# PACIFIC RUBIALES ENERGY CORP.

## MANAGEMENT DISCUSSION AND ANALYSIS
**April 1, 2009**

Form 51-102F1
For the year ended December 31, 2008

The following discussion (the "MD&A") is management's assessment and analysis of the results and financial condition of Pacific Rubiales Energy Corp. (the "Company"), and should be read in conjunction with the accompanying audited consolidated financial statements for the year ended December 31, 2008 and related notes. The preparation of financial data is in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and all figures are reported in thousands of United States dollars, except for production, share data or as otherwise stated. On May 9, 2008 the Company consolidated its common shares, stock options and warrants on a one for six basis. All references to net barrels or net production reflect only the Company's share of production after excluding royalties and the operating partner's working interest.

Additional information relating to the Company, including the Company's Annual Information Form for the year ended December 31, 2008, is available on SEDAR at www.sedar.comwww.sedar.com.

***Financial and Operating Summary***

| *(in thousands of US$ except per share amounts or as noted)* | Year ended December 31, 2008 | 2007 |
|---|---|---|
| **Financials:** | | |
| Net sales | 579,064 | 80,416 |
| Net Income for the period | 76,698 | 13,275 |
| Net Income per share - basic and diluted[1] | | |
| - basic | 0.38 | 0.24 |
| - diluted | 0.36 | 0.21 |
| Capital expenditures (includes $53,762 in accounts payables) | 280,838 | 35,500 |
| (excludes 40% taxable benefit in Colombia of $53.3 million) | | |
| Total assets | 2,299,108 | 779,078 |
| Fund flow from operations [2] | 257,982 | 42,962 |

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | 2008 Oil | 2008 Gas | 2008 Combined | 2007 Combined |
| **Operations:** | | | | |
| Operating netback ($/boe) [3] | | | | |
| Crude oil and natural gas sales price | 81.67 | 33.50 | 69.98 | 55.44 |
| Lifting costs | 5.47 | 0.88 | 4.36 | 4.39 |
| Transportation and other costs | 12.47 | 0.01 | 9.45 | 13.73 |
| Upgrading Cost (Diluent including transportation) | 15.39 | - | 11.66 | - |
| Other production costs | 7.44 | 4.06 | 6.62 | 4.71 |
| Operating netback | 40.89 | 28.54 | 37.89 | 32.61 |

*(1) On May 9, 2008, the Company consolidated its common shares on a 1:6 basis by issuing one common share for every six common shares outstanding. On March 9, 2007, the Company split its issued and outstanding common shares on a 7:1 basis by exchanging seven common shares for every one common share outstanding. All references to earnings per share, weighted average number of common shares outstanding, common shares issued and outstanding, and authorized common shares have been adjusted to reflect the share split and subsequent share consolidation.*
*(2) Calculated based on cash flow from operations before changes in non-cash operating working capital.*
*(3) Combined operating netback data based on weighted average daily production sold.*
*(4) Natural gas conversion rate used was 6 mcf = 1 barrel of oil equivalent ("boe"). Boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.*

***2008 Results Summary***

- The Company completed the acquisitions of Pacific Stratus Energy Corp. ("Pacific Stratus") and Kappa Energy Holdings Ltd. ("Kappa").

- On March 3 2009, the Company announced the independently certified Statement of Reserves Data and Other Oil and Gas Information for all of the Company's assets, which estimated gross working interest proved plus probable (2P) reserves to be 247 mmbbl of oil equivalent. Proven reserves increased 50%, from 136 mmbbl at the end of 2007, to 204 mmbbl at the end of 2008. These reserves represent almost one barrel of net proven reserves (P1) per outstanding share.

- During 2008, the Company was the most dynamic E&P company operating in Colombia, showing the highest growth in operated production of any company, totalling an increase of 36,571 boed from January to December from all the fields it operates, both oil and gas. This growth in operated production came through acquisitions (8,673 boe/d) and development of assets (27,898 boe/d).

- In the course of the year the Company drilled 12 exploratory wells and acquired 355 km of 2D seismic and 292 km2 of 3D seismic, for a total expenditure $ 71.7 million. The drilling campaign had a 75% success ratio, adding 24.23 million boe of new 2P reserves at a cost of $ 3/ boe.

- On January 2, 2008, the Company announced that it had signed a memorandum of understanding with Ecopetrol S.A. for the construction and operation of the Rubiales-Monterrey Pipeline, through a special purpose vehicle, Oleoducto de los Llanos Orientales S.A. ("ODL"), with a participation of 65% ECP and 35% for the company . On completion, the 235 km pipeline will have a capacity of 170,000 bbl/d and will connect the Rubiales oil field to the Coveñas port for export through the Colombian pipeline system. On March 12, 2009, the Company announced that ODL signed a debt facility agreement with GRUPO AVAL (AVAL), a Colombian financial group for approximately US$200 million (to be disbursed in Colombian currency) to finance the construction of this pipeline. By the end of March 2009 overall construction progress of the project stood at 60%.

- In April 2008 a new blending facility at Guadas (PF2) was put into operation, allowing the Company to export 100% of its share of the Rubiales heavy oil production, and a significant increase in the net back per barrel, almost doubling it for the whole year. As a result, the Company became a player in the international market, in particular in the medium/ heavy oil segment.

- The Company consolidated its position as an important player in the commercialization of natural gas in the Colombian domestic market, achieving average sales of approximately 33 mmbtu/day at a price of 5.42 $/mmbtu, which represents an estimated premium of $2 above the average market price.

- On August 28, 2008 the Company issued $224.9 million (C$240 million) of convertible secured subordinated debentures due August 29, 2013 and convertible into common shares of the Company at C$13.00 per share. The debentures bear interest at 8% annually and are payable on June 30 and December 31. The Company used a portion of the net proceeds to pay for the acquisition of Kappa.

- Revenues increased over the previous year to $579.1 million from $80.4 million in 2007 primarily due to increased production, higher realized crude oil prices in 2008 and the acquisitions of Pacific Stratus and Kappa in January and September 2008, respectively.

- Ebitda amounted to $ 300.8 million, which represented a seven fold increase to the 2007 figure of $ 45.4 million. Ebitda from international sales represented 75% of this amount, while Ebitda from gas and domestic sales contributed 15% and 10%, respectively.

- The cash capital expenditures in 2008 totalled $280.8 million (including the 40% taxable benefit in Colombia of $53.3million) of which$ 71.7 million went into exploration activities; $118.5 million were invested in the expansion and construction of infrastructure and $90.6 million in production drilling activities.

- On May 9, 2008, the Company consolidated its common shares on a 1:6 basis by issuing one common share for every six common shares outstanding. On March 9, 2007, the Company split its issued and outstanding common shares on a 7:1 basis by exchanging seven common shares for every one common share outstanding. All references to earnings per share, weighted average number of common shares outstanding, common shares issued and outstanding and authorized common shares have been adjusted to reflect the share split and subsequent share consolidation.

- During 2008, the Company reinforced the internal audit function pursuant to National Instrument 52-109. As a result of the evaluation of the design effectiveness and operating effectiveness of ICFR (Internal Controls over Financial Reporting) the Company identified, assessed, and tested 413 controls, which cover all of the Company's processes with an impact on financial statements. Also, the Company identified risks which could involve significant accounts and relevant assertions, and considered quantitative and qualitative factors on significant accounts and disclosures. The Company concluded there are opportunities to improve controls in the following areas:.
    - Focus on control and review procedures in the financial consolidation process to ensure compliance with the Canadian securities requirements in a timely manner.
    - The Company will hire additional expert resources which may be necessary and will provide training for all personnel involved in the Canadian statutory reporting process.
    - The implementation of SAP on July 1, 2009 as the corporate ERP will facilitate standardization of accounting and reporting.

***Forward Looking Statements***

Certain statements in this MD&A constitute forward-looking statements. Often, but not always, forward-looking statements use words or phrases such as: "expects", "does not expect" or "is expected", "anticipates" or "does not anticipate", "plans" or "planned", "estimates" or "estimated", "projects" or "projected", "forecasts" or "forecasted", "believes", "intends", "likely", "possible", "probable", "scheduled", "positioned", "goal", "objective" or state that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved. Such forward-looking statements, including but not limited to statements with respect to anticipated levels of production, the estimated costs and timing of the Company's planned work programs and reserves determination involve known and unknown risks, uncertainties and other factors which may cause the actual levels of production, costs and results to be materially different from estimated levels of production, costs or results expressed or implied by such forward-looking statements. The Company believes the expectations reflected in these forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements should not be unduly relied upon. Factors that could cause actual results to differ materially from those anticipated in these forward-looking statements are described under the caption "Risks and Uncertainties". Although the Company has attempted to take into account important factors that could cause actual costs or operating results to differ materially, there may be other unforeseen factors to cause costs to the Company's program and results may not to be as anticipated, estimated or intended.

***Non-GAAP Measures***

This report contains two financial terms, operating netback and funds flow from operations that are not considered measures under Canadian GAAP.

***Corporate Development Highlights***

Convertible Debenture Offering

On August 7, 2008 the Company entered into an agreement with a syndicate of underwriters led by GMP Securities L.P. and including Canaccord Capital Corporation, Cormark Securities Inc., Macquarie Capital Markets Canada Ltd. and Thomas Weisel Partners Canada Inc., to issue C$220 million principal amount of 8% convertible unsecured debentures. The debentures expire five years and one day from the date of issue and are convertible into common shares of the Company at

C$13.00 per share. The Company granted to the underwriters an option, exercisable in whole or in part for a period of 30 days following the closing of the issuance, to purchase up to an additional C$20 million principal amount of debentures at the same offering price, to cover over-allotments, if any, and for market stabilization purposes. On August 28, 2008 the Company completed the offering and issued $224.9 million (C$240 million) of convertible unsecured subordinated debentures due August 29, 2013 and convertible into common shares of the Company at C$13.00 per share. The Company used the net proceeds of the offering to pay for the acquisition of Kappa and the excess funds were used for the general working capital requirements of the Company.

ODL Pipeline

On January 2, 2008, the Company announced the execution of a memorandum of understanding for the construction of a 235 km long oil pipeline (the "ODL Pipeline") that will allow for the transportation of the heavy crude oil produced out of the Rubiales oil field. The pipeline will originate at the Rubiales oil field and will connect with the Monterrey Station in Casanare, which is an integral part of Colombia's oil transport system and is connected with the Oleoducto Central S.A. ("OCENSA").

The Company, in conjunction with Ecopetrol established a special purpose vehicle, ODL for the project. The Company's interest in ODL is 35% with the balance of 65% owned by Ecopetrol S.A.. ODL entered into an EPC contract to build the 235 kilometres 24 inch pipeline by September 30, 2009. The budgeted cost of the project is estimated at $530 million.

On March 12, 2009 the Colombian Branch of ODL signed a debt facility denominated in Colombian Pesos in the amount of approximately $200 million with AVAL, a syndicate of local banks led by Banco de Bogota.

The initial capacity of the pipeline will be 170,000 bbl/d (pipeline grade) blended Rubiales heavy oil and can be upgraded to 260,000 bbl/d of blended oil by adding booster pump stations. The Rubiales field's heavy oil is to be diluted to an API gravity of 18.5. .. This would allow for the development and expansion of the Rubiales field to its full potential as well as allowing for the development of the Quifa Block, while reducing transportation costs by almost 50%.

Business Acquisitions

Rubiales

On July 16, 2007, the Company acquired 75% of the outstanding shares of Rubiales Holdings ºLtd. ("RHL") in consideration for $255 million, of which $245 million was paid in cash and $10 million was paid by the issuance of 12,701,176 units of the Company at a price of C$0.85 per unit (the "Rubiales Acquisition"). Each unit consisted of one pre-consolidation common share of the Company and one-half of one common share purchase warrant, with each whole warrant entitling the vendors to acquire one additional preconsolidation common share at an exercise price of C$1.30 per pre-consolidation common share until July 12, 2012.

On December 4, 2007, the Company increased its ownership of RHL from 75% to 100% by acquiring the remaining 25% of RHL's outstanding shares. Consideration was $10 million in cash and the issuance of 14.2 million (85 million pre-consolidation) common shares of the Company at a price of C$9.72 (C$1.62 pre-consolidation). Acquisition costs were $0.1 million.

The above step-by-step acquisitions have been accounted for using the purchase price method with the Company identified as the acquirer and RHL as the acquiree in accordance with Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1581 "Business Combinations". The results have been included in the consolidated financial statements from the dates of acquisition.

RHL holds interests in certain hydrocarbon properties pursuant to three contracts with ECP, for the exploration and exploitation of hydrocarbons in the Meta Department, Llanos Basin in Colombia:

(a) 40% of the Rubiales Association Contract (the "Rubiales concession");

(b) 50% of the Piriri Association Contract (the "Piriri concession"); and

(c) 60% of the Quifa Exploration Contract (the "Quifa concession").

It also holds exploration interests in the following blocks: Jagueyes (100%), Alicante (55%), CP1 (100%), CP6 (50%), CPO1 (100%), CPO12 (40%), CPO14 (62.5%)

RHL currently produces heavy crude oil from its Rubiales and Piriri concessions, which expire in June 2016. The Quifa concession expires in December 2031 and it is currently in the exploration stage of development.

The remaining production interest partner in both Rubiales and Piriri blocks is Ecopetrol. Under both Association Contracts, the royalty rate is 20%. The royalties on the oil are paid in kind.

Pacific Stratus

On January 23, 2008, the Company completed the acquisition of Pacific Stratus (the "Pacific Stratus Acquisition") through an amalgamation with a wholly-owned subsidiary of the Company. Consideration for the acquisition was the issuance of 79.3 million (475.5 million pre-consolidation) shares of the Company to Pacific Stratus shareholders at a fair value of C$8.34 (C$1.39 pre-consolidation) per each share issued and for a total amount of $648.9 million in exchange for all the shares of Pacific Stratus that were outstanding at closing, at a ratio of 9.5 pre-consolidation shares of the Company for every Pacific Stratus share. 5.1 million (30.4 million pre-consolidation) warrants with a fair value of $28.0 million and 6 million (35.8 million pre-consolidation) Company incentive stock options with a fair value of $29.6 million were issued to Pacific Stratus warrant and option-holders upon closing and exchanged based upon the same ratio. Acquisition costs amounted to $8.8 million.

The acquisition has been accounted for using the purchase price method with the Company being identified as the acquirer and Pacific Stratus as the acquiree. Therefore the results of operations for Pacific Stratus commencing January 23, 2008 are included in the Company's results. The purchase price allocation has been finalized and the fair value of the assets acquired and liabilities assumed are based on management's best estimate including an independent valuation. The adjustment to the preliminary purchase price is primarily attributed to a higher discount rate used by the independent valuation than the estimated discount rate used in the preliminary purchase price.

Pacific Stratus holds a 100% interest in the La Creciente producing block, 90.6% interest in the Guaduas producing block, 27.3% interest in the Rio Ceibas producing block, 80% interest in the Moriche exploration block, 100% interest in the Guama

exploration block, 100% interest in the Tacacho technical evaluation agreement ("TEA") 50% interest in the Puli-7 exploration well, 100% SSJN-3, 50% SSJN-7, and 60% CR-1, all located in Colombia. Pacific Stratus also holds 100% interests in exploration blocks 135, 137 and 138 located in Peru.

Kappa Energy Holdings

On September 3, 2008, the Company acquired 100% of Kappa (the "Kappa Acquisition") for $168 million cash and acquisition costs of $2.7 million.

The above acquisition has been accounted for using the purchase method with the Company being identified as the acquirer and Kappa as the acquiree. Therefore the results of operations for Kappa commencing August 28, 2008 are included in the Company's results. The purchase price allocation has been done on a preliminary basis to the fair value of the assets acquired and liabilities assumed based on management's best estimate and taking into account all relevant information available at the time the consolidated financial statements were prepared. Management is performing further analysis with respect to these assets, including an independent valuation prior to finalizing the purchase price allocation. The fair value of proved and unproven reserves has been reallocated based on an updated estimate of the discount rate used to determine the proved, probable and possible reserves. Amounts reported in this preliminary purchase price allocation will change to the extent the independent valuation differs from the preliminary estimate of fair value. The purchase price allocation will be completed before June 30, 2009.

Kappa has gross acreage of 747,000 gross acres and consisting of the following blocks:Abanico25%, Chipalo 100%, Cicuco 94%, Buganviles 49.4%, Guásimo 100%, Arrendajo 32.5%, Las Quinchas 50%, Alhucema 50%, Topoyaco 50% and. Cerrito 81%.

In October 2008, the Company executed a memorandum of understanding (the "**Cerrito MOU**") with Alange, Corp. under which the Company agreed to assign to Alange, Corp its interest in the Cerrito Contract for US$ 7.5 million. The Cerrito MOU is subject to all necessary approvals from the ANH and the International Finance Corporation. Until such approvals are obtained Alange Corp must bear the costs of the Cerrito operation and its entitled to its profits.

Investments

The Company, in conjunction with Ecopetrol established ODL for the ODL Pipeline. The Company's interest in ODL is 35% with the balance of 65% owned by Ecopetrol. ODL has entered into a construction contract to complete the construction of the 235 kilometre 24 inch pipeline between the Rubiales field and the Monterrey Station by September 30, 2009. The lump sum fixed price contract has a value of $190 million and does not include construction of the pumping station at the Rubiales oil field, which will be awarded separately. Total ODL capital commitments for the completion of this project will exceed $320 million.

Port Investment

In July, 2008 the Company acquired from ELE Financial S.A., an option to purchase two lots of land in Cartagena with the intent to build a gas compression plant for export purposes in one of the lots. The second lot is intended to be used for the construction of an oil products terminal. The total transaction cost for the lots is US$ 11 million , of which the Company advanced US$ 6 million to Lando Industrial Park S.A.(Lando) The balance of the purchase price is payable on the date that Lando and the Company execute the public deeds for the sale of the Lots.

Reserve Reports

On July 28, 2008 the Company filed on SEDAR the Kappa independent reserve and resource assessment report in conjunction with the Kappa Acquisition. The report estimates net 2P reserves of 5.6 MMbbl of light and medium crude and heavy oil of which net proved reserves or 1P reserves are 2.5 MMbbl

On February 11, 2009, the Company announced that its gross total proved reserve in the Rubiales-Piriri blocks is 114.3 million bbl of heavy oil, as of December 31, 2008. This represents an increase of 82.3% of the proved reserve of 62.7 million bbl of heavy oil for December 2007. The proved reserve is based on a production level of 100.000 bbl of heavy oil per day in the Rubiales field, which is the level approved by Ecopetrol for 2009.

With the completion of its 2008 development drilling, the Company's gross probable reserve of $58,2 million bbl of heavy oil in 2007 has been moved to the proved reserve category. The gross reserve is the Company's share of the reserve before deduction of royalty payments. The Company's working interest is 40% in the Rubiales block and 50% in the Piriri block.

It also announced that with the discovery of the Quifa 5 well, the Company's gross total proved reserve at Quifa is 1.5 million bbl and probable reserve is 1.3 million bbl of heavy oil. Additional exploration and appraisal wells are scheduled for the 2009 work program. The Company's working interest is 60%.

The Company has filed on SEDAR, in conjunction with this MD&A and for the year ended December 31, 2008, its Form 51-101F1 – "Statement of Reserves Data and Other Oil and Gas Information", a Form 51-101F2 – "Report on Reserves Data by Independent Qualified Reserves Evaluator or Auditor" and its Form 51-101F3 – "Report of Management and Directors on Oil and Gas Disclosure".

***Summary of Properties***

As at the date of this MD&A, the Company has working interests in the following oil and gas properties:

| Basin | License | | Net Acres ('000) | Interest | Contract | Origin | Status | Royalty |
|---|---|---|---|---|---|---|---|---|
| Llanos | Rubiales | | 103 | 40% | Ecopetrol | Rubiales | Production | 20% |
| | Piriri | | 259 | 50% | Ecopetrol | Rubiales | Production | 20% |
| | Quifa | | 226 | 60% | Ecopetrol | Rubiales | Exploration | 6,4% |
| | CP01 | | 153 | 100% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| | CP012 | | 283 | 40% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| | CP014 | | 324 | 63% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| | CPE1 | | 2.446 | 100% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| | CPE6 | | 751 | 50% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| | Moriche | | 25 | 80% | ANH | Stratus | Exp/PRO | 8% |
| | Jagueyes | | 53 | 100% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| | Alicante | | 53 | 55% | ANH | Purchase | Exploration | 8%-OIL 6.4%-GAS (1) |
| | Arrendajo | | 25 | 33% | ANH | Kappa | Exploration | 8%-OIL 6.4%-GAS (1) |
| | Arauca TEA | | 726 | 100% | ANH | Stratus | TEA | N/A |
| putumayo | Tacacho | | 1.480 | 100% | ANH | Stratus | TEA | N/A |
| | Topoyaco | | 30.016 | 50% | ANH | Purchase | Exploration | 8%-OIL 6.4%-GAS (1) |
| Lower Mag | Guama | | 216 | 100% | ANH | Stratus | Exploration | 8%-OIL 6.4%-GAS (1) |
| | La Creciente | | 68 | 100% | ANH | Stratus | Exp/PRO | 6,4% |
| | Cicuco | | 93 | 94% | Ecopetrol | Kappa | Production | 8% |
| | SSJN3 | | 634 | 100% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| | SSJN7 | | 334 | 50% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| Middle Mag | Dindal | | 14 | 91% | Ecopetrol | Stratus | Production | 20% |
| | Rio Seco | | 14 | 91% | Ecopetrol | Stratus | Production | 20% |
| | Alhucema | | 81 | 50% | ANH | Kappa | Exploration | 8%-OIL 6.4%-GAS (1) |
| | Las Quinchas | | 62 | 50% | Ecopetrol | Kappa | Production | 6% |
| Upper Mag | Puli-B | | 7 | 50% | Ecopetrol | Stratus | Production | 20% |
| | Caguan | | 2 | 27% | Ecopetrol | Stratus | Production | 20% |
| | Abanico | | 16 | 25% | Ecopetrol | Kappa | Production | 5%-OIL 6.4%-GAS (1) |
| | Chipalo | | 64 | 100% | Ecopetrol | Kappa | Production | 20% |
| | Guasimo | | 27 | 100% | ANH | Kappa | Exploration | 8% |
| | Buganviles | | 152 | 49% | Ecopetrol | Kappa | Exploration | 8% |
| Rancheria | CR1 | | 187 | 60% | ANH | PRE award | Exploration | 8%-OIL 6.4%-GAS (1) |
| Catatumbo | Cerrito | | 10 | 81% | Ecopetrol | Kappa | Production | |
| Maranon | | 135 | 2.521 | 100% | Perupetro | Stratus | Exploration | 12% |
| | | 137 | 1.109 | 100% | Perupetro | Stratus | Exploration | 115% |
| Ucayali | | 138 | 1.024 | 100% | Perupetro | Stratus | Exploration | 12% |

(1) Sliding Scale minimum

**Exploration**

Overview

The Company has 34 exploration and production blocks: 31 in Colombia and 3 in Peru. In 2008, the Company conducted exploration activities in most of the blocks.

In the two bidding rounds offered by the ANH in 2008, the Company was awarded eight new exploration blocks: CPE-1, CPE-6, CPO-1, CPO-12, CPO-14 in the Llanos basin; SSJN-3 and SSJN-7 in the Lower Magdalena Valley and CR-1 in the Cesar Rancheria basin. In addition, eight more blocks entered the Company's asset portfolio as a result of the Kappa Acquisition: Abanico, Alhucema, Las Quinchas, Buganviles, Guásimo and Chipalo in the Middle Magdalena Valley; Cicuco in the Lower Magdalena Valley and Arrendajo in the Llanos basin. Two more blocks came into the portfolio through farm-in agreements signed with Ecopetrol and Alange, Corp.: the Alicante (Western Llanos basin) and Topoyaco (Putumayo basin) blocks, respectively.

Exploratory Wells

In 2008, the Company concentrated its exploration efforts in the Llanos and Lower Magdalena Valley basins, with 10 of 12 wells drilled there, resulting in 9 discoveries: in the Llanos basin, the Rub-147, Rub-51, Rub-52, Rub-53 and Quifa-5 wells were successful,. In the Lower Magdalena Valley, four exploratory wells reached the Ciénaga de Oro Formation, the main target reservoir for this basin; two wells discovered gas at La Creciente: LCA-2st3 and LCD-1 (this well was drilled during 2007 but completed and tested in 2008); Net 2P reserves of 57.2 bcf of natural gas were booked for the LCD-1 well for 2007), which was drilled during 2007 but completed and tested in 2008. Wells LCJ-1 and LCE-1 were unsuccessful. The fifth discovery came when drilling the Lisa-1 well in the Guásimo block of the Upper Magdalena Valley. The total capital expenditure for these 12 wells was $57.9 million, which included the drilling of ten new wells and the completion of two wells carried over from 2007

As a result of this activity, the total certified and proved producing new additional reserves net to the Company reached 14.83 million boe and the total certified probable new additional reserves net to the Company reached 9.39 million boe for total proved plus probable (2P) new additional certified reserves of 24.23 million boe.

Exploration Indices

Total exploration expenditures during 2008 were approximately $ 71.7 million. Taking into account the addition to the Company's 2P reserves of 24.23 million boe, the Company's discovery cost was approximately US$3/boe. The Company's net production during 2008 was 7.5 million boe – comprised of 5.5 million bbl of liquid hydrocarbons and approximately 2 million boe from natural gas at La Creciente. Since the reserves added as a result of exploration are 24.23 million boe, then the net reserve growth from exploration alone was 16.71 million boe and the Reserves Replacement Index can be estimated at 3.22 boe discovered per every boe produced. Also, the successful results at nine out of the twelve wells drilled in 2008 gives the Company an Exploration Success Ratio of 75%

Exploration Focus on Quifa-Rubiales Blocks

Total exploration activity in the Quifa-Rubiales blocks for 2008 included five exploratory wells and the acquisition of 2D seismic profiles for a total investment of US$9.6 million. The Company acquired, processed and interpreted 120 km of 2D seismic in the southwest corner of the block. The total cost for this seismic data including acquisition and processing was $4.0 million. The interpretation of the seismic data allowed the identification of six new prospects (C, D, E, F, H and I) and one lead (G).

In the Rubiales field, in the so-called "Buffer Zone" (a 5 km strip that surrounds the Rubiales and Piriri Blocks), the wells RUB-51, RUB-52, RUB-53 and RUB-147 were exploration successes. The petrophysical evaluation of wells RUB-51, RUB-52, RUB-53 and RUB-147 indicated a net pay zone from 35 to 62 feet with porosities averaging 30%. These results, will not only extend the known Rubiales reservoir into the Rubiales block, but will give a clear indication of the prospectivety of the Quifa block. The Company completed these wells as vertical producers and the wells have been producing with rates from 200 to 350 barrels of oil per day. Total net proved reserves incorporated from these 4 wells reached 6.5 MMbbl and total net probable reserves reached 3.5 MMbbl, for a total of 10 MMbbl. Total capital expenditure for these wells was $3.96 million.

During November 2008, the Quifa-5 well was drilled on prospect E. Petrophysical analysis indicated a net pay zone of 25 feet with porosities over 32%. The Quifa-5 well was completed successfully as a vertical producer in December 2008 and has been tested with different configurations resulting in average daily rates of 300 barrels of oil per day of 13.4 API. The fact that the oil-water contact at the well is 26 feet deeper than the deepest closing contour (meaning that the trap is larger than the individual structure at prospect E), along with the fact that the well exhibits the same pressure regime as that of the Rubiales field, indicates a very good chance that the discovery on prospect E is connected with the Rubiales field. As a result of this, the chance of discovery of prospects H and I, which are located halfway between the prospect and the Rubiales field increase significantly. Total net proved reserves incorporated from the Quifa-5 well reached 1.4 MMbbl and total net probable reserves reached 1.2 MMbbl for a total of 2,6 MMbbl. Total expenditure for this well was $1.7 million.

The total net proved reserves incorporated in the Quifa and Rubiales blocks reached 7.9 MMbbl and total net probable reserves of 4.7 MMbbl, for a total discovery of 12.6 MMbbl of heavy oil. Currently, the Company is acquiring the required permits and preparing the site-locations to continue the exploration campaign and drill 3 additional exploratory as well as 2 appraisal wells during 2009.

***Financial position***

Total assets increased $1.5 billion to $2.3 billion compared to $0.8 billion in the previous year. The increase in total assets primarily resulted from the increase in oil and gas properties and equipment of $1.3 billion and the increase in investments of $0.1 billion. The fair market values of the oil and gas properties in the acquisitions of Pacific Stratus and Kappa completed in 2008 accounted for $1.1 billion of the increase in 2008. The increase in Investments of $0.1 billion is primarily due to the $0.1 billion invested in the ODL. $29 million of the cash and cash equivalent balance is held in short term investments. Cash generated from operations before non-cash working capital or fund flows from operations was $258 million compared to $43 million in the previous year.

Long term debt of $11.6 million (December 31, 2007 - $7.7 million) represents the non-current portion of a balance of $30 million (December 31, 2007 - $22.7 million) in debt existing as at December 31, 2008. The debt is held in Colombia and repayable as indicated under the "*Liquidity and Capital Resources"* section of this MD&A.

On August 28, 2008 the Company issued $228.2 million (C$240 million) of convertible unsecured subordinated debentures due August 29, 2013 and convertible into common shares of the Company at C$13 per share. The debentures bear interest at 8% annually and are payable semi-annually in arrears on June 30 and December 31. The Company used the net proceeds of the offering to pay for the Kappa Acquisition. Any excess funds were used for the general working capital requirements of the Company.

The debentures have been classified into their debt and equity components based on fair values. The fair value of the equity component was valued using the Black-Scholes pricing model using the a risk free rate of 3,65%, no dividends paid, expected life of 5 years and an expected volatility of 50%. As a result, on the issuance of the debentures $149.7 million (net of $8.5 million issuance costs) was classified as the debt component and $66.1 million (net of $3.8 million issuance costs) was classified as the equity component. The liability portion will accrete up to the principal balance over the term of the debenture. The accretion and interest paid are expensed as interest expense yielding an effective rate annual rate of 18%. If the debentures are converted to common shares, the relative portion of the value of the conversion in shareholders' equity and in the convertible debt component will be reclassified to common share capital.

| | | |
|---|---|---|
| Gross proceeds | $ | 228,158 |
| Costs | | (12,316) |
| | $ | 215,842 |
| | | |
| Fair value of equity component (net of share of cost) | | 66,130 |
| Value attributed to liability component on issuance | | 149,713 |
| Accretion to September 30, 2008 | | 3,954 |
| Foreign exchange effect upon conversion to US$ | | (21,666) |
| Balance of liability component, December 31, 2008 | $ | 132,001 |

***Results of Operations for the year ended 2008 compared to 2007***

***Average Daily Oil and Gas Production***

| Producing Fields | 2008 BOED | 2007 BOED |
|---|---|---|
| Rubiales / Piriri | 13,288 | 7,901 |
| La Creciente | 5,800 | |
| Puli | 32 | |
| Dindal / Rio Seco | 681 | |
| Moriche | 127 | |
| Quinchas | 17 | |
| Abanico | 777 | |
| Buganviles | 29 | |
| Rio Ceibas | 524 | |
| Chipalo | 6 | |
| Cerrito | 60 | |
| **Total** | 21,341 | 7,901 |

Average production for the year 2008 was 21,341 boe/day (2007 – 7,901 boe/day). The increase over the previous year of 13,440 boe/d or 170%. This growth in operated production came about through acquisitions (6,546 boe/d) and development of assets (6,894 boe/d). The increase in the Rubiales field of 6,646 boe/d or 100% is attributable to the successful execution of the development program for the field. The development program consisted of a total of 69 wells drilled and 13 workovers. The construction and enhancement of storage, offloading and blending facilities at the Rubiales field and the Guaduas Station also contributed to the increased production. Currently all product is trucked from the Rubiales field to Guaduas Station and then transported via pipeline to Coveñas the export terminal for the Colombian pipeline system.

Production continued to increase subsequent to year end, averaging net production of 34,000 boe/day in February 2009.

**Crude and Gas Prices**

Average benchmark crude oil and natural gas prices for the years ended 2008 were as follows:

| | 4Q 2008 ($/bbl) | 2008 ($/bbl) | API ($/bbl) |
|---|---|---|---|
| Domestic Market | 46.02 | 58.91 | 12.5 |
| WTI Nymex (Weighted Average Cargoes PRE) | 52.75 | 91.48 | 38 |
| Vasconia (Weighted Average Cargoes PRE) | 43.41 | 82.66 | 24 |
| Rubiales Blend | 39.6 | 76.21 | 18.5 |
| | | | |
| PRE Natural Gas Sales ($/mcf) | 6.44 | 5.58 | |
| Average Natural Gas Reference Price ($/mcf) | 4.98 | 4.02 | |
| Henry Hub Natural Gas ($/mcf) | 6.72 | 9.15 | |

The volatile commodity markets have resulted in a sharp increase in crude oil prices during the middle of 2008 and a decline during the fourth quarter of 2008. The realized oil sales price for the Company for 2008 was $82.66 per barrel (2007 – $47.60 per barrel) representing an increase of 74% The higher realized price was the result of increased oil prices and the Company's export program. The Company obtained better prices in the international market as the Rubiales crude oil (18.5 API) exported during 2008 was indexed to Vasconia (24 API)

Realized natural gas sales prices in Colombia averaged $5.58 per mcf for the year 2008 representing a 39% premium over the average domestic market price. During 2008, the Company obtained better prices than the domestic benchmark due to long term take or pay contracts signed with several clients at a price of 19% on average higher than the regulated domestic price..

The Company has entered into the following risk management contracts outstanding at December 31, 2008:

| Country | Term | Volume | Price (US$/bbl) | Benchmark | Fair value |
|---|---|---|---|---|---|
| Colombia | Dec. 4, 2008 - Jun 30, 2009 | 2,100,000 | $40 floor/$59 ceiling | WTI | $ 1,468 |
| Colombia | May 1, 2009 - Jun 30, 2009 | 600,000 | $40 floor/$65 ceiling | WTI | $ 1,374 |
| Colombia | Jan 1, 2009 - April 30, 2009 | 1,200,000 | $40 floor/$58.25 ceiling | WTI | $ 3,732 |

On March 23, 2009 the Company contracted with BNP Paribas, another hedging operation to cover the risk associated with oil price for the extended period of July 1 – September 30, 2009 for an agreed volume of 900,000 barrels of oil. The Hedge facility is in the format of the so-called "Zero Cost Collar", establishing a price band for the West Texas Intermediate Light Sweet Crude oil (WTI).

For the year ended December 31, 2008 there were no realized losses on these risk management contracts for actual monthly settlements. The unrealized loss on risk management contracts represents the change in the fair value of the contracts related to the expected future settlements which totaled $6.6 million.

**Revenues**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net sales | $ 123,216 | $ 53,897 | $ 579,064 | $ 80,416 |
| $ per boe | 43.23 | 68.78 | 69.98 | 55.44 |

The increase in net sales for 2008 is attributable to the increase in the Rubiales production, the January acquisition of Pacific Stratus and the September acquisition of Kappa. The increase in the Rubiales field was the result of both an increase in production and in oil prices realized in 2008.

For the fourth quarter of 2008, the decrease in price per boe is due to the decline in oil prices. Net sales increased as a result of the Pacific Stratus and Kappa acquisitions offset by the lower price of oil and gas realized during this period.

**Operating Costs**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Operating Costs | $ 83,463 | $ 20,848 | $ 265,512 | $ 33,123 |
| $ per boe | 29.29 | 26.61 | 32.09 | 22.83 |

Operating costs for the year ended 2008 were $265.5 million (2007 - $33.1 million); the increase over the previous year is primarily due to the Rubiales field production increase of 100% and the acquisitions of Pacific Stratus and Kappa. Production costs per barrel of oil equivalent basis also increased 41% to $32.09 (lifting cost $4.36, dilution cost $11.66 and transportation cost $9.45 other $6.62) mainly due to the following:

a) In 2007 the Rubiales oil did not require diluents for upgrading as it was fully sold in the Colombian market as fuel oil and intermediate fuel oil. Towards the end of 2007, Rubiales crude oil began to be exported and therefore diluents were required to upgrade it from 12.5° to 18.5° API.
b) In 2008, there was a sharp increase in the cost of diluents due to the overall increase of WTI prices. In addition, there was an increase in the volume of diluents used to upgrade the Rubiales crude oil due to the increase in production.
c) The increase in the level of production at the Rubiales field generated a higher volume of chemicals and equipment necessary for the treatment of water produced along with the crude oil.

Fourth quarter operating costs were $83 million (2007 – $20.8 million), which resulted in operating costs of $29.29 (2007 – $26.61) per boe; higher net back is attributable to the higher oil prices realized in 2008 compared to 2007. The increased cost is due to the effect of the increase in the volume of crude oil and gas produced during the last quarter of 2008.

**Depletion, Depreciation and Amortization**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Depletion, depreciation and amortization | $ 38,100 | $ 16,110 | $ 104,671 | $ 18,617 |
| $ per boe | 13.37 | 20.56 | 12.65 | 12.83 |

For the nine months ending September 30, 2008 the Company used the historical reserve reports in calculating depletion. As the Company's exploration program progressed during the year it was determined that the reserves had increased and as a result the fourth quarter depletion was estimated using the December 31, 2008 reserve report.

The 2008 depletion charge of $104.7 million is calculated on $3.4 billion of oil and gas property costs subject to depletion of which $643 million is attributed to the proved portion of oil and gas properties acquired with the Pacific Stratus Acquisition and $98 million in the Kappa Acquisition. Included in the costs subject to depletion is $1.4 million of future development costs that are estimated to bring proved undeveloped reserves to development. The increase in 2008 depletion, depreciation and amortization over 2007 primarily relates to the increase in the depletion base as a result of assigning fair values to the proved properties in the acquisitions of Pacific Stratus and Kappa.

**General and Administrative**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| General and Administrative Costs | $ 15,773 | $ 3,207 | $ 45,487 | $ 4,294 |
| $ per boe | 5.53 | 4.09 | 5.50 | 2.96 |

General and administrative expenses for the year ended December 31, 2008 were $45.5 million (2007 - $4.3 million), primarily due to the acquisitions of Pacific Stratus and Kappa, and also to additional personnel as a result of expanding operations to further develop the Rubiales field. As a result, general and administrative expenses on a per boe basis reflected an 85% increase to $5.50.

The fourth quarter administrative expenses were $15.8 million (2007 – $3.2 million) which resulted in an operating cost of $5.53 per boe, an increase over the previous year of $4.09. The increase is due to the greater resources required to support the increased operations compared to the previous year.

**Stock-Based Compensation Costs**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Stock - based compensation costs | $ 6,625 | $ 265 | $ 38,573 | $ 5,179 |
| $ per boe | 2.32 | 0.34 | 4.66 | 3.57 |

For the year ending December 31, 2008, stock compensation increased to $38.6 million from $5.2 million for the previous year. The Company granted 14,907,944 options in 2008 compared to 2,362,500 in 2007. The increased number of options granted in 2008 is a reflection of the greater number of employees eligible under the Company's stock option plan as a result of the acquisitions completed in 2008. The options granted in 2008 all vested immediately upon the grant.

**Foreign Exchange**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Foreign Exchange Gain | $ 58,283 | $ 7,596 | $ 31,736 | $ 7,856 |
| $ per boe | 20.45 | 9.69 | 3.84 | 5.42 |

The foreign exchange gain is primarily a result of the effect of devaluation of both the C$ and Colombian Peso against the US$ in 2008. The gain resulting for the conversion of Colombian denominated future income tax liability and the C$ denominated convertible debenture is offset by the losses on the conversion of cash to pay the C$ and Colombian Pesos denominated expenditures.

The Company is exposed to non-cash unrealized foreign exchange risk in future income tax liabilities, which are denominated in Colombian Pesos. As a result of the acquisitions of RHL, Pacific Stratus and Kappa, the Company recorded $463.1 million of future income tax liabilities on oil and gas properties, which are denominated in Colombian Pesos as the assets to which the future income tax liabilities relate are in Colombia. The gain or loss is recorded in net earnings of the period. The devaluation of the Colombian Peso has generated a non-cash unrealized gain in the year of $38 million.

The Company is exposed to non-cash unrealized foreign exchange risk on the convertible debenture as it is repayable in C$. The devaluation of C$ compared to the US$ has resulted in a non-cash unrealized gain of $22 million.

The Company is exposed to foreign currency fluctuations as certain expenditures and cash balances are denominated in Colombian pesos and C$. As both the C$ and Colombian Peso have devalued against the US$ this has resulted in a loss on these types of transactions.

**Interest Expense**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Interest expense | $ 10,909 | $ 555 | $ 16,872 | $ 2,019 |
| $ per boe | 3.83 | 0.71 | 2.04 | 1.39 |

Interest expense includes the amount of interest paid on bank loans and convertible debentures and fees on letters of credit. In the year ended December 31, 2008, interest expense totalled $16.8 million (2007 - $2.0 million), and the increase is attributable to the $224.9 million (C$240 million) convertible debenture completed in August 2008 bearing interest at 8% which is payable semi-annually in June and December, and to the $30 million bank loans held as of the end of 2008. The interest related to the convertible debenture includes the cash portion of $5.6 million as well as a non-cash portion of $3.9 million yielding an effective annual rate of 18%.

Interest in the fourth quarter of 2008 increased $10.4 million over the previous year primarily due to cash and non-cash interest on the convertible debenture.

**Income Tax Expense**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Current Income Tax | (12,813) | 8,479 | 11,942 | 8,479 |
| Future Income Tax | 33,280 | (3,071) | 57,041 | 968 |
| Total | 20,467 | 5,408 | 68,983 | 9,447 |

Excluding the effect of non-taxable stock compensation costs, the Company's effective tax rate was 47% for 2008 (2007 – 34.2%).

**Net Income**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | $ 12,556 | $ 13,599 | $ 76,698 | $ 13,275 |
| $ per boe | 4.41 | 17.35 | 9.27 | 9.15 |

Net income for the year ended December 31, 2008 totalled $76.7 million (2007 – $13.3 million), which was significantly higher from the prior year due to the increase in production and realized prices as well as the acquisitions of Pacific Stratus and Kappa.

Although net income in the fourth quarter decreased $1.0 million from the previous year due to the decrease in international prices, increased depletion charge and general and administrative costs, the significant increase in production offset a portion of the combined effect of those factors

**Funds Flows from Operations**

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Funds flow from operations | $ 40,810 | $ 30,529 | $ 257,982 | $ 42,962 |
| $ per share, diluted | 0.19 | 0.24 | 1.23 | 0.33 |

Funds flows from operations for the year ended December 31, 2008 increased $215 million and for the fourth quarter increased $10.3 million. The increase from the prior year is primarily attributable to the 156% increase in production and higher realized crude oil prices, as well as the acquisitions of Pacific Stratus and Kappa.

The following table shows the reconciliation of funds flows from operations to cash flows from operating activities for the year:

| | Q4 | | Year | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Cash flow from operating activities | 90,241 | 7,207 | 271,646 | 26,705 |
| Changes in non-cash working capital | 49,431 | (23,322) | 13,664 | (16,257) |
| Funds flow from operations (non-GAAP) | 40,810 | 30,529 | 257,982 | 42,962 |

**Capital Expenditures**

Capital expenditures in 2008 totalled $280.8 million of which$ 71.7 million went into exploration activities; $118.5 million were invested in the expansion and construction of infrastructure and $90.6 million in production drilling activities. For the year 2009 the projected capital expenditures are $379 million distributed as follows: exploration $70.7 millions, development drilling $103.8 million, production facilities $195.9 million and other $8.7 million.

The Company has a substantial plan of development to bring the current gross capacity of the Rubiales field of ~ 58,000 gross Bbl/d (net – 21,170 Bbl/d) to 100,000 gross Bbl/d (net – 36,000 Bbl/d) by the fourth quarter of 2009, when the ODL Pipeline will be operational.

In the light medium blocks we expect to increase the production to 9,000 bb/d by the end of the year. In La Creciente Field we expect to increase the production of gas to 80 mmscf/d pending the removal of the bottleneck in the transportation system.

On the exploration side, the Company has re-examined its commitments, and will concentrate its activities during 2009 in the Quifa block and on those blocks for which it has immediate contractual obligations to the Agencia Nacional de Hidrocarburos ("ANH").

***Liquidity and Capital Resources***

*Liquidity*

Net cash provided by operating activities during the year 2008 was $271.6 million (2007 - $26.7 million). Since the acquisitions of RHL and Pacific Stratus, the Company has been generating cash flows from operations from the sale of crude oil and natural gas and continues to plan for increased future production.

As of December 31, 2008, the Company held debt denominated in Colombian Pesos with three Colombian banks and the International Finance Corporation for a total amount of $30 million (December 31, 2007 - $22.7 million). Maturities are in March 2009 of $0.3 million, April 2009 of $2.3 million, June 2009 of $10.7 million, April 2010 of $6.6 million, and $10 million in 2012. Of the total debt position of $30 million, $13 million was incurred during the fourth quarter of 2008.

During the third quarter of 2008, the Company issued convertible debt resulting in net proceeds after costs of $216 million. The debt is repayable August 29, 2013 and bears interest at 8%, which is payable semi-annually in June and December. The proceeds were used for the Kappa Acquisition and for general working capital purposes.

As of December 31, 2008 the Company had a negative working capital of $29.3 million (December 31, 2007 – positive $133 million) primarily due to accounts payable and accrued liabilities on services rendered by contractors and suppliers as of the end of 2008.

Possible sources of funds available to the Company to finance its capital expenditure program and operations include cash flows from operations, which are expected to continue to increase with anticipated increases in production and expected recovery of oil and natural gas prices, the issuance of additional common shares (if necessary), existing working capital and incurring new debt.

In February 2009, the Colombian Branch of ODL, received credit approval for a $200 million debt facility, in Colombian Pesos equivalent, to be provided by a Colombian banking group ( AVAL). This facility will ensure funding for the completion of the phase one of the ODL Pipeline project.

The Company's investment program calls for an expenditure of $379 million (net) for 2009, which will be funded through the cash flow generated by operations as well as financing from credit facilities being negotiated or already in place. The Company's capital expenditure program results from two main initiatives: the development drilling program, the optimization of the production facilities at the Rubiales field, and the rescheduling of the Company's exploration plan.

The original development plan for Rubiales called for the expansion of the existing production facility (CPF1) to a capacity of 70,000 bopd and the construction of a second facility (CPF2) with an additional capacity of 100,000 bopd. The Company has done some significant re-engineering and the CPF1 will now be expanded to a capacity of 100,000 bopd, which will come on-line in the second half of 2009. A redesigned CPF2, with a capacity of 70,000 bopd, will now be operational in 2010. This re-engineering will synchronize the development of the production and pumping facilities with the original production profile for the field. The re-engineering also modifies the capital expenditures profile, in particular reducing the outlays for 2009 by almost $180 million (as compared to the original plan), but achieves this without affecting the Company's original production targets for the Rubiales field or its exploration obligations.

In parallel with the reshaping of the capital expenditure profile, Phase I of the construction of the ODL Pipeline that will ultimately connect the Rubiales field to the Monterrey station will be operational by the third quarter of 2009. Phase I will see the Rubiales field connected to the main Colombian oil transportation system, significantly improving the Company's costs of transportation and allowing early pumping of Rubiales' production, even before the main pumping facilities are completed. The Company has been able to create this two-phased approach to utilizing the ODL Pipeline through the utilization of temporary

pumping capacity that the Company has located and put in place. This early utilization of the pipeline, in conjunction with the rescaling of the trucking currently used by the Company to transport its crude, will set the foundation for ramping up the field to an average production of 90,000 bopd in the second half of 2009. Phase II of the ODL Pipeline construction will see the pipeline reaching full capacity (170,000 bopd) by the second half of 2010. The Company has already funded its equity portion of the ODL Pipeline, with no further equity contributions anticipated; the pipeline's development is proceeding well and on schedule. It is expected that the debt portion for the pipeline project will come from multilateral agencies and commercial banks and due diligence in that regard is well advanced.

At its light and medium oil assets in Colombia, and at the La Creciente natural gas field, the Company will continue to focus on developing the proven reserves with a goal of reaching its production targets for 2009 of 8,000 boepd and 90 mmscf, respectively. While serving the goal of maximizing cash flow, this will allow the Company to continue to increase the certainty of the resource base.

On the exploration side, the Company has re-examined its commitments, and will concentrate its activity during 2009 on those blocks for which it has immediate contractual obligations to the ANH to explore. The Company will reschedule the rest of its exploration activity according to the same ANH obligations; for instance, the six new blocks that the Company was recently awarded by the ANH will not require exploration expenditures until 2010. The Company anticipates meeting all of its exploration obligations and remains committed to its exploration program, recognizing its major exploration position in Colombia, which management regards as one of the Company's most enduring competitive advantages.

In this environment of relatively low oil prices, the Company has received credit approvals for commitments totalling $100 million under a senior secure revolving credit facility of up to $250 million, consisting of $50 million commitment from each of BNP Paribas and Davivienda Financial Group, lead arrangers for the credit facility. The company expects to use the proceeds from the facility for the development of oil infrastructure in order to increase the production capacity of the Rubiales field up to 100,000 gross barrels of oil per day (including drilling, oil dehydration and water treatment), as well as for general working capital purposes, subject to certain restrictions to be set out in the credit agreement. Additionally, if there are any delays in completing the financing of the ODL Pipline, the Company will have its corporate facility to draw down.

***Selected Quarterly Information***

| *(In thousands of US$ except per share amounts or as noted)* | Q4 2008 | Q3 2008 | Q2 2008 | Q1 2008 | Q4 2007 | Q3 2007 | Q2 2007 | Q1 2007 |
|---|---|---|---|---|---|---|---|---|
| **Financials:** | | | | | | | | |
| Net sales | 123,216 | 202,354 | 158,567 | 94,927 | 53,897 | 26,519 | - | - |
| Net income (loss) for the period | 12,556 | 77,716 | 42,165 | (55,739) | 13,599 | 630 | (918) | (35) |
| Capital expenditures (net of amounts in accounts payable) | 90,126 | 63,918 | 57,006 | 21,242 | 21,088 | 6,204 | - | - |
| Fund flow from operations (1) | 40,810 | 117,032 | 62,145 | 37,995 | 30,529 | 12,433 | | |
| Earnings (loss) per share (2) | | | | | | | | |
| - basic | 0.06 | 0.37 | 0.21 | (0.31) | 0.12 | 0.01 | (0.06) | (0.00) |
| - diluted | 0.06 | 0.35 | 0.19 | (0.31) | 0.11 | 0.01 | (0.06) | (0.00) |
| **Operations:** | | | | | | | | |
| Operating netback ($/boe) (3) | | | | | | | | |
| Crude oil and natural gas sales price | 43.23 | 91.11 | 85.93 | 69.90 | 68.78 | 39.76 | - | - |
| Lifting cost | 3.92 | 4.21 | 4.09 | 3.55 | 4.63 | 4.11 | - | - |
| Transportation | 7.12 | 8.77 | 8.93 | 15.17 | 12.44 | 15.25 | | |
| Upgrading Cost (Diluent including transportation) | 8.55 | 14.88 | 15.47 | 12.64 | - | - | - | - |
| Other Production Cost | 9.70 | 5.05 | 4.20 | 4.46 | 6.07 | 3.11 | - | - |
| Operating netback | 13.94 | 58.20 | 53.24 | 34.08 | 45.64 | 17.29 | | |
| Average daily crude oil sold (Bbls/day) | 24,549 | 19,045 | 14,901 | 10,658 | 8,517 | 7,250 | - | - |
| Average daily natural gas sold (Boe/day) (4) | 6,770 | 5,363 | 5,603 | 4,431 | - | - | - | - |
| Average daily oil and gas sold (Boe/day) | 31,319 | 24,408 | 20,504 | 15,089 | 8,517 | 7,250 | - | - |

*Amounts in the periods ending on or before June 30, 2007 have been translated and restated in United States dollars from previously reported Canadian dollar amounts. See "Significant accounting policies".*

*Figures for the first quarter of 2008 include 100% of Pacific Stratus' operations and net income from January 23, 2008 to March 31, 2008.*

*(1) Calculated based on cash flow from operations before changes in non-cash operating working capital.*
*(2) Combined operating netback data is based on weighted average daily production sold.*
*(3) On May 9, 2008 subsequent to the quarter end the Company consolidated its common shares on a 1:6 basis by issuing one common share for every six common shares outstanding. On March 9, 2007, the Company split its issued and outstanding common shares on a 7:1 basis by exchanging seven common shares for every one common share outstanding. All references to earnings per share, weighted average number of common shares outstanding, common shares issued and outstanding and authorized common shares have been adjusted to reflect the share split and subsequent share consolidation.*
*(4) Operating netback data based on weighted average daily production sold.*
*(5) Natural gas conversion rate used was 6 mcf = 1 boe. Boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.*

The Company restated its 2007 financial statements with respect to the application of CICA 3465 –Accounting Income tax. The Company's Colombian operations are eligible for a special 40% deduction in the year of acquisition of qualified expenditures. As the benefit is greater than the cost the application of CICA 3465 effectively reduces the cost of the eligible property acquired and the future income tax asset is recognized. The future income tax expense is recognized upon the deduction of this special 40% deduction when calculating current income tax expense for the period. The effect is to recognize the special 40% deduction through a reduction in the cost of oil and properties and hence a reduction in depreciation and depletion over the life of the asset compared to a direct recognition of the income tax benefit in the year the eligible expenditure was made. The previous quarters have been restated as follows:

| | Prev | Rest | Prev | Rest | Prev | Rest |
|---|---|---|---|---|---|---|
| Oil and gas properties | 1,947,006 | 1,932,846 | 1,604,156 | 1,596,652 | 1,546,677 | 1,542,104 |
| Future income tax asset | 11,493 | 15,755 | 7,536 | 10,012 | 7,710 | 5,224 |
| Future income tax liability | 495,744 | 496,988 | 401,015 | 401,015 | 424,895 | 424,895 |
| Retained earnings | 94,756 | 74,015 | 8,356 | (3,731) | (38,807) | (45,867) |
| | | | | | | |
| Depletion, depreciation and amortization | 25,101 | 24,532 | 23,215 | 22,848 | 19,040 | 19,191 |
| Future income tax provision (recovery) | 8,048 | 17,271 | 45 | 5,440 | (1,319) | 1,050 |
| Net Income | 86,370 | 77,716 | 47,193 | 42,165 | (53,219) | (55,740) |
| Net Income per share - Basic | 0.41 | 0.37 | 0.23 | 0.21 | (0.30) | (0.31) |
| Net Income per share - Diluted | 0.39 | 0.35 | 0.21 | 0.19 | (0.30) | (0.31) |

| | 2007 | | | | | |
|---|---|---|---|---|---|---|
| | Q4 | | Q3 | | Q2 | Q1 |
| | Prev | Rest | Prev | Rest | | |
| Oil and gas properties | 611,249 | 607,679 | 284,217 | 279,913 | - | - |
| Future income tax asset | 922 | 2,181 | 3,904 | 5,156 | - | - |
| Future income tax liability | 166,593 | 166,593 | 16,270 | 17,095 | - | - |
| Retained earnings | 14,412 | 9,873 | 1,894 | 8,767 | - | - |
| | | | | | | |
| Depletion, depreciation and amortization | 17,196 | 16,862 | 2,709 | 2,709 | - | - |
| Future income tax provision (recovery) | (6,468) | 313 | 1,609 | 1,609 | - | - |
| Net Income | 17,032 | 13,599 | 1,736 | 630 | (918) | (36) |
| Net Income per share - Basic | 0.16 | 0.12 | 0.02 | 0.01 | (0.06) | (0.00) |
| Net Income per share - Diluted | 0.13 | 0.11 | 0.02 | 0.01 | (0.06) | (0.00) |

The following discussion highlights some of the significant factors that had impact on the results in the eight most recently completed quarters ended December 31, 2008.

Revenue in the fourth quarter of 2008 reduced $79.1 million to $123.2 million in comparison to the prior quarter of 2008, primarily due to significantly lower international oil and gas prices realized, compensated by higher crude oil production from the Rubiales field. Combined average oil and gas selling prices reduced by $47.88/boe over the fourth quarter to $43.23/boe (53%) when compared to the prior quarter, due to the strong reduction of oil prices. The average volume daily oil and gas sold of the fourth quarter increased to 31,319 boe/day from 24,408 boe/day the prior quarter, as a result of the drilling program initiated during 2008 and the optimization of field facilities to store, load and transport the crude oil from the Rubiales field. Operating netback was significantly reduced by $44.26 boe to $13.94, in comparison to the prior quarter primarily due to reduction of realized prices in the fourth quarter over the third quarter and higher production costs as detailed in the Operating Costs section.

Revenue in the third quarter of 2008 increased $43.8 million over the second quarter of 2008 to $202.4 million primarily due to higher oil and gas prices realized and higher production. Operating netback improved primarily due to increased realized prices in the third quarter over the second quarter.

Revenue in the second quarter of 2008 increased $63.6 million over the first quarter of 2008 to $158.6 million primarily due to higher oil and gas prices realized and higher production. Net income increased by $97.9 million over the previous quarter primarily due to increased revenues, a decrease in the non-cash stock compensation of $31 million and a decrease in foreign exchange loss of $52.6 million.

During the first quarter of 2008, net sales increased by $41 million to $94.9 million over the previous quarter due to higher production, increasing oil and gas prices, higher crude oil volume, sold in the international market due to the Company's new commercial scheme, and revenue from Pacific Stratus properties since the acquisition. Net income decreased by $69.3 million from the prior quarter due principally to increased DD&A expenses, non-cash stock based compensation expense of $31.3 million, non-cash foreign exchange loss of $41 million and partially offset by interest income and future income tax recovery.

During the fourth quarter of 2007, sales increased by $27.4 million over the previous quarter primarily due to increasing commodity prices, the increasing production at the Rubiales field, selling 3,000 Bbl/d in the international market for first time according to a new operational and commercial scheme, instead of domestically, and the inclusion of revenue from the Company's variable interest entity, Transportadora del Meta S.A. Net income increased by $16.2 million from the prior quarter as a result of higher revenue combined with a reduction in stock-based compensation, as a majority of the stock options were issued in the previous quarter and the foreign exchange gain more than offset the impact of the increase in operating expenses due to an increase in water dehydration and treatment costs, in general and administrative expenses, in DD&A due to the increase in the value of oil and gas properties subject to depletion and future development costs to bring proved reserves to development, and income tax expense.

***Outstanding Share Data***

Authorized

Unlimited number of common shares without par value

Issued and Fully Paid Common Shares

On March 9, 2007, the Company split its common shares on a 7:1 basis and on May 9, 2008 the Company consolidated its common shares on a 1:6 basis. All share and per share amounts in this MD&A have been adjusted to reflect the share split and subsequent share consolidation.

As at March 27, 2009, 210,566,340 common shares were issued and outstanding

The Company does not have shares subject to escrow restrictions or pooling agreements.

Stock Options and Warrants

As at December 31, 2008, 44,803,552 warrants to acquire an equal number of common shares were outstanding and exercisable (48,479.098 – December 31, 2007) and 15,051,885 stock options were outstanding (2,357,500 – December 31, 2007) of which all were exercisable (1,860,278 – December 31, 2007). On July 8, 2008 the Company waived the vesting period on 435,070 options which had vesting periods; as a result 435,070 options became exercisable.

***New Accounting Pronouncements***

The Canadian Accounting Standards Board (AcSB) issued two new Sections in relation to financial instruments: Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation. Both sections will become effective for the Company's 2008 financial year and will require increased disclosure regarding financial instruments.

The AcSB issued Section 1535, Capital Disclosures. This standard requires disclosure regarding what the Company defines as capital and its objectives, policy and processes for managing capital. This standard will be effective for the Company's 2008 financial year. The only effect is additional disclosures on the Company's capital and how it is managed.

The AcSB issued Section 3031, Inventories. This standard prescribes the accounting treatment for inventories, and will be effective for the Company's 2008 financial year. The standard does not have a material impact on the Company

The AcSB confirmed recently that public companies will be required to report under International Financial Reporting Standards ("IFRS") effective January 1, 2011. The Company will assess the impact of adopting IFRS, including an examination of recognition, measurement and disclosure differences.

**Critical Accounting Policies and Estimates**

The Company's financial statements are prepared in accordance with Canadian GAAP, which require management to make judgments, estimates and assumptions, which may have a significant impact on the financial statements. A summary of the Company's significant accounting policies can be found in Note 1 to the Company's 2008 consolidated financial statements. The following is a discussion of those accounting policies and estimates that are considered critical in the determination of the Company's financial results.

*Capital Assets – Full Cost Accounting*

The Company follows the full cost method of accounting. Under the full cost method of accounting, capitalized costs are subject to a country-by-country cost centre impairment test. Under the successful efforts method of accounting, the costs are aggregated on a property-by-property basis and the carrying value of each property is subject to an impairment test. These policies may result in a different carrying value for capital assets and a different net income. The full cost method is the method most commonly followed by the Company's peer group.

Under full cost accounting, in order to test impairment, a limit is placed on the carrying value of the net capitalized costs in each cost centre. Impairment exists when the carrying value of developed properties of a cost centre exceeds the estimated undiscounted future net cash flows associated with the cost centre's proved reserves. Costs relating to undeveloped properties are subject to individual impairment assessments and when impairment exists is included in the basis to calculate depletion. If impairment is determined to exist, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the cost centre's proved plus probably reserves are charged to income.

*Reserve Estimates*

Reserve estimates can have a significant impact on net income and the carrying value of capital assets. The process of estimating reserves requires significant judgment based on available geological, geophysical, engineering, and economic data, projected rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to interpretation and uncertainty. Reserve estimates impact net income through depletion expense and the application of impairment tests. Revisions or changes in reserve estimates can have either a positive or a negative impact on net income and can impact the carrying amount of capital assets.

*Future Income Taxes*

The Company recognizes a future income tax liability based on estimates of temporary differences between the book and tax value of its assets. An estimate is also used for both the timing and tax rate upon reversal of the temporary differences. Actual differences and the timing of reversals may differ from estimates, impacting the future income tax balance and net income.

**Changes in Accounting Policies**

*Capital Disclosures*

Effective January 1, 2008, the Company prospectively adopted the CICA Section 1535, "Capital Disclosures" which establishes standards for disclosing information about the Company's capital and how it is managed. It requires disclosures of the Company's objectives, policies and processes for managing capital, the quantitative data about what the Company regards as capital, whether the Company has complied with any capital requirements and if it has not complied, the consequences of such non-compliance. The only effect of adopting this standard are disclosures on the Company's capital and how it is managed and are included in Note 12 to the consolidated financial statements.

*Financial Instruments Disclosures and Presentation*

Effective January 1, 2008, the Company prospectively adopted Section 3862, "Financial Instruments Disclosures" and Section 3863, "Financial Instruments Presentations." These new accounting standards replaced Section 3861, "Financial Instruments – Disclosure and Presentation." Section 3862 requires additional information regarding the significance of financial instruments for the entity's financial position and performance, and the nature, extent and management of risks arising from financial instruments to which the entity is exposed. The additional disclosures required under these standards are included in Note 13 to the consolidated financial statements.

*Recent Accounting Pronouncements*

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets," replacing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs." Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. The Company adopted these standards for its fiscal year beginning January 1, 2009 with no impact on its consolidated financial statements.

In January 2009, the CICA issued Section 1582, “Business Combinations”, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted.

In January 2009, the CICA issued Sections 1601 “Consolidated Financial Statements”, and 1602, “Non-controlling Interests”, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted.

*International Financial Reporting Standards*

In February 2008, the AcSB confirmed the convergence of Canadian GAAP with International Financial Reporting Standards (“IFRS”) will be required for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010.

The International Accounting Standards Board (“IASB”) has also issued an exposure draft relating to certain amendments and exemptions to IFRS 1, *First-time Adoption of International Financial Reporting Standards.* It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment, if implemented, will permit the Company to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company’s full cost pool, with the provision that a ceiling test, under IFRS standards, be conducted at the transition date.

Although the amended IFRS 1 standard would provide relief, the changeover to IFRS represents a significant change in accounting standards and the transition from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Company’s reported financial position and reported results of operations.

The Company has completed its high-level IFRS impact study and has established a preliminary timeline for the conversion project. The impact study included a preliminary assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS to accounting and reporting processes, information systems, business processes and external disclosures. This assessment has provided insight into what are anticipated to be the most significant areas of difference applicable to the Company.

During the next phase of the project, scheduled to take place during 2009, the Company will perform an in-depth review of the significant areas of difference, identified during the preliminary assessment, in order to identify all specific Canadian GAAP and IFRS differences and select ongoing IFRS policies. Key areas addressed will also be reviewed to determine any information technology issues, the impact on internal controls over financial reporting and the impact on business activities including the effect, if any, on covenants. Where required, external advisors will be retained and assist management with the project on an as needed basis. Staff training programs will begin in 2009 and continue.

The Company will also continue to monitor standards development as issued by the IASB and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators (CSA), which may affect the timing, nature or disclosure of its adoption of IFRS.

***Commitments and Contingencies***

As part of the Company’s normal course of business, the Company entered into arrangements that will impact the Company’s future operations and liquidity, some of which are already reflected as liabilities in the consolidated financial statements at year end. The principal commitments of the Company are ship or pay arrangements on gas transportation, asset retirement obligations, debt repayments, service contracts with suppliers in relation with the exploration and operation of oil properties and engineering and construction contracts, among others. Commitments as of December 31, 2008 are summarized in the following table:

| | 2009 | 2010 | 2011 | 2012 | 2013 | subsequent to 2013 | Total |
|---|---|---|---|---|---|---|---|
| Operating leases | $ 1,418 | $ 1,486 | $ 215 | $ 183 | $ 192 | $ 1,011 | $ 4,506 |
| Transportation and processing commitments | $ 13,121 | $ 34,969 | $ 32,240 | $ 29,500 | $ 26,776 | $ 10,955 | $ 147,560 |
| Minimum w ork commitments | $ 83,345 | $122,920 | $ 43,600 | $ 30,435 | $ 20,035 | $ 54,210 | $ 354,545 |
| Abandonment obligations | $ 2,221 | $ 1,158 | $ 1,771 | $ 1,211 | $ 1,419 | $ 18,156 | $ 25,935 |
| Other service contracts | $ 1,300 | $ 1,365 | $ 1,433 | $ 1,505 | $ 1,580 | $ 4,977 | $ 12,161 |
| Repayment of Debt | $ 18,392 | $ 6,600 | $ - | $ 10,000 | $ - | $ - | $ 34,992 |
| Total | $119,797 | $168,498 | $ 79,258 | $ 72,835 | $ 50,003 | $ 89,309 | $ 579,699 |

The Company has various commitments in place in the ordinary course of business between 2009 and subsequent to 2013:

a) Operating leases of $4.5 million mainly related to office rental in Bogota for 2009 and 2010.
b) Ship or pay contract totaling $147.6 million signed with ODL for the transportation of crude oil from Rubiales field to connect the Colombia´s oil transportation system.
c) Minimum capital investments agreed in the contracts with Ecopetrol and ANH in Colombia that include acquisition and processing of seismic data and drilling exploration wells in Colombia ($302.5 million), as well as exploration and drilling activities in Peru ($52 million).
d) Amount of the asset retirement obligation considering the present as well as the future obligations on drilling of wells or construction of facilities.
e) Service contracts with suppliers for $12.1 million in relation with the exploration and operation of oil properties and engineering and construction contracts.
f) Debt repayment of $30 million on the short and long term debt, details of which are in the Liquidity and Capital Resources section.

Disclosure about the Company's significant commitments can be found in note 16 to the consolidated financial statements. The Company has no off-balance sheet arrangements.

Certain association contracts signed before 2003 with Ecopetrol include a clause in which at any time Ecopetrol may commence participating in the operation of the new discovery made by its Associates, without prejudice to the Associates' right to be reimbursed for the investments made on their sole account and risk (back-in right). The contract provides that if Ecopetrol decides to declare the commerciality of the field and participate in the commercial phase of the association contract, then the Associates shall have the right to be reimbursed for 200% of the total costs incurred during the exploration phase of the contract. Once the reimbursement has been made, Ecopetrol is entitled to acquire a 50% share of the oil production of the fields.

The Company is involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favor, the Company does not currently believe that the outcome of adverse decisions in any pending or threatened proceedings related to these and other matters or any amount which it may be required to pay by reason thereof would have a material impact on its financial position, results of operations or cash flows.

***Related-party transactions***

During the first quarter of 2008, the Company paid Endeavour Financial, a company related by way of a director in common, a success fee in connection with the Pacific Stratus Acquisition for a total amount of C$7.0 million, pursuant to an amending agreement dated November 8, 2007 to a financial advisory services agreement dated May 14, 2007.

During the first quarter of 2008, and pursuant to the above agreement, the Company paid $366.000 to Endeavour in retainer fees for acting as the Company's financial advisor and C$250,000 in financing fees for Endeavour's involvement in assisting the Company to obtain debt financing for the construction of the ODL Pipeline. **Those financial costs where capitalized into the Company´s ODL investment.**

At the time of the Pacific Stratus Acquisition, one member of the board of directors of the Company was also a member of the board of directors of Pacific Stratus. As a consequence of the resulting conflict of interest, the affected director abstained from all decision making by the boards of directors of both companies in respect of all matters relating to the Pacific Stratus Acquisition.

In June 2007, the Company entered into a 5-year lease agreement with Blue Pacific Assets Corp. ("Blue Pacific"), a British Virgin Islands corporation, for administrative office space in its Bogota, Colombia location. Monthly rent expense of $ 36,995 is payable to Blue Pacific under this agreement. Three directors and officers of the Company control, or provide investment advice to the holders of, 75% of the shares of Blue Pacific.

On May 24, 2007 and in connection with the Rubiales Acquisition, Endeavour, a company related by way of a director in common, provided the Company with an unsecured $15 million bridge loan with an interest rate of 10% per annum. The loan was repaid in full on July 16, 2007. As consideration for providing the bridge loan the Company issued Endeavour 4,000,000 share purchase warrants with a fair value of $0.83 million, with each warrant exercisable into one common share of the Company at a price of C$1.05 per share expiring May 24, 2008. The fair value of the warrants was calculated using the Black-Scholes pricing model, based on the assumptions disclosed in note 11(c) to the Company's financial statements and charged to interest expense in the consolidated statement of income and corresponding credit included in contributed surplus.

All of the above transactions occurred in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

***Risks and Uncertainties***

The business and operations of the Company will be subject to a number of risks. The Company considers the risks set out below to be the most significant to potential investors in the Company, but not all of the risks associated with an investment in securities of the Company. If any of these risks materialize into actual events or circumstances or other possible additional risks and uncertainties of which the Company is currently unaware or which it considers not to be material in relation to the Company's business, actually occur, the Company's assets, liabilities, financial condition, results of operations (including future results of operations), business and business prospects, are likely to be materially and adversely affected. In such circumstances, the price of the Company's securities could decline and investors may lose all or part of their investment.

*Fluctuating Prices*

Oil and gas prices will have a direct impact on the Company's earnings and are subject to volatile price fluctuations. The Company's revenues are expected to be in large part derived from the extraction and sale of oil and natural gas. The price of oil will be affected by numerous factors beyond the Company's control, including international economic and political trends, expectations of inflation, war, currency exchange fluctuations, interest rates, global or regional consumption patterns, speculative activities and increased production due to new extraction developments and improved extraction and production methods. Any substantial decline in the prices of oil or natural gas could have a material adverse effect on the Company and the level of its oil and natural gas reserves.

Prices varied considerably throughout 2008 and since August 2008 the price of oil has decreased significantly, concurrent with the downturn in the global economy. Decreases in oil and natural gas prices typically result in a reduction of the Company's net production revenue and may change the economics of producing from some wells which could result in a reduction in the volume of the Company's reserves. Any further substantial declines in the prices of crude oil or natural gas could also result in delay or cancellation of existing or future drilling, development or construction programs or the curtailment of production. All of these factors could result in a material decrease in the Company's net production revenue, cash flows and profitability causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to the Company will in part be determined by the Company's borrowing base. A sustained material decline in prices from historical average prices could further reduce such borrowing base, therefore reducing the bank credit available and could require that a portion of its bank debt, if any, be repaid.

From time to time the Company has and may in the future enter into agreements to receive fixed prices on its oil and natural gas production to offset the risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, the Company will not benefit from such increases.

*Cash Flows and Additional Funding Requirements*

Although, since the Rubiales Acquisition, the Company has significant revenues from operations, a significant percentage of funds available to the Company for its acquisition and development projects have in the past been derived from the issuance of equity. Although the Company presently has sufficient financial resources and has been successful in the past in obtaining equity and debt financing to undertake its currently planned exploration and development programs, there is no assurance that it will be able to obtain adequate financing in the future or that such financing will be on terms advantageous to the Company. The ability of the Company to arrange such financing in the future will depend in part upon the prevailing capital market conditions as well as the business performance of the Company. The current financial crisis has resulted in severe economic uncertainty and

resulting illiquidity in capital markets which increases the risk that additional financing will only be available on terms and conditions unacceptable to the Company or not at all.

*Global Financial Conditions*

Current global financial conditions have been subject to increased volatility and numerous commercial and financial enterprises have either gone into bankruptcy or creditor protection or have had to be rescued by governmental authorities. Access to public financing has been negatively impacted by sub-prime mortgage defaults in the United States, the liquidity crisis affecting the asset-backed commercial paper and collateralized debt obligation markets, massive investment losses by banks with resultant recapitalization efforts and deterioration in the global economy.

Notwithstanding various actions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially.

Banks have been adversely affected by the worldwide economic crisis and have severely curtailed existing liquidity lines, increased pricing and introduced new and tighter borrowing restrictions to corporate borrowers, with extremely limited access to new facilities or for new borrowers. These factors could negatively impact the Company's ability to access liquidity needed for the Company's business in the longer term.

Petroleum and natural gas prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand of these commodities due to the current state of the world economies, OPEC actions and the ongoing global credit and liquidity concerns.

These factors may impact the Company's ability to obtain equity, debt or bank financing on terms commercially reasonable to the Company, or at all. Additionally, these factors, as well as other related factors, may cause decreases in asset values that are deemed to be other than temporary, which may result in impairment losses. If these increased levels of volatility and market turmoil continue, the Company's operations could be adversely impacted and the trading price of the Company's securities could continue to be adversely affected.

In addition, certain of the Company’s customers could be unable to pay it, in the event they are unable to access the capital markets to fund their business operations.

*Exploration and Development*

The exploration and development of oil and natural gas deposits involve a number of uncertainties that even thorough evaluation, experience and knowledge of the industry cannot eliminate. It is impossible to guarantee that the exploration programs on the Company’s properties will generate economically recoverable reserves. The commercial viability of a new hydrocarbon pool is dependent upon a number of factors which are inherent to reserves, such as the content and the proximity of infrastructure, as well as oil and natural gas prices which are subject to considerable volatility, regulatory issues such as price regulation, taxes, royalties, land tax, import and export of oil and natural gas, and environmental protection issues. The individual impact generated by these factors cannot be predicted with any certainty but, once combined, may result in non-economical reserves. The Company will remain subject to normal risks inherent to the oil and natural gas industry such as unusual and unexpected geological changes in the parameters and variables of the petroleum system and operations.

*Operating Hazards and Risks*

Exploration for natural resources involves many risks, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. Operations in which the Company has a direct or indirect interest will be subject to all the hazards and risks normally incidental to exploration, development and production of natural resources, any of which could result in work stoppages, damage to persons or property and possible environmental damage. Although the Company may obtain liability insurance in an amount which is expected to be adequate, the nature of these risks is such that liabilities might exceed policy limits, the liabilities and hazards might not be insurable, or the Company might not elect to insure itself against such liabilities due to high premium costs or other reasons, in which event the Company could incur significant costs that could have a material adverse effect upon its financial condition.

*Reserve Estimates*

Despite the fact that the Company has reviewed the estimates related to the potential reserve evaluation and probabilities attached thereto and it is of the opinion that the methods used to appraise its estimates are adequate, these figures remain estimates, even though they have been calculated or validated by independent appraisers. The reserves disclosed by the Company should not be interpreted as assurances of property life or of the profitability of current or future operations given that there are numerous uncertainties inherent in the estimation of economically recoverable oil and natural gas reserves.

*Transportation Costs*

Disruption in or increased costs of transportation services could make oil and natural gas a less competitive source of energy or could make the Company's oil and natural gas less competitive than other sources. The industry depends on rail, trucking, ocean-going vessel, pipeline facilities, and barge transportation to deliver shipments, and transportation costs are a significant component of the total cost of supplying oil and natural gas; currently, the Company trucks much of its production from the Rubiales oil field, its primary source of revenue. Disruptions of these transportation services because of weather-related problems, strikes, lockouts, delays or other events could temporarily impair the ability to supply oil and natural gas to customers and may result in lost sales. In addition, increases in transportation costs, or changes in transportation costs for oil and natural gas produced by competitors, could adversely affect profitability. To the extent such increases are sustained, the Company could experience losses and may decide to discontinue certain operations forcing the Company to incur closure and/or care and maintenance costs, as the case may be. Additionally, lack of access to transportation may hinder the expansion of production at some of the Company's properties and the Company may be required to use more expensive transportation alternatives.

*Disruptions in Production*

Other factors affecting the production and sale of oil and natural gas that could result in decreases in profitability include: (i) expiration or termination of leases, permits or licenses, or sales price re-determinations or suspension of deliveries; (ii) future litigation; (iii) the timing and amount of insurance recoveries; (iv) work stoppages or other labor difficulties; (v) worker vacation schedules and related maintenance activities; and (vi) changes in the market and general economic conditions. Weather conditions, equipment replacement or repair, fires, amounts of rock and other natural materials and other geological conditions can have a significant impact on operating results.

*Political Risk*

The Company's projects are located in Colombia and Peru and consequently the Company will be subject to certain risks, including currency fluctuations and possible political or economic instability. Exploration and production activities may be affected in varying degrees by political stability and government regulations relating to the industry. Colombia is home to South America's largest and longest running insurgency, and over the past two decades has experienced significant social upheaval and criminal activity relating to drug trafficking. While the situation has improved dramatically in recent years, there can be no guarantee that the situation will not again deteriorate. Any increase in kidnapping and/or terrorist activity in Colombia generally may disrupt supply chains and discourage qualified individuals from being involved with the Company's operations. Additionally, the perception that matters have not improved in Colombia may hinder the Company's ability to access capital in a timely or cost effective manner. Any changes in regulations or shifts in political attitudes are beyond the control of the Company and may adversely affect its business. Exploration may be affected in varying degrees by government regulations with respect to restrictions on future exploitation and production, price controls, export controls, foreign exchange controls, income taxes, expropriation of property, environmental legislation and site safety.

The Company's operations may also be adversely affected by laws and policies of Canada affecting foreign trade, taxation and investment. In the event of a dispute arising in connection with the Company's foreign operations, the Company may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons to the jurisdictions of the courts of Canada or enforcing Canadian judgments in such other jurisdictions. The Company may also be hindered or prevented from enforcing its rights with respect to a governmental instrumentality because of the doctrine of sovereign immunity. Accordingly, the Company's exploration, development and production activities in the foreign jurisdictions in which it operates could be substantially affected by factors beyond the Company's control, any of which could have a material adverse effect on the Company.

*Environmental Factors*

All phases of the Company's operations are subject to environmental regulation in Colombia.

Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. In addition, certain types of operations require the submission and approval of environmental impact assessments. Environmental assessments of proposed projects carry a heightened degree of responsibility for companies and directors, officers and employees. The cost of compliance with changes in governmental regulations has a potential to reduce the profitability of operations. The exploration, development and production activities of the Company will require certain permits and licenses from various governmental authorities and such operations are and will be governed by laws and regulations governing exploration, development and production, labor standards, occupational health, waste disposal, toxic substances, land use, environmental protection, safety and other matters. Companies engaged in exploration activities generally experience increased costs and delays as a result of the need to comply with applicable laws, regulations and permits. There can be no assurance that all licenses and permits which the Company may require to carry out exploration and development of its projects will be obtainable on reasonable terms or on a timely basis, or that such laws and regulations would not have an adverse effect on any project that the Company may undertake.

*Title Matters*

The acquisition of title to oil and natural gas properties in Colombia is a detailed and time consuming process. The Company's properties may be subject to unforeseen title claims. While the Company will diligently investigate title to all property and will follow usual industry practice in obtaining satisfactory title opinions and, to the best of the Company's knowledge, title to all of the Company's properties is in good standing; this should not be construed as a guarantee of title. Title to the properties may be affected by undisclosed and undetected defects.

*Dependence on Management*

The Company strongly depends on the business and technical expertise of its management team and there is little possibility that this dependence will decrease in the near term.

*Changes in Legislation*

The oil and natural gas industry in Colombia is subject to extensive controls and regulations imposed by various levels of government. All current legislation is a matter of public record and the Company will be unable to predict what additional legislation or amendments may be enacted. Amendments to current laws, regulations and permits governing operations and activities of oil and natural gas companies, including environmental laws and regulations which are evolving in Colombia, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in expenditures and costs, affect the Company's ability to expand or transfer existing operations or require the Company to abandon or delay the development of new oil and natural gas properties.

*Repatriation of Earnings*

Currently there are no restrictions on the repatriation from Colombia of earnings to foreign entities. However, there can be no assurance that restrictions on repatriation of earnings from Colombia will not be imposed in the future.

*Integration of Pacific Stratus and Kappa*

The Company recently completed the Pacific Stratus Acquisition and the Kappa Acquisition. The future success of the Company will depend to some extent on the success of management of the Company in integrating the operations, technologies and personnel of Pacific Stratus and Kappa now that each has been acquired. The failure of the Company to achieve such integration could result in the failure of the Company to realize some or all of the anticipated benefits of the Pacific Acquisition and the Kappa Acquisition, and could impair the results of operations, profitability and financial results of the Company. In addition, the overall integration of the operations, technologies and personnel of Pacific Stratus and Kappa into the Company may result in unanticipated operational problems, expenses, liabilities and diversion of management's attention.

*Enforcement of Civil Liabilities*

Substantially all of the assets of the Company will be located outside of Canada and certain of the directors and officers of the Company will be resident outside of Canada. As a result, it may be difficult or impossible to enforce judgments granted by a court in Canada against the assets of the Company or the directors and officers of the Company residing outside of Canada.

*Competition*

The oil and natural gas industry is competitive in all its phases. The Company will compete with many companies and individuals that have substantially greater financial and technical resources than the Company in the search for, and the acquisition of, properties as well as for the recruitment and retention of qualified employees. The Company's ability to increase its interests in the future will depend not only on its ability to explore and develop its present properties, but also on its ability to select, acquire and develop suitable properties or prospects.

*Dividends*

Any payments of dividends on the common shares of the Company will be dependent upon the financial requirements of the Company to finance future growth, the financial condition of the Company and other factors which the Company's Board of Directors may consider appropriate in the circumstance. It is unlikely that the Company will pay dividends in the immediate or foreseeable future.

***Internal Controls over Financial Reporting***

In June 2008 an internal audit function was reinforced to provide assurance to both management and the Audit Committee regarding the effectiveness of all aspects of the Company's system of internal control, risk management, and corporate governance practices including operational effectiveness.

The internal audit function established an internal control process to provide the Board of Directors and management with reasonable assurance over the following:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

The head of internal audit is responsible for reporting the results to the Audit Committee on a quarterly basis. The internal audit team operated in all business units in the period under review. The findings are also reported to senior management.

The Audit Committee assigned to the internal audit team the leadership to establish and manage the process to comply with National Instrument 52-109 ("NI 52-109"). A project with the commitment of the senior management was initiated and developed during the second half of 2008.

The internal audit teams performed assessments of controls and other procedures designed to ensure that information disclosed by the Company in its filings is recorded, processed, summarized, and reported within the time periods specified in securities regulations. Activities included testing controls and procedures designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management (including its chief executive and financial officer) for timely assessment and disclosure pursuant to NI 52-109.

In coordination with management, internal audit performed a risk-based and top-down audit of the financial reporting process and evaluated the operating effectiveness of the controls and procedures.

The evaluation of the effectiveness of internal controls, encompassed within the NI 52-109 requirements, over the design of controls and operating effectiveness of ICFR (Internal Controls over Financial Reporting) resulted in the identification and assessment of 413 controls. These controls were documented and their effectiveness evaluated in design and tested to evaluate their operating effectiveness. In addition, the project included activities which identified risks that involved significant accounts and relevant assertions, quantitative and qualitative factors to significant accounts and disclosures, identified vulnerabilities to fraudulent activities, documented evidence to provide reasonable support for evaluations.

The Company concluded there are opportunities to improve controls in the following areas:.

1. Focus on control and review procedures in the financial consolidation process to ensure compliance with the CSA requirements in a timely manner.
2. The Company will hire additional expert resources which may be necessary and will provide training for all personnel involved in the Canadian statutory reporting process.
3. The implementation of SAP on July 1, 2009 as the corporate ERP will facilitate standardization of accounting and reporting.

Regulatory Policies

Certification of Disclosures in Annual Filings

In accordance with Multilateral Instrument 52-109 of the Canadian Securities Administrators, the Company annually issues a "Certification of Annual Filings" ("Certification"). The Certification requires certifying officers to state that they are responsible for establishing and maintaining disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR").

The Certification requires certifying officers to state that they designed DC&P, or caused it to be designed under their supervision, to provide reasonable assurance that: (i) material information relating to the Company is made known to the certifying officers by others; (ii) information required to be disclosed by the Company in reports filed with, or submitted to, securities regulatory authorities is recorded, processed, summarized and reported within the time periods specified under Canadian securities legislation. In addition, the Certification requires certifying officers to state that they have designed ICFR,

or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes.

In completing the 2008 consolidated financial statements, the Company determined that oil and gas properties were overstated, future tax liabilities were overstated, depreciation, depletion and amortization was overstated, future income tax expense was understated and net income was overstated as a result of previously accounting for a special tax deduction associated with certain development expenditures incurred in Colombia as a reduction in income tax expense instead of accounting for it as a reduction in the cost base of the expenditure capitalized in oil and gas properties. The accounting for this matter affected the Company's annual 2007 audited consolidated financial statements and each of the 2008 interim consolidated financial statements previously reported. As a result, the Company's 2007 annual consolidated financial statements for the year ended December 31, 2007, and each of the 2008 interim financial statements have been restated to correct for this accounting matter.

During 2007 and the 2008, the Company experienced a significant level of growth through the acquisitions of RHL, Pacific Stratus and Kappa. Because of these transactions and the resultant activities associated with integrating and managing these operations, the Company lacked the sufficient personnel with the required experience and capabilities to complete all necessary control procedures associated with financial reporting.

The Company has concluded that its DC&P and ICFR were ineffective as at December 31, 2008. The impact of this ineffectiveness provides for the reasonable possibility that a material adjustment in the annual or interim financial statements of the Company would not be prevented or detected by the Company's ICFR or its DC&P.

The Company is undertaking a review of the structure and capacity of its financial reporting group and plans to hire the necessary resources and provide additional training for personnel involved in the financial reporting process. The Company is also in the process of completing the implementation of a company-wide ERP system which is expected to facilitate the standardization of the accounting and reporting functions. The Company expects to have its remediation efforts in place within the next three months and is taking the necessary steps in the interim to address this matter prior to the completion of its remediation efforts.

***Outlook***

The Company's current production is limited by infrastructure and transportation. An expansion of current facilities and the construction of the ODL Pipeline continue to be a focus as it is a key to the Company's future growth and development.

The Company will continue to sell on the international markets as 18.5° API blended crude via the blending process at the Guaduas station and pipeline to the Coveñas terminal. From January 2009 through to September 2009, the Company expects to increase sales to 28,800 bbl/d as 18.5° API blended crude on the international market through the same operational and commercial scheme. Subsequent to that, the ODL Pipeline is expected to be complete and all of the Company's production from the Rubiales oil field of 45,360 bbl/d will be sold in the international markets as 18,5 API blended crude via blending at the Rubiales field and transportation through the pipeline to Monterrey, where it will be connected to the Ocensa pipeline to Coveñas.

The exploration activities of the Company have continued at a steady pace during fiscal 2008. To date, the Company has processed or reprocessed 316 km of 3D and 5,198 km of 2D seismic data for the La Creciente, Guama, Moriche and Arauca blocks in preparation for the exploration campaign over the next 12 months.

The Company will focus on implementing its restructured investment program and the funding of the program as outlined above.