220 respectively compared to \$13,194 for the three and nine months ended September 30, 2006.

The provision for accretion due to the change in present values of asset retirement costs was \$1,317 for the three months ended September 30, 2007, and \$4,528 for the nine months ended September 30, 2007 compared to \$2,341 for the three and nine months ended September 32, 2006.

### Canadian oil and gas property carrying value

At September 30, 2007 the Company calculated an estimate of impairment and determined that no additional impairment of the carrying cost of its Canadian oil and gas assets existed at September 30, 2007. For the three months ended June 30, 2007 the Company did record an impairment of \$278,000 relating to the Canadian oil and gas properties. The impairment of \$278,000 has been included in depletion for the nine months ended September 30, 2007, resulting in total depletion of \$780,000 for the nine months ended September 30, 2007.

### Foreign exchange loss

The Company's main exposure to foreign currency risk relates to its investment in securities denominated in US dollars. The Company holds US dollars in cash and short-term deposits with Canadian financial institutions in anticipation of transmitting the funds to Argentina or Tunisia to fulfill its seismic and exploration activities. For the three months ended September 30, 2007 the total foreign exchange loss was \$111,525 on the conversion of US dollar deposits on hand at September 30, 2007. September 30, 2007 was the first reporting period in which the Company held US dollars on deposit, so there are no comparative numbers in prior periods. Currently, the Company does not hedge against fluctuations in the US dollar exchange rate.

### Loss from discontinued operations, distribution of assets, dividends, and gain on sale of marketable securities

In 2006 the Company decided to focus on international oil and gas exploration and development opportunities. In August of 2006 the Company received final approval to complete a plan of arrangement to distribute the mining exploration business, and marketable securities related to that business, to its shareholders. In the year ended December 31, 2006 the company identified \$58,662 of legal costs relating to the plan of arrangement that were removed from G&A and shown separately as a loss from discontinued operations. In the three and nine months ended September 30, 2006, \$52,909 and \$55,989 of the costs related to the discontinued operations were recorded separately in the financial statements.

On November 15, 2004 the Company declared a dividend in specie with respect to shares of Planet Exploration Inc. ("Planet"). Each shareholder of the Company at November 15, 2004 became entitled to receive 0.675 Planet shares for each Madalena share owned at November 15, 2004, subject to the shareholder fulfilling certain conditions. During 2006, and prior to the completion of the plan of arrangement, the Company distributed 96,963 Planet shares to shareholders that had fulfilled the conditions. The fair market value of the shares at the date of the distribution (determined from the trading value of the shares on the TSX Venture exchange) is recorded as dividends paid in kind, and any gain or loss on the disposition of the Planet shares is recorded as a gain on sale of marketable securities. During the year ended December 31, 2006 the Company recorded \$51,716 of dividends in kind and \$45,017 of gain on sale of marketable securities. For the three months ended September 30, 2006 the Company recorded \$18,563 of dividends paid in-kind and \$17,429 of gains on sale of marketable securities. For the nine months ended September 30, 2006 the Company recorded \$48,273 of dividends paid in kind and \$45,017 of gains on sale of marketable securities. At August 22, 2006 any Planet shares that had not been distributed by the Company were transferred to Great Bear Resources Ltd. who assumed the obligation to distribute the shares if the shareholders fulfilled the commitment specified for receipt of the dividend in specie.

### Net loss from operations

The net loss for the three months ended September 30, 2007 amounted to \$462,486, and the net loss for the nine months ended September 30, 2007 was \$2,408,779 compared to a net loss of \$405,633 and \$1,710,082 for the three and nine months ended September 30, 2006. The loss for the nine months ended September 30, 2007 is largely due to depletion, stock based compensation and foreign exchange losses. Operating netbacks from oil and gas operations and interest earned on cash investments allow the Company to cover the majority of its general and administrative costs. Funds from operations are still showing a use of cash resources but the amount has declined from 2006. The negative funds from operations for the three months ended September 30, 2007 of \$143,357 includes a loss on the conversion of Canadian dollar deposits in the amount of \$111,525.

## Income taxes

The Company has not recorded a provision for income taxes recovery in 2007 or 2006, as the likelihood of realizing a benefit from such a provision is uncertain at this time.

Future income tax assets and liabilities arise due to the difference between the tax basis of assets and their respective accounting carrying cost. At September 30, 2007 the Company has Canadian tax losses and other cumulative tax deductions in excess of net book values. The income tax benefit of these future tax assets have not been recognized in the recognized in the financial statements as their recoverability is uncertain at this time.

## Capital Expenditures

Madalena spent \$147,716 on petroleum and natural gas properties and office furniture and fixtures in the three months ended September 30, 2007 and \$3,348,804 in the nine months ended September 30, 2007 compared to \$5,437,133 and \$8,356,586 in the comparative periods for 2006. The expenditures incurred in 2007 compared to 2006 are summarized in the following table:

	Three months ended		Nine months ended	
	September 30	September 30,	September 30	September 30,
	2007	2006	2007	2006
<hr/>				
Canada:				
<u>Oil and gas properties:</u>				
Drilling and completions	\$ 150,420	\$ 4,907,929	\$ 808,804	\$ 7,590,878
Well equipment and production facilities	(27,721)	477,482	252,976	546,465
Land	-	632	49	52,419
Asset retirement obligations	31,021	38,525	31,021	58,525
Office furniture and equipment	-	12,565	1,302	87,958
<u>Mining properties</u>		-		20,341
Argentina - prospecting costs	(15,383)	-	(75,148)	-
Tunisia - prospecting costs	9,380	-	2,329,800	-
<hr/>				
Total capital expenditures	\$ 147,717	\$ 5,437,133	\$ 3,348,804	\$ 8,356,586

## **LIQUIDITY AND CAPITAL RESOURCES**

Presently, Madalena is in the initial exploration stage on its international oil and gas activities. The Company's main sources of funds are from its Canadian oil and gas properties and interest it earns on cash investments. These funds from operations are not sufficient to cover the Companies overhead, and in the three and nine months ended September 30, 2007 the Company had negative funds from operations of \$143,357 and \$182,388 respectively. During 2007, the Company raised funds from equity financings to pay for exploration activities and overhead expenses. Continuing operations and the recovery of property and equipment costs is dependent on the Company's ability to identify commercial oil and gas reserves, generate profitable operations and obtain sufficient funds to complete development activities.

At September 30, 2007 Madalena had working capital of \$15,144,369 compared to \$274,461 at September 30, 2006 and \$18,309,436 at December 31, 2006. Working capital at September 30, 2007 increased compared to September 30, 2006 as a result of the issuance of common stock from private placements in November of 2006 and the issuance of shares on the exercise of stock options and warrants during 2006. In the nine months ended September 30, 2007 the Company received \$238,625 on the exercise of warrants and \$60,000 on the exercise of options. The Company has no debt at September 30, 2007. Capital expenditures in the nine months ended September 30, 2007 were funded entirely from working capital.

The Company has announced that it intends to participate in the drilling of a test well in the Remada Sud area of Tunisia in the last quarter of 2007 or in the first quarter of 2008. The Company expects that its share of the cost of the well will be \$2,100,000. The Company has also announced work programs which have been approved by the Province of Neuquen in Argentina for three exploration blocks in the province. The total work programs amount to \$10,500,000 USD over three years for the three blocks. The Company's share of these work commitments will range from between 70 to 100%.

In October of 2007 the Company received approval from the TSX Venture stock exchange to extend the expiry date on 12,577,625 common share purchase warrants ("the warrants") from November 2, 2007 to May 2, 2008. The warrants were issued on November 2, 2006, and November 16, 2006 as part of a private placement offering through its agent, Canaccord Capital Corporation initially announced on September 19, 2006. 12,530,750 Shareholder Warrants issued on November 2, 2006 entitle the holder thereof to acquire a common share of Madalena at a price of \$0.90 per common share until November 2, 2007. 46,875 Shareholder Warrants issued on November 16, 2006 entitle the holder thereof to acquire a common share of Madalena at a price of \$0.90 per common share until November 16, 2007. If all outstanding warrants are exercised prior to May 2, 2008 the Company will receive \$11,319,862, which would be used to fund its capital expenditure commitments.

## **TRANSACTIONS WITH RELATED PARTIES**

Two directors of the Company are also directors of a public exploration company with which Madalena is engaged in joint venture operations. All of the Company's oil and gas revenue, royalties and operating expenses are derived from this joint venture. At September 30, 2007 the Company has accounts payable due to this joint venture partner of \$26,440.

The Company utilizes the services of a law firm in which one of the directors is a retired partner. During the three and nine months ended September 30, 2007 the Company expended \$5,000 and \$79,700 respectively (\$108,883 for the year ended December 31, 2006) on services obtained from this firm.

## **SHARE INFORMATION**

The Company has 107,368,699 common shares, 10,050,000 stock options and 14,086,940 warrants to purchase common shares outstanding at September 30, 2007. There were no changes to the Company's common shares in the three months ended September 30, 2007. During the nine months ended September 30, 2007 the Company issued 500,000 common shares pursuant to the exercise of options by a director at \$0.12 per share, granted incentive stock options to directors, officers, employees, and consultant to purchase up to 2,150,000 shares of the Company at \$0.60 per share, had 500,000 warrants to purchase common shares at a price of \$1.25 per share expire, issued 477,250 common shares at \$0.50 per share pursuant to the exercise of warrants, and had 7,500 warrants to acquire common shares at a price of \$0.50 per common share expire.

During the three months ended September 30, 2006 the Company issued 115,250 common shares at \$0.50 per share pursuant to warrants exercised. For the nine months ended September 30, 2006 the Company issued 12,000,000 common shares at \$0.50 per share and 1,000,000 common shares at \$1.00 per share pursuant to private placements, 1,500,000 common shares at \$0.12 per share and 200,000 common shares at \$0.41 per share pursuant to stock options exercised, and issued 5,350,000 common shares at \$0.08 per share and 115,250 common shares at \$0.50 per share pursuant to warrants exercised.

At November 21, 2007 the Company has 107,368,699 common shares, 10,150,000 stock options and 12,577,625 warrants outstanding. Subsequent to September 30, 2007 the Company received approval from the TSX Venture exchange to extend the expiry date on 12,577,625 common share purchase warrants ("the warrants") from November 2, 2007 to May 2, 2008. The warrants were issued on November 2, 2006, and November 16, 2006 as part of a private placement offering through its agent, Canaccord Capital Corporation ("Canaccord") initially announced on September 19, 2006. An additional 1,509,315 of common share purchase warrants issued to brokers on the private placement in November of 2006 were not extended and expired, unexercised, on November 16, 2007. On October 18, 2007 the Board of Directors of the Company agreed to grant

100,000 common share options to a consultant of the Company under the Companies TSX Venture approved stock option plan. The 100,000 common share options allow the consultant to purchase 100,000 common shares of the Company at a price of \$0.70 per common share. The options expire on October 18, 2012 and vest on the anniversary date of the grant over the next three years on October 18, 2008, 2009, and 2010.

## **BUSINESS RISKS**

The oil and gas industry involves inherent risks which include but are not limited to the uncertainty of the exploration process and finding new reserves, securing markets for production from existing reserves, commodity price fluctuations, exchange rate fluctuations, interest rate changes, and changes in government regulations related to pricing, royalties, taxes, land fees, allowable production volumes, and environmental requirements. The oil and natural gas industry is intensely competitive and the Company competes with a number of companies that may have better access to capital.

The Company's ability to increase reserves in the future will depend on its ability to select and acquire suitable prospects and the funds required to develop those prospects in a timely fashion. The ability of equity or debt financing is affected by many factors, some of which are not controllable by the Company.

The Company is focused on the international oil and gas exploration market. Conducting oil and gas exploration and development activities in foreign jurisdictions creates inherent risks in addition to oil and gas exploration risks which include but are not limited to currency instability, potential civil disturbances, currency and funds movement controls, price controls, political instability, changes in foreign ownership restrictions, and potential expropriation of property.

For addition detail regarding the Company's risks and uncertainties, refer to the Company's most recent Annual Information Form on SEDAR at [www.sedar.com](http://www.sedar.com).

## **NEW ALBERTA ROYALTY REGIME**

In October of 2007 the Government of Alberta announced that it would be altering the royalty regime in the province effective January 1, 2009. We anticipate that the royalty rate will increase on our oil and gas wells once royalty holidays are complete, but we are unable to quantify the magnitude of the changes at this time. As more information becomes available, Madalena will analyze the impact of the royalty changes on future cash flows, capital investment alternatives, reserves, and the access to capital markets.

## **CONTRACTUAL OBLIGATIONS**

The Company has committed to a lease for office premises terminating on September 15, 2010. The estimated obligation at September 30, 2007, including operating costs at current levels, is \$297,864 in total. On October 29, 2007, and November 14, 2007, the Company signed joint venture and operating agreements to explore for hydrocarbons on the Cortadera, Curamhuele and Coiron Amargo blocks in the Province of Neuquen, Argentina, and has committed to spending approximately \$10.5 million USD on approved work commitment programs on these three blocks over the next three years.

## **APPLICATION OF CRITICAL ACCOUNTING ESTIMATES**

Significant accounting policies used by Madalena are disclosed in note 2 to the December 31, 2006 audited financial statements. Preparing financial statements in accordance with Canadian GAAP requires management to make judgments and estimates with respect to the critical accounting policies. Changes to these judgments and estimates could have a material effect on the Company's financial statements and financial position. There were no changes to Madalena's critical accounting estimates.

## CHANGES IN ACCOUNTING POLICIES

In 2007 the Company adopted new accounting standards for “Accounting Changes”, “Comprehensive Income”, “Equity”, “Financial Instruments – Recognition and Measurement”, “Financial Instruments – Disclosure and Presentation”, and “Hedges”. Financial statements for prior periods have not been restated as a result of the adoption of these policies except as described below. For a detailed discussion of the accounting policies adopted please refer to Note 2 of the financial statements for the three and nine month periods ended September 30, 2007.

### Financial Instruments

The Company’s financial instruments consist of cash, asset-backed debt securities, bankers’ acceptances, discount notes issued by financial institutions, guaranteed investment certificates, accounts receivable, accounts payable, and accrued liabilities. At September 30, 2007, the carrying value of the cash, guaranteed investment certificates, accounts receivable, accounts payable, and accrued liabilities, approximated their fair value due to their short-term nature. The Company has no bank indebtedness.

The Company has designated its investments in asset-backed debt securities, which are included in cash and cash equivalents, as held-for-trading financial assets at January 1, 2007. During the year the Company disposed of its investments in asset-backed securities as they matured and were fully realized. Proceeds from the maturity of the asset backed securities were re-invested in bankers’ acceptances and discount notes issued by financial institutions which were also designated as held-for-trading financial assets on acquisition. The fair value of these assets has been determined at September 30, 2007 based on trading prices supplied by financial institutions for these instruments. The following table provides information on the fair value, carrying value, maturity value, maturity date, and interest yield of the investment at September 30, 2007. The increase in fair value has been recorded as interest income in the statement of operations for the three and nine months ended September 30, 2007.

As at September 30, 2007					Fair Value at	
	Cost	Maturity Value	Yield		September 30, 2007	Interest Income
Bank of Nova Scotia discount note due October 23, 2007	\$ 4,665,417	\$ 4,685,000	4.64%	\$	4,669,675	\$ 4,259
First Bank bankers' acceptance due October 1, 2007	6,598,517	6,626,000	4.64%		6,623,495	24,978
	\$ 11,263,934	\$ 11,311,000		\$	11,293,170	\$ 29,237

### Restatement of comparative information

The comparative information for the nine months ended September 30, 2006 has been retrospectively restated to correct errors in the calculation of stock based compensation. The affect of the restatement was to increase stock based compensation by \$450,823 to \$1,181,212 which results in a corresponding increase in the net loss for the nine months ended September 30, 2006 from \$1,315,248 to \$1,766,071 or \$0.01 per share and in the contributed surplus on the Balance Sheet. There was no affect on cash flows or funds from operations. There were no changes to the three months ended September 30, 2006.

Comparative information for previously issued quarterly results has been restated to reflect errors in the calculation of stock based compensation, petroleum and natural gas revenues, royalties, operating expenses, and depletion. A summary of the changes to net income (loss) for each period compared to previously published information is shown in the following table:

Restated quarterly financial information	March 31, 2006	June 30, 2006	Sept 30, 2006	Dec 31, 2006
Net loss previously reported	(2,779,060)	(417,208)	(416,154)	(2,796,247)
Adjustments to previously stated amounts in net loss				
Stock based compensation	1,830,609	15,742	-	(99,178)
Petroleum and natural gas revenues	-	18,580	(18,580)	-
Royalties	-	(74)	74	-
Operating expenses	-	(3,027)	3,027	-
Depletion, depreciation, and accretion	-	(26,000)	26,000	-
Restated net loss	(948,451)	(411,987)	(405,633)	(2,895,425)

### **OUTLOOK**

For the remainder of 2007, the Company will focus on completion of negotiations on its oil and gas exploration blocks in Argentina, evaluation of seismic information obtained in Tunisia and Argentina, organizing work crews and office staff for its exploration activities in Argentina, and creating a structure for the organization in Argentina and Tunisia.

## QUARTERLY FINANCIAL INFORMATION

The following table summarizes certain information for the previous eight quarters. For the periods ended March 31, 2006, December 31, 2005, and September 30, 2005, there was no production and therefore sales volumes and per unit information have not been shown.

	September 30, 2007	June 30, 2007	March 31, 2007	Restated * Dec. 31, 2006
<b>Sales Volumes:</b>				
Oil (bbl/d)	8	28	-	-
Natural gas (mcf/d)	180	155	161	198
Natural gas liquids (bbl/d)	7	8	6	7
Barrels of oil equivalent (boe/d)	45	62	33	40
<b>Per unit information:</b>				
Oil price (\$/bbl)	78.66	71.42	-	-
Natural gas price (\$/mcf)	6.04	8.31	8.03	7.54
Natural gas liquids price (\$/bbl)	65.26	58.81	50.41	51.65
Oil equivalent price (\$/boe)	48.38	60.88	48.60	46.39
Operating net back (\$/boe)	25.38	43.14	23.15	25.11
<b>Financial:(\$ except for share info)</b>				
Revenue:				
Petroleum and natural gas revenue	200,514	341,338	145,408	171,532
Interest Income	\$ 164,981	\$ 177,874	\$ 190,056	\$ 147,948
Gain on disposal of marketable securities	-	-	-	-
Income (loss) from continuing operations	(462,486)	(836,521)	(1,146,773)	(2,892,752)
Basic and diluted per share	(0.00)	(0.01)	(0.01)	(0.03)
Net income (loss)	(462,486)	(836,521)	(1,146,773)	(2,895,425)
Basic and diluted per share	(0.00)	(0.01)	(0.01)	(0.03)
Capital expenditures	\$ 147,716	\$ 2,487,592	\$ 701,188	\$ 1,471,112
Shares outstanding (000's)	107,369	107,369	106,869	106,391
Working capital	\$ 15,144,359	\$ 15,380,251	\$ 17,713,097	\$ 18,309,436

	Restated *	Restated *	Restated *	
	Sept 30,	June 30,	March 31,	Dec. 31,
	2006	2006	2006	2005
<b>Sales Volumes:</b>				
Natural gas (mcf/d)	109	68	-	-
Natural gas liquids (bbl/d)	2	2	-	-
Barrels of oil equivalent (boe/d)	20	13	-	-
<b>Per unit information:</b>				
Natural gas price (\$/mcf)	5.75	6.57	-	-
Oil and natural gas liquids price (\$/bbl)	62.47	65.66	-	-
Oil equivalent price (\$/boe)	37.01	43.02	-	-
Operating net back (\$/boe)	32.57	27.81	-	-
<b>Financial:(\$ except for share info)</b>				
Revenue:				
Petroleum and natural gas revenue	67,475	51,341	-	-
Interest Income	\$ 94,762	\$ 17,303	\$ 26,520	\$ 18,225
Gain on disposal of marketable securities	17,429	-	27,588	4,839
Income (loss) from continuing operations	(352,724)	(408,907)	(948,451)	(214,081)
Basic and diluted per share	(0.00)	(0.01)	(0.06)	(0.01)
Net income (loss)	(405,633)	(411,987)	(948,451)	(280,045)
Basic and diluted per share	(0.01)	(0.01)	(0.06)	(0.01)
Capital expenditures	5,398,608	1,718,484	1,181,058	133,108
Shares outstanding (000's)	71,586	71,471	66,521	51,421
Working capital	274,561	5,874,256	6,490,488	1,769,182

\* The information for quarters ended in 2006 has been restated to reflect adjustments noted in the Accounting Changes information above.

## **DIRECTORS**

Raymond G. Smith  
*Chairman,  
Madalena Ventures Inc.*

Kenneth L. Broadhurst  
*President and Chief Executive Officer,  
Madalena Ventures Inc.*

Dwayne H. Warkentin  
*Sr. Vice President and Chief Operating Officer,  
Madalena Ventures Inc.*

Ving Y. Woo  
*Director,  
Cork Exploration Inc.*

Michael J. Lock  
*President,  
Upsilon Holdings Ltd.*

J. G. (Jeff) Lawson  
*Partner,  
Blackmont Capital Inc.*

James K. Wilson  
*VP Finance, CFO and Corporate Secretary,  
Grizzly Resources Ltd.*

## **OFFICERS**

Kenneth L. Broadhurst  
*President and Chief Executive Officer*

Dwayne H. Warkentin  
*Senior Vice President and Chief Operating Officer*

Gregory J. Ford, CA  
*Vice President, Finance and Chief Financial Officer*

## **HEAD OFFICE LOCATION**

Suite 200, 441 – 5<sup>th</sup> Avenue S.W.  
Calgary, Alberta  
Canada T2P 2V1

## **LEGAL COUNSEL**

Burnet, Duckworth and Palmer LLP  
*Calgary, Alberta*

## **BANKERS**

BMO Bank of Montreal

## **AUDITORS**

KPMG LLP  
*Calgary, Alberta*

## **INDEPENDENT ENGINEERS**

GLJ Petroleum Consultants

## **REGISTRAR AND TRANSFER AGENT**

Inquiries regarding change of address, registered shareholdings, stock transfers or lost certificates should be directed to:  
Computershare Trust Company of Canada  
*Calgary, Alberta*

## **STOCK EXCHANGE LISTING**

TSX Venture Exchange  
Trading Symbol: "MVN"