

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 shown. It has a soft shadow underneath.

Management Discussion and Analysis
Three and six months ended December 31, 2009

February 24, 2010

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 and six months ended December 31, 2009 as well as the audited consolidated financial statements for the fiscal year ended June 30, 2009 (F2009) 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 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 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			Six Months Ended	
	December 31, 2009	September 30, 2009	December 31, 2008	December 31, 2009	December 31, 2008
<i>(\$000s), except share data</i>					
Petroleum and natural gas sales, net					
Colombia ⁽¹⁾	2,180	2,409	871	4,590	871
Brazil	619	600	862	1,218	2,175
Canada ⁽³⁾	-	-	33	-	70
	2,799	3,009	1,766	5,808	3,116
Tariff revenue	1,703	1,365	970	3,068	970
Interest and other	280	675	338	955	367
Total revenue, recurring operations	4,782	5,049	3,074	9,831	4,453
Cash from (used in) recurring operating activities	2,382	(1,091)	5,673	612	4,183
Per share - basic and diluted	0.01	(0.01)	0.05	0.00	0.04
Net loss from continuing operations	(3,714)	(1,459)	(8,847)	(5,172)	(11,492)
	(0.01)	(0.01)	(0.08)	(0.02)	(0.11)
Capital expenditures					
Colombia ⁽¹⁾	7,017	3,133	2,814	10,150	2,814
Brazil	401	226	18	627	1,764
Guyana	1,580	-	-	1,580	-
Canada	-	82	116	82	(528)
	8,998	3,441	2,948	12,439	4,050
Total assets	107,515	84,442	89,106	107,515	89,106
Total long-term liabilities	22,579	24,423	30,789	22,579	30,789
Weighted average shares outstanding					
Basic (000s)	303,312	180,834	117,041	242,073	103,562
Basic and Diluted (000s)	303,312	180,834	117,063	242,073	103,656

OPERATING RESULTS	Three Months Ended						Six Months Ended								
	December 31, 2009			September 30, 2009			December 31, 2008			December 31, 2009			December 31, 2008		
	Colombia (1)	Brazil (2)	Canada (3)	Colombia (1)	Brazil (2)	Canada (3)	Colombia (1)	Brazil	Canada (3)	Colombia (1)	Brazil	Canada (3)	Colombia (1)	Brazil	Canada (3)
Production															
Crude oil and NGLs (tbb/d)	313	105	-	330	110	-	335	128	1	321	108	-	335	134	1
Natural gas (mcf/d)	-	-	-	-	-	-	-	-	62	-	-	-	-	-	48
Total (boe per day)	313	105	-	330	110	-	335	128	11	321	108	-	335	134	9
Total tariff production (tbb/d)	1,651	-	-	1,377	1,354	-	1,354	-	-	1,514	-	-	1,354	-	-
Average sale prices															
Crude oil (\$/bbl)	75.64	63.83	-	69.20	55.51	-	42.64	77.65	-	77.59	61.55	-	42.64	100.25	-
Natural gas (\$/mcf)	-	-	-	-	-	-	-	-	5.99	-	-	-	-	-	-
Oil equivalent (\$/boe)	-	-	-	-	-	-	-	77.65	35.93	-	61.55	-	-	100.25	46.82
Operating netback (\$/boe)															
Commodity sales revenue	75.64	63.83	-	69.20	55.51	-	42.64	77.65	35.93	77.59	61.55	-	42.64	100.25	46.82
Tariff revenue ⁽⁴⁾	13.12	-	-	12.96	-	-	11.74	-	-	13.05	-	-	11.74	-	-
Non-refundable sales taxes	-	(2.74)	-	-	(2.54)	-	-	1.57	-	-	(2.64)	-	-	(4.46)	-
Realized loss on financial derivative	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Royalties ⁽⁵⁾	(5.87)	(7.56)	-	(5.54)	(7.03)	-	(3.41)	(6.55)	(4.11)	(5.70)	(7.29)	-	(3.41)	(8.26)	(5.17)
Transportation & processing ⁽⁶⁾	(2.73)	(14.43)	-	(3.03)	(13.42)	-	(9.10)	(29.06)	-	(2.87)	(13.91)	-	(9.10)	(20.68)	-
Well workover & repair	(2.15)	(2.54)	-	(0.01)	(2.54)	-	(0.02)	(2.39)	-	(1.16)	(2.54)	-	(0.02)	(2.00)	-
MEP work unit provision	-	(3.22)	-	-	(3.22)	-	-	(4.70)	-	-	(3.22)	-	-	(4.53)	-
Operating expenses ⁽⁷⁾	(13.53)	(35.05)	-	(14.54)	(32.19)	-	(14.97)	(41.19)	(7.33)	(13.82)	(33.59)	-	(14.97)	(36.49)	(11.48)
Netback ⁽⁸⁾	51.36	(1.71)	-	46.08	(5.43)	-	15.14	(4.67)	24.49	54.04	(1.64)	-	15.14	23.83	30.17

⁽¹⁾ Colombian operations commenced in October 30, 2008.

⁽²⁾ Brazil results were estimated based on the results from Q4 F2009.

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

⁽⁴⁾ Colombian Tariff revenue includes transportation revenue included in "other revenue".

⁽⁵⁾ Royalties apply to non-tariff oil production.

⁽⁶⁾ Colombian transportation and processing charges relate to non-tariff production.

⁽⁷⁾ Colombian operating expenses relate to both tariff and non-tariff oil production volumes.

⁽⁸⁾ "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.

HIGHLIGHTS FROM Q2-F2010

- On October 15, 2009, the Corporation closed an underwritten private placement financing for total gross proceeds of \$40 million. The Corporation issued 142,858,000 common shares at a price of \$0.28 per common share.
- 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 GRCI, 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 costs associated with GRCI's of 10% net working interest 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 million on its reserves based credit facility.
- On November 3, 2009, the Corporation repaid US\$4.1 million 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\$1.25 million 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\$1.75 million, and 27.5% of cash calls thereafter. Sagres is entitled to 30% of net revenues until recovery of its first US\$3 million paid to Canacol, 27.5% of net revenues until its full cost recovery, and 25% thereafter.
- On November 10, 2009, the Corporation paid \$0.23 million 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 under its royalties based arrangement with Gemini, bringing the total advanced by Gemini to US\$9 million.
- On December 8, 2009, the Corporation announced a new pool discovery at its Rancho Hermoso field in Colombia. The RH5 well reached a total depth of 9,578 feet and targeted an undrilled southern extension of the Rancho Hermoso field. It encountered two new oil bearing reservoirs in the Los Cuervos and Guadalupe Formations which will produce under production sharing terms, in addition to its targeted tariff oil producing reservoir in the Mirador Formation.

The well penetrated the Mirador reservoir approximately 40 feet high to prognosis, and encountered interpreted oil pay in 3 separate reservoir intervals: the Mirador from 8,939 to 8,974 feet true vertical depth with 7 feet of net interpreted oil pay thickness and average porosity of 26%, the Los Cuervos from 8,990 to 9,020 feet with 9 feet of net interpreted oil pay thickness and average porosity of 27%, and the Guadalupe from 9,037 to 9,069 feet with 4 feet of interpreted oil pay thickness and average porosity of 28%

The Guadalupe reservoir flowed at a final rate of 3,994 barrels per day of 33° API gravity oil and 318 mcf of gas per day. On December 14, the Company tested the Los Cuervos reservoir, which flowed at a rate of 4,434 barrels per day of 36° API gravity oil with a water cut of 0%.

- On December 15, 2009, the Corporation provided details of its calendar 2010 work program for its Capella heavy oil discovery and surrounding unexplored acreage. In the calendar year 2010, the Corporation plans to participate in the following activities:
 - The drilling of 4 appraisal wells, including the Romero 1 well which will appraise the northeast part of the discovery, and one horizontal well within the southwest part of the discovery, to commence in the first quarter of calendar 2010.
 - The drilling of 3 development wells, which may be vertical or horizontal depending on the success of the first horizontal well planned, to commence in the third quarter of calendar 2010.
 - Commencement of a steam injection pilot utilizing one of the existing wells in the first quarter of calendar 2010.
 - The acquisition of 100 square kilometers of 3D seismic, to commence in the third quarter of calendar 2010.
 - The construction of an early production facility to handle 2,000 barrels per day of fluid to commence in the first quarter of calendar 2010.
 - The laying of flow lines to all producing wells to commence in the first quarter of calendar 2010.
 - The upgrading of existing roads and bridges to commence in the first quarter of calendar 2010.
 - The drilling of a water disposal well in the third quarter of calendar 2010.

The primary objectives of the program include:

- Continued appraisal of the discovery to determine its size through the drilling of appraisal wells and a resulting increase in production, reserves, and resources.
- Formulation of a full field development plan for the discovery by year end through the acquisition of a 3D seismic program, the quantification of horizontal well performance on oil rate and recovery, and the quantification of the steam injection pilot in terms of oil rate and ultimate recovery.
- Installation of an early production facility, flow lines, and upgrading of roads and bridges to increase the overall volume of oil sales from the field and accelerate monetization of the early production volumes.

SUBSEQUENT EVENTS AFTER Q2-F2010

- On January 20, 2010, the Corporation granted 5,774,000 stock options. A total of 4,374,000 of these stock options were granted to directors and officers of the Corporation. The options were granted at an exercise price of \$0.60 per common share, the January 18, 2010 closing price. The options expire five years from the date of grant.
- On February 1, 2010, the Corporation engaged Citivalores S.A. Sociedad Comisionista de Bolsa in Colombia ("Citi") to commence the process whereby Canacol intends to list on the "RNVE", the Registro Nacional de Valores y Emisores in Colombia as well as on the "BVC", the Bolsa de Valores de Colombia. Both listings will qualify as secondary listings, and the Company's primary exchange will remain the TSX Venture Exchange.
- On February 8, 2010, the Corporation announced a US\$46 million capital budget in calendar 2010 for exploration and development activities in Colombia, Guyana and Brazil. The budget includes the drilling of 15 wells, which includes 3 exploration wells, one each in Colombia, Guyana and Brazil, and 3 appraisal and 9 development wells in Colombia. The budget also provides for the acquisition of 100 km of 3D seismic and 160 km of 2D seismic in Colombia and Brazil, the building of a 2,000 barrel of fluid per day early production facility at the Capella discovery in Colombia, and the expansion of the Canacol operated Rancho Hermoso production

facilities in Colombia. Although not provided for in the calendar 2010 budget, Canacol also plans to participate in the exploration bid round scheduled in Colombia for late June as a qualified operator.

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 through several long-term contracts with Petrobras, Brazil's state-owned petroleum company. Effective December 31, 2008, Canacol's ownership in BCH Ltd. was sold to Allis-Chalmers Energy Inc.

Colombia

Canacol has interests in 6 exploration and production contracts in Colombia, and plans to spend US\$37 million on various exploration and development projects there in calendar 2010. The capital programs, which include the drilling of 13 wells, the acquisition of 60 km of 2D seismic and 100 square kilometres of 3D seismic, acquisition of 2,250 kilometres of aero magnetic gravity data (Pacarana) and construction of new facilities and expansion of existing facilities are outlined below.

Llanos Basin

The Corporation has operated interests in the Rancho Hermoso Field (100% working interest) and Entrerrios Field (60% working interest) producing fields in the Llanos Basin. Both contracts are operated under Production Sharing and Risked Service contracts with Ecopetrol, the state oil company of Colombia.

Rancho Hermoso Production Contract (100% operated working interest)

The Corporation currently anticipates production to average 4,200 barrels of oil per day ("bbl/d") for calendar 2010, with an exit rate of 7,000 bopd which excludes any production resulting from exploration success. The Corporation's current share of production is approximately 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 calendar 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 calendar 2009 was 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 calendar 2012 and will remain at that level for the duration of the life of the field. The average tariff price for calendar 2010 will be approximately US\$12.04 per barrel.

The Corporation completed the calendar 2009 drilling program schedule in early December 2009. The original drilling program consisted of the drilling of three development wells- two wells in the Rancho Hermoso Field and one development well in Entrerrios Field. The program also included working over three existing wells (Entrerrios 1, Entrerrios 3 and Rancho 4) 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 has increased the Corporation's production capacity in Colombia at a net cost of approximately US\$10.1 million.

The Corporation plans to drill up to 5 infill development wells as a direct result of the success of the Rancho Hermoso #5 well drilled in December 2009, which tested over 8,000 bopd combined flow of 33° to 36° API gravity oil from a new pool discovery in the Guadalupe and Los Cuervos reservoirs. The 5 new wells will target the Mirador, Los Cuervos, Guadalupe, and Ubaque reservoirs, all of which are

currently producing reservoirs. The drilling program is anticipated to commence in the second calendar quarter of 2010, and will continue through to December 2010, focusing primarily on obtaining production from the Los Cuervos, Guadalupe, and Ubaque reservoirs, in which the Corporation has a net royalty interest. In addition to the new development wells, the Corporation plans to expand fluid handling capacity of existing facilities in order to handle additional production.

Putumayo - Caguan Basin

The Corporation is one of the largest exploration landholders in the Putumayo - Caguan Basin of southern Colombia, with working interests in two exploration and production contracts and one technical evaluation area, all of them awarded under the new terms as regulated by the Agencia Nacional de Hidrocarburos ("ANH").

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 *bb/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 penetrated 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 drilled and completed.

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 subject to approval of the Operator. As the contract was awarded to the vendor on a turnkey success basis, no costs were incurred related to this program.

The Corporation and its joint venture operating partner plan to spend approximately US\$50 million gross on drilling and infrastructure programs at this significant discovery in calendar 2010.

Commencing in the first calendar quarter of 2010, the Corporation will participate in the drilling of 3 appraisal wells, including the Romero 1 well which will appraise the northeast part of the discovery, one horizontal well within the southwest part of the discovery, a steam injection pilot utilizing one of the existing vertical wells, the construction of an early production facility to handle 2,000 barrels of fluid per day, the laying of flow lines to all producing wells, and the upgrading of existing roads and bridges.

Commencing in the third calendar quarter of 2010, the Corporation will participate in the drilling of 3 infill wells in the central part of the discovery, which may be vertical or horizontal depending on the success of the first horizontal well to be drilled in the first calendar quarter of 2010, the acquisition of 100 square km of 3D seismic, and the drilling of a water disposal well.

The primary objectives of the program are to:

- 1) Continue appraisal of the discovery through the drilling of appraisal wells to increase production, reserves and resources;

- 2) Formulate a full field development plan by December 2010 through the acquisition of a 3D seismic program, the quantification of horizontal well performance on oil production rate and recovery, and the quantification of the steam injection pilot results in terms of oil rate and ultimate recovery; and
- 3) Install an early production facility, flow lines, and upgraded roads and bridges to increase the volume of oil sales from the field from the currently producing wells and new wells to be drilled this year.

Tamarin E&P contract (100% operated working interest)

Effective August 31, 2009, Canacol, through its subsidiary Rancho Hermoso, was awarded the Tamarin Exploration and Production Contract ("Tamarin E&P contract") by the ANH.

The Tamarin contract is located approximately 25 km to the southwest of the Ombu contract. Based upon the available geophysical and geological data in this frontier area, the Corporation has determined that the fault trend present at its Capella discovery to the northeast continues onto the Tamarin contract, setting up the potential for another Capella type heavy oil prospect. Together with the nearby Pacarana TEA, awarded to the Corporation in July 2009, Canacol now has a significant operated exploration position at 100% working interest immediately offsetting its Capella heavy oil discovery. Canacol is currently tendering a 60 km 2D exploration seismic program which will be acquired in second calendar quarter of 2010, ahead of drilling an exploration well in 2011.

Pacarana Technical Evaluation Area (100% operated working interest)

Effective July 2, 2009, Canacol, through its subsidiary Rancho Hermoso, was awarded the Pacarana Technical Evaluation Area ("Pacarana TEA") by the ANH. 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. Interpretation of 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\$0.47 million.

The Corporation is currently in the process of tendering a 2,500 km aeromagnetic gravity survey, which it anticipates completing in second calendar quarter of 2010.

Middle Magdalena Valley Basin

La Sierra E&P Contract (25.5% operated working interest)

The Sierra contract is located along the western margin of the prolific Middle Magdalena Basin, and was also awarded under terms as regulated by the ANH. The contract contains a discovery well, Sierra 1, drilled in 1991, which recovered 22 barrels of 17° API medium gravity oil during swabbing from 10 feet of interpreted oil pay within the Tertiary aged Honda sandstone at a measured depth of 1,700 feet, a prolific producing reservoir within the Basin. Management estimates that the discovery contains approximately 8 million barrels of gross mean unrisked recoverable prospective resources. Canacol acquired 46 square km of 3D seismic at a net cost of \$1.1 million over the discovery in calendar 2009, and plans to drill the Sierra 2 exploration well in March of 2010.

The Sierra 2 well will be drilled approximately 60 metres away from the discovery well in order to penetrate the same 10 feet of interpreted oil pay encountered in the Sierra 1 well. Unlike the discovery well, however, the Corporation will equip the well with a progressive cavity pump; production technology commonly used in Western Canada.

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-days 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 December 2009, the mean prospective resources associated with the Karanambo discovery are 128 million barrels gross (83 million barrels net). The block also contains 2 exploration prospects, Pirara and Rewa High, with mean prospective resources of 133 million barrels (86 million barrels net) in Pirara and 169 million barrels gross (110 million barrels net) in Rewa High. Civil works and location construction have been completed. Under the terms of the farm-in agreement, Canacol was required to fund the first US\$12 million 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 farmin 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 agreeing to fund 30% (US\$1.25 million) of 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's 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.

Canacol and its joint venture operator, Groundstar Resources Ltd., are currently reviewing bids for a drilling rig and associated services in order to move a rig into the country in second calendar quarter 2010 to drill the K-2 exploration well. It is anticipated that the joint venture will award the contracts in early March 2010 and immediately commence mobilization of the drilling rig to Guyana. The bottom hole location for the K-2 well will be approximately 400 metres northwest of the Karanambo 1 discovery well, and will target the same productive reservoirs that tested 411 bbl/d of 42° API gravity oil in 1982. Gaffney Cline and Associates attributed gross mean risked recoverable prospective resources of 128 million barrels of oil to the discovery in the December 2009 report compiled for the Corporation. The joint venture to date has completed construction of the drilling pad, access roads, and staging areas in preparation of drilling, and has purchased and mobilized tubulars and wellheads sufficient to drill 3 wells, which are now in country and on location. The well is anticipated to spud in late of second calendar quarter of 2010 or early of third calendar quarter 2010, and is anticipated to take 50 days to drill and test, and if successful will be put on a long term production test to establish the deliverability and performance of the reservoir. The cost of drilling the K-2 well net to Canacol is US\$6 million, and upon completion of drilling operations operatorship will be transferred from Groundstar to Canacol.

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, Espirito 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 reserves.

Canacol holds a 47.5% working interest and W. Washington holds a 52.5% interest in 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. Canacol holds rights to produce hydrocarbons from 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.

Reconcavo Basin

Block 170 (37.5% non-operated working interest)

Canacol will participate in the drilling of the Catu exploration prospect located on Block 170 in the second calendar quarter of 2010. The prospect contains three prospective stacked reservoir sandstones that management estimates may contain up to 6 million barrels of gross mean unrisked recoverable light oil resource. The preferred well location is situated updip from an old well that recovered light oil from one of three prospective intervals.

Espirito Santo Basin

Block 318 (100% operated working interest)

Through its wholly owned subsidiary, Brazalta Brazil Norte, Canacol will acquire 100 km of 2D seismic commencing in first calendar quarter 2010. The objective of the survey is to improve the resolution of an exploration lead identified on available seismic.

Canada and Ireland E&P

Operations in Canada are considered to be non-core. The Corporation continues to hold minor 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 Canadian 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 currently has no planned 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 and six months ended December 31, 2009 and 2008 is contained in the "Discontinued Operations" section. The Colombian and Guyanese operations of the acquired Canacol Energy Inc. are for the period October 31, 2008 through December 31, 2009.

General

Canacol acquired its Colombian operations on October 30, 2008 and production and revenue began to be recognized on November 1, 2008. The Corporation sold its Canadian producing properties effective January 1, 2009. As a result of these transactions, the comparable production and revenue for the three and six months ended December 31, 2009 is not meaningful. As well, the nature of 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 present the production, revenue and expenses for the three and six months ended December 31, 2009

together with discussion referring the same periods in 2008 and to the three months ended September 30, 2009.

Quarterly Information - Recurring Operations	F2010		F2009			F2008		
<i>(\$000s, except production data and per share)</i>	Q2	Q1	Q4	Q3	Q2 ⁽¹⁾	Q1	Q4	Q3
Petroleum and natural gas sales								
Colombia ⁽¹⁾	2,180	2,409	2,247	1,200	871	-	-	-
Brazil	619	600	80	767	862	1,313	1,515	1,487
Canada ⁽³⁾	-	-	-	-	33	37	33	8
Total production revenue	2,799	3,009	2,327	1,967	1,766	1,350	1,548	1,495
Tariff revenue	1,703	1,365	1,001	1,069	970	-	-	-
Interest and other	280	675	496	123	338	29	232	101
Total operating revenue	4,782	5,049	3,824	3,159	3,074	1,379	1,780	1,596
Total production (boe)	38,519	40,427	37,855	39,413	33,251	13,637	62,697	18,543
Total tariff production (bbl)	151,907	126,673	92,367	104,101	82,600	-	-	-
Cash used in (from) operating activities	1,702	(1,091)	(3,815)	(2,445)	5,673	(1,490)	(604)	(546)
Per share ⁽¹⁾	0.01	(0.00)	(0.03)	(0.02)	0.01	(0.02)	(0.01)	(0.00)
Net (loss) gain ⁽⁴⁾	(4,394)	(779)	(5,250)	(5,050)	(8,847)	(2,645)	(1,390)	(2,620)
Per share ⁽¹⁾	(0.01)	(0.01)	(0.04)	(0.04)	(0.08)	(0.03)	(0.02)	(0.03)
Total assets ⁽⁴⁾	107,515	84,442	85,209	87,958	89,106	48,299	42,703	49,861
Total long term liabilities ⁽⁴⁾	22,579	24,423	26,967	13,828	30,789	3,245	21,892	16,165

⁽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.

⁽⁴⁾ The amounts for Q1-F2010 have been updated to reflect future tax and foreign exchange adjustments reflected in Q2-F2010.

Petroleum and Natural Gas Sales (Net of Royalties)

The operating revenue from continuing operations for the three months ended December 31, 2009 totalled \$4,782 (Q1-F2010 - \$5,049; Q2-F2009 - \$3,074), representing a decrease of \$267 or 5% compared to Q1-F2010. Operating revenue from continuing operations for the six months ended December 31, 2009 was \$9,831 (Six months ended December 31, 2008 - \$4,453). Operating revenue for the six months ended December 31, 2009 includes one additional month of Colombian operations which is not reflected in the prior year's comparative period numbers due to the October 31, 2008 acquisition date of Colombian operations.

The operating revenue consists of production revenue (non-tariff production), tariff production and interest and other revenue. The production revenue during Q2-F2010 totalled \$2,799 (Q1-F2010 - \$3,009; Q2-F2009 - \$1,766) representing a decrease of \$210 or 7% compared to Q1-F2010. For the Q1 and Q2-F2010, production revenue was \$5,808 (Q1 and Q2 F2009 - \$3,116). The tariff revenue during the Q2-F2010 totalled \$1,703 (Q1-F2010 - \$1,365; Q2-F2009 - \$970) representing an increase of \$338 or 25% compared to Q1-F2010. For the six months ended December 31, 2009 the tariff revenue was \$3,068 (Q1 and Q2 F2009 - \$970). Interest and other income are discussed below.

The decrease in the production revenue during Q2-F2010 compared to Q1-F2010 is due to a decrease in production volume due to workover activities conducted in the Entrerrios field during the quarter.

The increase of the tariff revenue in Q2-F2010 compared to Q2-F2009 is due to higher production volumes.

In Colombia, production volumes of crude oil achieved during the three months ended December 31, 2009 totalled 28,825 bbls (313 bbl/d) (Q1-F2010 30,327 bbls (330 bbl/d); Q2-F2009 (November and

December only) - 20,462 bbls (335 bbl/d)). Production volumes for the six months ended December 31, 2009 totalled 59,152 bbls (321 bbl/d) (Q1 and Q2 F2009 - 20,462 bbls (November and December only) (330 bbl/d). The average price achieved in Colombia in Q2-F2010 was \$75.64/bbl compared to \$69.20/bbl in Q1-F2009 and \$42.64 in Q2-F2009. In Colombia, tariff production volumes during Q2-F2010 totalled 151,907 bbls (1,651 bbl/d) (Q1-F2010 126,673 bbls (1,377 bbl/d); Q2-F2009 (November and December only) - 82,600 bbls). For the six months ended December 31, 2009, the tariff production totalled 278,580 bbls (1,514 bbl/d) (Q1 and Q2 F2009 (November and December only) - 82,600 bbls (1,354 bbl/d). The average tariff price for Q2-F2010 was \$13.12/bbl (including \$1.91 of transportation revenue); (Q1-F2010 was \$12.96/bbl (including \$2.19 of transportation revenue); Q2-F2009 - \$11.74).

Brazil production volumes during Q2-F2010 totalled 9,694 bbls of light oil (105 bbl/d); (Q1-F2010 - 10,100 bbls (110 bbl/d); Q2-F2009 - 11,754 bbls (128 bbl/d)). Production from Brazil totalled 19,794 bbls of light oil in the first six months of F2010 (108 bbl/d) (Q1 and Q2 F2009 - 24,741 bbls (134 bbl/d). The average price achieved per bbl in Brazil in the Q2-F2010 was \$63.83/bbl; (Q1-F2010 - \$55.51/bbl; Q2-F2009 - \$77.65/bbl), representing a 15% increase compared to Q1-F2010 and an 18% decrease compared to Q2-F2009.

In Canada, production consisted of oil, natural gas, and natural gas liquids from the Corporation's properties in Alberta. Production from Canada to December 31, 2009 totalled Nil (Q1-F2010 - Nil; Q2-F2009 1,035 boe (11 boe/day). Canadian producing properties were sold effective January 1, 2009.

Production Volumes (boe)	Three Months Ended			Six Months ended	
	December 31, 2009	September 30, 2009	December 31, 2008	December 31, 2009	December 31, 2008
Colombia *	28,825	30,327	20,462	59,152	20,462
Brazil	9,694	10,100	11,754	19,794	24,741
Canada**	-	-	1,035	-	1,685
Total net production	38,519	40,427	33,251	78,946	46,888
Tariff production	151,907	126,673	82,600	278,580	82,600
Total	190,426	167,100	115,851	357,526	129,488

* Colombian operations commenced on October 30, 2008

** 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 December 31, 2009 and the 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 six months ended December 31, 2009 in Brazil was 12.7% compared to 9.6% during Q1 and Q2 F2009 period. In Brazil, royalty rates are based on a sliding scale on incremental production over and above certain production thresholds, calculated 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 Q2-F2010 Colombian royalties averaged 8%.

	Royalties				
	Three months ended			Six months ended December 31,	
	December 31, 2009	September 30, 2009	December 31, 2008	2009	2008
Colombia *	8.0%	8.0%	8.0%	8.0%	8.0%
Brazil	12.7%	12.7%	13.5%	12.7%	9.6%
Canada**	-	-	11.4%	-	11.0%

* Colombian operations commenced October 30, 2008

** Canadian producing properties were sold effective January 1, 2009.

Brazil oil sales are subject to non-refundable sales taxes. This totalled \$52 during the six months ended December 31, 2009 (Q1 and Q2 F2009 - \$111). This has been recorded and netted against revenue for the three and six month periods ended December 31, 2009.

Interest and Other Income

During the three months ended December 31, 2009 interest and other income of \$280 (Q1-F2010 - \$675; Q2-F2009 - \$338) was recorded. The decrease in the interest and other income was due to the sale of some Casing which was sold to Union Temporal Andina to be used in the drilling of ER-5 for proceeds of \$487 during Q1-F2010. During the six months ended December 31, 2009 interest and other income was \$955 (Q1 and Q2 F2009 - \$367).

Operating Expenses - Petroleum and Natural Gas

For the three months ended December 31, 2009, operating expenses totalled \$3,672 (Q1-F2010 - \$3,080; Q2-F2009 - \$2,621) and for the six months ended December 31, 2009 overall operating expenses totalled \$6,752 (Q1 and Q2 F2009 - \$3,298). 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			Six Months Ended December 31,	
	December 31, 2009	September 30, 2009	December 31, 2008	2009	2008
Operating expenses					
Colombia ⁽²⁾	2,254	2,595	1,543	4,849	1,543
Brazil ⁽¹⁾	340	329	453	669	872
Canada ⁽³⁾	-	-	8	-	19
	2,594	2,924	2,004	5,518	2,434
Colombia transportation & processing charges	494	475	186	969	186
Colombia well workover & repair	388	3	2	391	2
Brazil transportation & processing charges	140	136	345	276	514
Brazil well workover & repair	56	-	28	56	49
MEP work unit provision	-	(458)	56	(458)	113
	3,672	3,080	2,621	6,752	3,298
Operating expenses per boe					
Colombia ⁽²⁾	13.53	14.54	14.97	13.82	13.82
Brazil ⁽¹⁾	35.05	32.19	41.19	33.59	36.49
Canada ⁽³⁾	-	-	7.33	-	11.48
Weighted Average	14.63	15.61	36.01	14.91	33.73

⁽¹⁾ Expenditures related to the planned non-routine enhancement workover program undertaken 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.

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

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

Depletion, Depreciation, and Accretion (DD&A)

For the three months ended December 31, 2009, DD&A from recurring operations totalled \$2,316 (Q1-F2010 - \$2,313; Q2-F2009 - \$1,749) while for six months ended December 31, 2009, overall DD&A expense was \$4,629 (Q1 and Q2 F2009 - \$2,756). The respective increase on a quarter-over-quarter basis is a result of an increase in the production volume in tariff oil production and the increase on a year-over-year basis is a result of the increase in proven properties included on the depletion calculation for Brazil plus the addition of Colombian properties.

General and Administrative

For the three months ended December 31, 2009, general and administrative (G&A) expenses from recurring operations were \$2,164 (Q1-F2010 - \$1,679; Q2-F2009 - \$1,892) while G&A expenses from recurring operations for six months ended December 31, 2009 were \$3,842 (Q1 and Q2 F2009 - \$3,271). 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.

Canacol is continuing to review 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 December 31, 2009, interest and financial expense was \$753 (Q1-F2009 - 893; Q2-F2009 - \$904). For the six months ended December 31, 2009, interest and financial expenses were \$1,646 (Q1 and Q2 F2009-\$1,109). 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 Q2-F2010 totalled \$385 (Q1-F2010 - \$311; Q2-F2009 - \$206) while the non-cash interest charges for the six months ended December 31, 2009 totalled \$696 (Q1 and Q2 F2009 - \$336).

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 December 31, 2009, the Corporation incurred a net foreign exchange gain of \$800 (Q1-F2010 - \$1,507; Q2-F2009 - \$12). For the six month period ended December 31, 2009, the Corporation incurred a net foreign exchange gain of \$2,307 (Q1 and Q2 F2009 - loss of \$865). The foreign exchange gain for the three and six months ended December 31, 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 Peso 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 December 31, 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 December 31, 2009.

At December 31, 2009, the Corporation had a total net financial derivative liability of \$741 (June 30, 2009 - \$497) relating to the oil financial option collar.

For the three months ended December 31, 2009, the Corporation had a net realized financial derivative gain of \$Nil (Q1-F2010 - \$Nil; Q2-F2009 - gain of \$2,276) on its oil collar hedge while for the six months ended December 31, 2009, the Corporation had a net realized financial derivative gain of \$Nil (Q1 and Q2 F2009 - gain of \$1,992).

For the three months ended December 31, 2009, the Corporation had a net unrealized financial derivative loss of \$323 (Q1-F2009 - gain of \$80; Q2-F2009 - gain of \$1,363) on its oil collar hedge while for the six months ended December 31, 2009, the Corporation had a net unrealized financial derivative loss of \$243 (Q1 and Q2 F2009 - gain of \$1,884).

Stock Based Compensation

For the three months ended December 31, 2009, a total of \$877 (Q1-F2010 - \$155; Q2-F2009 - \$47) was expensed relating to the vesting of stock options while for six months ended December 31, 2009, a total of \$1,032 was expensed (Q1 and Q2 F2009-\$163).

Income Taxes

Canacol is subject to taxation in Canada, Brazil, and Colombia. The current income tax expense for Q2-F2010 was a charge of \$595 (Q1-F2009 - charge of \$314; Q2-F2009 - recovery of \$276) 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 Q2-F2010.

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 December 31, 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 December 31, 2009, future income tax recovery was \$724, resulting in an outstanding future income tax liability of \$8,270 at December 31, 2009 (Q1-F2010 - \$11,005; Q2-F2009 - \$11,339).

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

Operating

For the three months ended December 31, 2009, cash flow from ongoing operating activities totalled an inflow of \$1,702 (Q1-F2010 - outflow of \$1,091; Q2-F2009 - inflow of \$5,673) while for the six months ended December 31, 2009, it totalled an inflow of \$612 (Q1 and Q2 F2009 - \$4,183). For the three months period ending December 31, 2009, cash flow from operating activities before changes in non-cash working capital totalled an outflow of \$139 (Q1-F2010 - outflow of \$1,014; Q2-F2009 - inflow of \$270), while for the six months ended December 31, 2009, it totalled an outflow of \$1,152 (Q1 and Q2 F2009 - \$1,057).

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 December 31, 2009, the Corporation recorded net cash inflow from ongoing financing activities of \$27,917 (Q1-F2010 - inflow of \$8,657; Q2-F2009 - outflow of \$10,123). For the six months ended December 31, 2009, the Corporation recorded net cash inflow from ongoing financing activities of \$31,675 (Q1 and Q2 F2009 - outflow of \$11,071). Cash inflow from financing activities primarily relates to a \$40,000 share issue, less repayments of the Corporation's line of credit and long term debt.

Investing

For the three months ended December 31, 2009, cash flows from ongoing investing activities totalled an outflow of \$6,252 (Q1-F2010 - \$393; Q2-F2009 - \$494). For the six months ended December 31, 2009, cash flows from ongoing investing activities totalled an outflow of \$1,821 (Q1 and Q2 F2009 - \$6,463). For the three months ended December 31, 2009, the Corporation incurred \$8,998 in capital

expenditures, offset by a \$4.6 million draw on the Gemini financing. 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 and six months ended December 31, 2009 and 2008 include:

Drilling Services Revenue

As noted above, BCH was sold on December 31, 2008. Thus, for the three and six months ended December 31, 2009, the total drilling services segment revenue, before inter-company consolidation eliminations, was \$Nil (Q2-F2009 - \$10,214) while for the six months ended December 31, 2009, total drilling services revenue before inter-company consolidated eliminations, was \$ Nil (Q1 and Q2 F2009 - \$20,083).

Drilling Services Revenue				
	Three Months Ended		Six Months ended	
	December 31,		December 31,	
<i>(\$000s)</i>	2009	2008	2009	2008
Drilling services segment revenue	-	10,214	-	20,083
Less: Inter-segment sales ⁽¹⁾	-	-	-	(44)
Less: Sales taxes	-	(604)	-	(1,328)
Drilling services revenue	-	9,610	-	18,711

⁽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 Q2-F2010 totalled \$Nil (Q2-F2009 - \$6,380) while for the six months ended December 31, 2009, the operating expenses related to the operations of BCH totalled \$Nil (Q1 and Q2 F2009 - \$13,854). The respective year-over-year decrease in operation expenses was attributable to BCH being sold. Operating margin for Q2-F2010 was \$Nil (Q2-F2009 - \$3,230).

Depreciation

During Q2-F2010, depreciation expense relating to the operations of BCH totalled \$Nil (Q2-F2009 - \$1,088) while for six months ended December 31, 2009, depreciation expenses relating to the operations of BHC totalled \$Nil (Q1 and Q2 F2009 - \$2,102).

General and Administrative

During Q2-F2010, general and administrative (G&A) expenses related to BCH were \$Nil (Q2-F2009 - \$1,367).

Income Taxes

BCH was subject to taxation in Canada and Brazil. Current income tax expense for the three months ended December 31, 2009 was \$Nil (Q2-F2009 - \$1,380) relating to Brazilian withholding taxes on the lease portion of BCH's drilling rig contracts which was paid to Canadian entity. During the six months ended December 31, 2009 future income tax was \$Nil (Q1-F2009 - recovery of \$3,877). For the six months ended December 31, 2009, the net tax expense was \$Nil (Q2-F2009 - expense of \$2,497).

Stock Based Compensation

Included in discontinued operations, for six months ended December 31, 2009, stock compensation expense of \$Nil (Q2-F2009 - \$17) was recognized relating to stock options issued by BCH.

Interest and Financial Expenses

During Q2-F2010, interest and financial expenses were \$Nil (Q2-F2009 - \$3,201). Interest and financial expense was 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 six months ended December 31, 2009 totalled \$Nil (Q2-F2009 - \$1,404).

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 were based on a US\$ price with a portion paid in BRL\$ and a portion of which was 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 Q2-F2010 (Q2-F2009 - loss of \$10,065). The foreign exchange loss was a result of the depreciation of the Canadian dollar relative to the US dollar and the corresponding impact on US denominated debt balances in Q2-F2009.

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 were not designated as hedges and therefore unrealized gains on these contracts were recorded on the balance sheet with changes in their fair value recorded in the net earnings for the period. Details of the outstanding contracts were 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

During the six months ended December 31, 2009, BCH had a net realized financial derivative loss of \$Nil (Q1 and Q2 F2009 - 640). For the three months ended December 31, 2009, BCH had a net realized financial derivative gain of \$Nil (Q2-F2009 - \$695). During the six months ended December 31, 2009, BCH had a net unrealized financial derivative loss of \$Nil (Q1 and Q2 F2009 - loss of \$1,498). For the three months ended December 31, 2009, BCH had a net unrealized financial derivative loss of \$Nil (Q2-F2009 - loss of \$472).

LIQUIDITY AND CAPITAL RESOURCES

Working Capital

Funding for the Corporation's expenditures during the period ended December 31, 2009 was provided through a combination of share issuances and financing draws. At December 31, 2009, the Corporation had positive working capital of \$19,145 (June 30, 2009 - deficiency of \$15,262).

During the six months ended December 31, 2009, the Corporation placed \$4,000 of convertible debentures with interest payable in common shares and 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 allow it to execute the Corporation planned drilling programs and exploration commitments in Colombia, Guyana and Brazil.

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 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 had 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 used to repay the Corporation's outstanding mezzanine debt facility.

As at December 31, 2009, the Corporation had repaid in full its original amount on the mezzanine debt of US\$11,600.

As at December 31, 2009, Canacol had a reserve based credit facility with US\$11,682 drawn; the Rancho Hermoso reserves based revolving line of credit facility. Subsequent to December 31, 2009, the Corporation repaid US\$818, decreasing the credit facility to US\$10,863.

Capital program commitments

In Colombia and Guyana, the Corporation has non-discretionary work program commitments totalling approximately \$11,282 due within a year or less and \$6,065 due during the years following. The Corporation will continue to focus its efforts in calendar 2010 on its operated development programs in Colombia, its project in Guyana 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 Rancho Hermoso Field. Further, the Corporation is seeking to sell remaining 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. The Corporation has successfully attracted the required investment capital to fund operations and planned programs for calendar 2010.

COMMITMENTS, GUARANTEES, AND OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 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
7	Recôncavo & Sergipe ²	August 26, 2008	595	\$1,072 BRL \$1,785	79	\$141 BRL \$237
9	Recôncavo	March 12, 2010	1,600	\$2,881 BRL \$4,800	320	\$576 BRL \$960
9	Espirito Santo	March 12, 2011	1,020	\$1,837 BRL \$3,060	408	\$735 BRL \$1,224

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

² Operator has satisfied this obligation. Therefore, the Corporation is not in default.

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 December 31, 2009, equated to approximately \$142 (June 30, 2009 - 79 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 addition, the Corporation has commitments for office premises and other operating leases. As at December 31, 2009, the lease payments required in each of the next five years are as follows:

Leases	\$
2010	100
2011	100
2012	100
2013	100
2014	105

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 million, to be used to fund portions of the Corporation's development and appraisal programs in Colombia.

Under the terms the agreements, Gemini agreed to invest:

- a) Up to US\$3 million towards the drilling of a development well and the workover of 2 existing wells in the Entrerrios Field;
- b) Up to US\$3 million towards the drilling of 2 development wells and the workover of one existing well in Rancho Hermoso Field; and
- c) Up to US\$3 million 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 royalties from 11% to 31% of the Corporation's interest in gross revenue after government royalty less field operating costs from the field up to either a 400% payout ratio or until 95% of the ultimate recoverable reserves as determined from time to time as underlying the Concession area have been produced, whichever is the sooner. The Corporation has no obligation to repay these funds if the underlying properties defined in the transaction have no revenues. Gemini has indicated that, if requested, it may consider increasing its total investment up to maximum of US\$12 million.

As at December 31, 2009, the Corporation had drawn US\$9 million from the agreements 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.

TRANSACTIONS WITH RELATED PARTIES

During the three and six months period ended December 31, 2009, companies controlled by a director of the Corporation were paid a total \$Nil (Q1 and Q2 F2009 - \$47 and \$91 respectively) 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 for the three and six months ended December 31, 2009 totalled \$251 and \$493, respectively (Q1 and Q2 F2009 - \$362 and \$623 respectively) and are 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 7,000 bbl/d for these properties at the year end December 31, 2010. The Corporation will shortly complete long term production testing of the Guadalupe reservoir in the Rancho Hermoso 5 well, and will next initiate a long term production test of the overlying Los Cuervos reservoir. Upon completion of the long term production test of the Los Cuervos, the Corporation plans to comingle production from both the Los Cuervos and Guadalupe reservoirs and place the well on permanent long term production. The Corporation is also preparing to drill up to 5 new wells in the Rancho Hermoso field commencing in May, 2010, and will also expand the capacity of the permanent facilities to handle the additional fluids. 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. The Corporation is currently tendering a 2D seismic acquisition program for the Tamarin E&P contract, and an airborne magnetic gravity survey for the Pacaraba TEA, both programs to be completed in Q4 2010. 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 calendar 2010. These activities are also expected to yield near term production and reserve additions in calendar 2010.

SHARES OUTSTANDING (as at February 24, 2010)

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, December 31, 2009	329,551,890
Issued to consultants	81,151
Warrants exercised	2,759,000
Stock options exercised	200,000
Number of shares issued and outstanding, February 24, 2010	332,592,041

Subsequent to the year ended December 31, 2009, 200,000 shares were issued on exercise of options, 2,759,000 shares were issued on exercise of warrants, and 81,151 shares were issued in lieu of cash to consultants.

Options Outstanding (as at February 24, 2010)

The following are the outstanding stock options issued by the Corporation and their respective exercise prices and expiry dates. At February 24, 2010, vested stock options totalling 8,270,371

options were exercisable at a weighted average exercise price of \$0.38 per common share and a total of 23,841,701 options were issued and outstanding at a weighted average exercise price of \$0.34.

Stock Options Outstanding

	Number	Exercise Price	Expiry Date Range
Balance, December 31, 2009	18,667,701	\$0.27	
Option Grant	5,774,000	\$0.60	January 19, 2015
Cancelled & Expired Options	(50,000)	\$0.75	January 19, 2011
	(40,000)	\$1.20	November 10, 2011
	(10,000)	\$1.20	February 13, 2012
	(150,000)	\$1.20	June 5, 2012
	(150,000)	\$0.65	March 1, 2013
	<u>(400,000)</u>		
Exercised	(110,000)	\$0.19	June 5, 2014
	(90,000)	\$0.40	March 31, 2010
	<u>(200,000)</u>		
Balance, February 24, 2010	23,841,701	\$0.34	

WARRANTS OUTSTANDING (as at February 24, 2010)

Warrants Outstanding

	Number	Exercise Price	Expiry Date
Warrants Outstanding at December 31, 2009	33,762,424	\$0.38	2.05 years
Exercised Warrants	(10,000)	\$0.30	July 24, 2011
	(478,500)	\$0.30	January 7, 2011
	(1,602,500)	\$0.20	May 14, 2011
	(668,000)	\$0.20	May 28, 2011
Warrants Outstanding at February 24, 2010	31,003,424	\$0.40	2.00 years

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 14 and 28, 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). 4,276,100 of these warrants have been exercised as of February 24, 2010.

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 for 18 months.

Subsequent to the three months ended December 31, 2009, 488,500 warrants were exercised at an exercise price of \$0.30 and 2,270,500 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 periodic volatility of financial and capital markets may severely limit access to capital, the Corporation has been able to successfully attract the required investment capital.

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 December 31, 2009, the Corporation held \$49 (BRL\$ 81) on deposit in Brazilian currency (June 30, 2009 - \$13 (BRL\$ 22) and \$4,454 (COP\$ 7.9 billion) on deposit in Colombian Pesos (June 30, 2009 - \$31 (COP\$ 58,285)) and \$26.5 million (US\$ 25.4 million) on deposit in US dollars (June 30, 2009 - \$84 (US\$ 72)). As at December 31, 2009, the Corporation had \$12,225 (US\$11,682) in US dollar denominated debt outstanding (June 30, 2009 - \$20,344 (US\$ 17,500)) in connection with its debt facilities and \$613 (COP\$1.1 million) (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 referenced 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 5.7% to 7.0% per annum on the balance outstanding resulting in an average rate of 10.31%.

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 volatility global economic environment has resulted in a significant variation in crude oil prices over the last year. Any dramatic drop in crude oil prices will 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 on its ability to finance capital expenditures. In absence of externally-source capital, this could limit growth prospects over the short run or may even require the Corporation to dispose of assets and 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 signed an agreement with Gemini for the financing of US\$9 million, reducing exposure to the risk of reduction of this lender's appetite for the risks and exposures associated with financing a junior international company's operations. In addition, 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 credit facility did not take effect until periods occurring on or after March 31, 2009. There was a risk that the Corporation would 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 reviewed such situations with the lender and on October 22, 2009 the Corporation's 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 annual 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

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David Winter

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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

Transfer Agent & Registrar

Olympia Trust Company

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