# PACIFIC RUBIALES ENERGY CORP.

## MANAGEMENT DISCUSSION AND ANALYSIS
## August 10, 2010

Form 51-102F1
For the three and six months periods ended June 30, 2010

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 31.

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 consolidated financial statements for the second quarter of 2010 and related notes. The preparation of financial information is reported in United States dollars 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 30. All references to net barrels or net production reflect only the Company's share of production after deducting 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 to 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 on page 21.

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, are available on SEDAR at www.sedar.com and at www.pacificrubiales.com.Information contained in orotherwise 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***

| | Three months ended June 30, | | | |
|---|---|---|---|---|
| | 2010 | 2010 | 2010 | 2009 |
| | Oil | Gas | Combined | Combined |
| Average daily production sold (boe/day) | 54,291 | 10,038 | 64,329 | 35,688 |
| Operating netback ($/boe) (1) | | | | |
| Crude oil and natural gas sales price | 67.61 | 28.09 | 61.45 | 50.12 |
| Cost of Production (2) | 4.62 | 7.37 | 5.05 | 5.16 |
| Transportation | 6.62 | 0.39 | 5.65 | 10.46 |
| Upgrading cost (diluent including transportation) | 12.54 | - | 10.59 | 6.19 |
| Other costs (3) | 0.65 | 1.59 | 0.80 | 2.85 |
| Overlift/Underlift (4) | 0.19 | 0.08 | 0.18 | 6.05 |
| Operating netback | 42.99 | 18.66 | 39.18 | 19.41 |

*(1) Combined operating netback data based on weighted average daily production sold which includes diluents necessary for the upgrading of the Rubiales blend.*
*(2) Cost of production mainly includes lifting costs and other production costs such as personnel, energy, security, insurance and others. Cost of Production for gas includes work over for an amount of $6 million ($6.2./boe) executed during this quarter..*
*(3) Other costs mainly correspond to royalties on gas production, external road maintenance at Rubiales field, inventory fluctuation, and the net effect of the currency hedges of operating expenses incurred in COP during the period.*
*(4) Corresponds to the net effect of the overlift position for the period amounting to $1 million, which generated a reduction in the combined production costs of $0.18 per boe as explained in the section Corporate Development Highlights – Financial Position– Operating Costs.*

***Summary of Second Quarter 2010 Operating Results***

The results for the second quarter of 2010 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 under the umbrella of its paramount strategic focus: growth.

The average WTI price for the second quarter of 2010 was $78.05 per barrel (bbl) in comparison with $59.79/bbl for the same period of 2009, which represents an increase of 31%. As a result, the average combined realized oil and gas sales price for the Company for the second quarter of 2010 increased to $61.45 per barrel of oil equivalent (boe) from $50.12 per boe in the same period of 2009, representing an increase of 22%.

The increase in gross operated production of the Company during the second quarter of 2010 was a significant achievement, averaging 138,382 boe per day (boe/d), which is 65,325 boe/d (96%) greater than operated production for the same period of 2009. This growth in operated production came mainly through the increase in production at the Rubiales and Quifa heavy oil fields. Production continues to grow and as of August 9, 2010, the Company's total operated production has exceeded 147,514 boe/d for all its fields, which, as in previous quarters, continues to make the Company the fastest growing oil and gas company in Colombia, as well as the country's second largest operator.

In the execution of its commercial strategy, the Company continued exporting its oil production to international markets, namely, USA, Singapore, India and Ivory Coast, while maintaining a presence in the local market with direct sales to the bunker and industrial sectors. During the second quarter of 2010, the Company exported 4.6 million bbl of crude oil, and sold 0.4 million bbl of oil to the Colombian domestic market. In addition, gas sales to the domestic market averaged 61 mmscf/d of natural gas from the La Creciente field.

During the second quarter of 2010, the Company significantly increased revenues by 123% to $359.7 million as compared to $161 million in the same period of 2009. The total accumulated revenues for the six months of 2010 totalled $740.2 million, higher by 173% in comparison to the same period of 2009. This was the result of the considerable increase in production and the optimization of marketing activities, coupled with a higher combined crude oil and gas sale price in 2010, as mentioned above. This operational success not only resulted in increased revenues but also in an increase in net income for the period to $47.9 million, compared to a $118.5 million loss for the same period of 2009.

During the second quarter of 2010, the Company continued its exploration campaign in the Quifa block, drilling a total of five stratigraphic wells. The stratigraphic wells, Quifa 20X and Quifa 22X, drilled in the north-western border of the commercial area, confirmed the presence of hydrocarbons, thereby indicating that the producing area located in south-west Quifa can be extended towards this part of the area The Quifa 28X, Quifa 33X and Quifa 34X stratigraphic wells, drilled in the south-eastern and north-eastern part of the Block, did not show evidence of oil accumulation, indicating a stratigraphic control in the oil distribution in this part of the block. For the rest of the year, the Company has prepared an aggressive appraisal campaign to delineate the discoveries made on Quifa 20X and 22X, as well as the discoveries made on prospects A, F and Q during the first quarter of 2010.

Milestones

- Due to higher realized crude oil prices and a substantial increase in production volume during the second quarter of 2010, the Company was able to significantly increase revenues by 123% in comparison to the prior period ($359.7 million during the second quarter of 2010 versus $161 million during the same period of 2009), mainly due to a substantial increase in production volume, price increase and trading optimisation.

- As of August 9, 2010, the Company had reached the historical milestone of exceeding 147,514 boe/d of gross operated production, equivalent to 60,247 boe/d, net after royalties. The 147,514 boe/d milestone resulted from the continuous growth in production of heavy oil in the Rubiales/Piriri and Quifa 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 the La Creciente block and other smaller fields.

- EBITDA during the six months of 2010 totalled $432.3 million which represents a significant increase of 341% compared to the same period of 2009 EBITDA of $98.1 million. For the second quarter of 2010 EBITDA amounted to $202.6 million, mainly generated from international sales (86%), while EBITDA from gas and domestic sales contributed 6.5% and 7.5%, respectively.

- Capital expenditures during the second quarter of 2010 totalled $134.7 million, of which $30.8 million went into exploration activities including seismic, aerogravimetry, aeromagnetometry and drilling ($20.7 million to geophysics and $10.1 million to drilling of wells). Also, $73.9 million were invested in the expansion and construction of production infrastructure, $29.1 million in production drilling activities, and $0.9 million were invested in the development of other strategic projects (STAR, Llanomulsion and gas exportation projects).

- On June 23, 2010 the Company announced that it had been awarded six new blocks in the Ronda 2010 bidding process organized by the Agencia Nacional de Hidrocarburos of Colombia ("ANH"). The Company won sole rights to three blocks and was awarded three other blocks through a joint venture with Talisman (Colombia) Oil & Gas Ltd. ("Talisman Colombia"), a wholly owned subsidiary of Talisman Energy Inc. In all six blocks the Company will be the operator. The blocks awarded to the Company are located in the Putumayo, Llanos, and Cordillera Basins.

- On June 15, 2010 the Company announced that Ecopetrol S.A. ("Ecopetrol"), the Company's partner in the development of the Rubiales field, had given its approval to the request to expand the commercial area of the Rubiales field, located in the Llanos Basin in Colombia. This approval gives the Company all it requires to grow production and reach our stated production goal at Rubiales of 170,000 bbl per day by the end of 2010. Capacity expansion is underway, and construction of CPF2 is on schedule for completion by September 30, 2010. This is an important step in the Company's growth strategy and paves the way for future expansion not only in the block, but also in the region.

- On April 26, 2010 the Company announced the final results of the first phase of its exploration campaign from late 2007 through to April 2010, on its Quifa and Rubiales blocks. These results have led to a declaration of commerciality for the Quifa south-west area and the Rubiales south-west area, an important event for the Company as it has focused significant effort and capital to bring these areas into production. The closing of this first phase is a key milestone in the Company's strategy to continuously grow our resources, prove new reserves and rapidly bring new areas into our existing production infrastructure. The success of the exploration campaign within Quifa in particular, leading to over 40,000 ha of declared commerciality, is also very significant since it demonstrates the long term viability of the Rubiales region and the Llanos Basin. The drilling of 3 wells in the northern Quifa area (one exploratory and two stratigraphic wells) on Prospects “A”, “F” and “Q”, confirmed the presence of a hydrocarbon column on the top of the basal sandstones incorporating a total of 251 mmbbl of certified gross resources and we are currently working to incorporate these new resources in the Company´s proved and probable reserves at the end of 2010 by means of drilling appraisal and development wells on those prospects.

- The exploration program during the second quarter of 2010 resulted in a new exploratory success at the Company’s Guairuro-1 stratigraphic well located in the CPE-6 Block, in the Llanos Basin, Colombia. The results from the Guairuro-1 well confirmed the presence of hydrocarbons in the region and reinforce the exploratory potential of the CPE-6 Block. The Guairuro-1 well is the first of the six stratigraphic wells to be drilled in the block in 2010.

- As a result of the above-mentioned activity at Quifa and CPE-6, a total of six stratigraphic wells were drilled in the second quarter of 2010 totalling a net exploration expenditure of $30.8 million.

- On April 7, 2010, the Company announced the successful completion of the first phase of the Synchronized Thermal Additional Recovery (“STAR”) project, and the kick-off of the second phase, as contemplated by the Memorandum of Understanding (“MOU”) executed with Ecopetrol on April 6, 2009. This second phase, where we are negotiating with Ecopetrol the terms of the new contract will be agreed before the kick-off of the pilot project. During the first phase of the STAR project a number of studies and tests were carried out which confirm the feasibility and potential of the technology and clear the way for the next stages of the project. Engineering design has been contracted, the purchasing of the equipment is in progress, the area of the pilot test has been selected and the design of the synchronized wells is being finalized.

- During the second quarter of 2010, the Company exported a total of 4.6 million bbl of oil to USA, Singapore, and Ivory Coast refineries, including six Castilla crude oil cargoes for 4.1 million bbl, and one Vasconia crude oil cargo for 0.5 million bbl at an average price of $67.08/bbl, which is a significant commercial accomplishment. The Company also maintained its flexible commercial strategy by selling 0.4 million bbl of Rubiales production in the Colombian domestic market, at an average price of $66.80/bbl.

- During the second quarter of 2010 the sales of gas increased, to an average of 61 mmscf/d of natural gas from 31 mmscf/d in the same period of 2009 (97% increase), sold mainly from La Creciente field at an average price of $4.69/mmbtu (equivalent to $4.62/mscf), representing a premium of 20% over the weighted domestic regulated price ($3.89/mmbtu) and 11% over the Henry Hub natural gas prices in the United States Gulf Coast, and 9% over the realized sale gas price of the second quarter of 2009. The 97% increase in gas production during the second quarter of 2010 in comparison to the same period of 2009 was mainly due to the continuous investment in facilities and the fact that the average production for the second quarter of 2009 was affected by maintenance activities.

- In May 2010, construction of new facilities to process crude oil production from Quifa Block was initiated. These facilities will gather production from the western block of Quifa. Dehydrated heavy crude and treated water will be pumped directly to the ODL pumping station and to CPF-1, respectively. The planned capacity of these new facilities is 30,000 bbl/d of crude from the Quifa field.

- During the second quarter of 2010 the Company transported 63,303 bbl/d through the different trucking and pipeline systems, including 8,806 bbl/d of diluents; 80% of this volume was transported via pipeline, generating savings of $9.02/bbl in transportation costs for the Company.

- The Company entered into currency risk management contracts in the form of costless collars to reduce the foreign currency exposure associated with operating expenses, as well as general and administrative expenses, incurred in Colombian Pesos. During the second quarter of 2010, the Company had currency risk management contracts outstanding totalling $240.7 million with expiration dates between July and December 2010.

- On June 30, 2010 the Company solicited consents to amend the indenture (the “Indenture”) relating to its 8.75% senior unsecured notes due 2016 (the “Notes”), to provide the Company with needed flexibility to invest in minority equity investments in, and provide guarantees for, joint venture entities. This solicitation was approved by a majority of the Note holders on July 15, 2010.

## 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. 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 increasing its reserves and growing its production will be reached through exploration activities to add new discoveries on the one hand and on the other through an increase in the recovery rates by better delineating our existing resource base by the 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.

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. 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.

## 3. Project Updates

### Oleoducto de Los Llanos (ODL) Pipeline

The Company's interest in ODL is 35% with the balance of 65% owned by Ecopetrol. The project was completed on schedule at a total cost of $558 million. Since October 1, 2009 a total of 29,145,922 bbl of diluted crude have been transported from the Rubiales field to Monterrey Station.

In light of increasing production at the Rubiales and Quifa fields, in November 2009, the ODL board of directors approved an expansion to 340,000 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. As of the end of June 2010, 35% of the expansion project was completed, with an expected completion date of March 2011; an early stage will be operational by December 2010, in order to transport incremental production from the Rubiales and Quifa fields. During the second quarter of 2010 the transported volume through the ODL totalled 4,332,811 bbl at $1.90/bbl.

### Llanomulsion Project

As part of the efforts to minimize transportation costs in the ODL pipeline while maximizing line capacity, in January 2009 the Company initiated the development of a special transport emulsion formula (oil in water), which eliminates the need for 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.

During the second quarter, tests of a new surfactant developed by Ecopetrol´s research and development affiliate (ICP, Instituto Colombiano del Petróleo) have been performed in the Rubiales field pilot plant. The industrial test in the ODL pipeline will be performed when the new ODL leg to Cusiana becomes operational in the fourth quarter of 2010. In the meantime, design parameters for breaking the emulsion will be developed and tested in the pilot plant.

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 Llanos Basin.

### STAR Project

Pursuant to the previously signed binding MOU with Ecopetrol, the Company has continued laboratory and pilot tests which hitherto have confirmed that STAR 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 developed three combustion tests with the objective of assessing (i) the burning characteristics of the Rubiales oil under the same pressure conditions 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.

- The Alberta Research Council (ARC) carried out a Technology Screening in order to corroborate the suitable technologies for Rubiales reservoirs.

- Techsera Solutions determined the crude upgrading capability for the Rubiales reservoirs.

- High Level Heavy Oil Consultants contributed the numerical simulations to estimate the expected recovery factor, among other key parameters.

The Company successfully completed three 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.

Based on these results, on April 7, 2010, the Company announced the successful completion of the first phase of the STAR project, and the kick-off of the second phase, as contemplated by the MOU executed with Ecopetrol on April 6, 2009. This second phase, where we are negotiating with Ecopetrol the terms of the new contract will be agreed before the kick off of the pilot project. These results confirm the feasibility and potential of the technology and clear the way for the next stages of the project. Presently, the Company is preparing not only the land surface production facilities to install the In situ Combustion (ISC) equipment, but also the drilling of the synchronized new well as well as the reconditioning of the existing wells involved in the project. Engineering design has been contracted and the purchasing of the equipment is in progress.

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

**Exploration**

Overview

The exploration campaign for second quarter of 2010 was focused on the Quifa Block, with a drilling campaign of five stratigraphic wells. The Company's total net investment in exploration for the second quarter of 2010 for Quifa Block was $8.18 million. In addition, the Company commenced the drilling on the CPE-6 Block with the Guairuro-1 well. On June 30, 2010, the well had reached the total depth of 3273 feet MD and cored more than 220 feet of section along the Carbonera C-7 unit and Mirador Formation. Most of the sandstones in this whole interval showed strong impregnations of hydrocarbons along the Mirador Formation. The well was logged during the first week of July, 2010 and confirmed the presence of hydrocarbons in the Mirador sandstones with a total of 28 feet of net pay. The Guairuro-1 well is the first of the six stratigraphic wells to be drilled in the block in 2010. The Company is now planning to drill five additional wells during the third quarter to fulfil the minimum work program agreed to in this contract.

Exploratory Wells

The exploration campaign for the second quarter of 2010 was on schedule. In the Quifa Block, the Company drilled five wells: Quifa-20X, Quifa-22X, Quifa-28X, Quifa-33X and Quifa-34X. In the CPE-6 Block, the Guairuro-1 well was also drilled on schedule.

### Exploration Results and Milestones

For the second quarter of 2010, the Company made a net investment of $30.8 million in exploration activities, as follows:

| Block | Working Interest | Net Investment (Thousands of US$) |
|---|---|---|
| **Colombia - Llanos Basin** | | |
| CPE6 | 50% | $8,741 |
| CPO1 | 100% | $2,378 |
| CPO12 | 40% | $3,802 |
| CPO14 | 63% | $487 |
| Quifa | 70% | $8,178 |
| **Colombia - Lower Magdalena** | | |
| Guama | 100% | $4,178 |
| La Creciente | 100% | $3,107 |
| **Total** | | **$30,871** |

Exploration Indices

For the second quarter of 2010, the Company invested $51.49 million (net $30.8 million) in drilling the six stratigraphic wells. Because of the stratigraphic character of the wells, none were tested or required to be abandoned.

Exploration Milestones

Key milestones of the Company's exploration activity during the second quarter of 2010 were:

- On July 12, 2010 the Company announced new exploratory success at its Guairuro-1 stratigraphic well located in the CPE-6 Block, in the Llanos Basin, Colombia. The CPE-6 Block is a Special TEA awarded in 2008 by the ANH, in which Meta Petroleum Corp. ("Meta", a wholly-owned subsidiary of the Company) is the operator and holds a 50% working interest. The remaining 50% is held by Talisman Colombia. The results from the Guairuro-1 well confirm the presence of hydrocarbons in the region and reinforce the exploratory potential of the CPE-6 Block.
- The Company continued exploration in the Quifa block with the five stratigraphic wells drilled in this area, two of which confirmed the presence of hydrocarbons and three of which did not show any evidence of oil accumulation.
- In the CPE-6 and CPO-1 blocks, the Company started a 2D seismic program which will cover 879 km of 2D seismic lines.
- In the Guama, La Creciente and Arrendajo blocks, the Company started three 3D seismic programs which will cover a total of 313 $km^2$.
- In northern Quifa and as a result of the first phase of the exploration campaign, the Company added 251 mmbbl of certified recoverable resources. During the second quarter of 2010 the Company will drill all necessary appraisal wells to confirm these findings and convert most of them to recoverable reserves.
- In the search for liquid hydrocarbons during the second half of 2010, the Company plans to drill 27 additional exploratory wells: Quifa (11 wells), CPE-6 (5), CPO-1 (1), Guama (1), Arauca (1), Topoyaco (2), Guaduas (1), Buganviles (2), and Abanico (3). Also, for the second half, the Company will renew the exploration campaign on the La Creciente Block and acquire 164 $km^2$ of 3D seismic and drill one exploratory well south of prospect A on a new prospect named LCA-south.

### Ronda Colombia 2010

In the Ronda 2010 bidding process organized by the ANH, the Company was awarded six new blocks, located in the Putumayo, Llanos, and Cordillera Basins, as follows:

Putumayo Basin

With the three blocks described below, the Company acquired the largest exploration acreage in this basin, where the Company visualizes the continuation of the heavy oil belt to the south-east of the Rubiales and Quifa oil fields. The blocks that were awarded to the Company in the Putumayo are:

CAG 5 Block: This block was awarded to a joint venture formed by Meta (50%) and Talisman Colombia (50%). The block is a Type 3 Special Technical Evaluation Agreement (TEA) block with an area of 372,036 hectares located towards the central part of the Caguan Basin. During the 36 months of the first exploration phase, the joint venture will invest $82.2 million in the acquisition of 1,846 km of multi-spectral analysis, 1,152 km of 2D seismic, and the drilling of five stratigraphic wells. The winning bid carries an additional royalty of 2%. The block is located just to the north of the Company's Tacacho and Terecay contracts. The Company believes that this block has a very high potential for hydrocarbon accumulation and should maintain the continuity of the Tacacho and Terecay structures towards the north.

CAG 6 Block: This block was awarded to a joint venture formed by Meta (60%) and Talisman Colombia (40%). The block is a Type 1 E&P block with an area of 48,177 hectares located just to the west near the north-west of the CAG 5 Block and to the south of the Topoyaco Block, where the Company has a 50% working interest. During the 36 months of the first exploration phase, the joint venture will invest $21.1 million in the acquisition of 335 km of 2D seismic and the drilling of one exploratory well. The Company believes that it will find the continuity of the Caballos formation subthrust play found in the Topoyaco Block. The block carries an additional royalty of 2%.

PUT 9 Block: This block was awarded to a joint venture formed by Meta (60%) and Talisman Colombia (40%). This block is a Type 1 E&P block with an area of 49,150 hectares. It is located to the west of the CAG 5 Block and the Company's Terecay E&P Block and 60 km to the south of the Topoyaco Block. During the 36 months of the first exploration phase, the joint venture will invest $15.1 million in the acquisition of 200 km of 2D seismic and 1 exploratory well. The block carries an additional royalty of 18%. The Company expects to find new production opportunities similar to those identified in the surrounding blocks in the area, bearing in mind that there are several oil producing wells in this block in a previously identified structure.

Cordillera Basin

This basin is located in the thrust sheet east of the Cuisiana-Cupiagua giant fields in Colombia. In this basin there are abundant oil seeps and the few wells drilled in the basin show a very thick, heavy oil-saturated pay zone, where the expertise of the Company in the Llanos Basin can be applied.

COR 24 Block: 100% of the COR 24 Block was awarded to the Company as part of the Type 3 (TEA) blocks located in the Eastern Cordillera. This block has an area of 250,831 hectares and is located in the central part of the Eastern Cordillera. During the 36 months of the first exploration phase the Company will invest $9.6 million in the acquisition of 1,290 km of multispectral analysis, 230 km of 2D seismic, and 1,000 km of seismic reprocessing. The block carries an additional royalty of 2%. The Company believes that this block is highly prospective, being located approximately 40 km north of the Bolivar field, which produces oil with an API of 18 degrees. This block has an anticlinal structure in a north-south trend as associated with several oil seeps in the area and has the additional benefit of shallow wells, with an approximate total depth of 4,000 feet.

Llanos Basin

The Llanos Basin is a very well known and prolific basin in the foreland of the Colombian Andes, where the Rubiales and Quifa fields are located. It is also close to the giant Cano Limon oil field. The blocks in this basin that were awarded to the Company are:

LLA 7 Block: This block was awarded to the Company (100%) as a Type 1 E&P block. The block has an area of 61,785 hectares and is located 40 km southwest of the Arauca Block, which is also operated by the Company. The 36 month-long first exploration phase includes the drilling of one exploratory well and the acquisition of 404 km of 2D seismic for a total investment of $13.1 million. The Company expects to find a prospective area similar to the recently identified structures in the Arauca and CPE 1 blocks. The block carries an additional royalty of 2%.

LLA 55 Block: This block was awarded to the Company (100%) as a Type 1 E&P block. It has an area of 41,602 hectares and is located just to the southwest of the Arauca Block operated by the Company. The 36 month-long first exploration phase includes the drilling of one exploratory well and the acquisition of 404 km of 2D seismic for a total investment of $13.1 million. The Company expects to find a prospective area similar to the recently identified structures in the Arauca and CPE 1 Blocks. The block carries an additional royalty of 2%.

With the completion of the ANH 2010 Bidding Process, Pacific Rubiales has, once again, demonstrated its position as one of the most significant independent oil & gas companies in Colombia, with a total area awarded of 823,581 hectares. The net total investment for the Company will be $98.62 million for the first 36 month exploration phases in all contracts. This additional exploration spending will be funded with operating cash flow starting in 2011 and is subject to ANH exploration regulations that specify funding by type of block.

## Production

***Average Daily Oil and Gas Production – Net Volumes before and after Royalties***

| Producing Fields | Share before royalties Q2 2010 boe/d | Share before royalties Q2 2009 boe/d | Share after royalties Q2 2010 boe/d | Share after royalties Q2 2009 boe/d |
|---|---|---|---|---|
| Rubiales / Piriri (1) | 52,497 | 26,508 | 41,998 | 21,207 |
| Quifa (2) | 1,236 | 0 | 1,162 | 0 |
| La Creciente | 9,989 | 5,063 | 9,987 | 5,063 |
| Puli (3) | 62 | 38 | 50 | 30 |
| Dindal / Rio Seco | 607 | 776 | 486 | 621 |
| Moriche | 12 | 94 | 11 | 87 |
| Quinchas | 11 | 25 | 10 | 24 |
| Abanico | 1,111 | 828 | 933 | 786 |
| Buganviles (4) | 0 | 22 | 0 | 20 |
| Rio Ceibas (3) | 511 | 529 | 406 | 423 |
| Chipalo (5) | 0 | 5 | 0 | 5 |
| Cerrito | 59 | 82 | 59 | 68 |
| **Total** | **66,096** | **33,970** | **55,102** | **28,334** |

1. *Net of internal consumption at the field*
2. *New discoveries under production test*
3. *Corresponds to the Company´s share in non-operated fields*
4. *The Delta Field, in the Buganviles Association Contract has been temporally shut-in while the Company completed a standard process for changing the exploration environmental license to an exploitation license. The license was secured during July 2010 and the Company is currently evaluating options for restarting production.*
5. *The Samarkanda Field, in the Chipalo Association Contract, has been temporarily shut-in while the Company evaluates technical alternatives for its reactivation.*

Total operated production for the second quarter of 2010, averaged 138,382boe/d (55,102 boe/d net after royalties) for an increase of 67,634 boe/d (26,768 boe/d net after royalties) over the same period of 2009. This represents a 95% growth in operated production, which came about mainly through increased production at the Rubiales, Quifa and La Creciente fields, attributable to the following:

- The successful execution of the drilling program of a total of 42 producing and three injector wells at the Rubiales field during the second quarter of 2010, which increased production by an average of 10,300 bbl/d during this period.

- Optimization of the crude oil facilities constructed during 2009 at the Rubiales field as well as the construction of new facilities during the first quarter of 2010. During the second quarter the following new facilities were constructed, mainly at the Rubiales field: i) 7 km of new roads in Rubiales and 72 km in CPE-6, ii) 18 km of flow lines between 10" and 30", iii) 3 km of power distribution grid in the field, and 10 new power sub-stations, iv) the Phase 2 thermal Rubiales power plant with 38 MW additional installed capacity, v) 150,000 bbl additional storage capacity, vi) new Free Water Knock Out (FWKO) Tank at CPF-1 in order to handle an incremental volume of 500,000 bbl/d of fluid and vii) 80,000 bbl/d additional water disposal capacity in the existing injection pads.

The Company´s production continued to increase subsequent to June 30, 2010, such that during August 2010 the historical milestone of exceeding 147,514 boe/d of gross operated production was achieved, equivalent to 60,247 boe/d, net after royalties.

In a strategic move due to projected full capacity projected for Colombian pipelines, the Company bought firm pipeline capacity in the Ocensa system for 50,000 bbl/d in 2010 and 60,000 bbl/d from January 2011 until 2016, which ensures that the Company will not experience pipeline transport limitations in the future.

## Royalties

Royalty rates for hydrocarbons produced in the Company's assets can range from 5% to 30.01%. Royalties on production represent the entitlement of the respective governments to a portion of the Company´s share of production and are recorded using rates in effect under the terms of contract and applicable laws at the time of production. Due to the nature of the royalty payment (royalty for oil may be payable in barrels while royalty for gas is generally payable in cash), the Company records the crude oil revenue net of royalties while gas revenue is recorded based on gross volumes and the royalty for gas is reflected as part of the cost of production.

The following is the Company´s reconciliation of barrels equivalent produced with the barrels sold during the second quarter of 2010:

| **Inventory Movements** | **Total boe Net** | **Aver. day Net** |
|---|---|---|
| Ending inventory as of March 31, 2010 | 909,902 | |
| **Transactions of Q2, 2010** | | |
| Net oil and gas production | 5,014,312 | 55,102 |
| Settlement of overlift position from March 31, 2010(1) | (9,874) | (109) |
| Purchases of diluents | 773,440 | 8,499 |
| Total sales | (5,853,935) | (64,329) |
| Overlift position as of June 30, 2010 (2) | 25,949 | 285 |
| Volumetric compensation and operating gain/losses | (24,741) | (272) |
| **Ending inventory as of June 2010** | **835,053** | |

*(1) This volume corresponds to the settlement of the first quarter overlift position of 9,874 bbl of Rubiales crude oil which resulted in a lower volume of sales during the second quarter of 2010.*

*(2) This volume corresponds to overlift position of 25,949 boe of crude oil and gas as of June 30, 2010 which will be settled in the next quarters.*

**Reconciliation of Volumes Sold Vs. Volumes Produced during the Second Quarter of 2010**

| | **Volumes Produced** Oil and Gas (boe) | **Volumes Sold** Oil and Gas (boe) | **Difference** Oil and Gas (boe) | |
|---|---|---|---|---|
| Total Q2, 2010 | 5,014,312 | 5,853,935 | 839,623 | |
| Avg. per day | 55,102 | 64,329 | 9,227 | (a) |

(a) The higher volume sold in the second quarter of 2010 in comparison to the volumes produced is due to:

| | Avg. per day |
|---|---|
| Production after royalties Q2, 2010 | 55,102 |
| Production sold Q2, 2010 | 64,329 |
| **Difference** | **9,227** |
| ***Explanation of the difference*** | |
| Beginning inventory (3) | 9,999 |
| Purchase of diliuent | 8,499 |
| Overlift settlement from Q1, 2010 | (109) |
| Volumetric compensation | (272) |
| Overlift position at the end of Q2, 2010 | 285 |
| Ending Inventory | (9,175) |
| **Reconciliation** | **9,227** |

*(3) This volume corresponds to beginning inventory of 909,902 boe, divided by 91 days to determine the average barrels per day. .*

**Crude and Gas Prices**

Average benchmark crude oil and natural gas prices for the second quarter of 2010 and 2009 were as follows:

| Average Crude Oil Reference Prices | Q2 2010 ($/bbl) | 2Q 2009 ($/bbl) | °API |
|---|---|---|---|
| Domestic Market /Bunkers | 66.8 | 46.31 | 12.5 |
| WTI NYMEX (Weighted Average Cargoes PRE) | 77.54 | 60.32 | 38 |
| Vasconia (One Cargo) ** | 69,92 | 55.1 | 24 |
| Castilla (Weighted Average Cargoes PRE) | 66.73 | N/A | 19 |
| Rubiales Blend * | 65.99 | 52.91 | 18.5 |
| PRE Natural Gas Sales ($/mmbtu) | 4.69 | 4.30 | N/A |
| Combined Realized Oil and Gas Sales Price | 61.45 | 50.12 | N/A |
| WTI NYMEX ($/Bbl) | $78.05 | $59.79 | |
| Henry Hub average Natural Gas Price ($/MMBTU) | $4.31 | $3.71 | |

* Average weighted export price of Rubiales in the Company's Vasconia/Castilla cargoes.
** WTINYmex for the Vasconia Cargo was 74.97 $/bbl

During the second quarter of 2010, WTI NYMEX continued its upward and volatile trend, reaching an average of $78.05/bbl compared to $59.79/bbl in the second quarter of 2009 and $78.72/bbl in the first quarter of 2010. The combined realized oil and gas sales price for the Company for the second quarter of 2010 was $61.45 per boe (second quarter of 2009 – $50.12 per boe) representing an increase of 22% in comparison to the same period in 2009. An explanation of the increase in the revenue due to the change in volume and price for the three and six months of 2010 and 2009 is provided in the revenue section of this document.

The following is a summary of the Company's crude oil and gas commercial activities during the second quarter of 2010:

- The Company exported a total of 4.6 million bbl of oil to USA, Singapore, and Ivory Coast refineries, including six Castilla crude oil cargoes for 4.1 million bbl, and one Vasconia crude oil cargo for 0.5 million bbl at an average price of $67.08/bbl, which is a significant commercial accomplishment. The Company also maintained its flexible commercial strategy by selling 0.4 million bbl of Rubiales production in the Colombian domestic market, at an average price of $66.80/bbl.

- Our total crude exports of 4.6 million bbl realized an average price of $67.08/bbl compared to 2.25 million bbl (Vasconia) exported during the same period of 2009 at approximately $55.10/bbl.

- US refineries continued running at lower rates because of weak refinery margins. To optimize our commercial activities, the Company continued supplying the Asian and African markets, selling cargoes at better prices.

- The Company maintains its commercial flexibility by selling part of its Rubiales production 12.5°API in the Colombian domestic market. During the second quarter of 2010, the Company sold an average of 4,212 bbl/d at an average price of $66.80/bbl.

- The sales of gas increased to an average of 61mmscf/d of natural gas from 31 mmscf/d in the same period of 2009 (97% increase), sold mainly from the La Creciente field at an average price of $4.69/mmbtu (equivalent to

$4.62/mmscf), representing a premium of 21% over the weighted domestic regulated price ($3.89/mmbtu) and 11% over the Henry Hub natural gas prices in the United States Gulf Coast. This represents a 9% increase over the realized sale gas price for the second quarter of 2009. The 97% increase in gas production during the second quarter of 2010 in comparison to the same period of 2009 was mainly due to the continuous investment in facilities and the fact that the average production for the second quarter of 2009 was affected by maintenance activities.

- The Company continued purchasing light crude oils (8,591 bbl/d) in the eastern Llanos instead of using imported naphtha or natural gasoline, with estimated savings of $2.5/bbl. However, the blending cost incurred during the second quarter of 2010 was $8.21/bbl higher than the same period of 2009 due to a 31% increase in WTI prices and a 14% increase in trucking cost due to revaluation of the Colombian Peso against the US dollar when compared to the same period of 2009. Additionally, in the second quarter of 2009, the Company incorporated (via transportation contracts at our Guaduas facilities) 360,440 bbl of light crudes from other producers, which contributed to reduce our blending cost.

Although the WTI NYMEX remained steady at $78/ bbl during the first six months of 2010, the combined realized oil and gas sales price for the second quarter of 2010 was lower by $3/boe in comparison to the first quarter of 2010 mainly due to:

- USA cyclical refinery maintenance programs just before gasoline seasons coupled with unrelated Aruba and Curacao refineries shutdowns during the period meant that more crude was going to inventories.

- Venezuela increased heavy crude oil available in the market due to operational problems with oil belt upgraders and contributed to widening the price differential between light and heavy crude.

- Mexico´s heavy crude oil production declined less than forecasted. Therefore Mexico, which is an important oil producer, was forced to widen the WTI-Maya differential to pursue heavy crude oil buyers.

The above conditions generated a higher crude supply in the market and increased inventory levels which created downward pressure on crude oil prices. The Company decided to minimize this impact by moving volumes to other more profitable markets such as Asia and Africa.

## 4. Reserves Summary

Proved and probable oil-equivalent reserves

The total proved and probable oil-equivalent reserves of the Company as of June 30, 2010, discounting production for the second quarter of 2010, reached 318.69 million bbl gross (before royalties) or 271.47 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 bbl. The certified reserve report as of December 31, 2009 was prepared following all industry standard procedures and in conformity to COGE guidelines and is available on SEDAR at www.sedar.com.

The following table summarizes the proved plus probable (2P) reserve growth for the Rubiales-Piriri, Quifa, La Creciente, Guaduas, Rio Ceibas, Abanico and Puli blocks as at June 30, 2010:

| | 2P Reserves | | | | | | | | | Oil Equivalent | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Condensate, Light & Medium Oil | | | Heavy Oil | | | Associated & Non associated Gas | | | | | |
| | 100% (MMbbl) | Gross (MMbbl) | Net (MMbbl) | 100% (MMbbl) | Gross (MMbbl) | Net (MMbbl) | 100% BCF | Gross BCF | Net BCF | 100% (MMboe) | Gross (MMboe) | Net (MMboe) |
| Total Reserves at March 31, 2010 | 13.12 | 7.38 | 6.29 | 536.91 | 243.16 | 201.22 | 466 | 443.87 | 412.79 | 627.70 | 324.52 | 276.31 |
| Net Reserve Additions | | | | 0.21 | 0.19 | 0.18 | | | | 0.21 | 0.19 | 0.18 |
| Production Q 2, 2010 | 0.50 | 0.22 | 0.18 | 11.04 | 4.89 | 3.93 | 5.45 | 5.45 | 5.45 | 12.45 | 6.01 | 5.01 |
| Total Reserves at June 30, 2010 | 12.62 | 7.16 | 6.11 | 526.08 | 238.46 | 197.47 | 460.55 | 438.42 | 407.34 | 615.45 | 318.69 | 271.47 |

Certified Gross Resources

The 3 wells drilled on Prospects "A", "F" and "Q" in the northern Quifa area (one exploratory and two stratigraphic wells), confirmed the presence of a hydrocarbon column on the top of the basal sandstones incorporating a total of 251 mmbbl of certified gross resources, which we expect to incorporate as part of the proved and probable reserves of the Company before this year end. The following table summarizes the distribution of the certified resources as reported by Petrotech Engineering:

| Estimate | Low | Best | High |
|---|---|---|---|
| **Prospect A** | | | |
| Area, acres | 6,741 | 7,931 | 9,121 |
| Petroleum Originally in Place, Mbbl | 163,594 | 213,848 | 282,814 |
| Recovery factor, % | 18 | 18 | 18 |
| **Recoverable Oil Resources, Mbbl** | **29,447** | **38,493** | **50,906** |
| **Prospect F** | | | |
| Area, acres | 12,037 | 14,161 | 16,285 |
| Petroleum Originally in Place Mbbl | 658,062 | 860,212 | 1,137,630 |
| Recovery factor, % | 18 | 18 | 18 |
| **Recoverable Oil Resources, Mbbl** | **118,451** | **154,838** | **204,773** |
| **Prospect Q** | | | |
| Area, acres | 6,694 | 7,875 | 9,056 |
| Petroleum Originally in Place Mbbl | 245,391 | 320,773 | 442,222 |
| Recovery factor, % | 18 | 18 | 18 |
| **Recoverable Oil Resources, Mbbl** | **44,170** | **57,739** | **76,360** |
| **Total Recoverable Oil Resouces, Mbbl** | **197,068** | **251,070** | **332,039** |

## 5. Summary of Quarterly Results

| (in thousands of US$ except per share amounts or as noted) | 2010 Q2 | 2009 Q2 |
|---|---|---|
| Average production of oil and gas sold (boe/d) | 64,329 | 35,688 |
| Average combined crude oil and natural gas sales price ($/boe) | 61.45 | 50.12 |
| Combined operating netback ($/boe) | 39.18 | 19.41 |
| Net sales | 359,700 | 160,994 |
| Income from Operations (1) | 134,852 | 24,504 |
| Funds Flow from Operations (2) | 154,836 | 38,934 |
| Per share - basic ($) | 0.59 | 0.18 |
| - diluted ($) | 0.53 | 0.18 |
| EBITDA (3) | 202,634 | 48,310 |
| Per share - basic ($) | 0.77 | 0.23 |
| - diluted ($) | 0.69 | 0.23 |
| Net Income (4) | 47,928 | (118,540) |
| Per share (5) - basic ($) | 0.18 | (0.56) |
| - diluted ($) | 0.16 | (0.56) |

*(1) Income from operations includes revenues less operating costs, depletion, depreciation & amortization and G&A expenses, and excludes effect of the overlift, stock-based compensation and other income and expenses.*

*(2) Calculated based on cash flow from operations before changes in non-cash operating working capital.*

*(3) See Non-GAAP Financial Measures.*

*(4) Net income for the period of $47.9million includes a series of non-operating expenses and non- cash items totaling $39.5 million (June 30, 2009 – gain of $141.2 million), mainly corresponding to:*

*a) Non-cash items of $17.2 million (same period of 2009 – loss of $133.1 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 March 2010 (which may or may not materialize in future periods) and stock-based compensation costs. During the second quarter of 2010, the Company entered into foreign exchange hedging contracts to reduce its foreign currency exposure associated with operating expenses incurred in Colombian Pesos.*

*b) Non-operating expenses of $22.3 million (same period of 2009 – $8.1 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 basic weighted average number of common shares outstanding for the second quarter of 2010 and 2009 was 263,009,942 (diluted – 294,848,180) and 211,964,610 (diluted – 211,964,610), respectively.*

### *Financial Position*

Assets

Total assets were $3.3 billion as at June 30, 2010 compared to $2.8 billion as at December 31, 2009. The $3.3 billion in assets primarily consisted of $2.1 billion in oil and gas properties and equipment (December 31, 2009 - $2.0 billion), $584.1 million in cash and cash equivalents (December 31, 2009 - $398.8 million), $193.2 million in accounts receivable (December 31, 2009 - $135.0 million), $87.7 million in investments and other assets, primarily ODL (December 31, 2009 - $74.8 million), and $335.0 million in other assets (December 31, 2009 - $162.7 million). Total assets increased primarily due to an increase in cash and accounts receivable as a result of increased cash flows from operations.

EBITDA

EBITDA during the six months of 2010 totalled $432.3 million which represents a significant increase of 341% compared to the same period of 2009, which had EBITDA of $98.1 million. For the second quarter of 2010, EBITDA amounted to $202.6 million, mainly generated from international sales (86%), while EBITDA from gas and domestic sales contributed 6.5% and 7.5%, respectively.

Debt

The Company has the Notes outstanding, which have 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; payment began 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.

During April 2010, the Company closed the syndication of a $250 million unsecured revolving credit facility. As of June 30, 2010, no borrowing has been made on the facility. The interest rate for the facility is determined in accordance with the ratings assigned to the Company's senior debt securities by Standard & Poor's Ratings Group and Fitch Inc. Based on the Company's rating as of June 30, 2010, the interest rate would be LIBOR plus 3.25%. In addition, the Company is required to pay commitment fees of 1% on the unutilized portion of any outstanding commitments under the facility. Subject to customary acceleration events set out in the credit agreement, or unless terminated earlier by the Company without penalty, repayment of the outstanding principal on the facility will be made in full on April 26, 2012. Under the terms of the credit facility, the Company is required to maintain (1) a debt to EBITDA ratio of less than 3.5; and (2) an EBITDA to interest expense ratio of greater than 3. The Company was compliant with the covenants during the period.

On July 15, 2010, the Company announced the expiration of its consent solicitation and the receipt of the consents required to amend the Indenture relating to the Notes pursuant to the Company's Consent Solicitation Statement dated June 30, 2010. The Company solicited consents in order to provide the Company with needed flexibility to invest in minority equity investments in joint venture entities that are engaged in any business that is related, ancillary or complementary to the business of the Company, and to provide guarantees of the indebtedness of such entities. The Company paid to each Noteholder who validly delivered (and did not revoke) a consent prior to the expiration date, $2.50 for each $1,000 in principal amount of Notes with respect to which a consent was delivered, for an aggregate of $0.6 million.

As of June 30, 2010, the Company has issued standby and letters of credit for operational commitments for a total of $201.7 million (December 31, 2009 – $110.3 million). Most of these bank guarantees are related to naphtha and light oil purchases.

Securities

During the six months ended June 30, 2010, C$45,000 of the convertible debentures ($32,000 in amortized cost) was converted to 3,460 of the Company's common shares. The amortized cost of $32,000 and the corresponding equity portion of convertible debentures of $12,000 were reclassified to common shares as at June 30, 2010.

On December 14, 2009, the Company's proposed offer of 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 was approved by shareholders and warrantholders. The period commenced on December 14, 2009 and expired January 20, 2010. Warrantholders were able to exercise their warrants within this period to acquire one common share of the Company per warrant at an exercise price of C$6.30 instead of the original C$7.80 exercise price. As of December 31, 2009, 16,361,293 warrants had been exchanged for common shares under the early exercise program.

On January 12, 2010, the Company announced that greater than 66 2/3% of its publicly-traded warrants outstanding as of December 14, 2009 had been exercised pursuant to the early exercise transaction. As a result of reaching the 66 2/3% threshold, each warrant that had not been so exercised during the 30-day early exercise period was deemed automatically exchanged by the warrantholder, without any further action or payment of additional consideration on the part of the warrantholder (including payment of the exercise price thereof), for consideration payable by the Company of C$0.75 (the "Exchange Payment") plus a fraction of a common share (collectively, the "Exchange Shares") equal to: (A) the volume weighted average trading price of the common shares on the TSX for the five trading days immediately prior to the early exercise expiry date (the "Market Price") minus (B) the current exercise price, divided by (C) the Market Price. Warrants that were held by U.S. warrantholders were not subject to the automatic exchange. In total, 27,295,661 warrants were exchanged in the first six months of 2010, for C$170 million in cash and 27,106,081 common shares of the Company.

**Revenues**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues | 359,700 | 160,994 | 740,223 | 270,994 |
| $ per boe | 61.45 | 45.05 | 62.91 | 40.69 |

Revenue for the six months of 2010 totalled $740 million, higher by 173% in comparison to the same period of 2009. Net sales continued to grow mainly due to the increase in production in the Rubiales, Quifa and La Creciente fields.

Revenues in the second quarter of 2010 totaled $359.7 million, which were significantly higher by $198.7 million (123%) in comparison to the prior period in 2009, mainly attributable to the increase in net production in the Rubiales and La Creciente fields, which was almost doubled in comparison to the same period in 2009.

Summarized below is an analysis of the increase in the revenue due to the change in volume and price for the three and six months ending on June 30, 2010 in comparison to the same period of 2009:

| | Three month period ended June 30, | | | | Six month period ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | Differences | % Change | 2010 | 2009 | Differences | % Change |
| Total of boe sold (Mboe) | 5.854 | 3.212 | 2.642 | 82% | 11.767 | 6.659 | 5.108 | 77% |
| Avg. Oil & Gas Combined Price ($/bbl) | 61,45 | 50,12 | 11,33 | 23% | 62,91 | 40,70 | 22,21 | 55% |
| Total Revenue (MUSD$) | 359.700 | 160.994 | 198.706 | | 740.223 | 270.994 | 469.229 | |

| Three month period: Reasons for the difference (000$): | | | Six month period: Reasons for the difference (000$): | | |
|---|---|---|---|---|---|
| Increase due to Volume | 132.408 | 67% | Increase due to Volume | 207.892 | 44% |
| Increase due to Price | 66.326 | 33% | Increase due to Price | 261.302 | 56% |
| | 198.734 | | | 469.194 | |

**Operating Costs**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Operating costs | 129,296 | 79,238 | 265,528 | 127,043 |
| Overlift (Underlift) | 1,030 | 19,425 | (3,835) | 18,780 |
| $ per boe | 22.09 | 24.67 | 22.57 | 20.17 |
| $ per boe Over/Underlift | 0.18 | 6.05 | (0.33) | 2.98 |

Operating costs for the six months of 2010 were $265.5 million (2009 - $127.01 million); the increase over the previous period of 2009 is primarily due to the increase in oil production at the Rubiales and Quifa fields. Production cost per boe also increased to $22.57, or 12% higher than the same period in 2009.

Operating costs for the second quarter of 2010 were $129.3 million (June 30, 2009 - $79.2 million). The increase over the previous period is primarily due to the 96% increase in net oil production at the Rubiales field. However, production costs per boe were reduced to $22.09, or 6% lower than the same period of 2009, mainly explained by the higher volume of production. The $22.09 per boe consists of cost of production of $5.05, transportation cost of $5.65, dilution cost of $10.59 and other cost of $0.80. The overall operating cost during the second quarter of 2010 was higher when compared to the same period of 2009 mainly due to:

a) During the second quarter of 2010, using light crude oil for blending Rubiales crude in the ODL remained the best option versus using imported naphtha and natural gasoline: the purchase of the light crude oils (8,806 bbl/d) in the eastern Llanos resulted in an estimated savings of about $2.14/bbl for our net blending cost. However, the dilution cost increased to $2.26/bbl or 3% in comparison to the first quarter of 2010, due to market competitiveness and vendor options for the light crude.

b) The increased level of production at the Rubiales and Quifa fields generated a higher volume of chemicals and equipment required for the treatment of water produced along with the crude oil.

c) Blending cost during second quarter of 2010 was $8.21/bbl higher than the same period of 2009 due to a 31% increase in WTI prices and the 14% increase in trucking cost due to revaluation of the Colombian Peso against the US dollar when compared to the same period of 2009.

d) Increase in other production costs is mainly attributable to transportation of personnel to and from the field, technical assistance, catering, and security due to the expansion of the field's facilities and drilling campaign.

e) In addition to the above, the operating costs for this period were affected by the 13% revaluation of the Colombian Peso against the US dollar when compared to the same period of 2009 (Q2 2009 COP 2,159 to $1.00 against COP 1,916 to $1.00 for Q2 2010). The majority of the operating costs are incurred in Colombian pesos and therefore subject to fluctuation when converted to the US dollar, after taking into account our currency hedged positions.

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 off take 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 overlift recognized as of the end of June 2010 of $1 million is the net balance between the overlift position reflected as of the first quarter of 2010 of $0.6 million (9,874boe), settled in the second quarter of 2010, and the actual overlift as of the end of June 2010 of $1.6 million (25,949 boe). The overlift balance of $1 million was valued at the realized price of heavy crude oil, and recorded as a liability and a reduction in the operating costs at June 30, 2010. This overlift and its related financial impact will be reversed once the volume is settled in the third quarter of 2010.

**Depletion, Depreciation and Amortization**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Depletion, depreciation and amortization | 68,812 | 43,231 | 133,648 | 86,534 |
| $ per boe | 11.75 | 13.46 | 11.36 | 13.74 |

For the first six months of 2010 the Company used the historical reserve reports issued as of December 31, 2009, in calculating a depletion charge of $133.6 million (2009 – $86.5 million). The increase over the same period in 2009 was primarily due to $2.3 billion of oil and gas property costs subject to depletion. Included in the costs subject to depletion is $0.9 billion of future development costs that are estimated to be required to bring proved undeveloped reserves to development (2009 - $1.9 billion of oil and gas property costs and $1.07 billion of future development costs). The increase was also due to amortization expense of $2.3 million (June 30, 2009 - nil) related to the leased property is charged to depletion, depreciation and amortization. The amortization is based on the unit of production method over the term of the lease.

For the second quarter of 2010 the depletion, depreciation and amortization charge totalled $68.8 million, which was higher by $25.6 million over the same period in 2009, primarily due to the increase future capital investments in 2010 for the drilling campaign at the Rubiales and Quifa fields, as well as a production increase in the second quarter of 2010 compared to 2009.

**General and Administrative**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| General and administrative costs | 26,740 | 14,021 | 46,241 | 27,064 |
| $ per boe | 4.57 | 4.37 | 3.93 | 4.30 |

General and administrative expenses for the first six months of 2010 were $46.2 million (2009 - $27.0 million), and the increase is mainly attributable to salaries and benefits on the additional personnel hired during 2010 to support the increased operations and oil production at the Rubiales and Quifa fields. In addition to the above, the operating costs for this period were also affected by the 13% revaluation of the Colombian Peso against the US dollar when compared to the same period of 2009. The majority of the general and administrative costs are incurred in Colombian pesos and therefore subject to fluctuation when converted to the US dollar, after taking into account our currency hedged positions.

General and administrative expenses for the second quarter of 2010 were $26.7 million (June 30, 2009 - $14 million); the $12.7 million increase from the same period in 2009 primarily consisted of the following:

- Additional personnel needed to support the expanding operations at the Rubiales to increase oil production and Quifa fields and the drilling campaign at other exploratory blocks in 2010. The number of direct employees as of June 2009 totalled 738 while for the same period of 2010 it totalled 1,008, or 37% higher, which generated higher general and administrative expenses of $6.5 million.
- Office rental, services and professional fees, including the expanded operation at Peru, accounts for an increase of $4 million.
- The operating costs for this period were also affected by revaluation effect of the Colombian Peso against the US dollar when compared to the same period of 2009, as previously discussed.

General and administrative expenses on a per boe basis reflected an increase of $0.2/boe (5%) due to the above mentioned effects.

**Stock-Based Compensation Costs**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Stock-based compensation costs | 31,853 | 247 | 72,675 | 311 |
| $ per boe | 5.44 | 0.08 | 6.18 | 0.05 |

For the six months ended June 30, 2010, stock-based compensation increased to $72.7 million from $0.3 million for the same period in the previous year.The increase is due to new stock options granted in 2010 of 9,495,000 compared to 150,000 in 2009.

For the second quarter of 2010, stock-based compensation increased to $31.8 million from $0.2 million in the same period of 2009. The increase is due to 3,198,500 stock options being granted during the second quarter of 2010 compared to 100,000 stock option grants in the same period of 2009.

All stock options outstanding as ofJune 30, 2010 are completely vested and exercisable.

**Foreign Exchange**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Foreign exchange (loss) gain | 10,566 | (85,235) | (21,183) | (24,303) |
| $ per boe | 1.80 | (26.54) | (1.80) | (3.86) |

For the six months ended June 30, 2010, the Colombian Peso and the Canadian dollar continued their revaluation trend against the US dollar. Both currencies strengthened by an average of 13% during the period in comparison to the same period of 2009.

For the three months ended June 30, 2010, the strengthening of the Colombian Peso and the Canadian dollar against the US dollar averaged an additional 1%, while for the same period of 2009 both currencies had a strong devaluation of 19%. This significant fluctuation resulted in a gain during the second quarter of 2010 of $10.6 million and in a loss of $85.2 million during the same period of 2009. The foreign exchange gain of $10.6 million included $8.3 million in non-cash unrealized gains, primarily consisting of the following:

a) Non-cash Colombian Peso denominated future income tax liabilities resulted in a $0.7 million loss upon the conversion to US dollars for financial reporting purposes compared to a $26.7 million unrealized loss in the prior year. 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 $173.3 million, which is denominated in Canadian dollars, resulted in a foreign exchange gain of $8.1 million.
c) The conversion of Colombian Peso denominated debt resulted in a net unrealized loss of $0.1 million.

**Interest Expense**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Interest expense | 20,206 | 8,063 | 34,401 | 13,910 |
| $ per boe | 3.45 | 2.51 | 2.92 | 2.21 |

Interest expense includes interest on bank loans, convertible debentures, Notes and fees on letters of credit. For the first six months of 2010, interest expense totaled $34.4 million (2009 - $13.9 million).

Interest expense in the second quarter of 2010 increased to $20.2 million compared to $8.1 million for the same period in the previous year. The higher interest expense is mainly due to the increase in long-term debt upon the completion of the Notes offering on November 10, 2009.

**Income Tax Expense**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Current income tax | 29,664 | 2,759 | 86,741 | 6,927 |
| Future income tax | 17,752 | (957) | 9,999 | (1,382) |
| Total | 47,416 | 1,802 | 96,740 | 5,545 |

The tax rates in Canada and Colombia remain at 33% of taxable income. The special tax benefit has been reduced to 30% for acquisition of qualified expenditures in Colombia in 2010 and onward from 40% in 2009.

Income tax expense increased during the three and six months period ended June 30,2010, which is in line with increased revenues and operating income. The effective tax rate is greater than the statutory rate of 33% primarily due to the non-deductible costs for tax purposes such as the stock based compensation costs.

Current income tax represents the estimated cash income taxes payable for the period. Current income tax increased to $86.7 million from $6.9 million primarily resulting from an increase in the estimated taxable income. Increased estimated taxable income for the six month period was primarily due to increased operating income and increased deduction for qualified expenditures eligible for the special tax benefit. Operating income excluding the non-deductible stock-based compensation costs increased $287.0 million to $298.6 million from $11.6 million in the six month period of the prior year, resulting in an increase in the estimated taxable income for the six months ended June 30, 2010.

Future income tax increased by a net of $11.4 million to $10 million in the first six months of 2010 as compared to the same period in 2009, primarily due to the accounting recognition of the special tax benefit in the acquisition of qualified expenditures in Colombia reduced by the effect of the increase in non-deductible depletion and amortization calculated on higher production in 2010 compared to 2009.

**Net Income (Loss)**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net income (loss) | 47,928 | (118,540) | 80,053 | (65,904) |
| $ per boe | 8.19 | (36.91) | 6.80 | (10.47) |

Net cumulative income for the six months ended June 30, 2010 totaled $80.0 million (2009 - $65.9 million net cumulative loss). The increase in the results is primarily due the significant increase in the oil and gas production sold, which was 77% higher than 2009, coupled with improved realized prices higher by 46% in comparison to the same period of 2009. Net income for the first six months of 2010 was impacted by an increase in the operating costs, expenses, and taxes of $163 million, $91.5 million, and $91.2 million, respectively, primarily due to increased production and taxable revenues.

During the second quarter of 2010, net income totaled $47.9 million (2009 - $118.5 million net cumulative loss), which was the result of higher volume sold and realized oil and gas prices, offset by an increase in the operational costs and expenses, as mentioned above. The net cumulative loss for the same period of 2009 included a number of non-cash items mainly related to exchange losses and a loss in the fair value of management risk contracts; while for this quarter these two items reflected a gain which further improved the results of the second quarter of 2010.

**Funds Flow from Operations**

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Funds flow from operations | 154,836 | 38,934 | 305,563 | 70,482 |
| $ per share, diluted | 0.53 | 0.18 | 1.05 | 0.33 |

The Company continued to generate positive cash flow from operations as a result of the 96% increase in production together with the increase in the combined realized oil and gas price. The funds flow from operations during the six months of 2010 totaled $306 million.

Funds flow from operations for the second quarter of 2010 increased by $115.9 million over the same period of 2009. This increase is primarily attributable to the 102% increase in net back ($19.41 per boe in the second quarter of 2009 as compared to $39.18 per boe in the second quarter of 2010), as well as the significant increase in the production. The increase in net back is due to higher realized prices from $50.12 boe in the second quarter of 2009 to $61.45 boe in the second quarter of 2010.

## 6. Liquidity and Capital Resources

Liquidity

Funds provided by operating activities for the six months of 2010 totaled $368.1million (six months of 2009 – $43.2 million), and for the second quarter of 2010 totaled $103.3 million (June 30, 2009 – $21.0 million). The increase in cash flow in 2010 was the result of the considerable increase in production and higher combined crude oil and gas sale prices. 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 June 30, 2010, the Company held debt denominated in Colombian Pesos and US dollars totaling $657.2 million compared to $661.3 million as at December 31, 2009.

As of June 30, 2010, the Company had working capital of $457.6 million, mainly composed of $584 million of cash and cash equivalents, $193.2 million of account receivables, $37.7 million of inventory, $294.4 million of accounts payable and accrued liabilities, $6.4 million of risk management liability and $59.4 million of income tax payable.

The original development plan for the Rubiales field 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 of up to 70,000 bbl/d, will be operational in the fourth 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 addition to construction of new infrastructure to handle crude oil production from the Rubiales field, a new CPF is under construction to process new production from the Quifa western block. This facility, which is located in the Rubiales field, has been planned to process up to 30,000 bbl/d of crude and 300,000 bbl/d of produced water by the end of 2010.

On April 27, 2010 the Company closed the syndication of a $250 million unsecured revolving credit facility, which will replace existing smaller facilities currently available to the Company and will be utilized to support short and medium term revolving credit needs of the Company as they may arise in the ordinary course of business. The Company does not expect to fully draw down the facility during the 2010 financial year, and as of June 30, 2010, no borrowing has been made on the facility. The interest rate for the facility is determined in accordance with the ratings assigned to the Company's senior debt securities by Standard & Poor's Ratings Group and Fitch Inc. Based on the Company's rating as of June 30, 2010, the interest rate would be LIBOR plus 3.25%. In addition, the Company is required to pay commitment fees of 1% on the unutilized portion of any outstanding commitments under the facility. Subject to customary acceleration events set out in the credit agreement, or unless terminated earlier by the Company without penalty, repayment of the outstanding principal on the facility will be made in full on April 26, 2012. Under the terms of the credit facility, the Company is required to maintain (1) a debt to EBITDA ratio of less than 3.5; and (2) an EBITDA to interest expense ratio of greater than 3. The Company was compliant with the covenants during the period.

The Company believes it has adequate resources to fund its 2010 capital plan with the Company's cash flows from operations and current debt. However, if additional resources are required, possible sources of funds available to the Company to finance additional capital expenditures and operations include cash flows from operations, the issuance of additional common shares (if necessary), existing working capital and incurring new debt.

## 7. Capital Expenditures

Capital expenditures during the first six months of 2010 totalled $215.7 million. The capital expenditures during the second quarter of 2010 totaled $134.7 million, of which $30.8 million went into exploration activities including seismic, aerogravimetry, aeromagnetometry and drilling ($20.7 million to geophysics and $10.1 million to drilling of wells). Also, $73.9 million were invested in the expansion and construction of production infrastructure, $29.1 million in production drilling activities, and $0.9 million were invested in the development of other strategic projects (STAR, Llanomulsion and gas export projects). Details of the capital expenditures during the six months and three months of 2010 and 2009 are as follows:

| **Capital Expenditures (Thousands of USD$)** | **Q2** | | **Year to Date** | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Production facilities | 73,886 | 31,590 | 110,546 | 77,990 |
| Exploration drilling includin seismic acq. | 30,870 | 14,902 | 44,290 | 28,602 |
| Development drilling | 29,163 | 24,908 | 60,083 | 42,408 |
| Other projects (STAR, Llanoemulsion, Gas export) | 825 | nil | 825 | nil |
| Total Capital Expenditures | **134,744** | **71,400** | **215,744** | **149,000** |

The Company has generated synergies in the contracting process for drilling services, generating considerable savings of $4.5 million in capital drilling expenditures during the second quarter of 2010 drilling campaign. Savings arose from obtaining better prices and improved conditions governing the contracted services.

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. As of June 30, 2010, a total of $219.7 million of capital investments had been made.

## 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 as of June 30, 2010. 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 June 30, 2010 are summarized in the following table:

| | 2010 | 2011 | 2012 | 2013 | 2014 | Subsequent to 2014 | Total | |
|---|---|---|---|---|---|---|---|---|
| Operating leases | $ 1,454 | $ 1,609 | $ 789 | $ - | $ - | $ - | $ 3,852 | (a) |
| Transportation and processing commitmen | 23,490 | 46,980 | 46,980 | 46,980 | 46,980 | 124,740 | 336,150 | (b) |
| Minimum work commitments | 146,669 | 49,556 | 2,030 | - | - | - | 198,255 | (c ) |
| Accounts payable | 294,403 | - | - | - | - | - | 294,403 | (d) |
| Abandonment obligations | 2,331 | 1,180 | 393 | 106 | 2,402 | 32,758 | 39,170 | (e ) |
| Long-term debt and bank indebtedness | 21,133 | - | - | - | 149,985 | 300,015 | 471,133 | (f) |
| Convertible debentures - principal | - | - | - | 225,395 | - | - | 225,395 | (g) |
| Obligations under capital lease | 5,700 | 11,306 | 11,337 | 11,306 | 11,306 | 16,944 | 67,899 | (h) |
| Total | $ 495,180 | $ 110,631 | $ 61,529 | $ 283,787 | $ 210,673 | $ 474,457 | $ 1,636,257 | |

The Company has various commitments in place in the ordinary course of business between the second quarter of 2010 and subsequent to 2014:

a) Operating leases of $3.8 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 on three-months' notice with no penalty.
b) Ship or pay contracts totaling $336.2 million as follows: $311.8 million signed with ODL for the transportation of crude oil from the Rubiales field to Colombia's oil transportation system, and $24.4 million signed with Promigas for gas transportation from the 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 that include acquisition and processing of seismic data and drilling exploration wells in Colombia.
d) Corresponds to the balance as of June 30, 2010 that will be paid in July and August, in accordance with our accounts payable procedures.
e) 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.
f) Debt repayment of $471.1 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 Notes of $450 million with maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%).
g) This amount corresponds to convertible debentures, which are payable semi-annually in arrears on June 30 and December 31. The debentures have been classified into their debt and equity components.
h) 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 Piriri 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 13 to the consolidated financial statements. The Company has no off-balance sheet arrangements.

### 9. Risk Management Contracts

The Company has entered into the following commodity price risk management contracts that are outstanding at June 30, 2010:

| Type of Instrm. | Term | Volume | Strike Price ($/bbl) | Benchmark | | Fair value |
|---|---|---|---|---|---|---|
| Call option | Sep 1, 2010 - Nov 30, 2010 | 500,001 | 89.50 | WTI | $ | (853) |
| Call option | Dec 1, 2010 - Dec 31, 2010 | 300,000 | 95.30 | WTI | | (570) |
| | **Total** | **800,001** | | | | **(1,423)** |

| Type of Instrm. | Term | Volume | Strike Price ($/bbl) | Premium ($/bbl) | | Fair value |
|---|---|---|---|---|---|---|
| Put option | Jul 1, 2010 - Dec 31, 2010 | 600,000 | 40 | 2.45 | | (1,443) |
| Put option | Jul 1, 2010 - Dec 31, 2010 | 585,000 | 40 | 1.91 | | (1,092) |
| Put option | Jun 1, 2010 - Jul 31, 2010 | 300,000 | 65 | 0.94 | | (267) |
| Put option | Jan 1, 2011 - Jul 31, 2011 | 700,000 | 40 | 2.45 | | (1,440) |
| Put option | Jan 1, 2011 - Jun 30, 2011 | 585,000 | 40 | 1.91 | | (912) |
| | **Total** | **2,770,000** | | | | **(5,154)** |
| | **Total** | | | | **$** | **(6,577)** |
| | | | | | | |
| | Short-term | | | | | (6,395) |
| | Long-term | | | | | (182) |
| | **Total** | | | | **$** | **(6,577)** |

For the three and six months ended June 30, 2010, the Company recorded gains of $5.1 million and $10.2 million respectively (June 30, 2009 - $28.3 million and $22.7 million in losses) on commodity price risk management contracts in net income. Included in these amounts were $11.9 million and $18.7 million of unrealized gains (June 30, 2009 - $28.2 million and $22.7 million in losses) representing the change in the fair value of the contracts, and $6.8 million and $8.5 million of realized losses (June 30, 2009 - $0.1 million gain and $0.4 million loss).

If the forward WTI crude oil price estimated at June 30, 2010 had been $1/bbl higher or lower, the unrealized loss on these contracts would change by approximately 1.5 million (2009–1.3 million) and would be reflected in the statement of operations of the Company.

*Foreign currency derivatives*

To reduce its foreign currency exposure associated with operating and general and administrative expenses incurred in Colombian Pesos, the Company decided to enter into currency risk management contracts such as foreign exchange forwards, options, and costless collars. The Company had the following currency risk management contracts outstanding as at June 30, 2010 that qualify for cash flow hedge accounting:

| Instrument | Expiration Date | | Amount ($) | Floor / Ceiling (COP/$) | | Fair value ($'000) |
|---|---|---|---|---|---|---|
| Currency collars | July 26, 2010 | | 22,531,000 | 2000-2050 and 2000-2060 | | 1,084 |
| Currency collars | August 25, 2010 | | 24,887,000 | 2000-2050 and 2000-2060 | | 1,211 |
| Currency collars | September 27, 2010 | | 28,291,000 | 2000-2050 and 2000-2060 | | 1,355 |
| Currency collars | October 25, 2010 | | 38,825,000 | 2000-2050 and 2000-2060 | | 1,832 |
| Currency collars | November 26, 2010 | | 40,131,000 | 2000-2050 and 2000-2060 | | 1,839 |
| Currency collars | December 23, 2010 | | 41,653,000 | 2000-2050 and 2000-2060 | | 1,851 |
| Currency collars | December 23, 2010 | | 44,366,000 | 2000-2050 and 2000-2060 | | 1,972 |
| | **Total** | **$** | **240,684,000** | | **$** | **11,143** |

The effective portion of the change in the fair value of the above currency hedges is recognized in other comprehensive income as unrealized gains or losses on cash flow hedges. The effective portion is reclassified as operating expenses in net income in the same period as the hedged operating expenses are incurred. During the three and six months ended June 30, 2010, $2 million and $10 million of unrealized gains were recorded in other comprehensive income respectively, and $1.7 million (2009 – $nil) of realized hedge gains were recorded against operating expenses. The Company excludes changes in fair value due to the time value of options and records these amounts along with hedge ineffectiveness in foreign exchange gains or losses in the period that they arise. During the three and six months ended June 30, 2010, $1.5 million and $1 million of ineffectiveness respectively were recorded as foreign exchange losses (2009 - $nil).

## 10. *Selected Quarterly Information*

| *(In thousands of US$ except per share amounts or as noted)* | Q2 2010 | Q1 2010 | Q4 2009 | Q3 2009 | Q2 2009 | Q1 2009 | Q4 2008 | Q3 2008 |
|---|---|---|---|---|---|---|---|---|
| **Financials:** | | | | | | | | |
| Net sales | 359,700 | 380,523 | 211,650 | 156,557 | 160,994 | 110,000 | 123,216 | 202,354 |
| Net income (loss) for the period | 47,928 | 32,125 | (24,563) | (63,107) | (118,540) | 52,636 | 12,971 | 77,324 |
| Capital expenditures | 133,636 | 43,617 | 120,071 | 88,141 | 83,640 | 100,823 | 123,652 | 66,311 |
| Funds flow from operations (1) | 154,836 | 150,727 | 50,570 | 73,489 | 38,934 | 31,548 | 40,810 | 117,032 |
| Earnings (loss) per share (3) | | | | | | | | |
| - basic | $ 0.18 | $ 0.13 | $ (0.12) | $ (0.29) | $ (0.56) | $ 0.25 | $ 0.06 | $ 0.37 |
| - diluted | $ 0.16 | $ 0.13 | $ (0.12) | $ (0.29) | $ (0.56) | $ 0.25 | $ 0.06 | $ 0.35 |
| **Operations:** | | | | | | | | |
| Operating netback ($/boe) (2) | | | | | | | | |
| Crude oil and natural gas sales price | 61.45 | 64.35 | 55.94 | 55.31 | 50.12 | 35.65 | 43.23 | 91.11 |
| Costs of Production | 5.05 | 3.74 | 7.09 | 7.61 | 5.16 | 3.75 | 6.38 | 6.85 |
| Transportation | 5.65 | 6.59 | 10.90 | 11.18 | 10.46 | 6.76 | 7.08 | 8.78 |
| Upgrading cost (diluent including transportation) | 10.59 | 12.85 | 8.27 | 7.73 | 6.19 | 5.91 | 8.55 | 14.73 |
| Other costs | 0.80 | (0.14) | (2.04) | 0.10 | 2.85 | (0.93) | 3.21 | 2.65 |
| Overlift/Underlift | 0.18 | (0.82) | 0.37 | (7.89) | 6.05 | (0.21) | 4.08 | (0.10) |
| Operating netback | 39.18 | 42.14 | 31.35 | 36.57 | 19.41 | 20.37 | 13.94 | 58.20 |
| Average daily crude oil sold (Bbl/day) | 54,291 | 55,734 | 32,429 | 24,438 | 30,405 | 25,755 | 24,549 | 19,045 |
| Average daily natural gas sold (Boe/day) | 10,038 | 9,968 | 9,145 | 6,669 | 5,283 | 8,528 | 6,770 | 5,363 |
| Average daily oil and gas sold (Boe/day) (4) | 64,329 | 65,702 | 41,574 | 31,107 | 35,688 | 34,283 | 31,319 | 24,408 |

*(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) Operating netback data based on weighted average daily production sold.*

The following discussion highlights some of the significant factors that impacted the results in the eight most recently completed quarters since September 30, 2008:

During the second quarter of 2010, net sales totaled $359.7 million, which were lower by $20.8 million over the prior quarter of 2010, due to a reduction of 5% in realized price due to market conditions which put downward pressure on crude oil prices. Although production continued to increase during the second quarter of 2010, the volume of sales during this period was lower by 59,200 boe (1%) as compared to the prior quarter of 2010. Additionally, the operating costs in the second quarter of 2010 slightly increased to $23.46, per barrel, or 1.8%, mainly attributable to the increase in the production and higher dilution cost used to upgrade Rubiales crude oil.

During the first quarter of 2010, net sales totalled $380.5 million, which were higher by $168.8 million over the fourth quarter of 2009, due to the increase in both the combined realized price of $8.41 per barrel (a 15% increase) as well as the volume of sales from 41,575boe/d in the fourth quarter of 2009 to 65,702 boe/d in the second quarter of 2010, a 58% increase. Additionally, the operating costs in the second quarter of 2010 slightly increased to $23.04, per barrel, or 1%, mainly attributable to the increase in the production and higher diluents cost as light crude oil used to upgrade Rubiales crude oil is linked to the WTI NYMEX reference price.

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 $0.63 increase (a 1% increase) in both the combined realized price and the average daily volume of 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 the second quarter of 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 second 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 second 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 second 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 $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.

## 11. ***Outstanding Share Data***

Issued and Fully Paid Common Shares

As at June 30, 2010, 263,651,103 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 June 30, 2010, 611,682 warrants to acquire an equal number of common shares were outstanding and exercisable (27,910,343 – December 31, 2009) and 25,084,341 stock options were outstanding (19,223,131– December 31, 2009), of which all were exercisable.

## Health, Safety, Environmental and Quality - HSEQ

During the second quarter of 2010 the Company's subsidiaries operating in Colombia continued with their efforts to improve the overall HSEQ standards. During the second quarter of 2010, the number of man hours worked was almost doubled in comparison with the same period of 2009 due to the significant expansion of the facilities (2010 - 11.2 million man hours compared to 2009 – 5.7 million man hours). This was the main reason for the slight increase in the Company’s lost time injury rate (“LTIR”) during this period which totaled 1.08, in comparison to the 0.88 ratio in the second quarter of 2009.

During Q2 2010, the Company continued with the efforts to increase the HSEQ standards for contractors, thereby improving the HSEQ external audit results. Also, the Company is implementing “Behavior-based Safety” and "Rig Pass" programs to further improve the overall safety performance of the employees working at the oil fields.

**Labour Relations and General Labour Force**

The Company enjoys positive labour relations with its workforce and firmly believes in engaging in meaningful dialogue to ensure the alignment of the Company, its labour force, as well as other stakeholder groups. The Company conducted 14 dialogue sessions with all stakeholders over the course of a month in Bogota and the Rubiales, Abanico and La Creciente fields. The dialogues were based on the principles of the AA10002 standard, which are materiality, inclusiveness and responsiveness. One of the most relevant outcomes identified, among others, was work life balance and labour rights protection. The establishment of career development plans for our employees and programs for leadership development were set as high priorities, with the full commitment of management. The Company has policies in place to ensure reasonable recruitment practices, attracting and retaining human talent, promoting diversity and inclusiveness practices.

**Sustainability Policy - CSR**

In 2010 we are developing a new sustainability policy to direct our management strategy. This strategy was created with the purpose of conducting our business with transparency and inclusiveness and ensuring that we generate wealth and contribute to the sustainable development of society in harmony with our environment. This strategy guides our actions as follows:

- Develop and grow our business in a transparent manner, creating added value and confidence for our investors. Contribute to the development of society in harmony with the environment. Consolidate good practices in our main focus areas, expand them in accordance with our strategy, and encourage their adoption throughout our value chain. Engage our stakeholders through constant communication and lead the process inside the organization.

- The Company has developed corporate policies to promote and respect human and labour rights, to protect the environment and to prevent corrupt practices. These are standard principles of the Global Compact of United Nations.

The Company was a founding member of the Latin-American and Caribbean Regional Center of the Global Compact and our strategy results have been published in our sustainability report, measured against the Global Reporting Initiative indicators. Our sustainability policy received recognition as a model for Latin America, at the leadership meeting of the Global Compact held in New York in June 2010.

**12. *New Accounting Pronouncements***

Adopted

a) Business Combinations/Consolidated Financial Statements/Non-Controlling Interests

In January 2009, the CICA issued Handbook Sections 1582, “Business Combinations” (“Section 1582”), 1601, “Consolidated Financial Statements” (“Section 1601”) and 1602, “Non-controlling Interests” (“Section 1602”). Section 1582 replaces CICA Handbook Section 1581, “Business Combinations”, and establishes standards for the accounting for business combinations that are equivalent to the business combination accounting standard under IFRS. Section 1582 is applicable 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, with early adoption permitted. Section 1601 together with Section 1602 replaces CICA Handbook Section 1600, “Consolidated Financial Statements”. Section 1601 establishes standards for the preparation of consolidated financial statements and Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Sections 1601 and 1602 are applicable for interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011, with early adoption permitted. An entity must adopt Section 1582, 1601 and 1602 at the same time. The Company has adopted these standards effective January 1, 2010 and the adoption did not have a material impact on the results of operations or financial position.

b) Intangible assets

Intangible assets are recorded at their fair value on the date of acquisition. Intangible assets with finite useful lives are amortized over their useful lives. The Company does not have intangible assets that have an infinite life and would not be subject to amortization. The Company applies an impairment test to the carrying value of the intangible asset to ensure that such costs do not exceed the estimated amount ultimately recoverable. Any reduction in the carrying value, as a result of the impairment test, is included in depletion, depreciation and amortization expense. The intangible asset is amortized based on the usage of the 160 million barrel capacity over the term of the agreement.

## Future accounting changes

### International Financial Reporting Standards

In February 2008, the AcSB confirmed the convergence of Canadian GAAP with International Financial Reporting Standards (hereinafter 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 (hereinafter 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 Company currently anticipates that this exemption will be used. In addition, the Company is reviewing the cash generating unit (hereinafter CGU) level, and has anticipated it will be determined at the field level.

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; completed in March 2010, phase II - Impact analysis and evaluation; completed in May 2010, and phase III - Implementation and review to be completed by August 2010. Currently, the Company has completed phase I and II. As a result, the following key issues are reviewed and concluded to have the most significant impact on the results of operations, financial position and disclosures:

- IFRS 6 – Exploration and evaluation of mineral resources;
- IFRS 16 – Property, Plant and Equipment;
- IAS 36 – Impairment of assets;
- IAS 31 – Joint Venture
- SIC 12 – Special purpose entities
- IAS 12 – Income taxes

The Company has decided to use the oil and gas full cost “deemed cost” exemption as allowed under IFRS 1. Under this exemption, the development and producing assets (D&P) are to be allocated to each CGU based on reserves volumes or reserves values, and are required to perform impairment review at the transition date. Management has elected allocation at CGU level will be performed on reserves values.

Management is continuing training its personnel. 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.

### 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) 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 $55,000 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 $15,000 from Blue Pacific related to certain administrative costs paid by the Company on behalf of Blue Pacific.

b) As at June 30, 2010, the Company had trade accounts receivable of $0.7 million (December 31, 2009 - $10.5 million) from Proelectrica, in which the Company has a 21.7% indirect interest and which is 31.49% owned by Blue Pacific. The Company's and Blue Pacific's indirect interests are held through Ronter. Revenue from Proelectrica in the normal course of the Company's business was $2.8 million and $10.2 million for the three and six months ended June 30, 2010, respectively (June 30, 2009 - $0.6 million and $5.1 million respectively).

c) On April 19, 2010 the Company acquired a 9.4% interest in Lando for $3.5 million. The consideration consisted of a previous $3.5 million advance to Lando Industrial Park S.A ("Lando"), a Panama company which is executing a project to develop land in Colombia into a port, an industrial park and free trade zone. As of June 30, 2010, Lando is 25% owned by Ronter, 51.98% owned by Blue Pacific, 6.87% owned by Orinoquia Holdings Corp., a company that two directors of the Company control or provide advice to, and 6.75% owned by an unrelated party.

d) During the three months ended June 30, 2010, Transportadora Del Meta S.A. ("Transmeta"), a variable interest entity indirectly 100% owned by a director of the Company, paid a dividend of $2.2 million to its shareholder. The Company does not own any shares in Transmeta, but is the primary beneficiary and therefore consolidates Transmeta. The Transmeta dividend is included in other expense on the statement of operations.

e) The Company has an accounts receivable in the amount of $98,000 (December 31, 2009 - $173) from Medoro Resources Ltd., a company related by way of a director and one officer 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. This amount was repaid in full in July 2010.

f) Loans receivable from related parties in the aggregate amount of $566,000 (December 31, 2009 – $290,000) are due from two directors and four officers (December 31, 2009 – 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 valued 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 system, which is embedded in all operations, provides assurance to the Board of Directors, Audit Committee, and management, and contribute to the continuous improvement strategies of the organization without impairing its objectivity and independence. Internal auditor`s role involves providing guidance and expertise in areas including, but not limited to, corporate governance, risk management, fraud policies and prevention, and information technology systems, in addition to the traditional area of internal controls. 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 reports the results of the audit activities to the Audit Committee on a quarterly basis. The internal audit activities for second quarter 2010, approved by the Audit Committee, included the following activities:

- Evaluation of the effectiveness of internal controls, encompassed within the requirements of National Instrument 52-109 ("NI 52-109") issued by the Canadian Securities Administrators (CSA), over the design and operating effectiveness of the ICFR (Internal Controls Over Financial Reporting). The evaluation of 303 controls was performed during this quarter, 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.
- Five audit reports were completed by the internal audit team during the quarter. Another two audit projects have been started and are still in progress at the time of this report. These audit reports included the evaluation of operational effectiveness controls of core and support business processes in each of the following areas: Finance, Production, Security, Insurance, Treasury, and Information Technology SAP security design. The results were reported to management and the Audit Committee and action plans of improvement agreed with business process owners.
- Started the implementation of Governance, Risk and Compliance (GRC) solution to enable streamline governance programs, improve accountability and communication ensuring adoption of corporate governance principles and best practices, provide a systematic framework for documenting and assessing risks, define controls, managing audits identifying issues and implementing recommendations and remediation plans, provides an integrated approach to meet cross-industry mandates and regulations.
- As part of the risk management activities the internal audit coordinated with the senior management, plans to mitigate the corporate risks that had been identified. Internal audit provides coaching and coordinates Enterprise Risk Management activities.

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

- Financial consolidation process to improve on the timeliness of reporting,
- Purchasing process to improve on completeness of contracting , and
- Training for all personnel involved in the management of contracts.

The Company will continue to review its processes and procedures in 2010, including the integration of new resources hired and improvement in the use of SAP reporting tools.

Regulatory Policies

Certification of Disclosures 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 and 2010 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 June 30, 2010.

## 15. ***Outlook***

The Company will continue working on increasing its production and transportation capacity. Expansion of current facilities and of the ODL pipeline will allow the Company to double its production with a target of the end of the year of 225,000 boe/d (net) and significantly reduce its transportation costs.

The Company will continue to sell crude in the international markets, as well as in the domestic market. In 2010 the Company expects to increase its sales to an average of 68,000 bbl/d. Once the expansion of the ODL pipeline is completed, it will allow for transportation of all the Company's production from the Rubiales oil field to Monterrey, where it is connected to the main Colombian pipeline system.

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 will continue at a steady pace during 2010 and the Company is on schedule to complete its program for the year, which includes drilling 44 exploratory wells in Colombia: eleven more wells in the Quifa block (seven exploratory and four appraisal), and sixteen exploratory wells in the rest of the blocks. The campaign also included the final acquisition of 13,133 km of high resolution magneto-gravimetric airborne data in four blocks in Colombia and the acquisition of 2,279 km of 2D seismic and 694 $km^2$ of 3D seismic in 14 blocks: 12 in Colombia and 2 in Peru.

## 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.

A) Reconciliation of cash flow from operating activities to funds flow from operations:

The following table shows the reconciliation of funds flow from operations to cash flow from operating activities for the second quarter 2010 as compared with the second quarter of 2009:

| | Q2 | | Year to Date | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Funds flow from operating activities | 103,310 | 21,093 | 368,053 | 43,213 |
| Changes in non-cash working capital | (51,526) | (17,841) | 62,490 | (27,269) |
| Funds flow from operations (non-GAAP | 154,836 | 38,934 | 305,563 | 70,482 |

B) Reconciliation of Net (Loss) Income to EBITDA

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net (loss) income | 47,928 | (118,540) | 80,053 | (65,904) |
| Adjustments to net (loss) income | | | | |
| Income taxes expense | 47,416 | 1,802 | 96,740 | 5,545 |
| Foreign exchange (gain) loss | (10,566) | 85,235 | 21,183 | 24,303 |
| Interest expense | 20,206 | 8,063 | 34,401 | 13,910 |
| Realized and unrealized gain on risk management contracts | (5,143) | 28,227 | (10,161) | 22,681 |
| (Income) loss from equity investment | 1,509 | 0 | 1,473 | 10,720 |
| Other expense (income) | 619 | 45 | 2,277 | 7 |
| Stock-based compensation | 31,853 | 247 | 72,675 | 311 |
| Depletion, depreciation and amortization | 68,812 | 43,231 | 133,648 | 86,534 |
| EBITDA | 202,634 | 48,310 | 432,289 | 98,107 |

EBITDA was redefined in 2009 upon the completion of the offering of the Notes. The redefined EBITDA represents the EBITDA used in and defined in the covenants of the senior notes offering. The previous period'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" orstate 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:

- fluctuating oil and gas prices;
- cash flows and additional funding requirements;
- global financial conditions;
- exploration and development;
- operating hazards and risks;
- reserve estimates;
- transportation costs;
- disruptions in production;
- political risk;
- environmental factors;
- title matters;
- dependence on management;
- changes in legislation;
- repatriation of earnings;
- enforcement of civil liabilities;
- competition; and
- payment of dividends.

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. For more information, please see the Company's Annual Information Form which is available at www.sedar.com