

Canacol Energy Ltd.
(Formerly BrazAlta Resources Corp.)

Consolidated Financial Statements

Second Quarter Interim Report, Fiscal 2009

Three and Six Months Ended December 31, 2008
(Unaudited)

March 2, 2009

Canacol Energy Ltd.

(formerly BrazAlta Resources Corp.)

Consolidated Balance Sheets

As at

(\$000s) (unaudited)

	December 31, 2008	June 30, 2008 (note 17)
Assets		
Current Assets:		
Cash and cash equivalents	2,901	9,983
Cash - restricted (note 4)	877	668
Accounts receivable	1,813	7,818
Prepaid expenses and deposits	111	489
Financial derivative asset, net (note 11)	396	-
Asset held for sale	-	975
	6,098	19,933
Deferred acquisition costs	-	733
Cash call receivable	1,994	2,009
Cash reserved for asset retirement (note 8)	634	324
Future income tax asset	-	159
Property, plant, and equipment (note 5)	80,380	88,455
	89,106	111,613
Liabilities and Shareholders' Equity		
Current Liabilities:		
Line of credit (note 6c)	5,759	-
Accounts payable and accrued liabilities	7,155	7,540
Liabilities held for sale	-	132
Interest payable	127	2,799
Current portion of capital lease obligations (note 7)	47	974
Current portion of long term debt (note 6)	3,763	6,960
Financial derivative liability, net (note 11)	-	263
Reclassified portion of long term debt	-	18,786
	16,851	37,454
Capital lease obligations (note 7)	31	487
Future income tax liability	11,339	-
Long term debt (note 6)	17,111	2,080
Asset retirement obligation (note 8)	2,308	420
Financial derivative liability, net (note 11)	-	724
Convertible debenture (note 17)	-	36,191
	47,640	77,356
Going concern (note 1)		
Commitments and guarantees (note 16)		
Subsequent events (note 18)		
Non-controlling interest (note 17)	-	2,757
Shareholders' equity:		
Share capital (note 9)	65,701	58,604
Contributed surplus (note 10)	8,408	6,127
Cumulative translation adjustment	(120)	-
Deficit	(32,523)	(33,231)
	41,466	31,500
	89,106	111,613

See accompanying notes to the consolidated financial statements.

Canacol Energy Ltd.

(formerly BrazAlta Resources Corp.)

Consolidated Statements of Income (Loss) and Comprehensive Income (Loss) and Deficit

Three and six months ended December 31,

(\$000s, except per share amounts) (unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007 (note 19)	2008	2007 (note 19)
Revenues:				
Petroleum and natural gas, net of royalties of \$152 (2007 - \$192)	1,766	1,035	3,116	1,897
Tariff revenue	970	-	970	-
Interest and other	338	13	367	131
	3,074	1,048	4,453	2,028
Expenses:				
Operating expenses	2,621	754	3,298	1,413
Depletion, depreciation, and accretion	1,749	626	2,756	963
General and administrative	1,892	1,021	3,271	1,833
Interest and financial expenses (note 6c)	904	245	1,109	359
Foreign exchange (gain) loss, net (note 11)	(12)	(353)	865	(529)
Realized loss (gain) on financial derivatives, net (note 11)	(2,276)	121	(1,992)	126
Unrealized loss (gain) on financial derivatives, net (note 11)	(1,363)	444	(1,884)	585
Stock compensation expense (note 9d)	47	353	163	830
Impairment on goodwill (note 3)	5,123	-	5,123	-
Impairment on long-term assets (note 5)	3,555	-	3,555	-
	12,240	3,211	16,264	5,580
Loss before income taxes	(9,166)	(2,163)	(11,811)	(3,552)
Current income tax recovery	(276)	-	(276)	-
Future income tax recovery	(43)	-	(43)	-
	(319)	-	(319)	-
Net loss before discontinued operations	(8,847)	(2,163)	(11,492)	(3,552)
Discontinued operations and gain on sale, net of tax (note 17)	16,743	1,435	12,200	102
Net income (loss)	7,896	(728)	708	(3,450)
Deficit, beginning of period	(40,419)	(18,372)	(33,231)	(15,650)
Deficit, end of period	(32,523)	(19,100)	(32,523)	(19,100)
Net loss per share from continuing operations (note 9e)	(0.08)	(0.03)	(0.11)	(0.04)
Net income (loss) per share from discontinued operations - basic and diluted (note 9e)	0.14	-	0.12	-
Net income (loss) per share - basic and diluted (note 9e)	0.07	(0.01)	0.01	(0.04)
Net income (loss)	7,896	(728)	708	(3,450)
Other comprehensive income:				
Foreign currency translation adjustment	(120)	-	(120)	-
Comprehensive income (loss)	7,776	(728)	588	(3,450)

See accompanying notes to the consolidated financial statements.

Canacol Energy Ltd.

(formerly BrazAlta Resources Corp.)

Consolidated Statements of Cash Flows

Three and six months ended December 31,

(\$000s) (unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007 (note 19)	2008	2007 (note 19)
Cash provided by (used in):				
Operating Activities:				
Net loss from continuing operations	(8,847)	(2,163)	(11,492)	(3,552)
Adjustments for non-cash items:				
Non-cash interest expense	206	105	336	162
Non-cash income include in interest and other	(185)	-	(185)	(1)
Depletion, depreciation, and accretion	1,749	626	2,756	963
Stock compensation expense	47	353	163	830
Future income tax recovery	(43)	-	(43)	-
Impairment on goodwill	5,123	-	5,123	-
Impairment on long-term assets	3,555	-	3,555	-
Unrealized foreign exchange loss (gain), net	28	284	614	8
Unrealized financial derivatives loss (gain), net	(1,363)	444	(1,884)	585
	270	(351)	(1,057)	(1,005)
Change in non-cash operating working capital, net of effects of acquisition and disposition (note 15)	5,403	(195)	5,240	(145)
Cash flow from continuing operations	5,673	(546)	4,183	(1,150)
Cash flow from discontinued operations	(941)	(3,701)	(289)	(4,181)
Total cash flow from operating activities	4,732	(4,247)	3,894	(5,331)
Financing Activities:				
Issue of common shares	-	5,500	-	9,062
Draws on line of credit	2,496	-	2,496	4,554
Repayment of long term debt facilities and capital leases	(12,619)	(10)	(13,567)	(10)
Financing and share issue costs	-	(305)	-	(621)
Cash flow from continuing operation	(10,123)	5,185	(11,071)	12,985
Cash flow from discontinued operations	(3,952)	14,524	1,767	28,088
Total cash flow from financing activities	(14,075)	19,709	(9,304)	41,073
Investing Activities:				
Property, plant, and equipment purchases, net	(2,948)	(1,543)	(4,050)	(6,148)
Cash assumed on acquisition of Canacol Energy Inc.	1,602	-	1,602	-
Cash reserved for asset retirement	(16)	(14)	(23)	(18)
Cash - restricted	20	(151)	20	(3)
Change in non-cash investing working capital, net of effects of acquisition and disposition (note 15)	848	2,084	(4,012)	2,595
Cash flow from continuing operation	(494)	376	(6,463)	(3,574)
Cash flow from discontinued operations	4,666	(14,651)	3,923	(31,972)
Total cash flow from investing activities	4,172	(14,275)	(2,540)	(35,546)
Foreign exchange gain (loss) on cash and cash equivalents held in foreign currency	791	11	868	(19)
Net increase (decrease) in cash and cash equivalents	(4,380)	1,198	(7,082)	177
Cash and cash equivalents, beginning of period	7,281	1,930	9,983	2,951
Cash and cash equivalents, end of period	2,901	3,128	2,901	3,128
Supplementary disclosure of cash flow information:				
Interest paid	1,124	118	1,174	118
Taxes paid	-	-	-	-

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

1. BASIS OF PRESENTATION AND GOING CONCERN

Canacol Energy Ltd. (“Canacol” or the “Corporation”) (formerly BrazAlta Resources Corp. (“BrazAlta”)) and its subsidiaries are primarily engaged in petroleum and natural gas exploration and development activities in Colombia, Brazil, Guyana, Canada, and other international jurisdictions. The Corporation’s head office is located in Calgary, Alberta, Canada and the Corporation’s shares are traded on the TSX Venture Exchange.

These interim consolidated financial statements do not include all disclosures required for annual financial statements and should be read in conjunction with the most recent audited annual consolidated financial statements and the notes thereto for the year ended June 30, 2008. With the exception of the new accounting policies adopted by the Corporation (note 2), the significant accounting policies applied are consistent with those in the audited annual consolidated financial statements except for the changes described herein in note 2.

These consolidated financial statements are stated in Canadian dollars and have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”) on a going concern basis. The going concern basis presumes the realization of assets and settlement of liabilities as they come due in the normal course of operations.

As at December 31, 2008, the Corporation had negative working capital and history of recurring net losses. During the period ended December 31, 2008, the Corporation reduced its overall debt levels by selling its remaining interest in its subsidiary, BCH Ltd. (note 17) and by monetizing a forward commodity contract (note 11a) and applying the proceeds from these transactions towards the repayment of its mezzanine debt facility (note 6a) for a total of US\$10,000. In addition, through the disposition of BCH Ltd., the Corporation further reduced its debt exposure as the remaining long-term debt facility and the convertible debenture held by BCH Ltd. were assumed by Allis-Chalmers Energy Inc. following the disposition.

The debt covenants relating to the Corporation’s Rancho Hermoso reserves based revolving line credit facility (note 6a) do not take effect until periods occurring on or after March 31, 2009. There is, however, 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. As of the date of these statements, Management does not feel that it is likely that the Corporation will be able to achieve all of covenants. Management is reviewing the situation with the lender and may need to request a waiver from the lender or address any deficiencies as required by the lender if it cannot meet the covenant requirements. As of the date of these statements, the Corporation remains in compliance with the remaining non-financial covenants of the loan.

The lender of the W. Washington reserves based revolving line credit facility (note 6b) has reduced the maximum draw on the facility from US\$7,100 (net US\$3,373) to US\$4,000 (net US\$1,900). The Corporation, and its joint venture partner W. Washington, have received a notice of an Event of Default from the lender. As of the date of these statements, the Corporation and its joint venture partner W. Washington have not yet resolved this deficiency. The Corporation is currently working with the lender of this facility to renegotiate amendments and/or extensions. While the Corporation is focusing its best efforts on these matters and continues to negotiate with its lender, the outcome cannot be certain at this time.

As of the date of these statements, the Corporation cannot reasonably estimate the chance of success in renegotiating the necessary amendments to its debt facilities. Based on the above items, there is a risk regarding the Corporation’s ability to continue as a going concern. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Corporation may not be able to continue

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

in business and therefore be unable to realize its assets and discharge its liabilities in the normal course of business. Such adjustments could be material.

2. NEW ACCOUNTING POLICIES AND CHANGES IN ACCOUNTING POLICIES

The following new accounting policies were adopted by the Corporation upon the acquisition of Canacol Energy Inc. on October 30, 2008. These policies are in addition to significant accounting policies outlined in the audited annual consolidated financial statements for the year ended June 30, 2008.

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 June 30, 2008 consolidated financial statements.

Revenue recognition

The Corporation receives tariff revenue under a risk service contract with Ecopetrol S.A. ("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 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.

The following represent the changes in accounting policies as a result of new GAAP pronouncements:

Capital disclosures

On July 1, 2008, the Corporation applied CICA Section 1535, "Capital Disclosures". The main features of this section are to establish requirements for an entity to disclose qualitative information about its objectives, policies, and processes for managing capital, quantitative data about what it regards as capital, and whether it has complied with any externally imposed capital requirements and, if not, the consequences of such non-compliance. These disclosures may be found in note 12.

Financial instruments

On July 1, 2008, the Corporation adopted two additional CICA Handbook requirements relating to financial instruments, section 3862 "Financial Instruments – Disclosures" and section 3863 "Financial Instruments – Presentations". The effect of these standards are incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance, the nature, the extent, and management of risks to which the entity is exposed to arising from financial instruments as detailed in note 11.

Inventories

On July 1, 2008, the Corporation adopted section 3031 "Inventories". The adoption has had no impact on the Corporation.

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

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

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 will adopt 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)

On February 13, 2008, the AcSB confirmed that effective for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, International Financial Reporting Standards (IFRS) will replace Canada's current Generally Accepted Accounting Principles for all publicly accountable profit oriented enterprises.

3. BUSINESS ACQUISITION

Business acquisitions are accounted for using the purchase method. The results of acquired businesses have been included in the consolidated financial statements since the acquisition closing date.

Effective October 30, 2008, Canacol Energy Ltd. (operating as BrazAlta Resources Corp. at the time of acquisition) acquired all of the issued and outstanding shares and warrants of Canacol Energy Inc. Canacol Energy Inc. was a private Alberta based company with petroleum and natural gas interests in Colombia and Guyana. The purchase price of \$8,000 was paid through the issuance of 39,999,994 common shares of Canacol Energy Ltd. at a fair value of \$0.20 per share based on the five day weighted average share price on the date of measurement. In addition, acquisition costs of \$1,028 were incurred resulting in aggregate consideration of \$9,028.

The Corporation continues to review the net assets acquired in the acquisition but the preliminary fair values of the net assets acquired and aggregate consideration given are as follows:

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

Consideration given	\$
Common shares	8,000
Acquisition costs	1,028
Total consideration	9,028
Allocation of purchase price	
	\$
Current assets	8,478
Property, plant, and equipment	51,977
Other long-term assets	2,563
Goodwill	5,123
Total assets	68,141
Current liabilities	19,443
Long-term liabilities	26,475
Asset retirement obligation	1,813
Future income tax liability	11,382
Total liabilities	59,113
Net assets acquired	9,028

The above purchase price allocations are preliminary and have been allocated based upon a preliminary evaluation of the fair value of the assets and liabilities acquired. The purchase price allocations will remain preliminary until the Corporation finalizes it as part of the Corporation's year-end audit.

As part of the acquisition of Canacol Energy Inc., the Corporation recognized \$5,123 of goodwill. Following the acquisition, the significant drop in oil prices combined with the global economic and financial crisis has resulted in a change in the value of Canacol Energy Inc. During the period ended December 31, 2008, the Corporation recorded impairment on the goodwill relating to its purchase of Canacol Energy Inc. of \$5,123.

4. CASH - RESTRICTED

As at December 31, 2008, a total of \$877 (June 30, 2008 - \$668) in cash assets were restricted in conjunction with a reserve for interest instalments due within the next three months on the Corporation's debt facilities described in note 6. The balance at June 30, 2008 relates to discontinued operations.

5. PROPERTY, PLANT, AND EQUIPMENT

	Six Months Ended December 31, 2008			Year Ended June 30, 2008		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Petroleum and natural gas properties	89,965	(13,453)	76,512	29,549	(5,484)	24,065
Drilling rig	3,170	-	3,170	62,046	(1,819)	60,227
Service rig equipment	-	-	-	1,579	(83)	1,496
Vehicles	-	-	-	2,025	(344)	1,681
Office Equipment	336	(189)	147	841	(191)	650
Building & Leasehold	81	(3)	78	88	-	88
Equipment & Other	474	(1)	473	248	-	248
	94,026	(13,646)	80,380	96,376	(7,921)	88,455

The costs excluded from the depletion calculation include undeveloped land costs, completion equipment inventory, and drilling in progress. As at December 31, 2008, the total costs excluded from the depletion calculation and

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For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

ceiling test were \$20,527 (June 30, 2008 - \$2,507). No indirect overhead costs were capitalized during the six month periods ended December 31, 2008 or 2007. During six month the period December 31, 2008, the Corporation recorded an impairment of \$3,555 (2007- \$Nil) relating to long-term assets. The impairment charges recorded by the Corporation relate to the impairment recorded on the Corporation's non-core assets including its Canadian petroleum and natural gas properties, the remaining drilling rig held by the Corporation following the sale of BCH Ltd., and a provision for the Corporation's Ireland properties. Management determined that given the dramatic decline in commodity prices and current financial crisis, the Corporation will not likely be able to realize the carrying value of the assets in future periods. The impairment recorded was to adjust the carrying value of these long-term assets to the expected value to be realized.

6. LONG TERM DEBT

Canacol currently has two reserves based revolving line credit facilities; the Rancho Hermoso reserves based revolving line credit facility and the W. Washington reserves based revolving line credit facility

	December 31, 2008	June 30, 2008
	\$	\$
Reserves based revolving line credit facility - opening balance	3,049	-
Reserves based revolving line credit facility issued or assumed	31,142	4,554
Transaction costs	(1,215)	(1,740)
Repayment of long-term debt facility	(13,543)	-
Total long-term debt	19,433	2,814
Accretion of transaction costs	336	433
Unrealized foreign exchange (gain) loss	1,105	(198)
	20,874	3,049
Current portion, revolving line credit facility	(3,763)	(969)
Long-term reserves based revolving line credit facility - ending balance	17,111	2,080

a. Rancho Hermoso reserves based revolving line credit facility

On August 29, 2008, Canacol Energy Inc. (note 3) closed the acquisition of a private Colombian exploration and production company, Rancho Hermoso S.A. for US\$28,600. A debt facility from Standard Bank Plc totalling US\$25,600 was put in place in order to finance the acquisition of Rancho Hermoso S.A. The original loan was comprised of two credit facilities:

- a) a US\$50,000 three year senior secured borrowing base revolving credit facility with current availability of US\$14,000; and
- b) a US\$11,600 mezzanine facility.

The security package and terms for the Standard Bank Loan comprises a lien on the shares of Rancho Hermoso S.A., a guarantee from each of Canacol Energy Ltd. and Canacol Energy Inc., and a hedge of a percentage of Rancho Hermoso S.A. production. The revolving credit facility is payable in full on August 27, 2011 and the mezzanine facility is payable in six equal semi-annual payments beginning on February 27, 2009. During the six month period ended December 31, 2008, US\$10,000 has been repaid on the mezzanine facility to reduce the balance outstanding to US\$1,600 as at December 31, 2008. The revolving credit facility bears interest at LIBOR plus 4.00% while the mezzanine facility bears interest at LIBOR plus 12.00%.

In conjunction with the financing, Canacol issued to Standard Bank, warrants to acquire 10,000,000 Canacol Common Shares at a price of C\$0.80 per Canacol Common Share for a period of five years and cancelled 3,500,000 warrants previously issued to Standard Bank at US\$2.00 as part of the issuance of the W. Washington reserves

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

based revolving credit facility. Refer to note 9c for additional details regarding the warrants.

b. W. Washington reserves based revolving line credit facility

Canacol and its Brazil Joint Venture partner, W. Washington Petroleo S.A. (“W. Washington”) have entered into a reserves based revolving line of credit facility for up to US\$50,000. The facility limit is based on the lender’s evaluation of reserves estimates, and currently has a maximum draw of gross US\$4,000 (net US\$1,900). As of December 31, 2008, there was a gross draw of US\$7,100 (net US\$3,373) (June 30, 2008 - gross US\$9,000 (net US\$4,275)) drawn on the facility. The Corporation and its joint venture partner W. Washington have received a notice of an Event of Default from the lender in accordance with provisions of the credit facility. The Corporation has not yet resolved this deficiency as of the date of these statements. The Corporation is currently working with the lender to renegotiate amendments and/or extensions to its existing debt facilities.

The reserves based revolving line of credit facility is secured by a first charge on all of W. Washington’s assets, as well as W. Washington’s and Canacol’s interests in oil and gas concession contracts in Brazil and the receivables from any corresponding oil sales. In addition, the shares of BrazAlta Brasil Norte Comercializacao de Petroleo Ltda. (“BrazAlta Norte”) owned by Canacol have been pledged as security. Furthermore, the loan has been guaranteed by Canacol and BrazAlta Norte and is cross guaranteed by the Corporation as a 47.5% joint-interest partner.

The revolving facility requires interest payments only for three years with repayment of the outstanding principal due in full in August 2010. The facility bears interest at LIBOR plus 3.50%.

c. Revolving operating line of credit

The Corporation, through its wholly owned subsidiary Ranch Hermoso SA, has revolving operating lines of credit. These lines of credit bear interest at the Depósitos a Término Fijo (“DTF”) interest rate, a Colombian benchmark interest rate, plus spreads of 3.6% to 12.65% per annum on the balance outstanding resulting in an average rate of 15.36%. At December 31, 2008, a total of \$5,759 had been drawn on these facilities (June 30, 2008 – \$Nil). The operating lines of credit are unsecured.

d. Interest and financial expense

Interest and financial expense is comprised of both cash and non-cash components. The non-cash components relate to accretion of deferred financing charges incurred on the Corporation’s debt facilities which are accreted over the life of the respective loans using the effective interest rate method. Details of the cash and non-cash components of interest and financial expense are as follows:

	<u>Three Months Ended December 31,</u>		<u>Six Months Ended December 31,</u>	
	2008	2007	2008	2007
	\$	\$	\$	\$
Cash interest expense	698	140	773	197
Accretion of transaction costs	206	105	336	162
Total interest and financial expense	904	245	1,109	359

As outlined in note 4, the Corporation maintains a reserve in cash which is restricted relating to interest instalments due within the next three months on the Corporation’s debt facilities.

e. Principal repayments

Future repayments on the Corporation’s outstanding debt facilities for the next five years are as follows:

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For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

	2009 - 6 Months	2010	2011	2012	2013	Total
Rancho Hermoso facility	-	-	17,144	-	-	17,144
	-	-	US\$14,000	-	-	US\$14,000
Line of credit	5,759	-	-	-	-	5,759
	US\$4,702	-	-	-	-	US\$4,702
Mezzanine facility	1,959	-	-	-	-	1,959
	US\$1,600	-	-	-	-	US\$1,600
W. Washington facility	1,803	2,327	-	-	-	4,130
	US\$1,473	US\$1,900	-	-	-	US\$3,373
	9,521	2,327	17,144	-	-	28,992
	US\$7,775	US\$1,900	US\$14,000	US\$0	US\$0	US\$23,675

7. CAPITAL LEASE OBLIGATIONS

	December 31, 2008	June 30, 2008
	\$	\$
Capital leases secured by the related assets	90	1,642
Imputed interest	(12)	(181)
	78	1,461
Amounts due within one year	(47)	(974)
	31	487

The Corporation's capital leases primarily relate to a building. The lease bears interest at 12.5% and has a remaining term of 2 years. Assets under capital leases at December 31, 2008 totalled \$80 (June 30, 2008 - \$2,025). Accumulated depreciation of these assets at December 31, 2008 totalled \$2 (June 30, 2008 - \$344). Amortization expense related to the capital leases for the period ended December 31, 2008 totalled \$2 (2007 - \$344).

8. ASSET RETIREMENT OBLIGATION

	Six Months Ended December 31, 2008	Year Ended June 30, 2008
	\$	\$
Asset retirement obligation, opening balance	420	343
Liabilities incurred and acquired	1,829	51
Liabilities settled	-	(11)
Revision of estimates	-	1
Accretion expense	38	36
Vairance due to foreign exchange	21	-
Asset retirement obligation, ending balance	2,308	420

As at December 31, 2008, the estimated total undiscounted amount required to settle the asset retirement obligation was \$3,017 (June 30, 2008 - \$711) and these costs are expected to be settled over the useful lives of the underlying assets which currently extend up to 15 years into the future. The estimated cash flow has been computed using a credit-adjusted risk free discount rate of 9.5% and a country inflation rate as follows: Canada 2.0%, Brazil 5.0%, and Colombia 5.5%. In accordance with Brazilian and Colombian regulations, as of December 31, 2008, a total of \$634 (June 30, 2008 - \$324) of cash has been reserved for future asset retirement.

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

9. SHARE CAPITAL

a. Authorized

The Corporation is authorized to issue an unlimited number of common shares.

b. Issued

	Six Months Ended December 31, 2008		Year Ended June 30, 2008	
	Number of Securities	\$	Number of Securities	\$
Issued and outstanding				
Common Shares				
Common shares outstanding, opening balance	90,084,661	57,278	75,556,663	47,245
Issued on private placement	-	-	10,000,000	5,500
Issued on acquisition of Canacol Energy Inc. (note 3)	39,999,994	8,000	-	-
Stock options exercised	-	-	91,700	43
Contributed surplus related to stock options exercised	-	-	-	28
Warrants exercised	-	-	4,436,298	3,549
Fair value of warrants exercised	-	-	-	1,243
Share issue costs	-	-	-	(330)
Common shares outstanding, ending balance	130,084,655	65,278	90,084,661	57,278
Warrants				
Warrants outstanding, opening balance	9,172,000	1,326	10,136,633	2,569
Issued during debt financing arrangement (note 9c)	10,000,000	-	3,500,000	-
Exercised	-	-	(4,436,298)	(1,243)
Cancelled (note 9c)	(3,500,000)	-	-	-
Expired	(4,167,000)	(903)	(28,335)	-
Warrants outstanding, ending balance	11,505,000	423	9,172,000	1,326
Total Share Capital, ending balance		65,701		58,604

c. Warrants

Previously, in conjunction with entering into the W. Washington reserves based revolving credit facility (note 6), the Corporation issued 3,500,000 warrants, which were exercisable for a period of five years at an exercise price of US\$2.00 per common share. These warrants were cancelled and replaced with new warrants as part of the Rancho Hermoso debt financing (note 6). They were replaced with 10,000,000 new warrants with an exercise price of C\$0.80 per common share and an expiry of August 29, 2013. The warrants have a mandatory exercise clause in which they must be exercised if the closing price of Canacol's shares exceeds C\$0.95 per share for 60 consecutive trading days. At the date of issuance, the net fair value of the new warrants issued was calculated to be \$1,215 using a Black-Scholes pricing model based on the following assumptions: risk-free rate of 3.0%, expected life of five years, no dividends, and an expected volatility of 84% and have been included as part of financing costs.

Notes to the Consolidated Financial Statements

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(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

	Six Months Ended December 31, 2008		Year Ended June 30, 2008	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
Opening	9,172,000	\$1.87	10,136,633	\$1.35
Issued	10,000,000	\$0.80	3,500,000	US \$2.00
Exercised	-	-	(4,436,298)	\$0.80
Cancelled	(3,500,000)	US \$2.00	-	-
Expired	(4,167,000)	\$2.00	(28,335)	\$0.80
Ending	11,505,000	\$0.85	9,172,000	\$1.87

Exercisable warrants as at December 31, 2008 had the following exercise prices and expiry dates:

Number of Warrants	Exercise Price	Expiry Date
1,505,000	\$1.20	January 8, 2009
10,000,000	\$0.80	August 29, 2013
11,505,000	\$0.85	4.06 years

d. Stock Options

The Corporation has a stock option plan for the purpose of aligning the interest of its directors, officers, employees, and consultants in the growth and development of the Corporation by providing them with the opportunity, through share options, to acquire an interest in the Corporation. The outstanding options expire at various dates between March 2010 and December 2013. At December 31, 2008, a total of 6,129,677 options were exercisable at a weighted average exercise price of \$0.88 per common share.

	Six Months Ended December 31, 2008			Year Ended June 30, 2008		
	Number of Stock Options	Weighted Average Exercise Price \$	Fair Value Assigned \$	Number of Stock Options	Weighted Average Exercise Price \$	Fair Value Assigned \$
Opening	7,571,334	0.91	4,098	7,301,700	0.97	4,311
Exercised	-	-	-	(91,700)	0.46	(28)
Cancelled	(1,399,668)	1.07	(884)	(1,381,666)	1.05	(848)
Granted	400,000	0.10	23	1,743,000	0.77	663
Ending	6,571,666	0.83	3,237	7,571,334	0.91	4,098

Compensation expense for stock options is recognized using the fair value method when the stock options are granted and is amortized over the options' vesting periods. As at December 31, 2008, \$45 (June 30, 2008 - \$220) of stock based compensation expense remains unrecognized. During the three and six month periods ended December 31, 2008, \$47 and \$163 respectively (2007 - \$353 and \$830 respectively) has been recognized in the consolidated statement of loss using the Black-Scholes pricing model based on the following assumptions at the time of the option grant:

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

	Six Months Ended December 31, 2008	Year Ended June 30, 2008
Risk-free interest rate	2.27%	3.4% - 4.4%
Expected life of options	5 years	5 years
Dividend yield	Nil	Nil
Expected volatility	99%	72%
Weighted average fair value price	\$0.06	\$0.37

e. Per share amounts

Basic loss per share calculations are based on the loss attributable to common shareholders for the period divided by the weighted average number of common shares issued and outstanding during the period. The diluted loss per share calculation is based on the weighted average number of common shares outstanding during the period, plus the effects of dilutive common share equivalents. This method requires that the dilutive effect of outstanding options and warrants issued should be calculated using the treasury stock method. This treasury stock method assumes that all common share equivalents have been exercised and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of common shares during the period.

For the three and six months ended December 31st, the diluted loss per share from continuing operations is the same as basic loss per share as the effect of the exercise of options and warrants on loss per share would be anti-dilutive. In calculating the basic and diluted income per share from discontinued operations and net income per share for the three and six months ended December 31st, the weighted average number of common shares used in the calculation of basic and diluted net income per share is shown below.

	<u>Three Months Ended December 31,</u>		<u>Six Months Ended December 31,</u>	
	2008	2007	2008	2007
Basic	117,041,179	81,205,313	103,562,920	80,390,329
Diluted	117,063,694	81,205,313	103,656,004	80,390,329

10. CONTRIBUTED SURPLUS

The following table reconciles the Corporation's contributed surplus:

	December 31, 2008	June 30, 2008
	\$	\$
Contributed surplus, opening	6,127	3,136
Fair value of warrants issued during debt financing (note 9c)	1,215	1,425
Stock compensation expense	163	1,594
Warrants expired	903	-
Stock options exercised	-	(28)
Contributed surplus, ending	8,408	6,127

11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Classifications of financial instruments remain consistent at December 31, 2008 with those at June 30, 2008. The carrying value and respective fair value of financial assets and liabilities are summarized as follows:

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

	December 31, 2008		
	Carrying Value	Fair Value	Gain ¹
Assets held for trading			
Cash, restricted cash, and cash reserved for asset retirement	4,412	4,412	-
Financial derivative asset	396	396	3,876
Loans and receivables			
Accounts and cash call receivable	3,807	3,807	-
Liabilities held for trading			
Financial derivatives	-	-	-
Other liabilities			
Accounts and interest payable	7,329	7,329	-
Debt facilities and line of credit	26,711	26,711	-

¹ Gain relates to realized and unrealized gain on financial derivatives for the six months ended December 31, 2008

Credit risk

Credit risk reflects the risk of loss if counterparties do not fulfill their contractual obligations. The majority of the Corporation's accounts receivable balances relate oil and gas sales. 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 is mitigated. 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 while in Colombia all oil sales revenue and tariff oil revenue comes from two customers. For the six months ended December 31, 2008, this represents approximately 51%, 23%, and 24% respectively of operating revenue. The Corporation's net share of the outstanding accounts receivable from these customers totalled \$570 at December 31, 2008 (June 30, 2008 - \$596). The Corporation's aged receivables primarily relate to tax receivable balances that can be applied to future required tax payments. No provision has been recorded for these balances. Details of the Corporation's accounts receivable balances are as follows.

Trade and other receivable aging balances	As at	
	December 31, 2008	June 30, 2008
Current < 30 days	1,184	5,395
30 to 60 days	216	977
60 to 90 days	-	871
Over 90 days	413	575
Total	1,813	7,818

In addition, the Corporation has cash call receivables of \$1,994 (June 30, 2008 - \$2,009) relating to its joint venture operations in Colombia and Brazil. These balances are due from three partners and as such there is concentration of credit risk.

Market risk

Market risk is the risk or uncertainty that changes in price, such as commodity prices, foreign exchange rates, and interest rates will affect the Corporation's net earnings and the value of financial instruments.

a) Commodity price risk

Commodity price risk is the risk that the fair value of the future cash flows will fluctuate as a result of changes in commodity prices. Significant changes in commodity prices can also materially impact the Corporation's borrowing base under its reserve based credit facilities. Commodity prices are significantly impacted by world economic events impacting the supply and demand of oil and natural gas. In conjunction with the reserves based revolving

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line credit facility (note 6a), the Corporation has the following oil price financial derivative collars outstanding at December 31, 2008 with the following terms:

Period	Volume	Type	Price Range
Jan – Dec 2009	55 bbls/day	Financial Brent Crude Oil Collar	US\$60.00 - US\$74.72
Jan – Aug 2010	55 bbls/day	Financial Brent Crude Oil Collar	US\$60.00 - US\$74.72

In December 2008, the Corporation sold its Financial WTI oil collar entered into at the acquisition of Rancho Hermoso SA by Canacol Energy Inc. on August 29, 2008 for proceeds of US\$5,000. The proceeds were used to pay down the Corporation's mezzanine debt facility. At the time, a new Financial WTI oil collar was entered into with the following terms:

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

For the six months ended December 31, 2008, the Corporation recognized a realized gain of \$1,992 (2007 – loss \$126) and an unrealized gain of \$1,884 (2007 - loss of \$585) relating to its oil collar financial derivatives. The total fair value of these risk management assets at December 31, 2008 was \$396 (June 30, 2008 – liability \$987). During the three and six month period ended December 31, 2008, if oil prices had been US\$1.00 higher/lower, with all other variables held constant, the change in fair value would have result in a decrease/increase in earnings of approximately \$93 and \$100 respectively.

b) Foreign currency risk

Foreign currency risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign currency exchange rates. Many of the Corporation's business transactions and commitments occur in currencies other than Canadian dollars. The Corporation's activities in Brazil use the Brazilian Real (BRL) as its functional currency and the Corporation's activities in Colombia use the Colombian Peso (COP) as its functional currency. Therefore it is exposed to the risk of fluctuations in foreign exchange rates. In addition, the majority of the Corporation's sales purchase contract for the oil produced is based on a US dollar reference price, but paid in the local respective currency with the remainder paid in US dollars. As at December 31, 2008, the Corporation has not entered into any foreign currency derivatives to manage its exposure to currency fluctuations.

At December 31, 2008, the Corporation held \$1,160 (BRL\$ 2,191) on deposit in Brazilian Real (June 30, 2008 – \$2,064 (BRL\$ 3,234)), \$1,627 (COP 3.3 billion) on deposit in Colombian Peso (June 30, 2008 – \$Nil (COP \$NIL)) and \$80 (US\$ 66) on deposit in US dollar (June 30, 2008 - \$6,957 (US\$ 6,830)). The Corporation also has debt denominated in the US dollar. At December 31, 2008, the Corporation had \$23,233 (US\$18,973) in US dollar denominated debt outstanding (June 30, 2008 - \$4,354 (US\$ 69,275)). In addition, the majority of the Corporation's accounts receivables and accounts payable balances are denominated in currencies other than Canadian dollars including US dollars, Brazilian Real, and Colombian Peso. As of December 31, 2008, the Corporation had the following accounts receivable balances: \$449 (BRL\$848) in Brazilian Real (June 30, 2008 - \$3,610 (BRL\$5,655)), \$366 (US\$298) in US dollars (June 30, 2008 – \$3,436 (US\$3,373)), \$764 (COP\$1.4 billion) in Colombian Peso (June 30, 2008 – \$Nil). As of December 31, 2008, the Corporation had the following account payable and accrued liabilities balances: \$558 (BRL\$ 1,054) in Brazilian Real (June 30, 2008 - \$3,547 (BRL\$5,557)), \$3,146 (US\$2,569) in US dollars (June 30, 2008 – \$3,021 (US\$2,966) and \$2,438 (COP\$4.5 billion) in Colombian Peso (June 30, 2008 – \$Nil).

For the six month period ended December 31, 2008, the Corporation had a foreign exchange loss of \$865 (2007 –

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gain of \$529) primarily due to fluctuations in the Canadian dollar compared to the US dollar for which the long term debt is denominated and depreciation of the Brazilian Real. During the six month period ended December 31, 2008, a 1% increase/decrease in the Canadian dollar vis-a-vis the US dollar and Brazilian Real is estimated to increase/decrease the earnings of the Corporation by \$208, and \$102 respectively.

c) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in prevailing market interest rates. The Corporation is exposed to interest rate risk on certain variable interest rate US dollar denominated debt instruments which are based upon an underlying three month LIBOR reference rate. The remainder of the Corporation's financial assets and liabilities are not exposed to interest rate risk. During the six month periods ended December 31, 2008 and 2007, the Corporation did not enter into any interest rate swaps or other financial arrangements that mitigate the Corporation's exposure to interest rate fluctuations. The effects of a 1% increase/decrease in LIBOR interest rates is estimated to have \$60 decrease/increase in earnings for the six month period ended December 31, 2008.

d) Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due and describes the Corporation's ability to access cash. The Corporation requires sufficient cash resources in order to finance operations, fund capital expenditures, and to repay debt and other liabilities of the Corporation as they come due.

As at December 31, 2008, the Corporation had negative working capital. In addition, the lender of the W. Washington reserve facility (note 6b) has reduced the maximum draw on the facility from US\$7,100 (net US\$3,373) to US\$4,000 (net US\$1,900). The Corporation, and its joint venture partner W. Washington, have received a notice of an Event of Default from the lender. As of the date of these statements, the Corporation and its joint venture partner W. Washington have not yet resolved this deficiency. The Corporation is currently working with its lender to renegotiate amendments and/or extensions.

While the Corporation is focusing its best efforts on these matters and continues to negotiate with its lender, the outcome cannot be certain at this time. There is, therefore, a risk regarding the Corporation's ability to continue as a going concern. The following table outlines the contractual maturities of the Corporation's financial liabilities as of December 31, 2008.

	Recognized on Financial Statements	Payments Due By Period ^{1,2}				Total
		Less than 1 year	1 -2 years	2-5 years	After 5 years	
Accounts payable and accrued liabilities	Yes - Liability	6,750	-	-	-	6,750
Capital leases	Yes - Liability	47	31	-	-	78
Interest payable	Yes - Liability	127	-	-	-	127
Operating line of credit	Yes - Liability	5,759	-	-	-	5,759
Reserves based credit facility	Yes - Liability	3,762	2,327	17,144	-	23,233
Work program commitments	No	12,246	6,735	-	-	18,981
Office and equipment leases	No	49	97	81	-	227
Round 7 minimum exploration commitments	Yes - Liability	405	-	-	-	405
Other minimum exploration commitments ³	No	-	1,156	-	-	1,156
Total		29,145	10,346	17,225	-	56,716

¹ Payments exclude ongoing operating costs and interest on debt facilities

² Payments denominated in foreign currencies have been translated at the respective December 31, 2008 exchange rate

³ Minimum work commitments reflect financial settlement liability if not satisfied through the completion of exploration work

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Derivatives

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 estimated forward prices as of the date of the consolidated balance sheet. The contracts are transacted with counter parties with whom management has assessed credit risk and deemed no adjustment for credit risk is required in determining the estimated settlement price. The actual amounts realized will be based on the settlement prices at the time of settlement and may differ from these estimates. The Corporation has not designated any of these financial contracts as hedges and has therefore recorded the unrealized gains and losses on these contracts in the balance sheet as assets or liabilities with changes in their fair value recorded in net earnings for the period.

12. CAPITAL DISCLOSURES

The Corporation's objectives when managing capital are to ensure the Corporation will have sufficient financial capacity, liquidity, and flexibility to fund the Corporation's operations, growth, and ongoing exploration and development commitment activities of its oil and gas assets. The Corporation is dependent upon funding these activities through a combination of debt and equity financings. Due to operational shortfalls and long lead cycles of some of its exploration and developments activities, the Corporation's capital requirements currently exceed its operational cash flow generated. As such, the Corporation is dependent upon financing in order to maintain its financial flexibility and liquidity.

The Corporation regularly monitors its capital structure and as necessary adjusts to changing economic circumstances and the underlying risk characteristics of its assets in order to meet current and upcoming obligations and investments by the Corporation. The Corporation is currently reviewing and assessing alternate financing options and arrangements to meet its current and upcoming commitments and obligations. The Corporation defines and computes its capital as follows:

	December 31, 2008	June 30, 2008
	\$	\$
Shareholder's equity	41,466	31,500
Long-term debt, including current portion	20,874	27,826
Line of credit facilities	5,759	-
Convertible debenture	-	36,191
Cash	(2,901)	(9,983)
	65,198	85,534

The Corporation's financial objectives and strategy as described above have remained substantially consistent with previous periods. The objectives and strategy of the Corporation are reviewed on a regular basis.

Through its debt facilities, the Corporation is subject to financial covenants. The key financial covenants relating to its various debt facilities are as follows:

a) *Senior reserves based revolving line of credit*

The following debt covenants are based on the consolidated financial statements of the Corporation's subsidiary Canacol Energy Inc. for quarterly periods occurring on or after March 31, 2009.

- Current ratio (current assets to current liabilities) of greater than 1.25 to 1.0.
- Leverage ratio of less than 3.0 to 1.0 calculated as aggregate indebtedness of the borrowers to EBITDA.
- Interest coverage ratio of less than 4.0 to 1.0 measured as EBITDA less non-recurring capital expenditures to total debt interest expense.

For the purposes of the above financial covenant calculations, EBITDA means consolidated net income before interest, income taxes, depreciation and amortization, amortization of intangible assets, any extraordinary unusual or

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non-recurring non-cash expenses, losses or gains, and any non cash charges or income.

As noted above, the Corporations debt covenants do not take effect until periods occurring on or after March 31, 2009. There is, however, 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. As of the date of these statements, Management does not feel that it is likely that the Corporation will be able to achieve all of covenants. Management is reviewing the situation with the lender and may need to request a waiver from the lender or address any deficiencies as required by the lender if it cannot meet the covenant requirements.

b) W. Washington reserves based revolving line of credit

The financial covenants relating to the reserve base revolving line of credit are based upon those of the Corporation's Brazilian Joint Venture partner W. Washington Petroleo S.A. As noted above, the lender of the W. Washington reserve facility (note 6b) has reduced the maximum draw on the facility from US\$7,100 (net US\$3,373) to US\$4,000 (net US\$1,900). The Corporation and its joint venture partner W. Washington have received a notice of an Event of Default from the lender. The Corporation has not yet resolved this deficiency as of the date of these statements. The Corporation is currently working with the lender to renegotiate amendments and/or extensions.

13. RELATED PARTY TRANSACTIONS

During the six month period ended December 31, 2008, companies controlled by a director of the Corporation were paid a total \$91 (2007 - \$163) 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, this individual ceased to be a director 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 was 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 made to W. Washington as a related party for the six month period ended December 31, 2008 totalled \$362 (2007 - \$330) 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.

14. SEGMENTED INFORMATION AND INTEREST IN JOINT VENTURE

The Corporation's reportable operating segments, as determined by management, are based on the core strategic business operations. Following the disposition of BCH Ltd. (note 17), the Services division is no longer a reporting segment of the Corporation. Details of the reporting segments are as follows:

- Brazil includes the Corporation's exploration for, and development and production of, oil and natural gas in the Recôncavo, Sergipe, and Tucano basins of Brazil. Note that substantially all of the operating activities of the Brazil E&P segment are carried out through a joint venture;
- Colombia includes the Corporation's exploration for, and development and production of, oil and natural gas through Rancho Hermoso and the Corporation's interest in the Capella conventional heavy oil project (Ombu);
- Guyana includes the Corporation's exploration for, and development and production of, oil and natural gas in Guyana; and

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- The Corporate segment provides management and administrative services to all of its subsidiaries and their respective operations as well as the non-core operations exploration for, and development and production of, oil and natural gas associated with the Corporation's activities in South Larne, Ireland and Canada.

	Three Months Ended December 31, 2008				
	E&P Brazil	E&P Colombia	E&P Guyana	E&P Other, Corporate & Eliminations	Total
	\$	\$	\$	\$	\$
REVENUE					
Petroleum and natural gas sales	921	951	-	37	1,909
Sales tax	19	-	-	(9)	10
Royalties	(77)	(80)	-	4	(153)
Petroleum and natural gas, net	<u>863</u>	<u>871</u>	<u>-</u>	<u>32</u>	<u>1,766</u>
Tariff revenue	-	970	-	-	970
Interest income	-	332	-	6	338
Total Revenues	<u>863</u>	<u>2,173</u>	<u>-</u>	<u>38</u>	<u>3,074</u>
EXPENSES					
Operating - petroleum and natural gas	882	1,731	-	8	2,621
Depletion, depreciation and accretion	834	785	-	130	1,749
General and administrative	617	229	-	1,046	1,892
Interest on long term debt	261	138	-	505	904
Foreign exchange loss (gain)	440	5	-	(457)	(12)
Realized gain on financial derivatives	(74)	-	-	(2,202)	(2,276)
Unrealized gain on financial derivatives	(1,111)	-	-	(252)	(1,363)
Stock compensation expense	-	-	-	47	47
Impairment on goodwill	5,123	-	-	-	5,123
Impairment on long-term assets	-	-	-	3,555	3,555
Total Expenses	<u>6,972</u>	<u>2,888</u>	<u>-</u>	<u>2,380</u>	<u>12,240</u>
EARNINGS (LOSS)					
Loss before income taxes	(6,109)	(715)	-	(2,342)	(9,166)
Current income tax	-	(276)	-	-	(276)
Future income tax	-	(43)	-	-	(43)
Net Income (Loss)	<u>(6,109)</u>	<u>(396)</u>	<u>-</u>	<u>(2,342)</u>	<u>(8,847)</u>
Total assets	25,259	56,566	2,327	4,954	89,106
Capital expenditures¹	18	2,814	-	116	2,948

¹ Intersegment sales have been netted against exploration and production capital expenditures on consolidation

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	Six months ended December 31, 2008				
	E&P Brazil	E&P Colombia	E&P Guyana	E&P Other, Corporate & Eliminations	Total
	\$	\$	\$	\$	\$
REVENUE					
Petroleum and natural gas sales	2,491	951	-	79	3,521
Sales tax	(111)	-	-	(9)	(120)
Royalties	(205)	(80)	-	-	(285)
Petroleum and natural gas, net	<u>2,175</u>	<u>871</u>	<u>-</u>	<u>70</u>	<u>3,116</u>
Tariff Revenue	-	970	-	-	970
Interest and other	20	332	-	15	367
Total Revenues	<u>2,195</u>	<u>2,173</u>	<u>-</u>	<u>85</u>	<u>4,453</u>
EXPENSES					
Operating - petroleum and natural gas	1,547	1,731	-	20	3,298
Depletion, depreciation and accretion	1,797	785	-	174	2,756
General and administrative	1,274	229	-	1,768	3,271
Interest and financial expenses	466	138	-	505	1,109
Foreign exchange (gain) loss	1,614	5	-	(754)	865
Realized loss (gain) on financial derivatives	210	-	-	(2,202)	(1,992)
Unrealized gain on financial derivatives	(1,632)	-	-	(252)	(1,884)
Stock compensation expense	-	-	-	163	163
Impairment on goodwill	5,123	-	-	-	5,123
Impairment on long-term assets	-	-	-	3,555	3,555
Total Expenses	<u>10,399</u>	<u>2,888</u>	<u>-</u>	<u>2,977</u>	<u>16,264</u>
EARNINGS (LOSS)					
Loss before income taxes	(8,204)	(715)	-	(2,892)	(11,811)
Current income tax	-	(276)	-	-	(276)
Future income tax	-	(43)	-	-	(43)
Net income (loss)	<u>(8,204)</u>	<u>(396)</u>	<u>-</u>	<u>(2,892)</u>	<u>(11,492)</u>
Total assets	30,781	44,585	2,327	11,413	89,106
Capital expenditures¹	1,764	2,814	-	(528)	4,050

¹ Intersegment sales have been netted against exploration and production capital expenditures on consolidation

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

	Three Months Ended December 31, 2007				Total \$
	E&P Brazil \$	E&P Colombia \$	E&P Guyana \$	E&P Other, Corporate & Eliminations \$	
	REVENUE				
Petroleum and natural gas sales	1,175	-	-	55	1,230
Sales tax	(93)	-	-	-	(93)
Royalties	(89)	-	-	(13)	(102)
Petroleum and natural gas, net	993	-	-	42	1,035
Tariff revenue	-	-	-	-	-
Interest income	-	-	-	13	13
Total Revenues	993	-	-	55	1,048
EXPENSES					
Operating - petroleum and natural gas	715	-	-	39	754
Depletion, depreciation and accretion	571	-	-	55	626
General and administrative	495	-	-	526	1,021
Interest and financial expenses	245	-	-	-	245
Foreign exchange (gain) loss	(334)	-	-	(19)	(353)
Realized loss on financial derivatives	121	-	-	-	121
Unrealized loss on financial derivatives	444	-	-	-	444
Stock compensation expense	-	-	-	353	353
Impairment on goodwill	-	-	-	-	-
Impairment on petroleum properties	-	-	-	-	-
Total Expenses	2,257	-	-	954	3,211
EARNINGS (LOSS)					
Loss before income taxes	(1,264)	-	-	(899)	(2,163)
Current income tax	-	-	-	-	-
Future income tax	-	-	-	-	-
Net Income (Loss)	(1,264)	-	-	(899)	(2,163)
Total assets	24,804	-	-	3,321	28,125
Capital expenditures¹	1,342	-	-	201	1,543

¹ Intersegment sales have been netted against exploration and production capital expenditures on consolidation

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

	Six months ended December 31, 2007				
	E&P	E&P	E&P	E&P Other,	Total
	Brazil	Colombia	Guyana	Corporate & Eliminations	
\$	\$	\$	\$	\$	
REVENUE					
Petroleum and natural gas sales	2,132	-	-	140	2,272
Sales tax	(182)	-	-	-	(182)
Royalties	(151)	-	-	(42)	(193)
Petroleum and natural gas, net	1,799	-	-	98	1,897
Tariff Revenue	-	-	-	-	-
Interest and other	99	-	-	32	131
Total Revenues	1,898	-	-	130	2,028
EXPENSES					
Operating - petroleum and natural gas	1,342	-	-	71	1,413
Depletion, depreciation and accretion	846	-	-	117	963
General and administrative	763	-	-	1,070	1,833
Interest and financial expenses	359	-	-	-	359
Foreign exchange (gain) loss	(514)	-	-	(15)	(529)
Realized loss on financial derivatives	126	-	-	-	126
Unrealized loss on financial derivatives	585	-	-	-	585
Stock compensation expense	-	-	-	830	830
Impairment on goodwill	-	-	-	-	-
Impairment on long-term assets	-	-	-	-	-
Total Expenses	3,507	-	-	2,073	5,580
EARNINGS (LOSS)					
Loss before income taxes	(1,609)	-	-	(1,943)	(3,552)
Current income tax	-	-	-	-	-
Future income tax	-	-	-	-	-
Net income (loss)	(1,609)	-	-	(1,943)	(3,552)
Total assets	24,804	-	-	3,321	28,125
Capital expenditures¹	5,856	-	-	292	6,148

¹ Intersegment sales have been netted against exploration and production capital expenditures on consolidation

Included in the Corporation's balance sheet for the Brazilian Joint Venture are the following balances:

	December 31, 2008	June 30, 2008
	\$	\$
Assets		
Current	2,505	3,981
Long-term	24,760	23,358
Liabilities		
Current	2,400	690
Long-term	2,326	4,355

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

Geographic information related to the Corporation's activities:

	Revenue		Property, plant, and equipment	
	Six Months Ended December 31,		As At	
	2008	2007	December 31, 2008	June 30, 2008
	\$	\$	\$	\$
Brazil	2,195	1,898	22,972	81,575
Colombia	2,173	-	51,722	-
Guyana	-	-	2,327	-
Canada & Other	85	130	3,359	6,880
	4,453	2,028	80,380	88,455

15. SUPPLEMENTAL INFORMATION

The changes in non-cash working capital are as follows:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
	\$	\$	\$	\$
Operating Activities				
Decrease (increase) in current assets				
Accounts receivable	1,523	(96)	1,912	(311)
Prepaid expenses and deposits	70	59	44	44
Commodity contracts	4,209	-	4,209	-
Increase (decrease) in current liabilities				
Accounts payable and accrued liabilities	66	(166)	(455)	59
Interest payable	(465)	8	(470)	63
	5,403	(195)	5,240	(145)
Investing activities				
Decrease (increase) in current assets				
Cash call and notes receivable	649	2,694	(5,189)	2,533
Increase (decrease) in current liabilities				
Accounts payable and accrued liabilities	199	(610)	1,177	62
	848	2,084	(4,012)	2,595

As at December 31, 2008, a total of \$219 of the cash and cash equivalents balance was held in cash equivalents consisting of short-term investments (June 30, 2008 - \$8,433). All investments had a maturity of less than 90 days and the investments were convertible into cash at anytime by the Corporation. Details of the cash balances and the interest rates earned on those balances at December 31, 2008 and June 30, 2008 are as follows:

December 31, 2008		June 30, 2008	
Balance	Average Interest Rate	Balance	Average Interest Rate
US\$0	N/A	US\$4,999	1.90%
C\$0		C\$5,092	
COP\$445,008	10.27%	COP\$0	N/A
C\$219		C\$0	
BRL\$0	N/A	BRL\$5,234	11.33%
C\$0		C\$3,341	
C\$219		C\$8,433	

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

16. COMMITMENTS AND GUARANTEES

Minimum exploration program

As at December 31, 2008, the Corporation had 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
7	Recôncavo & Sergipe	August 26, 2008	1,284	\$2,039 BRL \$3,853	255	\$405 BRL \$765
9	Recôncavo	March 12, 2010	1,600	\$2,540 BRL \$4,800	320	\$508 BRL \$960
9	Espirito Santo	March 12, 2011	1,020	\$1,619 BRL \$3,060	408	\$648 BRL \$1,224

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

The Corporation and W. Washington have 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 the Corporation for Round 7 in the table above is 255 units which, at December 31, 2008, equated to approximately \$405 (June 30, 2008 – 1,867 units or \$3,576). Based on actual work performed, the Corporation has made an accrual for the outstanding liability of \$405 (June 30, 2008 - \$1,119), relating to its net share of expected MEP work units yet to be fulfilled by means of financial settlement.

Reserves based revolving line of credit

As discussed in note 6b, the Corporation and its Brazil Joint Venture partner, W. Washington have jointly entered into a reserves based revolving line of credit facility. The revolving line of credit facility is cross guaranteed by the Corporation. The Corporation records its 47.5% net share of revolving line of credit facility in the consolidated financial statements, however, is guarantor on the gross balance of the facility. At December 31, 2008, there was a total draw on the facility of gross US\$7,100 (net US\$3,373) (June 30, 2008 gross US\$9,000 (net US\$4,275)).

Other

In Colombia and Guyana, the Corporation has work program commitments totalling approximately \$12,246 for calendar 2009 and \$6,735 in calendar 2010. In addition, the Corporation has commitments for leases and its office premises. As of December 31, 2008, the payments required in each of the next five years are as follows:

	\$
2009 - 6 Months	49
2010	97
2011	81
2012	Nil
2013	Nil

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

17. DISCONTINUED OPERATIONS

Effective December 31, 2008, the Company closed the sale of its remaining interest in its oilfield services subsidiary, BCH Ltd., for proceeds of US\$5,000. Summary details for the three and six month periods ended December 31, 2008 and December 31, 2007 from discontinued operations are as follows:

	Three months ended		Six months ended	
	December 31,		December 31,	
	2008	2007	2008	2007
Revenue - drilling services, net of tax	9,610	5,350	18,711	6,356
Expenses:				
Operating drilling services	6,380	2,573	13,854	4,331
Depreciation and amortization	1,088	298	2,102	452
General and administrative expenses	1,367	927	2,445	1,872
Interest expenses	3,201	663	6,079	951
Foreign exchange loss (gain), net	10,065	(65)	11,609	(871)
Realized loss on financial derivative	695	-	640	-
Unrealized loss (gain) on financial derivatives	472	(25)	1,498	(25)
Stock compensation expense	6	-	17	-
	23,274	4,371	38,244	6,710
Gain (loss) from discontinued operations, before taxes	(13,664)	979	(19,533)	(354)
Current income taxes	703	334	1,380	499
Future income taxes (recovery)	(1,874)	(790)	(3,877)	(955)
	(1,171)	(456)	(2,497)	(456)
Non controlling interest	(2,116)	-	(2,116)	-
Gain on sale of BCH	27,120	-	27,120	-
Discontinued operations and gain on sale of discontinued operations	16,743	1,435	12,200	102

The net book value of Canacol's interest in BCH Ltd. and the related assets that were sold on December 31, 2008 was -\$10,662, resulting in a net gain of \$27,120 (\$27,120 net of tax). Included in the assets and liabilities at June 30, 2008 were the following balance related to BCH Ltd.

Notes to the Consolidated Financial Statements

For the three and six months ended December 31, 2008 and December 31, 2007

(Unless otherwise stated, amounts presented are in thousands of Canadian dollars) (unaudited)

	June 30, 2008
Current Assets:	
Cash and cash equivalents	803
Cash - restricted	668
Accounts receivable	6,669
Financial derivative asset	501
Prepaid expenses and deposits	374
Total current assets	9,015
Long Term Assets:	
Property, plant, and equipment	58,583
Future income tax asset	159
Total long-term assets	58,742
Total Assets	67,757
Current Liabilities:	
Operating line of credit	1,444
Accounts payable and accrued liabilities	4,672
Current portion of long-term debt	5,992
Reclassification of long-term debt	18,786
Current portion of capital lease obligations	943
Interest payable	239
Total long-term liabilities	32,076
Long Term Liabilities:	
Interest payable	2,512
Capital lease obligations	487
Convertible debenture	36,191
Total current liabilities	39,190
Total Liabilities	71,266

18. SUBSEQUENT EVENTS

Subsequent to December 31, 2008, the Corporation announced a financing of a secured debenture ("Secured Debenture") in the amount of \$500. The Secured Debenture will bear an interest rate of 15% per annum and is secured by a security interest in a remaining drilling rig owned by the Corporation following the sale of BCH Ltd. The Secured Debenture is payable by the Corporation at the earlier of (i) 180 days or (ii) the day proceeds from the sale of the rig is received by the Corporation. The Corporation will use proceeds from the Secured Debenture for continuing working capital purposes. As part of the financing, the Corporation paid a 7% cash commission to an individual who is an arm's-length party to the Corporation for his part in introducing lenders to the Corporation.

19. COMPARITIVE FIGURES

Certain of the prior period figures have been reclassified to reflect the discontinued operations of BCH Ltd.

Corporate Information

Management Team

Charle Gamba – President & Chief Executive Officer

Mark Holliday - Chief Operating Officer

Mark Teare – Vice President Exploration

Board of Directors

Luis Baena

Alvaro Barrera

Jason Bednar

Charle Gamba

Stuart Hensman

Michael Hibberd

David Winter

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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

Legal Counsel

Davis & Company LLP - Canada

Heenan Blaikie LLP - Canada

Schmidt, Valois, Miranda, Ferreira & Agel – Brazil

Gamboa Chalela Salazar Abogados - Colombia

Stock Exchange Listing

TSX Venture Exchange: CNE

Transfer Agent & Registrar

Olympia Trust Company

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Calgary, Alberta T2G 0P6