

Canacol Energy Ltd.

A large, semi-transparent blue globe with a white grid of latitude and longitude lines. The continents are visible in a light blue/white color. The globe is centered on the Americas, with North and South America clearly visible. It has a soft shadow underneath.

Management Discussion and Analysis
Three months ended September 30, 2009

November 25, 2009

CAUTIONARY NOTE

This Management's Discussion and Analysis ("MD&A") for Canacol Energy Ltd. ("Canacol" or the "Corporation") (formerly BrazAlta Resources Corp. ("BrazAlta")) of the financial results and related data is reported in Canadian dollars, has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"), and should be read in conjunction with the interim financial statements for the three months ended September 30, 2009 as well as the audited consolidated financial statements for the year ended June 30, 2009 and the respective notes thereto. Additional information relating to the Corporation is on SEDAR at www.sedar.com.

Information provided herein in respect of barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf: 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Certain information set forth in this document contains forward-looking statements. All statements other than historical fact contained herein are forward-looking statements, including, without limitation, statements regarding the future financial position, business strategy, production rates, and plans and objectives of or involving the Corporation. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond the Corporation's control, including the impact of general economic conditions, industry conditions, governmental regulation, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. In particular to forward-looking comments in this MD&A readers are cautioned that there can be no assurance that: the Corporation will be able to attain sufficient capital and financing to fund its current and expected obligations; that the Corporation will be able to increase production in Brazil, Colombia, or Guyana and achieve expected variable cost efficiencies and an overall reduction of costs on a per barrel basis; that hydrocarbon based royalties assessed by the Brazilian and Colombian governments will remain consistent or that the Brazilian and Colombian royalties will continue to be applied on a sliding scale basis downward as production increases on any one block. The Corporation's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits the Corporation will derive there from.

In addition to historical information, the MD&A contains forward-looking statements that are generally identifiable as any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events of performance (often, but not always, through the use of words or phrases such as "will likely result," "expected," "is anticipated," "believes," "estimated," "intends," "plans," "projection" and "outlook"). These statements are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such forward-looking statements. Actual results achieved during the forecast period will vary from the information provided herein as a result of numerous known and unknown risks and uncertainties and other factors. Such factors include, but are not limited to: general economic, market and business conditions; fluctuations in oil and gas prices; the results of exploration and development drilling and related activities; fluctuation in foreign currency exchange rates; the uncertainty of reserve estimates; changes in environmental and other regulations; and risks associated with oil and gas operations, many of which are beyond the control of the Corporation. Accordingly, there is no representation by Canacol that actual results achieved during the forecast period will be the same in whole or in part as those forecasted. Except to the extent required by law, Canacol assumes no obligation to publicly update or revise any forward-looking statements made in this MD&A or otherwise, whether as a result of new information, future events or otherwise. All subsequent forward-looking statements, whether written or oral, attributable to Canacol or persons acting on the Corporation's behalf, are qualified in their entirety by these cautionary statements.

Readers are further cautioned not to place undue reliance on any forward-looking information or statements.

Unless otherwise stated, all dollar amounts presented in this MD&A are in thousands of Canadian dollars (unaudited). All references to C\$ or \$ are to Canadian dollars, references to US\$ are United States (U.S.) dollars, references to BRL\$ are to Brazilian Real, and references to COP\$ are to Colombian Pesos.

FINANCIAL RESULTS	Three Months Ended		
	September 30, 2009	June 30, 2009	September 30, 2008
<i>(5000s), except share data</i>			
Petroleum and natural gas sales, net			
Colombia ⁽²⁾	2,409	2,247	-
Brazil	600	80	1,313
Canada ⁽⁶⁾	-	-	37
	3,009	2,327	1,350
Tariff revenue	1,365	1,001	-
Interest and other	675	496	29
Total revenue, recurring operations	5,049	3,824	1,379
Cash from (used in) recurring operating activities	(1,091)	(3,815)	(1,492)
Per share - basic and diluted	(0.01)	(0.03)	(0.02)
Net loss from continuing operations	(1,459)	(5,250)	(2,646)
	(0.01)	(0.04)	(0.03)
Capital expenditures			
Colombia ⁽²⁾	3,133	2,525	-
Brazil	226	(16)	1,746
Guyana	-	-	-
Canada	82	(1,092)	(644)
	3,441	1,417	1,102
Total assets	86,454	85,209	43,537
Total long-term liabilities	25,103	26,967	3,245
Weighted average shares outstanding			
Basic (000s)	180,834	140,503	90,085
Basic and Diluted (000s)	180,834	140,503	90,085

OPERATING RESULTS	Three Months Ended								
	September 30, 2009			June 30, 2009			September 30, 2008		
	Colombia (2)	Brazil	Canada (5)	Colombia (2)	Brazil	Canada (5)	Brazil	Canada (5)	
Production									
Crude oil and NGLs (bbl/d)	330	110	-	298	118	-	141	-	1
Natural gas (mcf/d)	-	-	-	-	-	-	-	-	34
Total (boe per day)	330.00	110	-	298	118	-	141	-	7
Total tariff production (bbl/d)	1,377	-	-	-	-	-	-	-	-
Average sale prices									
Crude oil (\$/bbl)	69.20	55.51	-	68.79	42.06	-	120.90	-	-
Natural gas (\$/mcf)	-	-	-	-	-	-	-	-	10.69
Oil equivalent (\$/boe)	-	-	-	-	42.06	-	120.90	-	64.14
Operating netback (\$/boe)									
Commodity sales revenue	69.20	55.51	-	68.79	42.06	-	120.90	-	64.14
Tariff revenue	12.96	-	-	10.83	-	-	-	-	-
Non-refundable sales taxes	-	(2.54)	-	-	(5.83)	-	(9.98)	-	-
Realized loss on financial derivative	-	-	-	-	45.15	-	(21.83)	-	-
Royalties	(5.54)	(7.03)	-	(6.56)	(7.42)	-	(9.82)	-	(6.85)
Transportation & processing ^{(4) (6)}	(3.03)	(13.42)	-	(2.71)	(25.48)	-	(13.03)	-	-
Well workover & repair	(0.01)	(2.54)	-	(1.48)	(2.54)	-	(1.64)	-	-
MEP work unit provision	-	(3.22)	-	-	(3.22)	-	(4.38)	-	-
Operating expenses ⁽³⁾	(14.54)	(32.19)	-	(12.65)	(22.58)	-	(32.19)	-	(18.08)
Netback ⁽¹⁾	46.08	(5.43)	-	45.39	20.15	-	28.03	-	39.21

⁽¹⁾ "Netback" per boe is calculated as revenues net of sales taxes and royalties, less transportation & processing charges, well workover and repair and operating expenses and then divided by boes produced. Netbacks do not have a standard meaning prescribed by GAAP and therefore may not be comparable to similar measures used by other companies. Management feels this is a useful metric as it is a common metric used by other companies operating in the oil and gas industry in order to provide a comparison of relative overall performance between companies. Management uses the metric to assess the Corporation's overall performance relative to that of its competitors and for internal planning purposes.

⁽²⁾ Colombian operations commenced in October 30, 2008.

⁽³⁾ Colombian operating expenses relate to both tariff and non-tariff oil production volumes.

⁽⁴⁾ Colombian transportation and processing charges relate to non-tariff production.

⁽⁵⁾ The majority of the Canadian producing properties were sold effective January 1, 2009.

⁽⁶⁾ Restated to reflect total volumes including tariff production for the three months ended June 30, 2009.

HIGHLIGHTS FROM Q1-2010

- On July 2, 2009, Canacol was awarded the Pacarana Technical Evaluation Area in Colombia, immediately adjacent and to the south of the Ombu E&P contract. Canacol has 100% working interest in this block, which is approximately 470,022 hectares in size and is located in the Caguan-Putumayo Basin. Work obligations associated with this block include acquiring 2,240 kilometres of aeromagnetic and gravity data and conducting geotechnical studies over a period of 24 months for an anticipated cost of approximately US\$465.
- On July 7, 2009, Canacol sold a US\$1,000 promissory note receivable for proceeds of US\$910 to an arm's length party. Canacol issued 1,500,000 warrants, with each warrant being exercisable at a price of \$0.30 per common share for 18 months.
- On July 23, 2009, Canacol completed a \$1,500 private placement financing. Canacol issued a total of 2,219,048 units, each consisting of one common share and one-half warrant with a strike price of \$0.30 for gross proceeds of \$377.
- On July 27, 2009, Canacol commenced of its development drilling program at the Rancho Hermoso and Entrerrios Oil Fields in Colombia. The Corporation signed a definitive contract with Saxon Services de Panama to provide the drilling rig for 3 wells.

The Corporation also completed of the acquisition of a 46 square kilometre La Sierra 3D seismic program in early July 2009. The results of this program are to be used to drill an offset to the La Sierra 1 discovery well in early 2010.

- On August 31, 2009, Canacol was awarded the Tamarin E&P Contract in Colombia. The Tamarin contract is located 25 kilometres directly southwest of the Ombu contract, which is approximately 27,000 hectares in size and is located in the Putumayo-Caguan Basin. The terms of the 6 year contract include acquiring and interpreting 60 kilometres of 2D seismic.
- On September 4, 2009, Canacol announced closing of a convertible unsecured subordinated debenture offering. Canacol issued \$2.7 million of debentures, which mature on September 4, 2011. Canacol issued 753,624 common shares to the agent as commission.
- On September 10, 2009, Canacol announced the full exercise of its Agent's over-allotment option and a second closing of its convertible unsecured subordinated debenture financing. Canacol issued \$1.3 million of debentures, which mature on September 4, 2011. Canacol issued 376,812 shares to the Agent as commission.
- On September 17 and 21, 2009, Canacol provided updates on its development drilling program in its Rancho Hermoso and Entrerrios fields in Colombia. The Corporation commenced drilling operations on the Rancho Hermoso 3A well on August 18, which reached a total of 9,333 feet measured depth. The well encountered 24 feet of net interpreted oil pay within the Mirador reservoir, which was perforated from 9,118 to 9,133 feet. Early production testing was completed, yielding production rates of up to 799 barrels of 35 degree API oil per day from the Mirador reservoir at initial total fluid rates of up to 3,994 barrels of fluid per day. The well has now been tied in to the permanent production facility and the Corporation intends to increase the pump rate to attain a total stabilized fluid rate of between 7,000 and 8,000 barrels of fluid per day.

The Corporation also announced the mobilization of the Saxon 126 drilling rig to the Entrerrios field to commence drilling the Entrerrios 5 well. This well was drilled without incident, and is awaiting completion with a workover rig scheduled for November. The drilling rig has been mobilized back to the Rancho Hermoso field in early November to commence drilling the Rancho Hermoso 5 well.

SUBSEQUENT EVENTS AFTER Q1-2010

- On October 15, 2009, the Corporation closed an underwritten private placement financing, including the full exercise of the underwriters' option, for total gross proceeds of \$40,000. Pursuant to the financing, the Corporation issued 142,858,000 common shares at a price of \$0.28 per common share. The Offering was completed by a syndicate of underwriters led by Canaccord Capital Corporation and including First Energy Capital Corp.
- On October 26, 2009, the Corporation completed the purchase of all of the outstanding shares of Groundstar Resources Inc. ("GRI"), a Guyanese company which holds a Petroleum Prospecting License ("PPL") in the Takutu Basin in Guyana comprising approximately 7,800 square kilometres. Under the terms of the Agreement, Canacol acquired a 90% working interest in the PPL in exchange for a cash payment to Groundstar Resources (Cayman) Inc. ("GRCI"), the owner of GRI in the amount of US\$3.45 million. US\$1.2 million of this purchase price was previously paid to GRCI in May, 2009. The Corporation will carry a 10% net working interest for GRCI to first commercial production. Under the PPL, one well must be drilled on the property by May, 2010 and a second well must be drilled by May, 2011.
- On October 26, 2009, the Corporation repaid US\$5,000 on its reserves based line of credit.
- On November 3, 2009, the Corporation repaid US\$4,142 (CAD\$4,434) of its outstanding line of credit balance.
- On November 5, 2009, the Corporation completed a farmout agreement with Sagres Energy Inc. ("Sagres"), whereby Sagres acquired a 25% interest in the Takutu Basin Petroleum Prospecting License in Guyana. On closing, Sagres paid US\$1,250 to be applied first to 30% of prior direct costs incurred by Canacol, then to 30% of future cash calls to a maximum of US\$1,750, and 27.5% of cash calls thereafter. Sagres is entitled to 30% of revenues until recovery of its first US\$3,000 paid to Canacol, 27.5% of revenues until its full cost recovery, and 25% thereafter. In November of 2009 the Corporation purchased Roraima's 5% working interest in the contract, bringing the Corporation net working interest to 65%. Under the terms of the agreement, the Corporation and Sagres will carry Groundstar's 10% remaining working interest until first commercial oil production.
- On November 10, 2009, the Corporation paid \$231 to Roraima Energy Ltd. to buy back Roraima's 5% working interest in the Takutu Basin Petroleum Prospective License in Guyana. The two transactions detailed above leave Canacol with a 65% working interest in the Takutu Basin Prospecting License.
- On November 18, 2009, the Corporation drew US\$4.5 million from its financing arrangement with Gemini, bringing the total advanced by Gemini to US\$9,000.

COMPANY OVERVIEW AND BACKGROUND

Canacol Energy Ltd. ("Canacol" or the "Corporation") (TSX-Venture: CNE) is a Canadian-based independent oil exploration company operating primarily in Brazil, Colombia, and Guyana. Up to December 31, 2008, Canacol had a subsidiary, BCH Ltd. ("BCH"), which had established itself as a leading onshore provider of both drilling and service rigs in Brazil on several long-term contracts with Petrobras, Brazil's state-owned petroleum company, to provide rigs and services. Effective December 31, 2008, Canacol's ownership in BCH Ltd. was sold to Allis-Chalmers Energy Inc.

Colombia E&P

Rancho Hermoso and Entrerrios

In Colombia, the Corporation operates 2 producing oil fields located in the Llanos Basin under risked service contracts for Ecopetrol S.A. ("Ecopetrol"). Ecopetrol is a Mixed Economy Company, with a commercial orientation, organized as an "Anonymous Society" (equivalent to a Corporation), under the

Ministry of Mines and governed by the Social Statutes. Ecopetrol carries out hydrocarbon exploration, production and transportation activities in Colombia both directly and through participation agreements with other companies operating in Colombia. The two fields operated by Canacol are the Rancho Hermoso Field (100% working interest) and the Entrerrios Field (60% working interest). The drilling and workover program at Rancho Hermoso and Entrerrios are expected to add approximately 4,000 initial barrels of oil per day of revenue production for Colombia. The Corporation's share of production is 2,100 *bbl/d*, comprised of 350 *bbl/d* net of government royalty, and 1,750 *bbl/d* of tariff production. A portion of the Corporation's net oil production is currently hedged at a floor of US\$55.00 and a ceiling of US\$80.25 per barrel until late 2011. For the tariff oil production, the Corporation receives an operating tariff per gross produced barrel of oil from Ecopetrol. The average tariff price for F2009 is approximately US\$9.63 per gross barrel, and is insensitive to West Texas Intermediate oil price fluctuations. Under an existing agreement with Ecopetrol, the tariff will increase through a series of steps each year to approximately US\$17.36 per gross barrel in 2012 and will remain at that level for the duration of the life of the field. The average tariff price for F2010 will be approximately US\$12.04 per barrel.

The Corporation drilled one development well in the Rancho Hermoso field in August 2009, followed by the drilling of the Entrerrios 5 development well. The drilling program is scheduled to be completed by early December 2009 with the drilling of the Rancho Hermoso 5 well. The program also includes working over three existing wells to increase productivity by perforating oil bearing reservoirs behind pipe and comingling with existing oil production. The drilling and work over activities at Rancho Hermoso and Entrerrios are currently expected to add approximately 4,000 initial barrels oil per day ("bbl/d") of revenue production from Colombia. At a net cost of US\$10.1 million, this program is anticipated to capture significant value at a low cost.

Ombu E&P Contract - Capella Oil Discovery Appraisal

The Corporation, under a farm out agreement entered into in July 2008, earned a 10% working interest in the Capella conventional heavy oil discovery operated by Emerald Energy Plc. on the Ombu E&P contract, where the operator is continuing with its appraisal drilling. The Corporation received formal assignment of its 10% working interest in the contract by the ANH in July 2009.

The field is a large seismically defined structure at the Mirador reservoir interval. The southern part of the field, approximately 89 square kilometres in area, is currently being appraised. Six wells have been drilled to date. The Capella 1 and 2 wells tested 240 and 345 gross *bbl/d* from the Mirador Formation. The Capella 3 well, the first deviated well to be drilled in the block, has a surface location adjacent to the Capella 1 vertical well and penetrates the reservoir approximately 340 metres away. The Capella 4 vertical well was drilled approximately 1.6 kilometres to the southwest of the Capella 1 location. The Capella 3 and Capella 4 wells both encountered the target Cretaceous Mirador reservoirs with net hydrocarbon pay intervals similar to those encountered in Capella 1 and 2. The rig completed drilling and testing the Capella 5 vertical well, located approximately 3.4 kilometres to the northeast of Capella 1. The Capella 6 vertical well, located 4.2 kilometres to the southwest of Capella 1, was currently being drilled and completed. The operator plans to drill 1 additional appraisal well, Capella 7, in December, 2009, which is planned to be a horizontal well. All wells are put on production as soon as possible, shipping by truck to sales points within Colombia.

The Corporation participated in the drilling of 2 slim-hole delineation wells, both of which were abandoned due to mechanical problems experienced at shallow depths prior to penetrating the producing reservoir intervals. The Operator and the Corporation have decided not to attempt another slim hole until the contractor has prepared a revised drilling program for the wells that will ensure mechanical and operational success. As the contract was awarded to the vendor on a turnkey success basis, no costs were incurred related to this program. The Corporation will participate in the drilling of the first horizontal well within the field which is anticipated to spud in the southwest part of the field in December 2009. The horizontal well will target the thick Upper Mirador reservoir interval encountered in the Capella 6 well. Meanwhile, all of the steam injection equipment for the cyclic

steam pilot has arrived in the field and the Operator plans to commence cyclic steam injection in one of the existing vertical wells in Q1 of 2010.

La Sierra E&P Contract

The Corporation operates the La Sierra E&P contract (25.5% working interest) located in the Middle Magdalena Basin, awarded by the Agencia Nacional de Hidrocarburos (“ANH”) in 2007. The contract contains the La Sierra 1 oil discovery, drilled in 1992 with recovery of 23 barrels of 17 API oil from 10 feet of net pay in the Tertiary Honda Formation at 1,400 feet measured depth. The Corporation acquired 33 km of 2D seismic on the contract in 2008, and subsequently acquired an additional 46 square kilometres of 3D seismic at a net cost of US\$1,100. Seismic will allow the Corporation to target the reservoir with a great deal more precision. An exploration well is expected to be drilled in March, 2010 and will target the Tertiary Honda reservoir in close proximity to the existing La Sierra 1 well, which tested oil from this formation. The well may be production tested with a progressive cavity pump to improve deliverability from the reservoir, with possible follow up using cyclic steam injection to increase recovery.

Pacarana Technical Evaluation Area

Effective July 2, 2009, Canacol, through its subsidiary Rancho Hermoso, was awarded with the Pacarana Technical Evaluation Area (“Pacarana TEA”) by the Agency Nacional de Hidrocarburos. The Pacarana block is located adjacent and to the south of the Ombu E&P.

The Corporation has a 100% working interest in the block, which is approximately 469,968 hectares in size and is located in the Caguan - Putumayo Basin of Colombia. An interpretation of the existing geotechnical data on the block identified prospective structural trends similar to the Capella heavy oil discovery located immediately to the north on the Ombu E&P contract. The work obligation associated with the contract requires the Corporation to acquire 2,240 km of aeromagnetic and gravity data and to conduct geotechnical studies including the interpretation of available LandSat image data over a period of 12 months, for an anticipated cost of approximately US\$465.

Tamarin E&P contract

Effective August 31, 2009, Canacol, through its subsidiary Rancho Hermoso, was awarded the Tamarin Exploration and Production Contract (“Tamarin E&P contract”) by the Agencia Nacional de Hidrocarburos of Colombia.

The Corporation has a 100% working interest in the block, which is approximately 27,487 hectares in size and is located in the Caguan - Putumayo Basin of Colombia, approximately 25 kilometres directly southwest of the Ombu E&P Contract which contains the Corporation’s Capella heavy oil discovery, which is currently under appraisal. The terms of the six year contract are as follows:

- Phase 1 Exploration Period - The Corporation will acquire, process and interpret 60 kilometres of 2D seismic and interpret all existing magnetic and gravity geophysical data. The duration of this phase is 18 months, which anticipated costs of approximately US\$1,565.
- Phase 2 Exploration Period - The Corporation will drill one exploration well within a period of 18 months.
- Phase 3 Exploration Period - The Corporation will acquire, process and interpret 30 square kilometres of 3D seismic within a period of 12 months.
- Phase 4 Exploration Period - The Corporation will drill two exploration wells within a period of 24 months.

Brazil E&P

Effective January 5, 2006, Canacol entered into a Consortium and Joint Operating Agreement with W. Washington Empreendimentos E. Participações Ltda, which subsequently has changed its name to W. Washington Petroleo S.A. (“W. Washington”), for the creation and operation of a Brazilian domiciled joint venture entity (“Brazil Joint Venture”) to hold, explore, develop and produce hydrocarbons in

Brazil. Canacol holds a 47.5% interest and W. Washington, the operator, holds a 52.5% interest in the Brazil Joint Venture.

Canacol's E&P operations are primarily engaged in the exploration, development and production of oil and gas in the Recôncavo, Sergipe, Espírito Santo, and Tucano basins of Brazil. To date, the bulk of activity has been undertaken jointly by Canacol and W. Washington in the Recôncavo and Sergipe basins and has been higher risk and exploratory in nature with minimal success achieved, which has resulted in no appreciable increase in oil production or significant addition of reserves.

Canacol holds a 47.5% working interest and W. Washington holds a 52.5% interest in the four main production concessions in Recôncavo, from which over 90% of Canacol's current Brazilian production originates. The concession contracts were originally awarded to W. Washington by the Agência Nacional do Petróleo, Gás Natural e Biocombustível ("ANP"), Brazil's national regulator, and Canacol subsequently registered its 47.5% interest on these contracts directly with the ANP. Rights to produce hydrocarbons on these four producing blocks run until 2025. As operator, W. Washington sells all of the produced oil to Petrobras in Recôncavo at prices based on North Sea Brent less costs for transportation and processing.

Guyana E&P

In May 2008, the Corporation negotiated a farm-in to a 7,800 sq km exploration contract located in the Takutu Basin, onshore Guyana adjacent to the border with Brazil, awarded to Groundstar Resources Ltd. ("Groundstar") in July 2005 for a four year period. The operator was successful recently in extending the term of the contract to July 2012 with a commitment to drill 2 wells by July 2010. The block contains the Karanambo discovery made by Home Oil in 1982. The Karanambo 1 well tested 411 boe/d (42-degree API) from a sub-salt reservoir during a five-hour drill stem test proving the existence of a light oil hydrocarbon system within this frontier basin. Based on a report prepared by Gaffney, Cline & Associates dated July 2008, the mean contingent resources associated with the Karanambo discovery are 100 million barrels gross (55 million barrels net). The block also contains 2 exploration prospects, Pirara and Rewa High, with mean prospective resources of 71 million barrels (39 million barrels net) in Pirara and 153 million barrels gross (84 million barrels net) in Rewa High. Civil works and location construction have been completed. The Corporation is currently in the process of tendering a rig for the drilling of the K-2 exploration well, which will appraise the Karanambo discovery. The Corporation anticipates spudding the well between March and May of 2010. Under the terms of the farm-in agreement, Canacol is required to fund the first US\$12,000 of costs in order to earn a 55% working interest in the contract. On May 15, 2009, the Corporation announced that it had entered into a Share Purchase Agreement to acquire 35% of Groundstar's 45% remaining working interest in the exploration contract for consideration of US\$3.45 million. This transaction closed on October 26, 2009 increasing Canacol's working interest to 90% and eliminating the farm-in earning requirement. On November 5, 2009, the Corporation completed a farmout agreement with Sagres Energy Inc ("Sagres") whereby Sagres acquired a 25% interest in the exploration agreement by funding 30% (US\$1,250) of the costs of drilling the K-2 exploration well. In November of 2009 the Corporation purchased Roraima's 5% working interest in the contract, bringing the Corporation net working interest to 65%. Under the terms of the agreement, the Corporation and Sagres will carry Groundstar's 10% remaining working interest until first commercial oil production.

Canada and Ireland E&P

Operations in Canada are considered to be non-core. The Corporation continues to hold interests in some non-producing properties and is seeking to dispose of its interest in these remaining properties. The Corporation does not expect to receive any significant proceeds from the sale of the remaining interests and is not planning any operations activities for these interests.

Exploration in Ireland is considered to be non-core and high risk and includes oil and natural gas exploration and the potential for development of salt cavern gas storage. The Corporation is currently reviewing potential alternatives for its Ireland interests and will likely discontinue future activity in Ireland.

FINANCIAL HIGHLIGHTS AND SUMMARY OF RESULTS - ONGOING OPERATIONS

Unless otherwise stated, amounts presented in this MD&A are in thousands of Canadian dollars. All discussions under the financial highlights section relate to the ongoing operations of the Corporation and exclude the operations of BCH Ltd. Ongoing operations of the Corporation relate to the oil and gas exploration and production operations of the Corporation. Detailed discussion on the discontinued operations of BCH for the three months ended September 30, 2009 and 2008 is contained in the "Discontinued Operations" section. The Colombian and Guyana operations of the acquired Canacol Energy Inc. are for the period October 31, 2008 through September 30, 2009.

General

Canacol acquired its Colombian operations on October 30, 2008 and the production and revenue began to be recognized on November 1, 2008 and the Corporation sold its Canadian producing properties on January 1, 2009. As a result the comparable production and revenue for the three months ended September 30, 2008 is not meaningful. As well, the nature of the operations has changed so significantly that a comparison to the comparable period for royalties, operating expenses, transportation and operating netbacks is not meaningful. Therefore, the Corporation will compare the production, revenue and expenses for the three months ended September 30, 2009 to the three months ended June 30, 2009 as well.

Recurring Operations (\$000s, except production data and per share)	2010	2009				2008		
	Q1	Q4	Q3	Q2 ⁽¹⁾	Q1	Q4	Q3	Q2
Petroleum and natural gas sales								
Colombia ⁽¹⁾	2,409	2,247	1,200	871	-	-	-	-
Brazil	600	80	767	862	1,313	1,515	1,487	993
Canada ⁽³⁾	-	-	-	7	37	33	8	42
Total production revenue	3,009	2,327	1,967	1,740	1,350	1,548	1,495	1,035
Tariff revenue	1,365	1,001	1,069	970	-	-	-	-
Interest and other	675	496	123	338	29	232	101	13
Total operating revenue	5,049	3,824	3,159	3,048	1,379	1,780	1,596	1,048
Total production (boe)	40,427	37,855	39,413	32,276	13,637	15,146	18,543	14,932
Total tariff production (bbl)	126,673	92,367	104,101	82,600	-	-	-	-
Cash used in (from) operating activities	(1,091)	(3,815)	(2,445)	5,673	(1,492)	(604)	(546)	(963)
Per share ⁽¹⁾	(0.01)	(0.03)	(0.02)	0.01	(0.02)	(0.01)	(0.00)	(0.00)
Net (loss) gain	(1,459)	(5,250)	(5,050)	(8,847)	(2,646)	(1,390)	(2,620)	(2,620)
Per share ⁽¹⁾	(0.01)	(0.04)	(0.04)	(0.08)	(0.03)	(0.02)	(0.03)	(0.03)
Total assets	86,454	85,209	87,958	89,106	43,537	42,703	49,861	27,530
Total long term liabilities	25,103	26,967	13,828	47,640	3,245	21,892	16,165	10,238

⁽¹⁾ Colombian operations commenced October 30, 2008

⁽²⁾ Certain of the prior year figures have been reclassified to conform with the current year's presentation. Production revenue was historically presented net of transportation and processing charges.

⁽³⁾ Canadian producing properties were sold effective January 1, 2009.

Petroleum and Natural Gas Sales (Net of Royalties)

The operating revenue from continuing operations for the three months ended September 30, 2009 totalled \$5,049 (Q4-F2009 - \$3,824; Q1-F2009 - \$1,379), representing an increase of \$1,225 or 32% on quarter-over-quarter basis.

The operating revenue consists of production revenue (non-tariff production) and tariff production and interest and other revenue. The production revenue during the quarter totalled \$3,009 (Q4-F2009 - \$2,327; Q1-F2009 - \$1,350) representing an increase of \$682 or 29% on a quarter-over-quarter basis. The tariff revenue during the quarter totalled \$1,365 (Q4-F2009 - \$1,001; Q1-F2009 - \$Nil) represented an increase of \$364 or 36%. Interest and other income is discussed below.

The increase of the production revenue and tariff revenue quarter-over-quarter basis is due to higher production on volumes on quarter-over-quarter basis. The increase year-over-year is the resulted from the inclusion of production revenue from Colombia operations which commenced on October 30, 2008.

In Colombia, production volumes during Q1-F2010 totalled 30,327 bbls (330 bbl/d) (Q4-F2009 - 27,077 bbls (298 bbl/d); Q1-F2009 - Nil) of crude oil. The average price achieved in Colombia in the Q1-F2010 was \$69.20/bbl compared to \$68.79/bbl in Q4-F2009 and \$Nil in Q1-F2009. In Colombia, tariff production volumes during Q1-F2010 totalled 126,673 (1,377 bbl/d) (Q4-F2009: 92,367 bbls (1,015 bbl/d); Q1-F2009 - Nil). The average tariff price for Q1-2010 was \$12.96/bbl (including \$2.19 of transportation revenue). (Q4-F2009 was \$10.83/bbl; Q1-F2009 - Nil).

Brazil production volumes during Q1-F2010 totalled 10,100 bbls (110 bbl/d) (Q4-F2009 - 10,778 bbls (118 bbl/d); Q1-F2009 - 12,987 bbls (141 bbl/d)) of light oil. The average price achieved per bbl in Brazil in the Q1-2010 was \$55.51/bbl (Q4-F2009 - \$42.06/bbl; Q1-F2009 - \$120.90), which is a 22% increase quarter-over-quarter basis and 30% decrease on a year-over-year basis.

In Canada, production consisted of oil, natural gas, and natural gas liquids from the Corporation's properties in Alberta. Production from Canada to September 30, 2009 totalled Nil boe (Q4-F2009 - Nil; Q1-F2009 650 boe (7 boe/day)). Canadian producing properties were sold on January 1, 2009.

Production Volumes (boe)	Three Months Ended		
	September 30, 2009	June 30, 2009	September 30, 2008
Colombia *	30,327	27,077	-
Brazil	10,100	10,778	10,778
Canada**	-	-	650
Total net production	40,427	37,855	11,428
Tariff production	126,673	92,367	-
Total	167,100	130,222	11,428

* Colombian operations commenced on October 30, 2008

** The majority of the Canadian producing properties were sold effective January 1, 2009.

Royalties as a percentage of gross petroleum and natural gas revenues by geographic region for the three months ended September 30, 2009 and respective prior period comparables are shown in the table below. The current base royalty regime in Brazil averages between 5% and 13% of gross production revenue. The actual rate the Corporation achieved for the three months ended September 30, 2009 in Brazil was 12.7% compared to 8.5% during Q4-F2009 and 8.1% during Q1-F2009. In Brazil, royalty rates are based on a sliding scale on incremental production over and above certain production thresholds on a block by block basis. Therefore, if aggregate production on any one block increases above the contracted thresholds, the royalty on that block should decline over time. In Colombia, royalties are taken in kind and at a rate of approximately 8%. During Q1-F2010 Colombian royalties averaged 8%.

Royalties	Three Months Ended		
	September 30, 2009	June 30, 2009	September 30, 2008
Colombia *	8.0%	8.0%	-
Brazil	12.7%	8.5%	8.1%
Canada**	-	-	10.7%

* Colombian operations commenced October 30, 2008

** The majority of the Canadian producing properties were sold on January 1, 2009.

Brazil oil sales are subject to non-refundable sales taxes. This totalled \$26 during the three months ended September 30, 2009 (Q4-F2009 - \$119; Q1-F2009 - \$130). This has been recorded and netted against revenue for the period ended September 30, 2009.

Interest and Other Income

During the three months ended September 30, 2009 interest and other income of \$675 (Q4-F2009 - \$496; Q1-F2009 - \$29) was recorded. The increase year-over-year corresponds to Casing API 7° sold to Union Temporal Andina to be used in drilling of ER-5 for proceeds of \$487.

Operating Expenses - Petroleum and Natural Gas

For the three months ended September 30, 2009, operating expenses totalled \$3,080 (Q4-F2009 - \$2,622; Q1-F2009 - \$677). The Colombian operating expenses relate to both tariff and non-tariff oil production. Details by operating segment are outlined in the table below.

Operating Expenses (\$000s)	Three months ended		
	September 30, 2009	June 30, 2009	September 30, 2008
Operating expenses			
Colombia ⁽²⁾	2,595	1,521	-
Brazil ⁽¹⁾	329	348	417
Canada ⁽³⁾	-	-	12
	2,924	1,869	429
Colombia transportation & processing charges	475	315	-
Colombia well workover & repair	3	176	-
Brazil transportation & processing charges	136	275	170
Brazil well workover & repair	-	27	21
MEP work unit provision	(458)	(40)	57
	3,080	2,622	677
Operating expenses per boe			
Colombia ⁽²⁾	14.54	12.73	-
Brazil ⁽¹⁾	32.19	11.89	32.11
Canada ⁽³⁾	-	-	18.08
Weighted Average	15.61	12.69	31.44

⁽¹⁾ Expenditures related to the planned non-routine enhancement workover program undertaken during the year are presented separately and excluded from the calculation of ongoing operating costs. Transportation and processing charges and MEP work unit provision are also shown separately. Brazilian quarterly operating expenses have been based on the yearly average.

⁽²⁾ Colombian operations commenced October 30, 2008. Colombian operating expenses relate to both tariff and non-tariff oil production volumes.

⁽³⁾ The majority of the Canadian producing properties were sold on January 1, 2009.

Depletion, Depreciation, and Accretion (DD&A)

For the three months ended September 30, 2009, DD&A from recurring operations totalled \$2,313 (Q4-F2009 - \$2,417; Q1-F2009 - \$1,007). The respective increase on a quarter-over-quarter basis and year-to-date basis is a result of an increase in proven properties included in the depletion calculation for Brazil plus the addition of Colombian properties.

General and Administrative

For the three months ended September 30, 2009, general and administrative (G&A) expenses from recurring operations were \$1,679 (Q4-F2009 - \$2,551; Q1-F2009 - \$1,379). G&A expenses are incurred in Canada, Colombia, and Brazil and primarily consist of management and advisory fees, professional fees, travel, and other administrative expenses needed to support the Corporation's operations. Canacol did not capitalize any indirect overhead costs. Following the acquisition of Canacol Energy Inc. and the disposition of BCH during the quarter, Canacol conducted a detailed review of its

operations and administrative functions in order to identify inefficiencies and better integrate operations. Management considers this to be an ongoing project required to ensure that operations are managed efficiently.

Interest and Financial Expense

For the three months ended September 30, 2009, interest and financial expense was \$893 (Q4-F2009 - 1,081; Q1-F2009 - \$205). Interest and financial expense is comprised of interest on the Corporation's long-term debt facilities, capital leases, and non-cash interest charges. Non-cash interest charges relate to the accretion of the deferred financing charges incurred on the Corporation's debt facilities. Non-cash interest charges for the three months ended September 30, 2009 totalled \$311 (Q4-F2009 - \$414; Q1-F2009 - \$130).

Foreign Exchange

The Corporation's activities in Brazil use the Brazilian Real (BRL\$) and the Corporation's activities in Colombia use the Colombian Peso (COP\$) as the functional currency and therefore the Corporation is exposed to the risk of fluctuations in foreign exchange rates. The Corporation's sales contracts for oil produced in Brazil and Colombia are based on US dollar reference prices but are paid in Brazilian Real in Brazil and through a combination of US dollars and Colombian Pesos in Colombia. The Corporation's long-term debt facilities are denominated in US\$ while the Corporation's line of credit facilities are denominated in Colombian Pesos.

For the three months ended September 30, 2009, the Corporation incurred a net foreign exchange gain of \$1,507 (Q4-F2009 - loss \$479; Q1-F2009 - loss of \$878). The foreign exchange gain for the three months ended September 30, 2009 is a result of the appreciation of the Canadian dollar relative to the US dollar, and the corresponding impact on the Corporation's US dollar denominated debt balances, as well as the foreign exchange gain on translation resulting from the appreciation of the Brazilian Real and Colombian Pesos relative to the Canadian dollar.

The Corporation currently has not entered into any foreign currency derivative contracts to manage its exposure to the Brazilian Real, Colombian Peso, or the US Dollar. Refer to the Risk Factors Section below for additional details.

Financial Derivatives

For the three months ended September 30, 2009, the Corporation had one financial derivative in place. This was a WTI oil financial option collar. The Corporation has not designated this embedded derivative as a hedge and has therefore recorded the unrealized gain on the contract on the balance sheet with changes in its fair value recorded in the net earnings for the period. Refer to the Risk Factors section for specific details of the current financial derivative contract that remains outstanding as of September 30, 2009.

At September 30, 2009, the Corporation had a total net financial derivative liability of \$417 (Q4-F2009 - \$497; Q1-F2009 - liability of \$967) relating to the oil financial option collar.

For the three months ended September 30, 2009, the Corporation had a net realized financial derivative gain of \$Nil (Q4-F2009 - gain \$304; Q1-F2009 - loss of \$284) on its oil collar hedge. For the three months ended September 30, 2009, the Corporation had a net unrealized financial derivative gain of \$80 (Q4-F2009 - loss 589; Q1-F2009 - gain of \$521) on its oil collar hedge.

Stock Based Compensation

For the three months ended September 30, 2009, a total of \$155 (Q4-F2009 - \$366; Q1-F2009 - \$116) was expensed relating to the vesting of stock options. The year-over-year decline can primarily be attributable to the relative timing of option grants during the year.

Income Taxes

Canacol is subject to taxation in Canada, Brazil, and Colombia. The current income tax expense for Q1-F2010 was a charge of \$314 (Q4-F2009 - recovery \$13; Q1-F2009 - \$Nil) relating to Colombian

income taxes. Due to operating losses in Brazil and Canada, the Corporation was not subject to income taxes in these jurisdictions during F1-2010.

A future income tax asset is not recognized for the Corporation's Canadian net-capital losses, non-capital loss, or other tax pool balances. Further, a future income tax asset has not been recognized on the Corporation's Brazilian tax losses or other tax pools. A valuation allowance has conservatively been applied to the remainder of the future income tax assets in the entity due to uncertainty of realization.

As at September 30, 2009, the Company had a deferred income tax liability relating to the book value in excess of the tax basis value on its petroleum and natural gas assets acquired through the acquisition of Canacol Energy Inc. The future income tax liability recorded in conjunction with the acquisition totalled \$11,382. During the three months ended September 30, 2009, future income tax recovery was \$420, resulting in an outstanding future income tax liability of \$11,005 at September 30, 2009 (Q4-F2009 - \$11,378; Q1-F2009 - \$nil).

CASH FLOWS FROM OPERATING, FINANCING, AND INVESTING ACTIVITIES - ONGOING OPERATIONS

Operating

For the three months ended September 30, 2009, cash flow from ongoing operating activities totalled an outflow of \$1,091 (Q4-F2009 - \$3,083; Q1-F2009 - \$1,492). For the three months period ending September 30, 2009, cash flow from operating activities before changes in non-cash working capital totalled an outflow \$1,014 (Q4-F2009 - \$2,383; Q1-F2009 - \$1,328). Changes in non-cash working capital relating to operating activities in Q1-F2010 totalled an outflow of \$77 (Q4-F2009 - \$700; Q1-F2009 - \$164).

The change in the operating cash flow is primarily attributable to operating losses from operations in Brazil and Colombia.

Financing

For the three months ended September 30, 2009, the Corporation recorded net cash inflow from ongoing financing activities of \$8,657 (Q4-F2009 - inflow of \$5,073; Q1-F2009 - outflow of \$948). For the three months ended September 30, 2009, cash inflow from financing activities primarily relates to \$4,000 from the issuance of the convertible debentures and \$4,825 drawn from the Gemini financing.

Investing

For the three months ended September 30, 2009, cash flows from ongoing investing activities totalled an outflow \$393 (Q4-F2009 - \$2,529; Q1-F2009 - \$5,969). For the three months ended September 30, 2009, the Corporation incurred \$3,441 in capital expenditures. The majority of the capital spent was related to the Corporation's Colombian operations.

DISCONTINUED OPERATIONS - BCH LTD.

Effective October 1, 2008, BCH Ltd. completed a non-brokered private placement of 4,474,999 BCH common shares at a price of US\$4.163 per BCH common share for aggregate gross proceeds of US\$18,629. Canacol acquired 1,717,093 BCH Common Shares for consideration of US\$7,148 to settle loans receivable from BCH. Allis-Chalmers Energy Inc. acquired 2,192,750 BCH Common Shares in the financing for consideration of US\$9,128, with US\$3,500 settling accrued interest payable on the debenture and cash proceeds of US\$5,628. Following the completion of the private placement, BCH had 13,909,843 BCH Common Shares issued and outstanding of which Canacol owned 11,717,093 BCH Common Shares or 84.2%. Effective December 31, 2008, Canacol sold all of its 11,717,093 BCH Common Shares to Allis Chalmers for proceeds of US\$5,000. Under the terms of the transaction, Allis Chalmers assumed the liability for the US\$23.5 million long-term debt facility and the US\$40 million convertible debenture already owned by Allis Chalmers.

Financial highlights from BCH's operations, which are "Discontinued Operations" for the three months ended September 30, 2009 and 2008 include:

Drilling Services Revenue

As noted above, BCH was sold on December 31, 2008. Thus, for the three months ended September 30, 2009, the total drilling services segment revenue, before inter-company consolidation eliminations, was \$Nil (Q1-F2009 - \$9,869). For the three months ended the drilling services unit generated net third party revenue of \$Nil (Q1-F2009 - \$9,825). For the three months ended September 30, 2009, one-time mobilization revenue of US\$ Nil (Q1-F2009 - \$277) was recorded relating to the mobilization of BCH-06 to begin a one year contract.

Drilling Services Revenue		
Three Months Ended September 30,		
(\$000s)	2009	2008
Drilling services segment revenue	-	9,825
Less: Inter-segment sales ⁽¹⁾	-	12
Less: Sales taxes	-	(736)
Drilling services revenue	-	9,101

⁽¹⁾ Inter-segment revenue and profit have been netted against exploration and production capital expenditures on consolidation.

Operating Expenses and Operating Margin

Drilling services operating costs for Q1-F2010 totalled \$Nil (Q1-F2009 - \$7,474). The respective year-over-year decrease in operation expenses was attributable to BCH being sold. Operating margin for Q1-F2010 was \$Nil (Q1-F2009 - \$1,627).

Depreciation

During Q1-F2010, depreciation expense relating to the operations of BCH totalled \$Nil (Q1-F2009 - \$1,014). The respective year-over-year increases in depreciation expense relative to last year for BCH is primarily attributable to the increased size of the drilling fleet and overall increased utilization.

General and Administrative

During Q1-F2010, general and administrative (G&A) expenses related to BCH were \$Nil (Q1-F2009 - \$1,078). The respective year-over-year increases are attributable to the expanded administrative operations of BCH required to support and higher rig total general and administrative expenses were incurred in Canada and Brazil and primarily consist of management and advisory fees, professional fees, travel, and other administrative expenses needed to support operations. BCH did not capitalize any indirect overhead costs.

Income Taxes

BCH was subject to taxation in Canada and Brazil. Current income tax expense for the three months ended September 30, 2009 was \$Nil (Q1-F2009 - \$677) relating to Brazilian withholding taxes on the lease portion of BCH's drilling rig contracts which is paid to Canadian entity. During the three months ended September 30, 2009 future income tax recovery was \$Nil (Q1-F2009 - recovery of \$2,003). For the three months ended September 30, 2009, the net tax recovery was \$Nil (Q1-F2009 - expense of \$1,326). BCH recognizes a future income tax asset on the withholding tax amounts paid as the Corporation receives a business foreign tax credit in Canada related to these amounts. BCH has also recognized a future income tax asset for various timing differences arising between the book value

and tax value of its capital assets. The recovery during the current year-to-date period is primarily a result of foreign exchange losses on BCH's debt reducing BCH's taxable income.

Stock Based Compensation

Included in discontinued operations, for three months ended September 30, 2009, stock compensation expense of \$Nil (Q1-F2009 - \$11) was recognized relating to stock options issued by BCH.

Interest and Financial Expenses

During Q1-F2019, interest and financial expenses were \$Nil (Q1-F2009 - \$2,870). Interest and financial expense is comprised of interest on the long-term debt facilities, convertible debenture, capital leases, and non-cash interest charges. Non-cash interest charges relate to the accretion of the deferred financing charges incurred on debt facilities as well as accretion of the convertible debenture. Non-cash interest charges for Q1-F2010 totalled \$Nil (Q1-F2009 - \$817).

Foreign Exchange

BCH's activities in Brazil used the Brazilian Real (BRL\$) as its functional currency and therefore it was exposed to the risk of fluctuations in foreign exchange rates. BCH's drilling services contracts are based on a US\$ price with a portion paid in BRL\$ and a portion of which is paid in US\$. Both BCH's long-term debt facilities and its Convertible Debenture are denominated in US\$.

BCH incurred a foreign exchange loss of \$Nil in Q1-F2010 (Q1-F2009 - loss of \$1,544). The foreign exchange loss is a result of the depreciation of the Canadian dollar relative to the US dollar and the corresponding impact on US denominated debt balances as well as the foreign exchange loss on translation as a result of the depreciation of the Brazilian Real relative to the Canadian dollar during the year.

Derivatives

BCH had two types of derivative contracts in place; three foreign currency derivative contracts and an embedded derivative associated with drilling contracts. These embedded derivatives have not been designated as hedges and therefore unrealized gains on these contracts have been recorded on the balance sheet with changes in their fair value recorded in the net earnings for the period. Details of the outstanding contracts are as follows:

Period	Notional Balance	Type	Settlement	Average BRL/US Exchange Rate
June 2008 - April 2009	US\$500,000 / month	Non-Deliverable Forward	Financial	1.7621
July 2008 - April 2009	US\$200,000 / month	Deliverable Forward	Physical Delivery	1.7306
July 2008 - April 2009	US\$100,000 / month	Deliverable Forward	Physical Delivery	1.7570

For the three months ended September 30, 2009, BCH had a net realized financial derivative loss of \$Nil (Q1-F2009 - \$1,026).

LIQUIDITY AND CAPITAL RESOURCES

Working Capital

Funding for the Corporation's expenditures during the year ended September 30, 2009 was provided through a combination of share issuances and debt facilities. At September 30, 2009, the Corporation had a working capital deficiency of \$13,863 (June 30, 2009 - \$15,262).

During Q1-F2010, the Corporation placed \$4,000 of convertible debentures with interest payable in common shares, closed a private placement for \$377 in common shares, and subsequent to the quarter end closed a \$40 million common share financing. Management feels that a combination of cash on hand, cash generated from operating activities, funding from Gemini, potential farm-ins and equity offerings will finance the Corporation to allow it to execute planned drilling program and exploration commitments in Colombia, Guyana and Brazil.

More information on financing can be found in the Subsequent Events section.

Cash Flow From Operating Activities

The Corporation has generally had a history of negative cash flow from operating activities and may not be able to generate sufficient cash flow to fund operating activities in order to finance operations and other requirements. Following the conclusion of the acquisition of Canacol Energy Inc. and the disposition of BCH, Canacol completed a detailed review of its operations and administrative functions in order to reduce inefficiencies and better integrate operations. In addition, significant financing initiatives have been completed to ensure that operations activities and exploration obligations are met. See “Working Capital”.

Debt Facilities

The Corporation has been successful in reducing its overall debt levels. On December 31, 2008, Canacol announced that it has completed the sale of its remaining interest in BCH Ltd. to Allis-Chalmers Energy Inc. Under the terms of the transaction, Allis Chalmers assumed liability for the outstanding US\$23,500 long-term debt facility with the lender and the outstanding US\$40,000 convertible debenture. Further, the proceeds of sale of US\$5,000 went towards debt reduction of the Corporation’s outstanding mezzanine facility.

The Corporation further reduced its outstanding debt balances by monetizing a forward commodity contract for proceeds of US\$5,000, which were also used to repay the Corporation’s outstanding mezzanine debt facility.

As at September 30, 2009, the Corporation had repaid in full its original amount on the mezzanine debt of US\$11,600.

See note 4 to the financial statements for Q1-F2010.

As at September 30, 2009, Canacol had a reserve based credit facility with US\$17,500 drawn; the Rancho Hermoso reserves based revolving line of credit facility. Subsequent to September 30, 2009, the Corporation repaid US\$5,000, decreasing the credit facility to US\$12,500.

Capital program commitments

In Colombia and Guyana, the Corporation has non-discretionary work program commitments totalling approximately \$15,758 due within a year or less and \$6,433 due over one year. The Corporation will continue to focus its efforts in 2009 on its operated development programs in Colombia, and on its non-operated appraisal project at the Capella discovery, to provide operating cash flow, and seek to reduce its exposure to its non-operated production and exploration operations in Brazil. The majority of the Corporation’s committed and discretionary development drilling programs in Colombia focus on increasing oil production from the tariff oil reservoir at the Rancho Hermoso Field in which the Corporation receives a fixed price per barrel of oil production. The Rancho Hermoso drilling projects are insensitive to WTI price volatility. Further, the Corporation is seeking to discontinue non-core operations in Canada and Ireland and intends to focus its capital on Colombia, Guyana, and Brazil. The Corporation intends to continue to finance these commitments through a combination of cash flow from operations and through additional debt and equity financing alternatives (as discussed in greater detail below). The Corporation is also actively seeking additional farm-in partners for its exploration projects in Brazil.

Other

The Corporation continues to assess its requirements for capital on an on-going basis. Although the dramatic drop in oil prices over the last year combined with the overall current state of the public capital markets restricts the options available for the Corporation to raise additional equity or debt, the Corporation has successfully attracted the required investment capital to fund operations and planned programs for 2010. See “Subsequent Events”.

COMMITMENTS, GUARANTEES, AND OFF-BALANCE SHEET ARRANGEMENTS

As at September 30, 2009, Canacol has minimum exploration program (“MEP”) work unit commitments to complete negotiated exploration work on its onshore blocks awarded by the Agência Nacional do Petróleo, Gás Natural e Biocombustível (“ANP”), Brazil’s National Petroleum Agency. MEP work units are satisfied through completion of exploration wells, seismic programs, and other exploration survey methods all of which have prescribed work units for completion. Therefore, although actual dollars spent on projects do not directly correlate to reducing the MEP work units, the financial guarantees related to non-performance are shown in the table below. The commitment will be reduced as work is performed.

Bid Round	Basin	Commitment Date	Gross Remaining MEP Work Units	Gross Financial Guarantee	Net Remaining MEP Work Units	Net Financial Guarantee ¹
	Recôncavo & Sergipe			\$1,078		\$142
7		August 26, 2008	595	BRL \$1,785	79	BRL \$237
				\$2,900		\$580
9	Recôncavo	March 12, 2010	1,600	BRL \$4,800	320	BRL \$960
				\$1,849		\$739
9	Espirito Santo	March 12, 2011	1,020	BRL \$3,060	408	BRL \$1,224

¹Net financial guarantee based on Canacol’s net working interest.

The Corporation and W. Washington have each cross-guaranteed the working interest of the other partner for the non-performance guarantee placed with a Brazilian insurance company which has insured the performance of the MEP work units or the corresponding financial payment in lieu thereof to the ANP on certain of Round 7 exploration blocks. A large percentage of the Round 7 exploration commitments have been farmed-out and as such the Net Remaining MEP Work Units attributable to Canacol for Round 7 in the table above is 79 units which, at September 30, 2009, equated to approximately \$142 (June 30, 2009 - 70 units or \$139). Based on actual work performed, the Corporation has made an accrual for the outstanding liability of \$142 (June 30, 2009 - \$139), relating to its net share of expected MEP work units yet to be fulfilled by means of financial. The Operator has satisfied this obligation.

In Colombia and Guyana, the Corporation has work program commitments totalling approximately \$15,758 due within a year or less and \$6,433 due over one year. In addition, the Corporation has commitments for office premises and other operating leases. As at September 30, 2009, the lease payments required in each of the next five years are as follows:

Leases	\$ (000's)
2010	97
2011	57
2012	Nil
2013	Nil
2014	Nil

Gemini Oil and Gas Funds

The Corporation executed a series of agreements with Gemini Oil and Gas Fund II, L.P. (“Gemini”), a Jersey based oil and gas investment fund, on April 17, 2009, whereby Gemini agreed, subject to certain preconditions, to invest up to US\$9,000, to be used to fund a portion of the Corporation’s development and appraisal programs on its producing assets in Colombia in 2009.

Under the terms the agreements, Gemini will invest:

- Up to US\$3,000 towards the drilling of a development well and the workover of 2 existing wells in the Entrerrios Field;
- Up to US\$3,000 towards the drilling of 2 development wells and the workover of one existing well in Rancho Hermoso Field; and

- c) Up to US\$3,000 towards the drilling of additional delineation wells in the Capella Field, its new heavy oil discovery on the Ombu E&P contract.

In return, Gemini is entitled to receive payments equivalent to a percentage of Canacol's gross revenue from production. Gemini has indicated that, if requested, it may consider increasing its total investment up to maximum of US\$12,000.

As at September 30, 2009, the Corporation had drawn US\$4.5 million from the agreements with Gemini. Subsequent to the end of the quarter, on November 17, 2009, the Corporation drew an additional US\$4.5 million from the arrangements with Gemini.

SUBSEQUENT EVENTS & PENDING TRANSACTIONS

Round 8 Land Auction

The Corporation qualified for and bid for onshore land blocks offered by the ANP, Brazil's National Petroleum Agency in Brazil's Round 8 land auction held on November 28th and 29th, 2006 ("Round 8 Bid"). Canacol and its partners in the Round 8 Bid, W. Washington and Brownstone, were successful in winning and being awarded five separate blocks, each block totalling 180 square kilometres of exploration lands ("Round 8 Bid Lands") in the Tucano Basin which lies directly west of the Recôncavo Basin. However, the Round 8 Bid is the subject of a court injunction filed in Brasilia against the ANP. The premise for the injunction is that the restriction for any one E&P company to purchase more than four blocks of land in any one area, in any given bid round of land is not constitutional. As of this report date, the court injunction has been lifted in the superior court from one of two jurisdictions. Canacol and its partners in the Round 8 Bid have no information indicating that their successful Round 8 Bid Lands will not be retained by them.

On October 15, 2009, the Corporation closed its underwritten private placement financing, including the exercise in full of the underwriters' option, for total gross proceeds of \$40,000. Pursuant to the financing, the Corporation has issued 142,858,000 common shares at a price of \$0.28 per common share. The Offering was completed by a syndicate of underwriters led by Canaccord Capital Corporation and including First Energy Capital Corp.

On October 23, 2009 the Corporation completed the purchase of all shares of Groundstar Resources Inc. ("GRI"), a Guyanese company which holds a Petroleum Prospecting License ("PPL") in the Takutu Basin in Guyana comprising approximately 7,800 square kilometres. Under the terms of the Agreement, Canacol acquired a 90% working interest in the PPL in exchange for a cash payment to Groundstar Resources (Cayman) Inc. ("GRCI"), the owner of GRI in the amount of US\$3.45 million. US\$1.2 million of this purchase price was previously paid to GRCI in May, 2009. The Corporation will carry a 10% net working interest for GRCI to first commercial production. Under the PPL, one well must be drilled on the property by May, 2010 and a second well must be drilled by May, 2011.

On November 5, 2009, the Corporation completed a farmout agreement with Sagres Energy Inc. ("Sagres"), whereby Sagres acquired a 25% interest in the Takutu Basin Petroleum Prospecting Licence in Guyana. On closing Sagres paid US\$1,250, to be applied first to 30% of prior direct costs incurred by Canacol, then to 30% of future cash calls to a maximum of US\$1,750, and 27.5% of cash calls thereafter. Sagres is entitled to 30% of revenues until recovery of its first US\$3,000 paid to Canacol, 27.5% of revenues until full cost recovery, and 25% thereafter.

On October 26, 2009, the Corporation repaid US\$5 million and on November 3, 2009, the Corporation repaid US\$4.4 million on its reserves based line of credit facility.

On November 17, 2009, the Corporation drew an additional US\$4.5 million from the financing arrangements with Gemini.

TRANSACTIONS WITH RELATED PARTIES

For the three months ended September 30, 2009, companies controlled by a director or officers of the Corporation were paid a total \$Nil (Q1-F2009 - \$47) in professional and consulting fees and office rent. All of the transactions were completed on normal industry terms. None of these amounts remained outstanding at each respective period end. Effective February 6, 2009, no related party remains as a director or officer of the Corporation.

Canacol has an operating agreement under standard industry terms on the properties in Brazil with W. Washington. Previously, W. Washington was considered a related party by virtue that it is controlled by a director of the Corporation. Following the changes in the composition of the Corporation's Board of Directors after the acquisition of Canacol Energy Inc., effective October 30, 2008, W. Washington ceased to be considered a related party of the Corporation. Total management fee payments accrued to W. Washington as a related party for the year ended September 30, 2009 totalled \$242 (Q1-F2009 - \$261) and is included in general and administrative expenses. These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

OUTLOOK

Canacol's goal is to build a significant oil production and exploration company in Latin America. The Corporation has established a production platform in its core operating countries of Colombia and Brazil, along with a large onshore appraisal and exploration positions in Colombia, Brazil, and Guyana. The Corporation is using its strong technical management team to realize the full production and reserves potential of its producing assets. In Colombia, the Corporation has identified a number of low risk opportunities within its operated fields that it intends to pursue, which are expected to result in a significant increase in existing production and reserves. The Corporation estimates an exit rate of 5,000 bbl/d for these properties at the year end June 30, 2010. In Brazil, the Corporation is evaluating the implementation of a secondary waterflood recovery plan to add additional reserves and production from these mature fields. On the exploration side, the Corporation has met with success in its non-operated Ombu E&P contract in Colombia, with the discovery of the Capella oil field. This significant discovery, currently being appraised, will yield near term production and reserves gains, and represents a long term development project with large heavy oil reserves upside. The Corporation has acquired the Pacarana and Tamarin lands adjacent to the Capella oil field. In Guyana, the Corporation has a working interest in a large onshore exploration block that contains an existing light oil discovery, Karanambo, and 2 large exploration prospects. The Corporation has plans in place to delineate the discovery and drill one exploration well in 2010. These activities are also expected to yield near term production and reserve additions in 2010.

SHARES OUTSTANDING (as at November 25, 2009)

There are an unlimited number of no par value common shares authorized for issuance. Details of the issued and outstanding shares are as follows:

Issued & Outstanding Share Capital	
Number of shares issued and outstanding, September 30, 2009	182,419,584
Private Placement - October 15, 2009	142,858,000
Agent Commission (private placement) - October 15, 2009	333,333
Warrants exercised	340,000
Stock options exercised	181,633
Agent Commission (Gemini financing) - November 25, 2009	166,667
Number of shares issued and outstanding, November 25, 2009	326,299,217

Subsequent to the year ended September 30, 2009, 181,633 shares were issued on exercise of options and 340,000 shares were issued on exercise of warrants.

On September 23, 2009, the Corporation also entered into an underwriting agreement with a syndicate of underwriters led by Canaccord and including First Energy Capital Corp. 142,858,000 common shares were issued at a price of \$0.28 per share. The offering was closed on October 15, 2009.

On October 15, 2009, the Corporation issued 333,333 common shares as agent commission in connection with the placement.

On November 25, 2009, the Corporation issued 166,667 common shares as agent commission in connection with the Gemini financing.

Options Outstanding (as at November 25, 2009)

The following are the outstanding stock options issued by the Corporation and their respective exercise prices and expiry dates. At November 25, 2009, vested stock options totalling 7,197,336 options were exercisable at a weighted average exercise price of \$0.34 per common share and a total of 18,936,034 options were issued and outstanding at a weighted average exercise price of \$0.27.

Stock Options Outstanding

	Number	Exercise Price	Expiry Date Range
Granted	215,000	\$0.40	March - June 2010
	1,275,000	\$0.75	January 2011
	125,000	\$1.00	February 2011
	140,000	\$1.20	November 2011
	785,000	\$1.20	February 2012
	325,000	\$1.20	June 2012
	150,000	\$1.20	October 2012
	813,000	\$0.65	March 1, 2013
	133,333	\$0.10	December 3, 2013
	4,963,334	\$0.10	January 6, 2014
	760,000	\$0.10	March 4, 2014
	5,958,001	\$0.19	June 5, 2014
	<u>15,642,668</u>		
Cancelled & Expired Options	(100,000)	\$0.40	March 31, 2010
	(100,000)	\$0.75	January 19, 2011
	(1,125,000)	\$0.75	January 1, 2011
	(700,000)	\$1.20	February 12, 2012
	(135,000)	\$1.20	June 12, 2012
	(445,000)	\$0.65	March 1, 2013
	(333,334)	\$0.10	January 6, 2014
	<u>(2,938,334)</u>		
Exercised	(286,667)	\$0.10	January 6, 2014
Balance, September 30, 2009	12,417,667	\$0.22	
Option Grant	6,700,000	\$0.35	November 6, 2014
Cancelled & Expired Options			
Exercised	(148,333)	\$0.10	January 6 to March 4, 2014
	(33,300)	\$0.19	June 5, 2014
Balance, November 25, 2009	18,936,034	\$0.27	

WARRANTS OUTSTANDING (as at November 25, 2009)

Warrants Outstanding			
	Number	Exercise Price	Expiry Date
Issued in connection with debt facility	10,000,000	\$0.80	August 29, 2013
Issued Warrants - private placement - May 14, 2009	17,410,000	\$0.20	May 14, 2011
Issued Warrants - private placement - May 28, 2009	6,590,000	\$0.20	May 28, 2011
Issued Warrants - private placement - July 23, 2009	1,109,524	\$0.30	July 24, 2011
Exercised Warrants - September 21, 2009	(20,000)	\$0.20	May 14, 2011
Issued Warrants - Sale of receivable	1,500,000	\$0.30	January 7, 2011
Warrants Outstanding at September 30, 2009	36,589,524	\$0.37	2.24 years
Exercised Warrants	(340,000)	\$0.20	May 14, 2011
Warrants Outstanding at November 25, 2009	36,249,524	\$0.37	2.25years

As part of the Rancho Hermoso debt financing, 10,000,000 warrants were issued to the lender on August 29, 2008 at an exercise price of \$0.80 per share. The warrants have a mandatory exercise clause in which they must be exercised if the closing price of Canacol's shares exceeds \$0.95 per share for 60 consecutive trading days. These warrants replaced 3,500,000 cancelled warrants (at an exercise price of US\$2.00 per common share) which were previously issued in conjunction with the Corporation entering into the W. Washington reserves based revolving credit facility.

In addition, as part of the May, 2009 private placements, 24,000,000 warrants were issued. Each warrant entitles the holder to acquire one common share at a price of \$0.20 until May 14, 2011 (first closing) and May 28, 2011 (second closing). 20,000 of these warrants were exercised on September 21, 2009.

On July 23, 2009, the Corporation issued 1,109,524 warrants in connection with a private placement at an exercise price of \$0.30. In addition, the Corporation issued 1,500,000 warrants in connection with the sale of a promissory note receivable at an exercise price of \$0.30.

Subsequent to the three months ended September 30, 2009, 340,000 warrants were exercised at an exercise price of \$0.20.

RISK FACTORS

The Corporation is subject to several risk factors including, but not limited to: the volatility of oil and natural gas prices; foreign exchange and currency risks; general risks related to foreign operations such as political, economic, regulatory and other uncertainties as they relate to both foreign investment policies and energy policies; governments exercising from time to time significant influence on the economy to control inflation; developing environmental regulations in foreign jurisdictions; discovery of new oil and natural gas reserves; concentration of oil sales receipts with a few major customers; that the Corporation anticipates substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the long-term for which it may require additional financings to implement its business plan.

As the Corporation has not experienced sufficient positive cash flow from operations to independently finance its growth and operations, it has been reliant on access to growth capital in the form of both

debt and equity to fund on-going operations and to fund capital investments. Although the current state of the financial and capital markets may severely limit access to capital, the Corporation has been able to successfully attract the required investment capital. More information on the Corporation's ability to successfully attract the required investment capital can be found in the Subsequent Events section.

The Corporation is exposed to foreign exchange and currency risk as a result of fluctuations in exchange rates through its cash deposits and investments denominated in the Colombian Peso (COP\$), the Brazil Real (BRL\$), and the United States dollar (US\$) as well as its debt balances which are denominated in US\$. At September 30, 2009, the Corporation held \$52 (BRL\$ 86) on deposit in Brazilian currency (June 30, 2009 - \$13 (BRL\$ 22) and \$3,823 (COP\$ 6.9 billion) on deposit in Colombian Pesos (June 30, 2009 - \$31 (COP\$ 58,285)) and \$236 (US\$ 220) on deposit in US dollars (June 30, 2009 - \$84 (US\$ 72)). As at September 30, 2009, the Corporation had \$18,763 (US\$17,500) in US dollar denominated debt outstanding (June 30, 2009 - \$20,344 (US\$ 17,500)) in connection with its debt facilities and \$5,193 (COP\$9.3 billion) (June 30, 2009 - 5,686 (COP\$10.3 billion) in connection with the unsecured line of credit drawn by its subsidiary Rancho Hermoso in Colombia.

Much of the Corporation's revenue and exploration and development costs are expected to be received/paid in or by reference to US\$ denominated prices while a significant portion of its operating and general and administrative costs are denominated in Canadian dollars, the BRL\$, and the COP\$. As a result of the ongoing adverse conditions, the Brazilian Real and the Colombian Peso have seen significant valuation against the US\$ during 2009 and it continues to have significant daily fluctuations making this particular currency risk more acute. The Corporation has not entered into currency derivatives for its continuing operations in order to hedge its exposure to fluctuations between the US dollar, Colombian Peso, or the Brazilian Real.

The Corporation's debt facilities are based on a LIBOR plus applicable spread. As such, the Corporation is subject to changes in the LIBOR interest rates. Although central bank government interest rates have declined, the Corporation has not seen significant declines in its borrowing costs as LIBOR spreads have increased over government rates as a result of the credit crisis. The Corporation will continue to be subject to interest rate volatility associated with LIBOR based credit facility. The line of credit in Colombia bears interest at the Deposit a Termino Fijo ("DTF") interest rate, a Colombian benchmark interest rate, plus spreads of 5.8% to 13.33% per annum on the balance outstanding resulting in an average rate of 14.33%.

Fluctuations in energy prices will not only impact the revenues of the Corporation but may also affect lending policies of the Corporation's lenders for existing and new borrowings. Crude oil prices are correlated with overall global economic growth and activity. The continuing weak global economic environment has resulted in a significant decline in crude oil prices over the last year. The dramatic drop in crude oil prices will also have a negative impact on the profitability of the Corporation which in turn will impact the operational cash flows of the Corporation as well as its ability to finance capital expenditures. This in turn could limit growth prospects over the short run or may even require the Corporation to dedicate cash flow, dispose of assets, or raise new equity to reduce bank borrowings as discussed further in the Liquidity and Capital Resources section.

In conjunction with the reserves based revolving credit facilities, the Corporation entered into one oil price financial derivative collar with the following terms.

WTI crude oil financial option collar:

Period	Volume	Type	Price Range
Jan – Dec 2009	185 bbl/d	Financial WTI Oil Collar	US\$55.00 - US\$80.25
Jan – Dec 2010	140 bbl/d	Financial WTI Oil Collar	US\$55.00 - US\$80.25
Jan – Aug 2011	114 bbl/d	Financial WTI Oil Collar	US\$55.00 - US\$80.25

The fair value of these transactions is based upon the estimated amounts that would have been paid to or received from counter parties in order to settle the transactions outstanding with reference to

the forward prices as of the reporting date. The contracts have been transacted with a counter party with whom management has assessed credit risk and deemed no adjustment for credit risk is required in determining the estimated settlement price. In addition, the contracts are based on standard industry contracts and the Corporation does not feel that there is a liquidity risk associated with them and no adjustment has been recorded in computing their valuation. While hedging activities may have opportunity costs when realized prices exceed hedged pricing, such transactions are not meant to be speculative and are considered within the broader framework of financial stability and flexibility. Management continuously reviews the need to utilize such techniques.

The Corporation's policy is to enter into agreements with customers that are well established and well-financed entities in the oil and gas industry such that the level of risk associated with one or more of its customers facing financial difficulties is mitigated while balancing factors of economic dependence with profit maximizing. To date, the Corporation has not experienced any material credit loss in the collection of accounts receivable. All Brazilian oil sales made through the Joint Venture are to a single customer who is the government energy Company (Petrobras), while in Colombia all oil sales revenue and tariff oil revenue comes from three customers of which two are also government entities (Petrobras Colombia and Ecopetrol) and one is a public company in Colombia (Hocol). Management continuously reviews its relationships with its customers to minimize any exposure risks.

The Corporation has also signed an agreement with Gemini for the financing of \$9,000, reducing exposure to risks related to the health and viability of its lender in the current difficult financial markets, and is exposed to the risk of reduction of this lender's appetite for the risks and exposures associated with financing junior international company operations from its major lender Standard Bank Plc. In addition, subsequent to the quarter ended September 30, 2009, on October 15, 2009, the Corporation issued 142,858,000 common shares at a price of \$0.28 per share for gross proceeds of \$40 million.

Debt covenants relating to the Corporation's Rancho Hermoso reserves based revolving line credit facility did not take effect until periods occurring on or after March 31, 2009. There is a risk that the Corporation will not be able to meet its debt covenants in upcoming periods. Failure to meet the debt covenants could, at the discretion of the lender, constitute an event of default giving the lender the right to demand repayment of some, or all, of the loan. Management has reviewed such situations with the lender and on October 22, 2009, the Corporation credit agreement was amended, modifying financial covenants for future periods. As of the date of these statements, the Corporation is in compliance with all non-financial and financial covenants including the borrowing base of the credit facility.

The Corporation attempts to mitigate its business and operational risk exposures by maintaining comprehensive insurance coverage on its assets and operations, by employing or contracting competent technicians and professionals, by instituting and maintaining operational health, safety and environmental standards and procedures and by maintaining a prudent approach to exploration and development activities. The Corporation also addresses and regularly reports on the impact of risks to its shareholders, writing down the carrying values of assets that may not be recoverable.

CRITICAL ACCOUNTING ESTIMATES

Canacol's significant accounting policies are contained in Note 2 to the audited consolidated financial statements for the year ended June 30, 2009.

Currency translation

The accounts of the self-sustaining Colombian subsidiaries are translated using the current rate method, whereby assets and liabilities are translated at the period-end exchange rates and revenues and expenses are translated using average period exchange rates. Translation gains and losses relating to the self-sustaining operations are included as part of accumulated other comprehensive income. The Corporation continues to use the temporal method to translate the operations of its

Brazilian subsidiaries as detailed in the Corporation's September 30, 2009 consolidated financial statements.

Revenue recognition

The Corporation receives tariff revenue under a risk service contract with Ecopetrol in which a tariff price per barrel of tariff oil production is paid to the Corporation. Ecopetrol is a Mixed Economy Company, with a commercial orientation, organized as an "Anonymous Society" (equivalent to a Corporation), under the Ministry of Mines and governed by the Social Statutes. Ecopetrol S.A. carries out hydrocarbon exploration, production, and transportation activities in Colombia both directly and through participation agreements with other companies operating in Colombia. The Corporation recognizes revenue based on production of tariff oil and collection is reasonably assured.

All contracts that Rancho Hermoso S.A. ("RSHA") has signed with Ecopetrol are "risk contracts" because RSHA makes all investments and is in charge of producing at its own cost and risk. RSHA takes the risk regardless of the outcome. However, there are differences depending how the contract rewards RSHA. There are two cases:

In the case of Mirador in the RSHA field, it is a service contract because all of the crude belongs to Ecopetrol and RSHA gets paid through a tariff per barrel. RSHA provides the service for oil production. This is referred to as a Risk Service Contract.

In the other cases (such as Ubaque in Rancho Hermoso and all formations in Entrerrios), the contract is a participation contract because RSHA is entitled to a proportion of the production. Therefore, RSHA gets paid its share of the oil production sold in the market. This is referred to as a Risk Participation Contract.

Exploration contracts refer to activities that the Corporation performs to determine the existence and location of hydrocarbons in the subsurface, including but not limited to geophysical and geochemical methods, and other operations to determine whether the discovery is a commercial field.

With regards to the Corporation's accounting policies, certain policies are recognized as critical because in applying these policies management is required to make judgments, assumptions, and estimates that have a significant impact on the financial results of the Corporation. The estimates used in applying these critical accounting policies are regularly reviewed and have been discussed with the Audit Committee. These policies include:

Income taxes

The Corporation uses the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are based on the differences between asset and liability balances reported for financial accounting purposes and those reported for income tax. Future income tax assets and liabilities are measured using the substantively enacted tax rates expected to apply in the years in which the temporary differences are expected to be recovered or settled. Future income tax assets are recognized to the extent that they are more likely than not to be realized.

Property, plant, and equipment

Depletion and depreciation

Petroleum and natural gas properties are recorded in accordance with the Canadian Institute of Chartered Accountants' guideline on full cost accounting for the oil and gas industry whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized on a country-by-country basis. Such costs include land acquisition costs, geological and geophysical costs, costs of drilling both productive and non-productive wells, production equipment, and overhead charges directly related to acquisition, exploration, and development activities. Gains or losses on disposal of properties are recognized only when crediting the proceeds to the recorded costs would result in a change of 20% or more in the depletion and depreciation rate.

Ceiling test and unproved properties

An impairment loss is recognized in net earnings when the carrying amount of a cost centre of petroleum and natural gas assets and properties is not recoverable and the carrying amount of the cost centre exceeds its fair value. The carrying amount of the cost centre is tested for recoverability by determining if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited by the amount by which the carrying amount exceeds the sum of the fair value of the proved and probable reserves and the costs of unproved properties that are subject to a separate impairment test.

Certain costs related to unproved properties and major development projects are excluded from costs subject to depletion and depreciation until the earliest of a portion of the property becomes capable of production, development activity ceases, or impairment occurs. These properties are reviewed quarterly and are subject to a separate impairment test. Any impairment is transferred to the costs being depleted. If the properties are located in a cost centre where there is no reserve base, the impairment is charged directly to earnings.

Asset retirement obligations

The fair value of the estimated asset retirement obligations is recognized in the consolidated balance sheet in the period which the liability is identified and incurred and a reasonable estimate of the fair value can be made. The obligations recognized are the legal obligations of the Corporation to retire and perform site restoration on tangible long-lived assets such as well sites. The obligations are discounted to their present value using the Corporation's credit adjusted risk-free interest rate. The corresponding amount increases the carrying amount of the related asset. The liability is accreted over time for changes in the fair value of the liability through charges to accretion expense. The amounts capitalized to the related assets are amortized to earnings over the expected remaining life of the underlying resources using the unit of production method. Actual costs incurred upon settlement of the asset retirement obligations are charged against the obligation to the extent of the liability recorded.

Stock based compensation plan

The Corporation records compensation expense in the consolidated financial statements for stock options granted to employees, directors, and consultants using the fair value method. Fair values are determined using the Black-Scholes option pricing model with compensation costs recognized over their vesting period. Any consideration paid to the Corporation on the exercise of stock options, along with amounts previously credited to Contributed Surplus, is credited to share capital.

Financial instruments

The Corporation's financial assets and liabilities consist of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, convertible debentures, currency and commodity derivatives, and long-term debt. The fair value of these financial assets and liabilities approximates their carrying value, unless otherwise noted.

IMPACT OF NEW AND PROPOSED ACCOUNTING STANDARDS

Business combinations

In January 2009, the Accounting Standards Board ("AcSB") issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Corporation plans to adopt this standard July 1, 2011 and do not expect the adoption of this statement to have a material impact on our results of operations or financial position.

Consolidated financial statements and Non-controlling interests

In January 2009, the AcSB issued Sections 1601, Consolidated Financial Statements, and 1602, Non-controlling Interests, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Corporation plans to adopt these standards effective July 1, 2011 and does not expect the adoption will have a material impact on our results of operations or financial position.

Goodwill and intangible assets

In February 2008, the CICA issued Section 3064, “Goodwill and Intangible Assets”, replacing Section 3062, “Goodwill and Other Intangible Assets” and Section 3450, “Research and Development Costs”. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company has adopted the new standards for its fiscal year beginning July 1, 2009. It establishes standards for the recognition, measurement, presentation, and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062.

International Financial Reporting Standards (IFRS)

In April 2008, the CICA published the exposure draft “Adopting IFRSs in Canada”. The exposure draft proposes to incorporate IFRS into the CICA Accounting Handbook effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. At this date, publicly accountable enterprises will be required to prepare financial statements in accordance with IFRS. The Corporation is preparing the diagnostic analysis that identifies differences between the Corporation’s current accounting policies and IFRS to determine the impact of these differences and assess the need for amendments to existing accounting policies in order to comply with IFRS.

MAINTENANCE OF DISCLOSURE CONTROLS AND PROCEDURES (DC&P) AND INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR)

Management and the Board of Directors are committed to the promotion of investor confidence by ensuring that trading in the Corporation's securities takes place in an efficient, competitive, and informed market. In accordance with the continuous disclosure requirements under the securities commission rules and TSX Venture Exchange policies, the Corporation has adopted a Corporate Disclosure Policy and has procedures in place to ensure that any sensitive information is identified, reviewed by management, and disclosed in a timely manner to the regulatory authorities, shareholders, and the public.

However, in contrast to the requirements under National Instrument 52-109 Certification of Disclosure in Issuers’ Annual and Interim Filings (NI 52-109), the Corporation has opted out under the rules afforded to TSX Venture issuers and Management and the Board do not make any representations relating to the establishment and maintenance of disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR), as defined in NI 52-109.

ADDITIONAL INFORMATION

Additional information relating to the Corporation’s regulatory filings can be found on SEDAR at www.sedar.com.

Corporate Information

Management Team

Charle Gamba – President & Chief Executive Officer

Mark Holliday – Chief Operating Officer

Mark Teare – Vice President Exploration

Brian Hearst – Chief Financial Officer

Board of Directors

Michael Hibberd, Chairman

Luis Baena

Alvaro Barrera

Jason Bednar

Charle Gamba

Stuart Hensman

David Winter

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Auditors

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Bankers

HSBC Bank Canada – Calgary, Canada

HSBC Bank Brasil - Rio de Janeiro, Brazil

Banco de Credito, Bogota, Colombia

Independent Reserve Engineers

DeGolyer and MacNaughton Canada Limited

Ryder Scott Company LP

Netherland, Sewell & Associates, Inc.

Legal Counsel

Davis LLP - Canada

Heenan Blaikie LLP - Canada

Schmidt, Valois, Miranda, Ferreira & Agel – Brazil

Gamboa Chalela, Salazar Abogados - Colombia

Stock Exchange Listing

TSX Venture Exchange: CNE

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