PACIFIC RUBIALES ENERGY CORP.

MANAGEMENT DISCUSSION AND ANALYSIS
March 12, 2010

Form 51-102F1
For the year ended December 31, 2009

This Management Discussion and Analysis (the "MD&A) contains forward-looking information and is based on the current expectations, estimates, projections and assumptions of Pacific Rubiales Energy Corp. (the "Company"). This information is subject to a number of risks and uncertainties, many of which are beyond the Company's control. Users of this information are cautioned that actual results may differ materially. For information on material risk factors and assumptions underlying our forward-looking information, see page 30.

This MD&A is management's assessment and analysis of the results and financial condition of the Company, and should be read in conjunction with the accompanying audited consolidated financial statements for the year ended December 31, 2009 and related notes. The preparation of financial information is reported in United States dollar and is in accordance with Canadian generally accepted accounting principles ("GAAP") unless otherwise noted. The financial measures EBITDA and net operating income from operations referred to in this MD&A are not prescribed by GAAP and are outlined in Non-GAAP Financial Measures on page 29. 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.

Barrels of oil equivalent (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet (mcf) of natural gas: one barrel of crude is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

In order to provide shareholders with full disclosure relating to potential future capital expenditures, we have provided cost estimates for projects that, in some cases, are still in early stages of development. These costs are preliminary estimates only. The actual amounts are expected to differ and these differences may be material. For further discussion of the significant capital expenditures, see Capital Expenditures Update on page 19.

References to "we", "our", "us", "Pacific Rubiales" or "the Company" mean Pacific Rubiales Energy Corp., its subsidiaries, partnerships and joint venture investments, unless the context otherwise requires.

The table and charts in this document form an integral part of this MD&A.

Additional information relating to the Company filed with Canadian securities regulatory authorities including the Company's quarterly and annual reports and the Annual Information Form for the year ended December 31, 2009, are available on SEDAR at www.sedar.com and www.pacificrubiales.com. Information contained in or otherwise accessible through our website does not form a part of this MD&A and is not incorporated by reference into this MD&A.

Index to the MD&A

1. Company Overview with Selected Operating Financial Information

Operating Summary

	Year ended December 31,			
	2009 Oil	2009 Gas	2009 Combined	2008 Combined
Average daily production sold (boe/day)	28,026	7,348	35,374	22,670
Operating netback ($/boe) [1]				
Crude oil and natural gas sales price	55.48	26.73	49.51	69.98
Lifting costs	2.74	0.86	2.35	4.36
Transportation and other costs	11.82	2.18	9.82	9.45
Upgrading cost (diluent including transportation)	8.92	-	7.07	11.66
Other production costs [2]	3.20	4.79	3.53	5.14
Overlift/Underlift [3]	(0.21)	-	(0.17)	1.48
Operating netback	29.01	18.90	26.91	37.89

(1) Combined operating netback data based on weighted average daily production sold which include diluents necessary for the upgrading of the Rubiales blend.

(2) Other production costs mainly correspond to transport of personnel to and from the field, technical assistance, catering, royalties on gas production, and security.

(3) Corresponds to the net effect of the overlift position for the year amounting to $2.1 million, which generated a reduction in the combined production costs of $0.17 per boe.

Summary of 2009 Operating Results

The results for the year ended December 31, 2009 underline the strength of the company´s operational activity, its capacity to increase production and commitment from management to deliver robust financials. Management is focused on realizing challenging operational objectives while continuing the company's ambitious exploration and production ("E&P") investment program. This was achieved despite the fact that the oil and gas industry was adversely impacted in 2009 by the downturn in the global economy which had resulted in a significant decline in crude oil prices, with signs of recovery appearing only towards the end of the year. The average WTI price for the year was $62.09 per barrel (bbl) in comparison with $99.92/bbl in 2008, which represents a reduction of 38%. As a result, the average combined realized oil and gas sales price for the company for the year ended December 31, 2009 decreased to $49.51 per boe from $69.98 per boe in 2008, representing a reduction of 29%. This last figure demonstrates how the company was able to execute, through its trading and commercial initiatives, better than most.

The gross increase in operated production of the company during the year was a significant achievement, averaging 82,887 boe per day (boe/d), which is 36,123 boe/d (77%) greater than operated production for 2008. This growth in operated production came mainly through the increase in production at the Rubiales heavy oil field. As of March 15, 2010, the company's total operated production has exceeded 135,000 boe/d for all its fields, which makes the company the fastest growing oil and gas company in Colombia. As a consequence of this, and of management's commitment to control costs while increasing production, production costs per barrel have continued to decrease, showing a 26% reduction over the same period last year.

In the execution of its commercial strategy, the company continued exporting its oil production to its most attractive international markets (USA, Canada, Caribbean), while maintaining a presence in the local market with direct sales to the bunker and industrial sectors. During 2009, the company exported 8,625,955 barrels of crude oil, mostly to refineries in the US, and sold 1,603,363 barrels to the Colombian domestic market.

The company increased revenues by 10% to $639.2 million as compared to $579.1 million in 2008 despite lower prices for oil and gas during 2009. This was the consequence of the significant increase in production and the optimization of marketing mentioned above. Although this operational success enabled the company to increase revenues, net income was impacted by a number of non-cash charges, resulting in a net loss for the year of $154 million. These non–cash financial charges are: foreign exchange loss associated with future income tax liabilities; unrealized loss related to the fair value of the risk management contracts outstanding as of the end of 2009; and interest accruals related to the financing facilities used for the development of the oil infrastructure to increase the production capacity in the Rubiales field.

The company continues to move forward on its established investment plan, including the accelerated execution of the development plans for Rubiales and other fields. The official inauguration of the Oleoducto de los Llanos Orientales ("ODL") pipeline by the President of Colombia, Mr. Alvaro Uribe, on September 14, 2009, marked the beginning of operations of the most significant oil infrastructure project built in Colombia in a decade. It will allow for the development of the Rubiales field to its full potential, the leveraging of Quifa and the company´s surrounding exploration blocks, as well as allowing for the transportation of crude oil from other producing fields in the Llanos basin to local and international markets.

In 2009, the company focused its exploration and appraisal campaign on the Quifa and Rubiales blocks, drilling a total of 19 wells at those locations (5 exploratory and 14 appraisal wells). Of the 19 wells, 16 were successful and incorporated a total of 154.8 million bbl of combined proved plus probable (2P) gross reserves or 78.0 million bbl net reserves before royalties. The total net reserves after royalties reached 69.0 million bbl. At the Quifa block the discoveries were made on Prospects "D", "E", "H" and "I", as a result of 3 exploratory and 5 appraisals wells. At the Rubiales field the 8 successful appraisal wells extended the field to the west (Rub-147 on Prospect "D") and southwest (area of Rub-52). Only three dry-hole wells resulted from this exploration campaign: Quifa-15 and Rub-310 on Prospect "B" and Quifa-16 on Prospect "C".

Milestones

- On February 24, 2010, the company announced an update to the independently certified Statement of Reserves Data and Other Oil and Gas Information for all of the company's assets, estimating total 2P reserves at 280.6 million boe (MMboe), net after royalties, having a total net present value (NPV) (10% discount, before tax) of $8.32 billion. Despite a total net production of 12.4 MMboe in 2009, the company's net proven plus probable reserves increased by 34.3%, from 209 MMboe as of December 31, 2008. These reserves represent 1.3 barrel of net 2P reserves per outstanding share as of December 31, 2009.

- In 2009, the company exported a total of 8.6 million bbl of oil mainly to US refineries, including 15 Vasconia crude oil cargoes for 7.3 million bbl at a price approximately $4.60/bbl less than WTI, a significant commercial accomplishment. The company also demonstrated a flexible commercial strategy by selling 1.6 million bbl of Rubiales production in the Colombian domestic market, at an average price of $53.90/bbl.

- During 2009, the exploration activity concentrated on drilling campaigns, seismic work and data acquisition using leading-edge technology to reduce the uncertainty of exploration risk. As a result of this activity, a total of 22 exploratory and appraisal wells were drilled, and the company acquired 386 km^2 of 3D seismic; 2,200 km^2 of hyperspectral images; 4,369 km and 3,189 km of airborne magnetic and gravimetric data respectively; and 1771 km of stress field detector (SFD). The total gross exploration expenditure was $64.7 million: $36.1 million in drilling and $28.6 million in data acquisition. As a result of the drilling campaign, the company incorporated a total of 155 million bbl gross of oil reserves, for a total success ratio of 86%, and gross discovery costs of approximately $0.42/boe. The total net exploration expenditure of $48.3 million was comprised of $25.3 million in drilling and $23 million in data acquisition. Accordingly, the company incorporated a total of 69 million bbl oil net reserves after royalties, at a net discovery cost of approximately $0.7/boe.

- The construction of the ODL pipeline, with a length of 235 km, a diameter of 24 inches, and a design capacity of 160,000 bbl/d was concluded in early September. Construction was completed within 21 months. The line fill started on September 10, 2009, four days before its inauguration by Colombian President Alvaro Uribe. The completion of this first phase of the project allowed the transportation of 68,000 bbl/d of diluted crude (18° API) from the Rubiales field to the OCENSA pipeline system through the Monterrey pumping station, as soon as the line fill was completed.

- During 2009 the company transported 29,467 bbl/d through the different trucking and pipeline systems, 23,944 bbl/d of Rubiales crude (12.5° API), and 5,523 bbl/d of diluents. The ODL pipeline system began operations on October 1, 2009 and transported a combined volume of 6.3 million bbl for Ecopetrol and the company during the year, generating savings in transportation costs for the company of $16 million. The Guaduas system, through its PF-2 facility, also generated income of $3.7 million for the fourth quarter, for a total of $19.7 million for the year 2009.

- Despite lower realized crude oil prices throughout 2009, as compared with 2008, the company was able to increase revenues in 2009 ($639.2 million in 2009 versus $579 million in 2008), mainly due to a substantial increase in production volume and trading optimisation.

- As of February 15, 2010, the company had reached the historical milestone of exceeding 132,000 boe/d of gross operated production, equivalent to 53,419 boe/d net after royalties The 132,000 boe/d milestone resulted from the continuous growth in production of heavy oil in the Rubiales/Piriri blocks, further supported by the coming into operation of the ODL pipeline. This volume also incorporates the development of the company´s light and medium oil blocks, as well as the natural gas volume produced (at a conversion rate of 6,000 standard cubic feet per barrel) from La Creciente block and other smaller fields.

- EBITDA (See – Non-GAAP Financial Measures) during 2009 totalled $275.5 million, despite being affected by significantly lower oil prices; this represents an increase of 3% compared to 2008 EBITDA of $268.1 million. EBITDA from international sales represented 72% of this amount, while EBITDA from gas and domestic sales contributed 15% and 13%, respectively.

- Total capital expenditures during the year totalled $403.7 million ($345.2 million net of the 40% tax benefit effect in Colombia), of which $48.3 million went into exploration activities including seismic, aerogravimetry, aeromagnetometry and drilling ($23 million to geophysics and $25.3 million to drilling of wells). Also, $234.7 million were invested in the expansion and construction of production infrastructure and $120.7 million in production drilling activities.

- The company announced on November 4, 2009 an expanded and fully funded capital plan of $853 million for 2010. With this investment program the company expects to double its net production before royalties, reaching 92,000 boe/d at the end of 2010 versus the 2009 year end figure of 40,579 boe/d. The $853 million capital program for 2010 includes $165.5 million for development drilling, $190.8 million for exploration, $471.8 million for production facilities and $25 million to advance the STAR pilot project. This is an increase of $471 million over 2009 capital expenditures and $394 million over the previously projected 2010 budget.

- As part of the STAR project, the company successfully completed two In-situ Combustion Tests (ICT) in the lab testing phase (Phase I). These tests have been carried out using high temperature, high pressure combustion reactors in the University of Calgary's labs, and cores and fluids produced from wells in the Rubiales field. The results obtained clearly indicated the enhanced performance that the Rubiales field could achieve using this enhanced recovery technique.

- On November 10, 2009, the company closed a senior notes offering with an aggregate principal amount of $450 million and maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%). The company used the proceeds from the issuance of the senior notes for the development of its oil infrastructure (including costs of drilling, oil dehydration and water treatment) to increase the production capacity of the Rubiales and Piriri fields up to 170,000 gross bbl/d by the end of 2010, as well as for general working capital purposes and the repayment of short and long-term debt.

- On December 18, 2009, the company received approval from the Superintendencia Financiera de Colombia ("Superfinanciera"), the Colombian regulatory entity in charge of supervising public issuers, for the listing of its shares on La Bolsa de Valores de Colombia (the "BVC", or the "Colombian Stock Exchange"). The company is the first international company to have its shares listed on the BVC. Trading of the shares started during the week of December 21, 2009 under the symbol PREC, and will enable the company to access capital in the region if needed. The listing does not involve the issuance of new common shares of the company or any other securities or derivatives, such as ADRs, as it was structured solely to allow the common shares of the company that are currently outstanding and trading on the Toronto Stock Exchange, to be tradeable by investors on the BVC. Other than enabling investors to buy and sell shares in Colombian Pesos, the listing will not result in any changes to the rights and entitlements of holders of the company's shares, irrespective of whether they purchase their shares through the TSX or the BVC. The volume of trading in the company´s common shares on the BVC has increased steadily since they commenced trading. On March 4, 2010, the company's shares were for the first time the most actively traded equity securities on the BVC.

2. Company Vision and Strategy Statement

Vision

The Company aims to be the premier independent E&P company in the Latin American region, noted for its technical excellence, operational capabilities and its outstanding ability to discover, develop and market new hydrocarbon reserves.

Strategy

The Company has an enviable strategic position with the right combination of production assets and exploration areas. The cornerstone of the Company's strategy is the technical excellence of its people coupled with the experience and the know-how to deliver its vision. It is expected that the significant cash flows and profit from operations through production growth will be utilized to support the Company's ambitious exploration and production activities. The Company's goal of steadily increasing its reserves and growing its production will be reached through exploration activities on the one hand, and through an increase in the recovery rates by better delineating our resource base and by a continuous use of the appropriate technology. We will continue to concentrate our exploration activity in areas where our knowledge and talents can provide a significant advantage.

We have over 140 highly skilled geoscientists with 15 to 25 years of operating experience. Our management team is primed to take full advantage of present and future opportunities in exploration and production.

The combination of our valuable assets and our skilled people will allow us to take advantage of available oil and gas opportunities.

3. Corporate Development Highlights

ODL Pipeline

The Company's interest in ODL is 35% with the balance of 65% owned by Ecopetrol S.A. The budgeted cost of the project was estimated at $530 million.

As of December 31, 2009, Phase I of the ODL pipeline, involving 235 km of 24" 900# ANSI pipe from the Rubiales field to Monterrey Station was fully completed. The pipeline was inaugurated on September 14, 2009 by the Colombian President, Mr. Alvaro Uribe. Total oil pumped during the fourth quarter amounted to 6.3 million bbl, with an average of 68,000 bbl/d, which was above the planned capacity for Phase I of 60,000 bbl/d. Total construction costs by ODL were $519 million as of December 31, 2009. In addition to this amount, $23 million were paid in financing costs and interest during construction, which were capitalized by ODL.

Phase II of the ODL project includes installation and commissioning of the permanent pumping units in order to increase the capacity of the pipeline to 160,000 bbl/d. This phase started operations in late January 2010. On March 2, 2010, ODL carried out a very successful maximum transport capacity test, reaching a volume of 160,591 barrels of diluted oil transported.

As of December 31, 2009 the overall progress of the pipeline project, including the storage tanks and receiving station, was as follows:

Pumping Stations:	95% completed
Storage Tanks:	100% completed
Receiving Stations:	97% completed

In light of increasing production in the Rubiales field and Quifa, in November 2009, the ODL board of directors approved an expansion to 330,000 bbl/d. The project includes construction of two booster stations, increased storage capacity at the Rubiales Pumping Station and construction of a pipeline branch to Cusiana Station. Conceptual engineering has been now concluded and purchase orders of pumping units were placed in December 2009.

A $200 million non-recourse debt faciltiy was closed in March 2009 with Grupo Aval (Banco de Bogotá). The facility has an interest rate of DTF (Colombian base rate for fixed rate deposits over 3 months) + 5%, a maturity of 5 years with a 1 year grace period, and blended quarterly payments. The second tranche of financing was closed on October 2009. This second tranche included a structured debt instrument of $260 million issued in the Colombian capital market. This is a seven years debt instrument with a coupon of IPC + 4.88% (IPC = Official Colombian Consumer Price Index). Approximately $320 million of the proceeds of both debt transactions were used for completing the phase II of the project, and the remaining balance of $140 million were raised with the intention of returning excess capital, initially contributed by Ecopetrol and Pacific Rubiales to the project. After returning excess capital the debt to equity ratio of the Company will be 75% - 25%. During the first and fourth quarter of 2009, ODL repaid $14.2 million and $27.0 million to the Company respectively, corresponding to 50% of the excess capital invested in the ODL.

Agreement with Oleoducto Central S.A. ("OCENSA")

The Company announced on January 7, 2010 that it had entered into an agreement with Oleoducto Central S.A. ("OCENSA") to acquire preferential rights for the use of available capacity in the OCENSA pipeline system, for up to 160 million bbl oil for a 10

year period beginning February 1, 2010, in consideration for a one-time payment of $190 million. The transport capacity schedule in this agreement is as follows:

- 50,000 bbl/d during 2010
- 60,000 bbl/d between January 2011 and January 2017
- 20,000 bbl/d between February 2017 and January 2020

In parallel with this agreement, the Company also arranged to unload up to 10,000 bbl/d of diluent in Cusiana Station during a five year period starting in April 2010. Capacity in this agreement includes use of the OCENSA system from Cusiana Station to the export terminal of Coveñas.

These two agreements will guarantee transportation of the Company's share of production from the Rubiales Field up to the end of the concession, and allow optimization of diluents logistics with substantial savings in transportation.

Llanomulsion Project

As part of the efforts to minimize transportation costs in the ODL pipeline while maximizing line capacity, the Company initiated in January 2009 the development of a special transport emulsion formula (oil in water), which eliminates the need of diluents. The patented formula, called Llanomulsion, increases capacity of the pipeline by reducing fluid viscosity to one-third of the original viscosity of the diluted crude.

As of December 31, 2009 the Company had constructed a pilot plant in Rubiales and had successfully tested a 70/30 oil/water transportation emulsion. Development of an 80/20 formula was ongoing by the end of the year.

Industrial tests of Llanomulsion will take place during the first half of 2010. Implementation of this technology is expected to have a significant impact on the transportation costs for the Rubiales and Quifa fields, and could represent a breakthrough for the development of the Colombia Llanos Basin.

STAR Project

Based on a previously signed binding MOU with Ecopetrol, the Company has continued laboratory and pilot tests which hitherto have confirmed that STAR (Synchronized Thermal Additional Recovery) is the most suitable enhanced recovery technology for the Rubiales field.

To ensure the highest standard and quality of the design of the pilot test, the Company integrated a qualified multidisciplinary team and executed agreements with four well-regarded Canadian academic and research institutions:

- The University of Calgary to develop three in situ combustions tests with the objective of assessing (i) the burning characteristics of the Rubiales oil under the same conditions of pressure that would be encountered in the field, and (ii) the burning temperature of the Rubiales reservoirs. Also, the University was asked to determine the in situ combustion kinetic model and to assess key values needed for reservoir simulation.
- Alberta Research Council (ARC) to carry out a Technology Screening in order to corroborate the suitable technologies for Rubiales reservoirs.
- Techsera Solutions to determine the crude upgrading capability for the Rubiales reservoirs.
- High level Heavy Oil Consultants to contribute the numerical simulations to estimate the expected recovery factor, among other key parameters.

The Company successfully completed two in-situ combustion tests (ICT). These tests have been carried out using high temperature, high pressure combustion reactors in the University of Calgary's laboratories, and cores and fluids produced from Rubiales' wells. Tests have shown vigorous and stable combustion characteristics, as indicated by rapid ignition, stable combustion front velocities, stable gas composition and oil burned with observed peak temperatures, in the range of 480 - 530°C. Ramped temperature oxidation tests have also demonstrated stable kinetic reactions and the high temperature oxidation characteristics of the Rubiales field. All these results clearly indicated the good performance that the Rubiales field might have under the STAR process.

By January 2010, and in addition to the tests mentioned above, a set of preliminary numerical simulations have been performed based on the lab test results; more than 30 runs and scenarios have been simulated. The pilot tests location has been selected and production and economic models have been generated. An oil crude characterization has been made, as well as conceptual engineering in order to estimate the operational and capital expenditures involved in the pilot test and the eventual commercial project. We expect to start pilot testing by the third quarter of 2010.

The Company continues its commitment to the implementation of this technology, not only because it opens the door to an extended production at Rubiales, but also because it believes that once in place STAR will be a game changer for all the Llanos region.

Exploration

Overview

The exploration campaign for 2009 focused on the Quifa and Rubiales blocks with a drilling campaign of five exploratory and fourteen appraisal wells there. The exploration activity was also concentrated in data acquisition and the use of cutting edge technology to reduce uncertainties and quantify risks in the exploratory projects. As a result of this activity a total of 386 km^2 of 3D seismic, 2200 km^2 of hyperspectral images, 4,369 km and 3,189 km of airborne magnetic and gravimetric data, and 1771 km of stress field detector (SFD) lines, were acquired. The total net investment for the Company in exploration for the year was $48.3 million.

Exploratory Wells

The exploration campaign for the year ended December 31, 2009 was on schedule and the Company drilled the following wells at Quifa: Quifa-7, Quifa-8, Quifa-9, Quifa-10, Quifa-11, Quifa-12, Quifa-15, Quifa-16, Quifa-17 and I-9 wells. Also in the Rubiales-Piriri field, the Company drilled 9 wells: Rub-150, Rub-220, Rub-221, Rub-222, Rub-224, Rub-251, Rub-310, Rub-357 and 366. The petrophysical evaluation of these wells indicates a net pay thickness varying from 18 to 50 feet, with porosities averaging 31%. All these wells were completed as oil producers except the three dry holes (Quifa-15, Quifa-16 and Rub-310). The results of these wells allowed the Company to request the declaration of commerciality of SW Rubiales and SW Quifa, which is expected to be approved by the end of the first quarter of 2010.

Exploration Indices

For the year ended December 31, 2009, the Company invested $48.3 million in exploration activities which comprises the expenditures accrued during the period for the drilling of 22 wells in the Quifa, Rubiales-Piriri, Abanico and Arrendajo Blocks, as well as the acquisition of the mentioned geophysical data.

During 2009, the successful drilling of the Quifa, Rubiales-Piriri, Abanico and Arrendajo blocks resulted in an exploration success ratio of 86%, equal to 19 successful wells out of 22 drilled. The wells effectively incorporated 2P net certified reserves before royalties of 78 million bbl or 69 million bbl 2P net certified reserves after royalties.

Exploration Results and milestones.

Key milestones of the Company's exploration activity during the year ended December 31, 2009 are as follows:

- The Company continued exploration in the Quifa Block with ten wells drilled: five exploratory wells and five appraisal wells, eight of them with positive production results. These eight wells, which confirmed the extension of the Rubiales field into the Quifa Block, were completed as oil producers. All the wells are currently under extended production tests with an average individual production of 200 bbl/d. Based on these results, the Company plans to drill 11 additional appraisal and 9 exploratory wells in the Quifa Block during 2010.
- The Company also continued the appraisal campaign in the Rubiales and Piriri blocks and drilled 9 wells and all except one well extended the Rubiales field to the southwest and west, incorporating 24,500 acres of fresh reserves.
- In the Arauca area, the Company finished a high resolution remote sensing program (hyperspectral image survey) over a total area of 2,170 km^2. This survey is the first acquired in Colombia, and the results will be used to reduce geological uncertainty over the exploration prospects already defined. On June 30, 2009, the Company converted the Arauca TEA into an E&P contract.
- The Company finished the reprocessing of 1,683 km of existing 2-D data on the CPE-6 and CPO-12 blocks as part of the ongoing exploration activities.
- During the third quarter of 2009, the Company was awarded two new E&P contracts in the Putumayo basin, Tacacho (238,363 Ha) and Terecay (237,339 Ha) following the exploration assessment carried on under the recently finished Tacacho TEA. The Company also decided to relinquish the Alhucema and Alicante blocks due to a lack of prospectivity.
- In the search for light and medium oil, for 2010 the Company plans to drill 11 additional exploratory wells on the Moriche (1), Guama (1), Arauca (2), Topoyaco (2), Guaduas (1), Buganvilles (1), and Abanico (3) blocks. Following the

oil trend of the Rubiales-Quifa discoveries, the Company also will concentrate efforts by drilling 7 exploratory wells, 6 on the CPE-6 Block and one on the CPO-1 Block.

Farm-out and Farm-in Contracts

CPO-1 Block

During 2009, the Company completed a private competitive bidding process for the farming out of several blocks. As a result of this bidding process, on November 2009, the Company awarded 50% of its working interest in the CPO-1 Block to Petroamerica Oil Corp., a Calgary-based oil & gas company, in exchange for Petroamerica providing 100% of the total investment required to complete the first phase of the minimum exploratory program for the block. This minimum investment, calculated approximately at $8.6 million, must be spent on the acquisition of 200 km of 2D seismic, the drilling of one exploratory well and geological and geophysical studies. The Company will retain a 50% working interest in the block. The final agreement with Petroamerica Oil Corp. is still pending negotiation and execution.

Buganviles Block – Future Prospect

In November 2009, a Participation Agreement was signed by and between the Company and Petrodorado Ltd. As a result of this agreement, the Company has awarded 29.5% of its working interest in a future prospect in the block to Petrodorado in exchange for Petrodorado providing 100% of total investment for future exploratory work in the prospect, equal to approximately $2.27 million. This exploration activity involves a minimum investment of $4.6 million, which will be spent on the drilling of one exploratory well in a new prospect. The Company will retain a 19.75% working interest in said prospect and will keep 49.75% in the rest of the block. The final agreement with Petrodorado is still pending negotiation and execution.

Tacacho Block

In November 2009, a Participation Agreement was signed by and between the Company and Petrodorado. As a result of this agreement, the Company has awarded 49.5% of its working interest to Petrodorado in exchange for Petrodorado providing 100% of the total investment required to complete the first phase of the minimum exploratory program for the block, equal to $8.0 million, which will be spent on the acquisition of 480 km of 2-D seismic. The Company will retain a 50.5% working interest in the block. The final agreement was executed in January 2010.

Moriche Block – Prospect Mauritia East

In November 2009, a Participation Agreement was signed by and between the Company and Petrodorado, by which the Company assigned certain private interests in the Moriche Block. The Company awarded 49.5% of its working interest in the “Mauritia East Prospect” to Petrodorado in exchange for Petrodorado providing 100% of the total investment for the current exploratory phase for the block, equal to $5.53 million. This exploration phase requires a minimum investment of $6.5 million, which will be spent on the drilling of one exploratory well. The Company will retain a 37.5% working interest in the Mauritia East Prospect and an 87% working interest in the rest of the block. The final agreement was executed in January 2010.

Peru Blocks 135 and 138

During 2009, the Company awarded 45% of its working interest in Block 135 and Block 138 to Petrodorado in exchange for Petrodorado providing 45% of the total investment for the second exploratory phase for both blocks, equal to $16.2 million and to $15.3 million, respectively. The exploration phase for Block 135 requires a minimum investment of $36 million, which will be spent on the acquisition of 704 km of 2D seismic and the drilling of one exploratory well. The Company will retain a 55% working interest in Block 135. The exploration phase for Block 138 involves a minimum investment of $34 million, which will be spent on the acquisition of 525 km of 2D seismic and the drilling of one exploratory well. The Company will retain a 55% working interest in Block 138. The final agreement was executed in January 2010.

Production

Average Daily Oil and Gas Production – Net Volumes before Royalties

Producing Fields	Share before royalties 2009 boe/d	2008 boe/d
Rubiales / Piriri	30,514	13,288
Quifa*	322	0
La Creciente	7,382	5,800
Puli	38	32
Dindal / Rio Seco	744	681
Moriche	100	127
Quinchas	27	17
Abanico	819	777
Buganviles	14	29
Rio Ceibas	536	524
Chipalo	6	6
Cerrito	77	60
Total	**40,579**	**21,341**

**New discoveries under production test.*

Total operated production for the year ended December 31, 2009 averaged 82,887 boe/d (40,579 boe/d net before royalties) for an increase of 36,123 boe/d (19,238 boe/d net) over the previous period of 2008. This represents a 77% growth in operated production, which came about mainly through the increase in production at Rubiales, attributable to the following:

- The successful execution of the drilling program of a total of 99 producing wells in 2009: 23 wells as of March 2009, 27 drilled as of June 2009, another 21 as of September and 28 during the fourth quarter of 2009 (70 horizontal and 29 vertical wells).
- In addition, the Company has successfully drilled 18 other producing wells in Quifa and other fields (10 in Quifa, 2 in Acacia, 4 in Abanico and 2 in Mauritia).
- The construction of new facilities in the Rubiales field, including: i) 105 km of new roads, ii) 101 km of flow lines between 10" and 24", iii) 51 km of power distribution grid in the field, and 15 new power sub-stations, iv) the Phase 1 thermal Rubiales power plant with 22 MW installed capacity, v) new crude dehydration and water treatment facilities in CPF-1 in order to handle incremental volumes of 60,000 bbl/d of oil and 400,000 bbl/d of water, vi) 200,000 bbl additional storage capacity and vii) 2 new water injection pads with disposal capacity of 340,000 bbl of water per day.
- The ODL pipeline entered in operation during the fourth quarter of 2009 which significantly increased the volume of crude oil transported from the Rubiales field to export facilities at the Coveñas port. An average of 68,000 bbl/d had been transported through the ODL pipeline since the inauguration of the pipeline.
- Offloading facilities to increase the capacity for truck loading up to 70,000 bbl/d at the Rubiales field as well as blending facilities at the Guaduas Station which significantly contributed to the increase in production. During 2009, an average of 18,819 bbl/d was transported to Coveñas for export, and the remaining 5,126 bbl/d were trucked for local industry consumption.

During the year ended December 31, 2009 the Company averaged a daily production of 44.2 mmscfd from La Creciente natural gas field, which was 27% higher than the prior year´s sales. During 2009, natural gas production was limited by delivery constraints and by the execution of scheduled maintenance and testing activities agreed to by the transporter and the buyer. During the fourth quarter of 2009, the average production was 56 mmscfd as a result of additional investments made at the end of 2009, which will allow the Company to keep the same production trend during 2010. The Company will acquire 3D seismic toward the southeast of La Creciente Block so that the Company will be able to drill some of its identified new prospects by the end of the year 2010.

The Company´s production continued to increase subsequent to December 31, 2009, such that during February 2010 the historical milestone of exceeding 132,000 boe/d of gross operated production was achieved, equivalent to 53,419 boe/d net after royalties.

The following is the Company´s reconciliation of barrels equivalent produced with the barrels sold during 2009:

Inventory Movements	Total boe Net	Aver. day Net
Ending inventory as of December 2008	24,696	
Transactions of 2009		
Net oil and gas production	14,811,335	40,579
Royalties	(1,976,869)	(5,416)
Settlement of overlift position from 2008 (1)	(212,408)	(582)
Purchases of diluents	1,765,993	4,838
Total sales	(12,911,319)	(35,374)
Overlift position as of December 2009 (2)	94,941	260
Volumetric compensation	(330,511)	(906)
Ending inventory as of December 2009	**1,265,858**	

(1) This volume corresponds to the settlement of the 2008 overlift position of 212,408 bbl of Rubiales crude oil, which was settled in 2009, resulting in a lower volume of sales during the first quarter of 2009.

(2) This volume corresponds to overlift position of 94,941 bbl of Rubiales crude oil as of December 31, 2009 which was settled in the following year.

Health, Security, Environmental and Quality - HSEQ

During the year ended December 31, 2009 the Company's subsidiaries operating in Colombia continued improving the HSEQ standards. The Company's lost time injuries frequency ("LTIF") continued decreasing from 3.22 for 2008 to 0.93 in 2009, which is significantly lower by 71% in comparison to the LTIF ratio in 2008 (based on 14 million man hours worked during the 2009 against 9 million man hours worked in 2008). The Company has achieved by far its stated goal of a 20% reduction for 2009.

During 2009, Meta Petroleum Corp. and Pacific Stratus Energy Colombia Corp. received the certification of its environmental, health and safety management system under ISO 9001, 14001 and OHSAS 18001 standards. These management systems are well developed to comply with HSEQ international regulations and global performance and the Company devotes significant time and resources to achieve its E&S performance goals.

Crude and Gas Prices

Average benchmark crude oil and natural gas prices for 2009 were as follows:

Average Crude Oil Reference Prices	2009 ($/Bbl)	2008 ($/Bbl)	API
Domestic Market /Bunkers	$53.90	$58.91	12.5
WTI NYMEX (Weighted Average Cargoes PRE)	$62.69	$91.48	38
Vasconia (Weighted Average Cargoes PRE)	$56.21	$82.66	24
Castilla (Weighted Average Cargoes PRE)	$69.21	0	19
Rubiales Blend	$56.92	$76.21	18.5
PRE Natural Gas Sales ($/mscf)	$4.29	$5.58	
Henry Hub average Natural Gas Price ($/mscf)	$4.06	$9.15	

The volatile commodity markets resulted in a sharp increase of crude oil prices during the first three quarters of 2008 and a decline by the end of year. In 2009, WTI NYMEX reached an average of $62.09/bbl. The combined realized oil and gas sales

price for the Company for the year ended December 31, 2009 was $49.51 per boe (2008 – $69.98 per boe) representing a reduction of 29% in comparison to the prior year but favourable in comparison with the reduction of the average WTI NYMEX price from $99.92/bbl in 2009 to $62.09/bbl in 2008, which represents a reduction of 38%.

The following is a summary of the Company's crude oil and gas commercial activity during the year ended December 31, 2009:

- The Company exported fifteen Vasconia crude oil cargoes in 2009, totalling 7.3 million bbl mainly to US refineries at approximately $4.60 less than WTI, compared to 2.1 million bbl exported during 2008 at approximately $8.82 less than WTI. During 2009 the Company started the Castilla crude oil commercialization with two cargoes totalling 1.0 million bbl to US refineries at approximately $7.58 less than WTI; the WTI weighted average for the Company's exported cargoes for 2009 was $62.69/bbl and the weighted average WTI for the prior year's exported cargoes was $91.48/bbl. Additionally, during 2009 the Company exported close to 0.3 million bbl as Rubiales Crude Oil (12.5° API) at an average price of $57.74/bbl, to open new export markets in refining and bunkers.

- The Company maintains commercial flexibility by selling part of its Rubiales production in the Colombian domestic market; an average of 4,375 bbl/d was sold at an average price of $53.90/bbl.

- During the year ended December 31, 2009, an average of 44.1 mmscf/d of natural gas from La Creciente field was sold at an average price of $4.29/mscf, representing a premium of 33% over the weighted domestic regulated price ($3.23/mscf) and 6% higher than the Henry Hub natural gas prices in the United States Gulf Coast.

- During the year ended December 31, 2009, the Company has optimized the procurement of diluents generating a margin of $0.68/bbl ($0.96 million) in the purchase of 1.41 million barrels of light crude oil during the year for blending the Rubiales crude in the Guaduas facilities at a netback formula plus marketing fee of our exports of Vasconia plus a marketing fee. For the export of Rubiales crude oil made in the fourth quarter of 2009 through the ODL pipeline in the fourth quarter of 2009, we bought 0.17 million barrels of imported naphtha/natural gasoline at a the net blending cost of $4.07/bbl which significantly contributed to the reduction of the upgrading costs.

4. Reserves Summary

The total proved and probable oil-equivalent reserves of the Company as of December 31, 2009, discounting production from December 31, 2009, is 329.8 million bbl gross (before royalties) or 280.6 million bbl net to the Company. Oil equivalent is expressed in thousands of barrels (Mbbl). Gas volumes are expressed in billion cubic feet (Bcfg) and when expressed in oil equivalent were converted using 6,000 cubic feet of gas equivalent to one (1) barrel. The reserve report was prepared following all industry standard procedures and in conformity to the COGE guidelines.

The following table summarizes year-over-year proved plus probable (2P) reserve growth for the Rubiales-Piriri, Quifa, La Creciente, Guaduas, Rio Ceibas, Abanico and Puli blocks:

	2P RESERVES 2008 Vs 2009									Oil Equivalent		
	Condensate, Light & Medium Oil			Heavy Oil			Associated & Non-Associated Gas					
	100%	Gross	Net	100%	Gross	Net	100%	Gross	Net	100%	Gross	Net
	(MMbbl)	(MMbbl)	(MMbbl)	(MMbbl)	(MMbbl)	(MMbbl)	(Bcf)	(Bcf)	(Bcf)	(MMboe)	(MMboe)	(MMboe)
2008	15.00	8.78	7.48	366.55	158.89	127.52	485.19	480.63	443.84	452.41	247.77	208.98
2009	13.66	7.59	6.47	545.92	247.23	204.40	472.22	449.76	418.22	638.28	329.78	280.58
Net Reserve Additions	(1.34)	(1.18)	(1.01)	179.37	88.35	76.88	(12.98)	(30.87)	(25.62)	175.87	82.02	71.60
Production	2.04	0.74	0.62	25.23	11.32	9.07	19.60	18.30	16.80	29.87	14.50	11.95
Total Reserve Additions	0.70	(0.44)	(0.39)	204.90	99.67	85.95	6.62	(12.57)	(8.82)	205.74	96.51	83.56

5. ***Summary of Annual Results***

(in thousands of US$ except per share amounts or as noted)	2009	2008
Average production of oil and gas sold (boe/d)	35,374	22,670
Average combined crude oil and natural gas sales price ($/boe)	49.51	69.98
Combined Operating netback ($/boe)	26.91	37.89
Net sales	639,201	579,064
Income from Operations (1)	77,240	175,666
Funds Flow from Operations (2)	198,105	257,982
Per share - basic ($)	0.93	1.29
- diluted ($)	0.93	1.22
EBITDA (3)	275,527	268,065
Per share - basic ($)	1.29	1.34
- diluted ($)	1.29	1.27
Net (Loss) Income (4)	(153,574)	76,698
Per share (5) - basic ($)	(0.72)	0.38
- diluted ($)	(0.72)	0.36

(1) Income from operations includes all direct costs, Depletion, Depreciation & Amortization and G&A expenses, excluding the unrealized non-cash effect of the overlift and stock-based compensation.
(2) Calculated based on cash flow from operations before changes in non-cash operating working capital.
(3) See Non-GAAP Financial Measures
(4) Net cumulative loss for the period of $153.6 million includes a series of non-operating expenses totaling $184.7 million (2008 – $29.9 million), mainly corresponding to:
a) Non-cash items of $113.1 million (2008 - $26.6 million), due to unrealized exchange losses resulting from the strengthening of the Canadian dollar and Colombian peso against the US dollar, and unrealized loss on risk management contracts outstanding as of the end of 2009, which may or may not materialize in future periods and stock-based compensation costs.
b) Non-operating expenses of $71.7 million (2008 – $3.3 million) consisting of interest primarily due to financial costs associated with financing facilities for the development of the oil infrastructure to increase the production capacity of the Rubiales field and other costs.
(5) The weighted average number of common shares outstanding for the year ended December 31, 2009 was 213,294,237 and 200,574,170, respectively, with a basic net loss per share of $0.72 in 2009 and net income per share of $0.38 in 2008.

Financial Position

Total assets were $2.8 billion as at December 31, 2009 compared to $2.3 billion as at December 31, 2008. The $2.8 billion in assets primarily consisted of $2 billion in oil and gas properties and equipment (December 31, 2008 - $1.9 billion), $398.8 million in cash and cash equivalents (December 31, 2008 - $90.4 million), $135.0 million in accounts receivable (December 31, 2008 - $70.5 million), $74.8 million in investment, primarily ODL (December 31, 2008 - $120.8 million), and $191.6 million in other assets (December 31, 2008 - $118.3 million).

On September 3, 2008, the Company acquired 100% of Kappa Energy Holdings Ltd. ("Kappa"), an oil and gas exploration and production company, for $170.4 million cash and acquisition costs of $3.7 million. The 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 September 3, 2008 are included in the Company's results. The purchase price allocation was finalized in September 2009 and resulted in an adjustment to the preliminary purchase price allocation. The adjustment to the preliminary purchase price is attributable to the final valuation for the proved, probable, possible and exploration properties acquired in the acquisition. The final valuation for oil and gas properties was $240.6 million compared to $290.0 million previously estimated. Also included in this final valuation is goodwill of $36.6 million compared to previously estimated balance of nil. The difference from the preliminary estimate was due to the finalization of the fair market valuation including an independent valuation of reserves acquired.

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 debentures have been classified into their debt and equity components. The fair value of the equity component was valued using the Black-Scholes option 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% with the residual of the cash received allocated to the debt component. 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 issuance costs) was classified as the equity component. The debt component will accrete up to the principal balance over the term of the debenture using the effective interest method. The accretion and interest paid are expensed as interest expense yielding an effective annual rate of 18%.

		Amount
Gross proceeds due on maturity (C$240 million)	$	228,159
Costs		12,316
	$	215,843
Fair value of equity component (net of $3,773 issuance costs)		66,130
Value attributed to liability component on issuance (net of $8,543 issuance costs)		149,713
Accretion		3,954
Foreign exchange gain upon conversion to US$		(21,666)
Balance as at December 31, 2008	$	132,001
Accretion		10,470
Foreign exchange gain upon conversion to US$		23,140
Balance as at December 31, 2009	$	165,611

On May 5, 2009, the Company completed a syndicated $250 million extendible revolving credit facility with a stated term date of June 30, 2013. This facility was fully repaid in November 2009 using the proceeds of $450 million from the issuance of the senior notes (described below). The Company was fully compliant with the financial covenants during the term of this arrangement.

On November 10, 2009, the Company closed a senior notes offering with an aggregate principal amount of $450 million and maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%). The notes carry an interest rate of 8.75%, payable on May 10 and November 10 of each year, beginning on May 10, 2010. The notes may be redeemed in whole (but not in part) at any time at the discretion of the Company with a redemption price equal to the greater of (1) 100% of the principal amount of the Notes to be redeemed, and (2) the sum of the present values of the remaining scheduled payments of principal and interest discounted to the date of redemption on a semi-annual basis at the applicable Treasury Rate plus 75 basis points, in each case plus accrued and unpaid interest on the outstanding principal amount. The notes are senior unsecured and will rank equal in right of payment with all of the Company's existing and future senior indebtedness. The notes are listed on the Official List of the Luxembourg Stock Exchange and are traded on the Euro MTF.

As a condition of closing, the proceeds from the offering were used to repay the outstanding amount under the $250 million revolving credit facility. The senior notes are carried at amortized cost using the effective interest rate method with note discount and transaction cost of $13.3 million (2008 - $nil) netted against the principal of the revolving credit facility.

As of December 31, 2009, the Company has issued standby and letters of credit for operational commitments for a total of $110.3 million. Most of these bank guarantees are related to naphtha and light oil purchases.

On December 14, 2009, the Company offered a cash payment of C$1.50 per warrant as an incentive for holders of the warrants to exercise their warrants during an early exercise period (the "Early Exercise Period") that commenced on December 14, 2009 and ended on January 20, 2010, to assist the Company with its planned capital needs and simplify the Company's capital structure. The proceeds of the early exercise of the Warrants are intended to be used by the Company to fund a portion of its 2010 capital expenditure budget, and for general corporate purposes, including future growth opportunities and for potential repayment of outstanding debt. As of December 2009, a total amount of $97.7 million (C$103.1 million) had been converted pursuant to the $1.50 cash payment offer.

Operating Costs

	Year to Date	
	2009	2008
Operating costs	$ 293,992	$ 253,240
Overlift (Underlift)	$ (2,149)	$ 12,272
$ per boe	$ 22.77	$ 30.61
$ per boe Over/Underlift	$ (0.17)	$ 1.48

Operating costs for the year ended December 31, 2009 were $294.0 million (2008 - $253.2 million); and the increase over the previous year is primarily due to the 130% increase in oil production at the Rubiales field. However, production cost per boe was reduced to $22.77, or 26% lower than 2008. Operating cost of $22.77 per boe is consisted of lifting cost of $2.35, transportation cost of $9.82, dilution cost of $7.07 and others $3.53. The reduction of $7.84 per boe in 2009 (26% reduction) in comparison to the prior year was mainly due to:

a) The percentage of diluents needed to dilute and transport the Rubiales crude oil during 2008 to upgrade the Rubiales crude oil from 12.5° to 18.5° API was 18.5%, using high-priced naphtha locally sourced, while in 2009 this percentage reduced to 13% due to the importation of lower-priced, better quality naphtha and the use of light crude oil from other oil producers who pay for the transport of their own product, reducing the Company's transportation cost and increasing the Company's revenues.

b) As a result of a 38% decline in international oil prices in 2009 over 2008, some of the Rubiales oil was sold in the Colombian market as fuel oil and intermediate fuel oil and therefore it did not require diluents for upgrading. During 2008, the portion of domestic sales was almost nil, as international oil prices were much higher than the local prices and therefore there was no incentive to market the crude oil locally.

c) Lower transportation costs due to the entering in operation of the ODL pipeline towards the end of year 2009. This lower cost will be fully realised in 2010 and will represent additional savings in transportation costs.

d) The blending and upgrading costs reflect a reduction of $0.9 million ($0.68/bbl) resulting from the procurement of 1.4 million barrels of light/medium crudes in 2009 for blending the Rubiales crude oil at the Guaduas facilities which was purchased at a netback formula plus a marketing fee.

e) The increased level of production at the Rubiales field generated a higher volume of chemicals and equipment required for the treatment of water produced along with the crude oil; however the unit price per barrel was reduced because of the increased production.

f) Operations were optimized using existing third party facilities in Barranquilla and Cartagena, for exporting 0.3 million bbl of crude oil to the bunkering and refining markets during 2009, resulting in a reduction of operating costs and an improvement in the netbacks for the Company.

Overlift or underlift corresponds to any resulting short term imbalance between cumulative production entitlement and cumulative sales attributable to each participant at the reporting date. Lifting or offtake arrangements for oil and gas produced in jointly owned operations are frequently such that it is not practicable for each participant to receive or sell its precise share of the overall production during the period. Overlift represents an obligation to transfer future economic benefit (by foregoing the right to receive equivalent future production), and therefore constitutes a liability. Underlift represents a right to future economic benefit (through entitlement to receive equivalent future production) which constitutes an account receivable.

The balance of overlift recognized as of the end of December 2009, is the net balance of the overlift positions offset with the actual settlements throughout the year, which generated a net reduction in the 2009 operating cost of $2.1 million. The $2.1 million is the net balance between the overlift of $7.5 million (212,408 boe) originally reflected as of December 2008 and the actual overlift of $5.4 million (94,941 boe) recognized as of December 2009. The overlift was valued at the realized price of heavy crude oil, and recorded as a liability and an increase in the operating costs of December 2009. This overlift and its related financial impact will be reversed once the volume is being settled in 2010.

Depletion, Depreciation and Amortization

	Year to Date	
	2009	2008
Depletion, depreciation and amortization	$ 196,138	$ 104,671
$ per boe	15.19	12.65

The Company used the historical reserve reports issued as of December 2008, updated in June 30 and December 31, 2009, in calculating depletion and amortization for the year. The 2009 depletion charge of $196.1 million is calculated on $1.8 billion of oil and gas property costs subject to depletion. Included in the costs subject to depletion is $1.2 billion of future development costs that are estimated to bring proved undeveloped reserves to development.

The Company accounted for a power generation arrangement as a capital lease amounting to $38.8 million. Under this accounting treatment, the Company recorded an asset for the power generation unit and an obligation for the minimum payments under the arrangement. The asset is amortized using the unit of production method over the term of the lease. As at December 31, 2009, amortization expense of $1.6 million (2008 - $nil) related to the leased property is charged to depletion, depreciation and amortization.

General and Administrative

	Year to Date	
	2009	2008
General and administrative costs	$ 71,831	$ 45,487
$ per boe	5.56	5.50

General and administrative expenses for 2009 were $71.8 million (2008 - $45.5 million), and the increase from 2008 is primarily due to professional fees and additional personnel needed to support the increased operations and oil production at the Rubiales field in 2009. General and administrative expenses on a per boe basis reflected a slight increase of 1.1% due to the effect of higher expenses as mentioned above.

Stock-Based Compensation Costs

	Year to Date	
	2009	2008
Stock-based compensation costs	$ 28,361	$ 38,573
$ per boe	2.20	4.66

For the year ended December 31, 2009, stock-based compensation decreased to $28.4 million from $38.6 million in the previous year. The decrease is due to fewer stock options granted in 2009 of 4,596,500 compared to 14,907,944 stock option grants in 2008. The options granted in 2008 and 2009 all vested immediately upon grant.

All stock options outstanding as at December 31, 2009 are completely vested and exercisable.

Foreign Exchange

	Year to Date	
	2009	2008
Foreign exchange loss (gain)	$ 65,372	$ (31,736)
$ per boe	5.06	(3.84)

Foreign exchange gains or losses result from the translation of monetary assets or liabilities which are denominated in Colombian Pesos and Canadian dollars.

For the year ended December 31, 2009, the weakening of the Colombian Peso and the Canadian dollar against the US dollar in the first quarter was more than offset by the strengthening of both currencies during the third and fourth quarters. The strengthening of the Peso and the Canadian dollar against the US dollar averaged 9% and 15%, respectively.

The strengthening of both the Colombian Peso and Canadian dollar resulted in a loss during 2009 of $65.4 million (2008 – gain of $31.7 million). The 2009 foreign exchange loss of $65.4 million included $65.2 million in non-cash unrealized losses which primarily consisted of the following:

a) Non-cash Colombian Peso denominated future income tax liabilities resulted in a $39.1 million loss upon the conversion to US dollars for financial reporting purposes. The future income tax liability relates to the business acquisitions which generate temporary taxable differences (future income tax liability) when the fair value of the carrying amount is compared with the tax value of the asset.
b) The convertible debenture of $165.6 million, which is denominated in Canadian dollars, resulted in a foreign exchange loss of $23.1 million.
c) The conversion of Colombian Peso denominated debt resulted in a net unrealized loss of $3.3 million.

Interest Expense

	Year to Date	
	2009	2008
Interest expense	$ 48,150	$ 11,826
$ per boe	$ 3.73	$ 1.43

Interest expense includes interest paid on bank loans, revolving line of credit with reserve based lending (RBL), convertible debentures and fees on letters of credit and senior notes offering of $450 million. For 2009, interest expense totaled $48.2 million (2008 - $11.8 million), which represents an increase of $36.4 million over the previous year. The $48.2 million of interest expense primarily corresponds to:

a) Interest of $3.9 million on the reserve based lending (RBL) senior revolving credit facility of $250 million which was repaid in November 2009.
b) Cash and non-cash interest of $27.4 million on the $228.4 million (C$240 million) convertible debenture completed in August 2008 bearing interest at 8% and to the $250 million credit facility. The interest related to the convertible debenture includes the cash portion of $16.9 million as well as a non-cash portion of $10.5 million, yielding an effective annual rate of 18%.
c) Interest accrual of $5.4 million on the notes offering of $450 million in November 2009 to finance the expansion at the Rubiales field.
d) Non-cash interest totaling $3.1 million on the capital lease recognized during the third quarter of 2009 for the power plant contract at the Rubiales field.

Income Tax Expense

	Year to Date	
	2009	2008
Current income tax	30,089	11,943
Future income tax	15,963	57,040
Total	46,052	68,983

Current income tax expense totaled $30.1 million, an increase from 2008 of $18.1 million which was mainly attributable to the following:

a) A total of $56 million in loss carry forward losses for Pacific Stratus were utilized in Colombia in 2008 to reduce income tax expense, while for 2009 the amount of loss carry forward utilized totaled $4.5 million in the current year.

b) Although crude oil prices were lower in 2009, the volume of sales at the Rubiales field increased by 10% in comparison to the prior year, which generated a higher income tax payable in Colombia of $5.2 million in 2009.

The above increase was offset by the implementation of fiscal planning strategies to optimize income tax expense during 2009.

Future income tax expense decreased from 2008 primarily due to the following:

a) The utilization of previously unrecognized loss carry-forwards in Pacific Stratus as discussed in the current taxes, and
b) The increase in non-deductible depletion related to the Company's acquisitions.

The tax rate in Canada and Colombia was 33% in 2009. The effective tax rate was impacted in 2009 by non-deductible expenses which includes unrealized foreign exchange loss, tax loss valuation allowances, unrealized risk management loss and stock-based compensation.

Net Income (Loss)

	Year to Date	
	2009	2008
Net income (loss)	(153,574)	$ 76,698
$ per boe	(11.89)	9.27

Net loss for the year ended December 31, 2009 totaled $153.6 million, which was adversely impacted by a number of non-cash items which were primarily:

(a) Non-cash unrealized items of $113.1 million, including exchange losses due to the strengthening of the Canadian dollar and Colombian Peso against the US dollar, loss on the change in the fair value of risk management contracts and stock-based compensation costs.

(b) Costs not related to operating expenses of $71.7 million, primarily as a result of the increase in the credit facilities to finance the investment activities.

(c) An increase in the operating expenses and Depletion, Depreciation and Amortization expense due to the increase of production and development of the Rubiales field in 2009.

Funds Flows from Operations

	Year to Date	
	2009	2008
Funds flow from operations	$ 198,105	$ 257,982
$ per share, diluted	0.93	1.22

The Company continued to generate positive cash flow from operations despite the 29% decrease in the combined oil and gas price realized. The decrease in realized oil and gas prices and the increased depletion resulted in a decrease in fund flows from operations in 2009.

The following table shows the reconciliation of funds flow from operations to cash flow from operating activities for the years ended December 31, 2009 and 2008:

	Year to Date	
	2009	2008
Net cash provided by operating activities	110,637	271,646
Changes in non-cash working capital	87,468	(13,664)
Funds flow from operations (non-GAAP)	198,105	257,982

6. Liquidity and Capital Resources

Liquidity

Funds provided by operating activities during 2009 totaled $110.6 million (2008 – $271.6 million). The reduction of the cash flow in 2009 is explained by the increase in the non-cash working capital in 2009 of $87.4 million in comparison to the prior year. Since the acquisitions of Rubiales Holdings, Pacific Stratus, and Kappa, 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, 2009, the Company held debts denominated in Colombian Pesos and US dollars for a total amount of $455.7 million (2008 - $30 million). Of the total debt position of $455.7 million, the majority was incurred during the fourth quarter of 2009, through a senior notes offering of $450 million closed on November 10, 2009.

On November 10, 2009, the Company closed a senior notes offering with an aggregate principal amount of $450 million and maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%). The Company used the proceeds from the facility for development of its oil infrastructure (including costs of drilling, oil dehydration and water treatment) to increase the production capacity of the Rubiales and Piriri fields up to 170,000 gross bbl/d by the end of 2010, as well as for general working capital purposes and the repayment of short and long-term debt. The availability of the facility allowed the Company to maintain its originally budgeted capital expenditure plan for 2009, thus paving the way for further growth in production and in the previously announced exploration program.

As of December 31, 2009, the Company had working capital of $371.5 million consisting of $398.8 million of cash and cash equivalents, $135.0 million of account receivables, $39 million of inventory and $180.2 million of accounts payable and accrued liabilities, and $23.5 million of risk management liability as of the end of December, 2009.

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.

The original development plan for Rubiales called for the expansion of the existing production facility (CPF1) to a capacity of 113,000 bbl/d and the construction of a second facility (CPF2) with an additional capacity of 50,000 bbl/d. A redesigned CPF2, with a capacity up to 70,000 bbl/d, will be operational in the third quarter of 2010. This re-engineering will synchronize the development of the production and pumping facilities with the original production profile for the field.

In parallel with the reshaping of the capital expenditure profile, Phase I of the ODL pipeline entered in operation during the third quarter of 2009 connecting the Rubiales field 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 were completed. Phase II of the ODL pipeline construction was completed in January 2010, which increased the pipeline capacity, without additional boosters, to 160,000 bbl/d by the end of the first quarter of 2010.

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 gross production targets for 2010 of 7,133 bbl/d and 68 mmscf/d, respectively. While serving the goal of maximizing cash flow, this will allow the Company to continue to increase the certainty of its resource base.

On the exploration side, the Company has re-examined its commitments, and concentrated its activity during 2010 in Quifa and in those blocks for which it has immediate contractual obligations with the ANH to explore. The Company has complied with 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.

7. Capital Expenditures

Total capital expenditures during 2009 totalled $403.7 million ($345.2 million net of the 40% tax benefit effect in Colombia), of which $48.3 million went into exploration activities including seismic, aerogravimetry, aeromagnetometry and drilling ($23 million to geophysics and $25.3 million to drilling of wells); $234.7 million were invested in the expansion and construction of production infrastructure and $120.7 million in production drilling activities.

In line with the capital drilling expenditures, the Company has reduced the drilling time of wells from 16 days to 13 days for horizontal wells and from 13 to 10 days for vertical wells, on average (including completion), generating considerable savings of $21.4 million during the 2009 drilling campaign.

The Company has a substantial plan of development to bring the current gross capacity of the Rubiales field of 59,395 gross bbl/d (net 21,207 bbl/d) to 170,000 gross bbl/d (net – 61,200 bbl/d) by the fourth quarter of 2010, due to the expansion of the field facilities and the entering in operation of the ODL pipeline.

In the light/medium blocks we expect to increase the production to 7,133 bbl/d by the end of the year. At La Creciente field we expect to increase gas production to 68 mmscf/d at the beginning of 2011 pending the upgrade of the transportation system.

On the exploration side, the Company has re-examined its commitments, and will concentrate its activities during 2010 in the Quifa block and on those blocks for which it has immediate contractual obligations to the Agencia Nacional de Hidrocarburos ("ANH").

The Company announced on November 4, 2009 an expanded capital plan for 2010 that includes an $853 million capital expenditure program. With this investment program the Company will double its net production, before royalties, from the average 2009 production of 46,000 boe per day to 92,000 boe at the end of 2010. The $853 million capital program for 2010 includes $165.5 million for development drilling, $190.8 million for exploration, $471.8 million for production facilities and $25 million to advance the STAR pilot project. This is an increase of $471 million over the 2009 capital expenditures and $394 million over the previously projected 2010 budget.

8. 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 crude oil and 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, 2009 are summarized in the following table:

	2010	2011	2012	2013	2014	to 2014	Total	
Operating leases	$ 1,486	$ 40	$ -	$ -	$ -	$ -	$ 1,526	(a)
Transportation and processing commitments	62,062	61,949	61,949	61,949	61,949	169,646	479,504	(b)
Minimum work commitments	120,737	35,771	13,598	-	-	-	170,106	(c)
Abandonment obligations	2,331	1,180	393	106	2,402	32,758	39,170	(d)
Repayment of debt	13,128	-	-	228,159	149,985	300,015	691,287	(e)
BOOMT Contract (Power Generation Rubiales Field)	9,524	11,306	11,337	11,306	11,306	16,944	71,723	(f)
Total	$ 209,268	$ 110,246	$ 87,277	$ 301,520	$ 225,642	$ 519,363	$ 1,453,316	

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

a) Operating leases of $1.5 million mainly related to office rental in Bogota until the end of 2010. For 2011 and onwards, the office rental agreements do not include future payment commitments and can be terminated with a three-month notice with no penalty.
b) Ship or pay contracts totaling $479.5 million as follows: $452.3 million signed with ODL for the transportation of crude oil from the Rubiales field to the Colombia´s oil transportation system, and $27.2 million signed with Promigas for gas transportation from La Creciente field to connect the Cartagena gas pipeline to deliver the product to customers´ facilities.
c) Minimum capital investments agreed in contracts with Ecopetrol and ANH in Colombia that include acquisition and processing of seismic data and drilling exploration wells in Colombia ($131.6 million), as well as exploration and drilling activities in Peru ($38.5 million).
d) The amount of the asset retirement obligation of $39.2 million considers the present as well as the undiscounted future obligations on drilling of wells or construction of facilities.
e) Debt repayment of $691.3 million on the short and long term debt, details of which are in the Liquidity and Capital Resources section. This amount includes the future repayment of the Senior Notes of $450 million with maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%).
f) Corresponds to a capital lease on a BOOMT (Built, Operate, Own, Maintain and Transfer) contract signed with Energy International Corp. for power generation at the Rubiales and Priri fields until June 2016. This amount corresponds to the share on the contractual minimum lease payments recognized by the Company as a capital lease. Operational rates include the maintenance and service fees as well as the cost of the equipment throughout the life of the contract.

Disclosure about the Company's significant commitments can be found in note 17 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.

9. Risk Management Contracts

The Company has entered into the following risk management contracts that are outstanding at December 31, 2009:

Type of Instrm.	Term	Volume	Price (USD$/bbl)	Benchmark	Fair value usd$ 000 31/12/2009
Written call options	Jan 1, 2010 - Feb 28, 2010	300,000	$80 strike price	WTI	(805)
Written call options	Mar 1, 2010 - Apr 30, 2010	300,000	$76.1 strike price	WTI	(2,577)
Written call options	May 1, 2010 - May 31, 2010	152,000	$80 strike price	WTI	(1,238)
Written call options	June 1, 2010 - Aug. 31, 2010	504,000	$90 strike price	WTI	(2,844)
Written call options	Sept. 1, 2010 - Nov. 30, 2010	500,001	$89.5 strike price	WTI	(4,022)
Written call options	Jan 1, 2010 - May 31, 2010	785,000	$80 strike price	WTI	(4,111)
Written call options	June 1, 2010 - Jul. 30, 2010	304,000	$80 strike price	WTI	(2,956)
	Total				**(18,553)**

Type of Instrm.	Term	Volume	Price (USD$/bbl)	Premium	Fair value usd$ 000 31/12/2009
Put options	Jan 1, 2010 - Apr 30, 2010	600,000	$40 strike price	$1.16/bbl	1
Put options	May 1, 2010 - Jun 30, 2010	300,000	$40 strike price	$1.95/bbl	(547)
Put options	Jul 1, 2010 - Dec 31, 2010	600,000	$40 strike price	$2.45/bbl	(1,228)
Put options	Jan 1, 2010 - Jun 30, 2010	900,000	$40 strike price	$1.41/bbl	(1,223)
Put options	Jan 1, 2010 - Jun 30, 2010	900,000	$40 strike price	$1.28/bbl	(1,106)
Put options	Jul 1, 2010 - Dec 30, 2010	585,000	$40 strike price	$1.91/bbl	(882)
Put options	Jan 1, 2011 - Jul 30, 2011	700,000	$40 strike price	$2,45/bbl	(1,097)
Put options	Jan 1, 2011 - Jun 30, 2011	585,000	$40 strike price	$1.91/bbl	(623)
	Total				**(6,705)**
	Total				**(25,258)**

On November 9, 2009, the Company entered into a novation agreement with Bank of America Merrill Lynch and Citibank, related to the pre-payment of the RBL. At December 2009 the Company had risk management contracts in the format of calls and deferred premium puts.

The realized gain and loss on the risk management contracts settlements for the year ended December 31, 2009 resulted in a realized loss of $2.8 million included in the financial results.

The unrealized gain (loss) on risk management contracts represents the change in the fair value of the contracts outstanding as at December 31, 2009 related to the expected future settlements, which totalled $18.7 million in loss (2008 – $6.6 million). The unrealized losses were recorded in statement of operations

If the forward WTI crude oil price estimated at December 31, 2009 had been $1/bbl higher or lower, the unrealized loss on these contracts would change by approximately $1.3 million and would be reflected in the statement of operations of the Company.

Subsequent to December 31, 2009, the Company has entered into the following derivative contracts to manage its exposures to fluctuations in commodity prices and foreign exchange rates.

Commodity price derivatives

Call options	Term	Volume	Strike Price ($/bbl)	Benchmark
Written Call Option	Dec 01, 2010 - Dec 31, 2010	300,000	95.30	WTI
Bought Call Option	Feb 1, 2010 - March 31, 2010	464,000	80.00	WTI
Bought Call Option	March 1, 2010 - April 30, 2010	300,000	76.10	WTI
	Total	**1,064,000**		

Put options	Term	Volume	Strike Price ($/bbl)	Premium ($/bbl)
Put Option	March 01, 2010 - March 31, 2010	150,000	65.00	0.88
Put Option	April 01, 2010 - April 30, 2010	150,000	65.00	1.38
Put Option	March 01, 2010 - April 30, 2010	300,000	65.00	0.86
Put Option	May 01, 2010 - May 31, 2010	150,000	65.00	0.92
Put Option	June 01, 2010 - June 30, 2010	150,000	65.00	0.94
Put Option	May 1, 2010 - May 31, 2010	150,000	65.00	0.90
Put Option	June 1, 2010 - June 30, 2010	150,000	65.00	0.95
	Total	**1,200,000**		

Foreign currency derivatives

Currency collars	Expiration Date	Amount ($)	Floor / Ceiling (COP/$)
	March 15, 2010	22,302,000	2000-2050 and 2000-2060
	April 15, 2010	20,445,000	2000-2050 and 2000-2060
	April 30, 2010	20,894,000	2000-2050 and 2000-2060
	May 25, 2010	17,691,000	2000-2050 and 2000-2060
	June 25, 2010	19,288,000	2000-2050 and 2000-2060
	July 26, 2010	22,531,000	2000-2050 and 2000-2060
	August 25, 2010	24,887,000	2000-2050 and 2000-2060
	September 27, 2010	28,291,000	2000-2050 and 2000-2060
	October 25, 2010	38,825,000	2000-2050 and 2000-2060
	November 26, 2010	40,131,000	2000-2050 and 2000-2060
	December 23, 2010	41,653,000	2000-2050 and 2000-2060
	December 23, 2010	44,366,000	2000-2050 and 2000-2060
	Total	**341,304,000**	

10. Selected Quarterly Information

(In thousands of US$ except per share amounts or as noted)	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008	Q1 2008
Financials:								
Net sales	211,650	156,557	160,994	110,000	123,216	202,354	158,567	94,927
Net income (loss) for the period	(24,563)	(63,107)	(118,540)	52,636	12,971	77,908	42,128	(56,309)
Capital expenditures	120,071	88,141	83,640	100,823	123,652	66,311	64,877	25,998
Funds flow from operations (1)	68,382	55,677	38,934	31,548	40,810	117,032	62,145	37,995
Earnings (loss) per share (3)								
- basic	$ (0.12)	$ (0.29)	$ (0.56)	$ 0.25	$ 0.06	$ 0.37	$ 0.21	$ (0.32)
- diluted	$ (0.12)	$ (0.29)	$ (0.56)	$ 0.25	$ 0.06	$ 0.35	$ 0.19	$ (0.32)
Operations:								
Operating netback ($/boe) (2)								
Crude oil and natural gas sales price	55.94	55.31	50.12	35.65	43.23	91.11	85.93	69.90
Lifting cost	1.53	2.85	3.00	2.23	3.92	4.21	4.09	3.55
Transportation	9.89	11.64	10.93	6.90	7.12	8.77	8.93	15.17
Upgrading cost (Diluent including transportation)	8.27	7.73	6.19	5.91	8.55	14.88	15.47	12.64
Other production cost	4.90	(3.48)	10.59	0.24	9.70	5.05	4.20	4.46
Operating netback	31.35	36.57	19.41	20.37	13.94	58.20	53.24	34.08
Average daily crude oil sold (Bbl/day) (4)	32,429	24,438	30,405	25,755	24,549	19,045	14,901	10,658
Average daily natural gas sold (Boe/day)	9,145	6,669	5,283	8,528	6,770	5,363	5,603	4,431
Average daily oil and gas sold (Boe/day) (5)	41,574	31,107	35,688	34,283	31,319	24,408	20,504	15,089

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. 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 consolidation.
(4) Weighted average daily production sold for Q2, 2009 has been changed to correct an overstatement of 362,082 bbls reported in this interim period. As a result, the corrected netback is $21.41, which is higher by $3.93 /bbl from that previously reported. No additional changes are derived from this correction.
(5) Operating netback data based on weighted average daily production sold.

The Company restated each of the 2008 interim 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:

	2008					
	Q3		Q2		Q1	
	Prev	Rest	Prev	Rest	Prev	Rest
Oil and gas properties	1,947,006	1,908,901	1,604,156	1,584,110	1,546,677	1,534,190
Future income tax liability	495,744	478,796	401,015	393,663	424,895	420,037
Retained earnings	(94,756)	(73,599)	(8,386)	4,308	38,807	46,436
Depletion, depreciation and amortization	25,101	24,770	23,215	22,902	19,040	18,897
Future income tax expense	8,048	16,425	45	5,423	-	3,233
Foreign exchange (gain) loss	-		-		-	
Net Income	86,370	77,908	47,193	42,128	(53,219)	(56,309)
Net Income per share - Basic	0.41	0.37	0.23	0.21	(0.30)	(0.32)
Net Income per share - Diluted	0.41	0.37	0.21	0.19	(0.30)	(0.32)

The following discussion highlights some of the significant factors that impacted the results in the two most recently completed years ended December 31, 2009:

During the fourth quarter of 2009, net sales totalled $211.7 million, which were higher by $55.1 million over the previous quarter, due to the increase in both the combined realized price of $0.63 per bbl (a 1% increase) as well as the average daily volume at oil and gas sold from 41,574 boe/d in the third quarter of 2009 to 31,107 boe/d in the fourth quarter, a 34% increase. This increase in the volume of sales in the fourth quarter is the result of the drilling program initiated during 2009 and the optimization of field facilities to improve the storage and transport capacity at the Rubiales field. Operating netback was reduced by $5.22 boe to $31.35, in comparison to the prior quarter, primarily due to the increase in other production costs and upgrading costs in the fourth quarter as detailed in the Operating Costs section, and the effect of the overlift position recognized in the third quarter.

During the third quarter of 2009, net sales totalled $156.6 million, which were lower by $4.4 million over the previous quarter, due to the settlement of the overlift position recognized in the prior period of 455,000 boe amounting to $19.4 million, offset with an increase in the crude and gas production, which resulted in a slight reduction of the volume of sales as compared to the second quarter of 2009 (a 2% reduction). The effect of the lower volume of sales was offset by the increase in the combined realized price of $10.26 per barrel (22%) over the second quarter of 2009.

During the second quarter of 2009, net sales totalled $161.0 million, which were higher by $50.9 million over the previous quarter, due to the increase in both the combined realized price of $14.47 per barrel (a 41% increase) as well as the volume of sales from 34,283 boe/d in the first quarter of 2009 to 35,688 boe/d in the second quarter, a 4% increase. Additionally, the operating costs in the second quarter of 2009 totaled $27.62 per barrel, which was negatively affected by the overlift position of 455,000 boe as of June 30, 2009 amounting to $19.4 million, or $5.44 per barrel.

During the first quarter of 2009, net sales were reduced by $13.2 million to $110.0 million over the previous quarter due to a reduction in realized oil and gas prices. Even though the production sold during this quarter was increased by 9% to 3.1 million bbl, the average realized price was 18% lower at $35.65 per bbl in the first quarter of 2009 in comparison to $43.23 per bbl in the fourth quarter of 2008.

Revenue in the fourth quarter of 2008 fell by $79.1 million to $123.2 million in comparison to the previous quarter in 2008, primarily due to significantly lower international oil and gas prices realized, in part compensated by higher crude oil production from the Rubiales field. Combined average oil and gas selling prices fell by by $47.88/boe over the fourth quarter to $43.23/boe (53%) when compared to the prior quarter, due to the strong reduction in oil prices. The average daily volume of oil and gas sold in the fourth quarter increased to 31,319 boe/d from 24,408 boe/d in 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/boe, in comparison to the prior quarter primarily due to the reduction in 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 $31.0 million and a decrease in foreign exchange loss of $52.6 million.

During the first quarter of 2008, net sales increased by $41.0 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 subsequent to its 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 $41.0 million and partially offset by interest income and future income tax recovery.

11. Outstanding Share Data

Issued and Fully Paid Common Shares

As at December 31, 2009, 232,904,772 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, 2009, 27,910,343 warrants to acquire an equal number of common shares were outstanding and exercisable (44,803,552 – December 31, 2008) and 19,223,131 stock options were outstanding (19,747,748 – December 31, 2008), of which all were exercisable.

Subsequent to December 31, 2009, 6,278,500 options were granted at a weighted exercise price of C$14.08.

12. New Accounting Pronouncements

Adopted

a) Goodwill and Intangible Assets

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". The changes are applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company retrospectively adopted the new standard for its fiscal year beginning January 1, 2009. The new standard establishes the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. This new guidance requires recognizing all goodwill and intangible assets in accordance with CICA section 1000, "Financial Statement Concepts." Section 3064 has eliminated the practice of recognizing items as assets that do not meet the section 1000 definition and recognition criteria. Under this new guidance, fewer items meet the criteria for capitalization. The adoption of this standard had no significant impact on the Company's consolidated financial statements.

b) Credit Risk and Fair Value of Financial Assets and Liabilities

On January 1, 2009, the Company retrospectively adopted the CICA's EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". This abstract provides guidance on how to take into account credit risk of an entity and its counterparty when determining the fair value of the financial assets and financial liabilities, including derivative instruments. The adoption of this abstract did not have a significant impact on the Company's consolidated financial statements as at December 31, 2009.

c) Financial Instruments - Disclosures

In May 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures", to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of

assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. These amendments are effective for the Company on December 31, 2009.

Future accounting changes

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.

In July 2009, the International Accounting Standards Board (IASB) issued an amendment to IFRS 1 "First Time Adoption of International Reporting Standards." The amendment allows full cost accounting corporations to elect, at the time of adoption, to measure exploration and evaluation assets at the amount determined under the entity's previous GAAP. The amendment will also permit full cost accounting corporations to measure, at the time of adoption, oil and gas assets in the development or production phases, by using the total value determined under the entity's previous GAAP and allocating values at the unit of account level based on the Company's reserve volumes or reserve values as of the date of conversion. This exemption will relieve the Company from retrospective application of IFRS for its oil and gas assets. The Company currently anticipates that this exemption will be used, however, this will not be determined until the impact analysis and evaluation phase of the conversion project is complete.

The Company has hired an external advisor to assist management in the implementation of this project to generate comparative 2010 consolidated financial statements under Canadian GAAP and IFRS. The Company has established that the conversion project will be executed in three phases: phase I - Initial diagnostic and planning to be completed March 2010, phase II - Impact analysis and evaluation to be completed by May 2010, and phase III - Implementation and review to be completed by August 2010. Currently, the Company has completed phase I, related to the diagnostic of major differences between Canadian GAAP and IFRS, as well as the potential effects of IFRS (to) for accounting and reporting processes, information systems, business processes and external disclosures. As a result, the following key issues are expected to have the most significant impact on the results of operations, financial position and disclosures:

• IFRS 1 – First-time adoption of International Financial Reporting Standards;
• IFRS 6 – Exploration and evaluation of mineral resources;
• IFRS 16 – Property, Plant and Equipment;
• IAS 36 – Impairment of assets;

Management started training programs during 2009, which will continue throughout the project implementation. The project is currently on track, however, at this time, the impact from the changeover to IFRS on the Company´s financial statements is not reasonably determinable until completion of the project.

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.

Business Combinations/Consolidated Financial Statements/Non-Controlling Interests

In January 2009, the CICA adopted sections 1582, "Business Combinations", 1601, "Consolidated Financial Statements", and 1602, "Non-Controlling Interests" which superseded current sections 1581, "Business Combinations" and 1600 "Consolidated Financial Statements". These sections will be applied 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 1, 2011. Earlier adoption is permitted. If an entity applies these sections before January 1, 2011, it will disclose that fact and apply each of the new sections concurrently. These new sections were created to converge Canadian GAAP with IFRS. The Company plans to adopt these standards effective January 1, 2010 and does not expect the adoption will have a material impact on the results of operations or financial position.

Under the guidance of new section 1582, the purchase price used in a business combination is based on the fair value of shares exchanged at their market price at the date of the exchange. Currently the purchase price used is based on the market price of the shares for a reasonable period before and after acquisition is agreed and announced. This new guidance generally requires all acquisition costs to be expensed, which currently are capitalized as part of the purchase price. Contingent liabilities are to be recognized at fair value at the acquisition date and re-measured at fair value through earnings each period until settled. Currently only contingent liabilities that are resolved and payable are included in the cost to acquire the business. In addition,

negative goodwill is required to be recognized immediately in earnings, unlike the current requirement to eliminate it by deducting it from non-current assets in the purchase price allocation.

Under the guidance of new section 1602, when there is a change in control the previously held interest is revalued at fair value. Currently a gain of control is accounted for using the purchase method and a loss of control is accounted for as a sale resulting in a gain or loss in earnings. Minority interest currently referred to as non-controlling interest, and is presented within equity is recorded at carrying amount and can only be in a deficit position if the non-controlling interest has an obligation to fund the losses. Under the new guidance non-controlling interest can be in a deficit position because it is recorded at fair value.

Critical Accounting Policies and Estimates

The Company's financial statements are prepared in accordance with Canadian GAAP, which requires 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 2009 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.

Property, Plant and Equipment – 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.

The Company applies an impairment test to the net carrying value of oil and gas properties and equipment designed to ensure that such costs do not exceed the estimated amount ultimately recoverable. This amount is the aggregate of estimated undiscounted future net cash-flows from production of proved reserves and the cost of unproved oil and gas properties less impairments. Future cash-flows are estimated using future prices and costs without discounting. Should the net carrying value of oil and gas properties and equipment exceed the amount ultimately recoverable, the amount of the impairment is determined by deducting the discounted estimated future cash-flows from proved and probable reserves based on the future prices plus the cost of unproved properties, net of impairment allowances, from the carrying value of the related assets. Any reduction in the net carrying value, as a result of the impairment test, is included in depletion, depreciation and amortization expense.

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.

13. Related-party transactions

a) On April 16, 2009, 538,334 common shares ($3.3 million) of the Company were issued to a director of the Company as settlement of a contingent consideration on acquisition of La Creciente by Pacific Stratus in 2004.

b) The Company paid Endeavour Financial Corp. ("Endeavour"), a company related by way of a director in common, $180 in retainer fees. The Company also paid Endeavour financing fees of $3 million (2008 - $nil) for ODL pursuant to an advisory agreement dated November 8, 2007.

c) On May 5, 2009 the Company closed on initial commitments totaling $180 million of a senior secured revolving credit facility of up to $250 million. The facility consisted of $50 million commitments from each of BP Paribas, Calyon and Banco Davivienda S.A. and $30 million from West LB A.G. In June 2009, the Company paid Endeavour an amount of $2.6 million in retainer and advisory fees for the arrangement of this revolving credit facility. The Company received an additional $45 million under the revolving credit facility and paid Endeavour an amount of $1.2 million in advisory fees related to the additional credit.

d) As at December 31, 2009, the Company had trade accounts receivable of $10.5 million (2008 - nil) from Proelectrica, in which the Company has a 21.4% indirect interest. Revenue from Proelectrica in the normal course of the Company's business was $17.5 million for 2009 (2008 - $2.7 million).

e) 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 one of its Bogota, Colombia locations. Monthly rent expense of $55 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. In addition, the Company has a receivable of $16 from Blue Pacific related to certain administrative costs paid by the Company on behalf of Blue Pacific.

f) The Company has an accounts receivable in the amount of $173 (2008 - $13) from Medoro Resources Ltd., a company related by way of a director and two officers in common. The receivable balance is related to the Company's share of general and office expenses, including administrative support and office premises in Canada.

g) Loans receivable from related parties in the aggregate amount of $290 (2008 – nil) are due from one director and two officers of the Company. The loans are non-interest bearing and payable in equal monthly payments over a 48-month terms.

All these transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

14. Internal Controls over Financial Reporting

The Pacific Rubiales internal audit function provides assurance to Board of Directors and management regarding the effectiveness of all aspects of the Company's system of internal control, risk management, and corporate governance. The internal audit process delivers reasonable assurance over the:

- Effectiveness and efficiency of operations
- Reliability of internal and external reporting, and
- Compliance with applicable laws and regulations

The Chief Corporate Auditor (head of the internal audit function) reports the results of the audit activities to the Audit Committee on a quarterly basis. The internal audit activities for 2009 were approved by the Audit Committee through the Audit Plan.
The 2009 Audit Plan included the following activities:

- Quarterly evaluation of the effectiveness of internal controls, encompassed within the requirements of National Instrument 52-109 ("NI 52-109") issued by the Canadian Securities Administrator (CSA), over the design and operating effectiveness of the ICFR (Internal Controls Over Financial Reporting). Evaluation of the controls was performed to ensure that the information required to be disclosed by the Company is accumulated and communicated to management for timely assessment and certification by the Chief Executive Officer and Chief Financial Officer.
- With the implementation of the SAP 6.0 as corporate ERP in July 2009, a review of the ICFR was performed by the internal audit team, new updated controls were documented and their design and operational effectiveness evaluated, and risk-based top-down assessment approach applied as part of the methodology used.
- 19 audit reports were performed by the internal audit team during the year. These audit reports included the evaluation of operational effectiveness controls of core and support business processes in each of the following businesses: Exploration, Production, Logistics, Trade, Projects, Finance, Information Technology, Human Resources, Procurement, Legal, Treasury, Joint Ventures, New Acquisitions, and Reserves. The results were reported to management and the Audit Committee and action plans of improvement agreed with business process owners.

The Company concluded that there are opportunities to improve on the design and operation of the ICFR in the following areas:

- Financial consolidation process to improve on the timeliness of reporting,
- Distribution of appropriate segregation of duties through SAP modules, and
- Training for all personnel involved in the financial reporting process.

The Company will continue to review its processes and procedures in 2010, including the engagement of professional consultants to improve on the areas identified.

Regulatory Policies

Certification of Disclosures in Annual Filings

In accordance with NI 52-109 of the CSA, the Company quarterly and annually issues a "Certification of Filings" ("Certification"). The Certification requires certifying officers to state that they are responsible for establishing and maintaining disclosure controls and procedures ("DC&P") and 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.

During 2007 and 2008, the Company experienced a significant level of growth through the acquisitions of RHL, Pacific Stratus and Kappa. The Company concluded that its DC&P and ICFR were ineffective as at December 31, 2008. In 2009 the Company reviewed the structure and capacity of its financial reporting group and made changes to enhance DC&P and ICFR. The changes included the hiring of additional resources, engaged professional consultants to augment internal resources and provided additional training for personnel involved in the financial reporting process. The Company also has completed the implementation of a Company-wide ERP system to facilitate the standardization of the accounting and reporting functions. As a result the Company has concluded that its DC&P and ICFR were effective as at December 31, 2009.

15. Outlook

The Company will continue working on increasing its production and transportation capacity. Expansion of current facilities and completion of the ODL pipeline will allow the Company to double its production and significantly reduce its transportation costs.

The Company will continue to sell 18.5° API blended crude on the international markets, as well as to the domestic market. In 2010 the Company expects to increase its sales through this scheme to 57,500 bbl/d. The ODL pipeline will allow transportation of all the Company's production from the Rubiales oil field to Monterrey, where it is connected to the Ocensa pipeline to Coveñas port.

The Company will also concentrate on increasing its gas sales from the La Creciente Field, and in order to achieve this, is currently negotiating with the gas transporters the commercial terms for an expansion of the latter's infrastructure in the area.

The exploration activities of the Company will continue at a steady pace during 2010 and the Company is well on schedule to complete its program for the year, including drilling of twelve exploratory wells in Quifa, eight appraisal wells also in Quifa and eighteen more exploratory wells in the rest of the blocks in Colombia. The campaign also includes acquisition of approximately 13,133 km of high resolution magneto-gravimetric airborne data. The Company will also acquire 5,305 km of 2D seismic and 695 km^2 of 3D seismic in 14 blocks; 12 in Colombia and 2 in Peru.

The Company will focus on implementing its revised investment program using the funding structured in November 2009, thus ensuring a robust financial base to develop the business plan for 2010.

16. **Non-GAAP Financial Measures**

This report contains the following financial terms that are not considered measures under Canadian GAAP: operating netback, net operating income from operations, funds flow from operations, and EBITDA.

Reconciliation of Net (Loss) Income to EBITDA

	2009	2008
Net (Loss) income	(153,574)	76,698
Adjustments to net (loss) income		
Income taxes expense	46,052	68,983
Foreign exchange loss	65,372	(31,736)
Interest expense	48,150	11,826
Realized and unrealized loss on risk management contra	21,525	6,574
Other expense (income)	25,160	(9,034)
Stock-based compensation	28,361	38,573
Depletion, depreciation and amortization	196,138	104,671
Non-controlling interest	0	937
Loss (income) from equity investment	(1,657)	573
EBITDA	275,527	268,065

EBITDA was redefined in 2009 upon the completion of the senior notes offering with an aggregate principal amount of $450 million. The redefined EBITDA represents the EBITDA used in and defined in the covenants of the senior notes offering. The previous year's EBITDA has been recalculated to conform to the current year's definition.

17. Legal Notice – Forward-Looking Information and 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.

18. 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 2008-2009 concurrent with shifts in the global economy. Any decreases in oil and natural gas prices would 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 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 at that time, 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 the Company has significant revenues from operations, a significant percentage of funds available to the Company for its acquisition and development projects has in the past been derived from the issuance of equity and debt. 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 global financial crisis of 2008-2009 resulted in severe economic uncertainty and illiquidity in capital markets which, if it were to reoccur, would increase the risk that additional financing will only be available on terms and conditions unacceptable to the Company or not at all.

Global Financial Conditions

Recent global financial conditions have been subject to high volatility resulting in numerous commercial and financial enterprises having either gone into bankruptcy or creditor protection or having had to be rescued by governmental authorities. In 2008-2009, access to public financing was 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 a 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 had been adversely affected by the worldwide economic crisis and had 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, if they were to reoccur, 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 variable for the near future as a result of market uncertainties over the supply and demand of these commodities due to the fluctuation of world economies, OPEC actions and global credit and liquidity concerns.

These factors may impact the Company's future 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 reoccur at levels experienced during 2008-2009, the Company's operations could be adversely impacted and the trading price of the Company's securities could be adversely affected.

In addition, certain of our customers could be unable to pay us, in the event that 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 transports via pipeline and trucks (to a certain extent) 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, mechanical problems 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 licences, 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 labour 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, labour 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.

Enforcement of Civil Liabilities

Substantially all of the assets of the Company are located outside of Canada and certain of the directors and officers of the Company are 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.