

Canacol Energy Ltd.

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

Management Discussion and Analysis
Three months ended September 30, 2010

November 11, 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 United States dollars, has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"), and should be read in conjunction with the audited consolidated financial statements for the fiscal year ended June 30, 2010 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 therefrom.

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 United States dollars (audited). All references to C\$ are to Canadian dollars, references to US\$ or \$ are United States (U.S.) dollars, references to BRL\$ are to Brazilian Real, and references to COP\$ are to Colombian Pesos.

FINANCIAL RESULTS	For the three months ended September 30,	
	2010	2009
<i>(US\$000s), except share data</i>		
Petroleum and natural gas sales, net		
Colombia ^{(1) (4)}	14,360	2,196
Brazil ⁽²⁾	859	546
	15,219	2,742
Tariff revenue	1,579	1,244
Interest and other revenue	251	615
Total revenue, recurring operations	17,049	4,601
Cash from (used in) continuing operating activities	2,076	(994)
Per share - basic and diluted	0.00	(0.01)
Net loss from continuing operations	(2,602)	(1,329)
Per share - basic and diluted	(0.01)	(0.01)
Capital expenditures		
Colombia ⁽¹⁾	6,141	2,855
Brazil ⁽²⁾	345	206
Guyana	1,755	-
Canada ⁽³⁾	-	75
	8,241	3,136
Total assets	179,149	80,633
Total long-term liabilities	33,314	23,413
Weighted average shares outstanding		
Basic (000s)	430,260	180,834
Basic and Diluted (000s)	430,260	180,834

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

⁽²⁾ Brazil results were estimated based on Agencia Nacional do Petroleo "ANP" data.

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

⁽⁴⁾ Under the terms of one of Canacol's crude oil marketing agreement ("the Hocol agreement"), Canacol retains ownership of oil in transit until it reaches the export pipeline which can take several days at which point the ownership of the oil transfer from Canacol to Hocol. At the end of September 30, 2010, the 57,000 bbls of oil in inventory as at June 30, 2010 was delivered to Hocol and the respective revenues and expenses were recognized during the quarter ended September 30, 2010. At as September 30, 2010, 7,000 bbls of crude oil was held in inventory.

OPERATING RESULTS	For the three months ended September 30,			
	2010		2009	
	Colombia	Brazil (1)	Colombia (2)	Brazil (1)
Sales Volume				
Crude oil and NGL (bbl/d)	2,283	123	163	110
Natural gas (mcf/d)	-	-	-	-
Total (boe per day)	2,283	123	163	110
Total tariff sales (bbl/d)	1,253	-	1,344	-
Production				
Crude oil and NGLs (bbl/d)	1,684	123	330	110
Natural gas (mcf/d)	-	-	-	-
Total (boe per day)	1,684	123	330	110
Total tariff production (bbl/d)	1,226	-	1,377	-
Average sale prices				
Crude oil (\$/bbl) ⁽⁶⁾	72.77	85.51	63.06	50.59
Oil equivalent (\$/boe)	-	-	-	-
Operating netback (US\$/boe)				
Commodity sales revenue ⁽⁶⁾	72.77	85.51	63.06	50.59
Tariff revenue ⁽⁴⁾	13.70	-	11.81	-
Non-refundable sales taxes	-	(3.56)	-	(2.31)
Realized gain on financial derivative	-	-	-	-
Royalties ⁽⁶⁾	(5.79)	(5.63)	(5.05)	(6.41)
Transportation & processing ⁽⁴⁾	(2.60)	(11.62)	(2.76)	(12.23)
Well workover & repair	(0.55)	-	(0.01)	(2.31)
MEP work unit provision	-	-	-	(2.93)
Operating expenses ⁽⁵⁾	(16.68)	(32.85)	(13.25)	(29.34)
Netback ⁽⁶⁾	47.15	31.85	41.99	(4.94)

⁽¹⁾ Brazil results were estimated based on Agencia Nacional do Petroleo "ANP" data.

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

⁽³⁾ Colombian commodity sales revenue and tariff revenue include transportation revenue.

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

⁽⁵⁾ Colombian operating expenses relate to both tariff and non-tariff oil production volumes.

⁽⁶⁾ "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 bbls sold. 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. In Colombia, the total sales volume for the three months ended September 30, 2010 were 210,000 bbls (non-tariff) and 115,302 bbls (tariff).

HIGHLIGHTS FROM Q1-F2011

- On July 16, 2010, the Corporation closed an 8% convertible debenture financing, on a “bought deal” basis, with a syndicate of underwriters (“the Underwriters”) led by Canaccord Genuity Corp., and including FirstEnergy Capital Corp., Cormark Securities Inc., Citigroup Global Market Canada Inc. and Mackie Research Capital Corp. The Underwriters purchased \$39.0 million (C\$41.5 million) principal amount of Canadian dollar denominated convertible unsecured debentures with an interest rate of 8% per annum, payable semi-annually on the last day of June and December commencing on December 31, 2010. The debentures are convertible at the holder’s option into common shares of the Corporation at any time prior to the earlier of the maturity date or the business day immediately preceding the date fixed by the Corporation for redemption at a conversion price of \$0.9989 (C\$1.0526) per common share, being the ratio of 950 common shares per \$949 (C\$1,000) principal amount of debentures. On July 21, 2010, the debentures, including the underlying common shares issuable upon conversion, redemption or maturity of the debentures commenced trading on the TSXV under the trading symbol “CNE.DB”.
- On July 16, 2010, the Corporation issued 4,421,260 common shares of the Corporation in connection with the purchase of royalty interest from Gemini Oil and Gas Fund II, LP (“Gemini”) in addition to \$18,000 cash payment to Gemini.
- On July 22, 2010, the Corporation commenced trading on the Bolsa de Valores de Colombia (“BVC”) under the trading symbol “CNEC”.
- August 27, 2010, the Corporation completed flow testing of the three zones in the Rancho Hermoso 6 (“RH 6”) well and achieved a total gross flow rate of 12,847 barrels of oil per day (“bbl/d”). The RH 6 well encountered 115 feet (“ft”) of net oil pay within 5 different reservoir intervals, which include, from top to bottom, the C7, Mirador, Los Cuervos - Barco, Guadalupe, and Ubaque.
- On September 7, 2010, the Corporation completed the drilling and testing of the first horizontal well, Capella FH-10 which tested at a gross rate up to 437 bbl/d, and the Romero A1 well. The Corporation also completed the acquisition and processing of 184 square kilometres of 3D seismic over the discovery, and noted that it had commenced the drilling of the Capella L-11 well.

SUBSEQUENT EVENTS AFTER Q1-F2011

- On October 26, 2010 the Corporation completed drilling and testing of the Rancho Hermoso 7 well (“RH7”), which tested a flow rate of 5,019 barrels of oil per day (“bbl/d”) from the Los Cuervos reservoir. The Los Cuervos - Barco reservoir at RH 7ST contains 34 ft of net oil pay. The Los Cuervos - Barco was perforated between 9,206 and 9,217 ft md and flowed at a final gross rate of 5,019 bbl/d (1,255 bbl/d net) of 34° API light gravity oil with 4% water cut using an electrical submersible pump set to a frequency of 35 Hz during a 24 hour flow period. Following a 12 hour shut in period to obtain reservoir pressure, the drilling rig is being demobilized from location in advance of the well being placed on production through the permanent production facilities. The Corporation plans to co-mingle production from the Los Cuervos - Barco and underlying Guadalupe reservoirs at some point in 2011 after the long term production performance of the zone has been established.

- The rig was mobilized to the Rancho Hermoso 8 (“RH 8”) well which was spud in the first week of November. The RH 8 well targeted the Los Cuervos - Barco and Guadalupe reservoirs at a location approximately 1,500 ft to the southwest of the Rancho Hermoso 5 (“RH 5”) well. Meanwhile, the Corporation contracted the Saxon 132 drilling rig which is being mobilized to the Rancho Hermoso 9 (“RH 9”) location to commence drilling in mid November. The RH 9 well will target the deeper Ubaque reservoir at a location approximately 3,000 ft to the southwest of the RH 5 well.
- On November 9, 2010, the Corporation engaged with Citivalores S.A. Sociedad Comisionista de Bolsa in Colombia to lead a non-deal road show to Santiago, Chile and Lima, Peru November 16th through 18th in preparation of the integration of the stock exchanges in these three countries. The integration of these three markets offers the potential to significantly broaden Canacol’s institutional and retail shareholder base in South America as initially Canacol will be one of only three energy stocks available for investment in the integrated market. The Corporation also plans to commence the process of listing on the Toronto Stock Exchange to concurrently broaden institutional and retail exposure in North America.
- The Corporation anticipated to spud the first well in Guyana in December 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 Capella budget capital budget for calendar 2011 has not yet been finalized with the operator.
- Subsequent to the three months ended September 30, 2010, 883,966 shares were issued on exercise of options, 1,622,000 shares were issued on exercise of warrants, 40,678 shares were issued to consultants for services, C\$6,307,000 in debentures were converted, resulting in the issuance of 5,991,650 common shares and 2,266 shares were issued as payment of interest on debentures.

COMPANY OVERVIEW AND BACKGROUND

Canacol Energy Ltd. (“Canacol” or the “Corporation”) (TSX-Venture: CNE) and (Bolsa de Valores de Colombia: CNEC) is a Canadian-based independent oil exploration company operating primarily in Colombia, Guyana and Brazil. The Corporation’s current worldwide production is approximately 5,800 barrels of oil per day (“bbl/d”), which consists of 4,000 bbl/d net royalty production and 1,800 bbl/d of tariff production. Through the drilling of 13 new development wells in Colombia the Corporation anticipates worldwide production to average 4,200 bbl/d for calendar 2010, with an exit rate of 7,000 bbl/d which excludes any production resulting from exploration success, and is dependent on completion on schedule of planned drilling programs.

Colombia

Canacol has interests in 9 exploration and production contracts in Colombia, and currently plans to spend \$42 million on various exploration and development projects in its contract areas in calendar 2010. The capital programs, currently include the drilling of 13 wells in 2010 (to date 6 wells were drilled), the acquisition of 310 km of 2D seismic (60km Tamarin and 250 km Cedrela) and 184 square kilometres of 3D seismic (Capella) (completed in September 2010), acquisition of 2,250 kilometres of aero magnetic gravity data (Pacarana) and construction of new facilities and expansion of existing facilities. This does not include spending on the acquisition of two blocks won on the bid round 10 in Colombia.

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) and Entrerrios Production Contract (60% operated working interest)

The Corporation's current share of production from the Rancho Hermoso and Entrerrios fields is approximately 5,700 *bbl/d*, comprised of 3,900 *bbl/d* net of government royalty, and 1,800 *bbl/d* of tariff production. A portion of the Corporation's net oil production currently is security by commodity contracts (Refer to the Risk Section).

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 2010 and 2011 is expected to be approximately \$12.04 and \$15.04, respectively (2009 - \$9.63) per gross barrel plus transportation reimbursement, and was insensitive to West Texas Intermediate oil price fluctuations. Under an existing agreement with Ecopetrol, the tariff increases through a series of steps each year to approximately \$17.36 per gross barrel in calendar 2012 plus transportation reimbursement and will remain at that level for the duration of the life of the field.

The Corporation planned to drill 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 *bbl/d* 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 production from the Mirador, Los Cuervos, Guadalupe, and Ubaque reservoirs, all of which are currently producing reservoirs. The drilling program commenced with the June 2010 success with Rancho Hermoso 6, which tested total of 12,847 *bbl/d* from 3 separate zones, Rancho Hermoso 7, which tested 5,019 barrels of oil per day from the Los Barcos zone 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 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 three 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 Sinochem Corporation (formerly 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. Ten wells have been drilled to date. The Capella 1 and 2 wells tested 240 and 345 gross *bbl/d* from the Mirador Formation. The Capella 3 well, the first deviated well to be drilled in the block, has a surface location adjacent to the Capella 1 vertical well and 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 Capella 5 vertical well, located approximately 3.4 kilometres to the northeast of Capella 1, has been drilled and completed. The Capella 6 vertical well, located 4.2 kilometres to the southwest of Capella 1, was also drilled and completed.

The Corporation has completed the drilling and testing of the first horizontal well, Capella FH-10, and the Romero A1 and Capella L-11 wells and commenced a steam injection pilot on one of the existing vertical wells. The Corporation has also completed the acquisition and processing of 184 square kilometres of 3D seismic over the discovery, and has drilled Capella L-11.

The Corporation and its joint venture operating partner plan to spend approximately \$42 million gross on drilling and infrastructure programs at this significant discovery in calendar 2010.

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.

The Corporation's Capella reserves increased by 100% from F2009 to F2010 in net after royalty proven and probable reserves from 2.1 to 4.2 million net barrels. This resulted in a 227% increase in net associated NPV10 to \$64.7 million for Capella.

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 Corporation has a 100% working interest in the block, which is approximately 27,487 hectares in size and 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 has acquired 60 km of 2D exploration seismic in satisfaction of the Phase 1 work program commitments. The seismic is currently being processed and interpreted; estimated to be completed in the last calendar quarter of 2010.

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 required 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 ending September 2010, for an anticipated cost of approximately \$0.47 million. The Corporation acquired the required 2,250 km aeromagnetic gravity survey in March 2010, and is in the process of converting the northern part of the TEA into an E&P contract.

Cedrela Exploration and Production Contract (100% operated working interest)

Effective May 4, 2010, Canacol, through its subsidiary Rancho Hermoso SA, was awarded the Cedrela Exploration and Production Contract ("Cedrela") by the ANH. Cedrela is located immediately south of the Tamarin E&P Contract.

The Corporation has a 100% working interest in the block, which is approximately 129,418 hectares in size and is located in the Caguan - Putumayo Basin of Colombia. Based upon the available geophysical and geological data in this frontier area, the Corporation has identified 2 large structures similar in character to Capella on the Cedrela block. During the Phase 1 Exploration Period, the Corporation will acquire, process, and interpret 250 kilometres of 2D seismic, and interpret all existing magnetic and gravity geophysical data. The duration of this phase is 18 months, with an anticipated cost of approximately \$5.4 million.

Middle Magdalena Valley Basin

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

The Corporation has a 25.5% working interest in the block, which covers approximately 8,204 net acres. 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 unrisks recoverable prospective resources. Canacol acquired 46 square kms of 3D seismic at a net cost of \$1.1 million over the discovery in calendar 2009, and drilled 2 exploration wells (Recio 1 and 2).

The Recio 1 well targeted the Lower Tertiary Honda Formation, which is a prolific oil producer within the Middle Magdalena Basin of Colombia. The Recio 1 well encountered approximately 10 feet of potential oil pay within a sandstone of the Middle Honda Formation at 1,548 to 1,558 feet measured depth with good oil and gas shows, and also encountered approximately 27 feet of potential oil pay within the sandstone of the Lower Honda Formation at 1,608 to 1,635 feet, also with good oil and gas shows while drilling. Due to an unfavourable economic analysis of the proposed stimulation, the Corporation will abandon the well in December and the block will be returned to the ANH. Recio 2 was drilled and abandoned as a dry hole.

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 in extending the term of the contract to July 2012 with a commitment to drill 2 wells by May 2011. The block contains the Karanambo discovery made by Home Oil in 1982. The Karanambo 1 well tested 411 bbl/d (42-degree API) from a sub-salt reservoir during a 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 risks recoverable 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 \$12 million of costs in order to earn a 55% working interest in the contract. On May 15, 2009, the Corporation entered into a Share Purchase

Agreement to acquire 35% of Groundstar's 45% remaining working interest in the exploration contract for consideration of \$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% (\$1.25 million) of costs of drilling the K-2 exploration well, 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., have signed an agreement for a drilling rig and associated services. During October 2010, the rig was mobilized to drill the K-2 exploration well. 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. 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 December 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 approximate cost of drilling the K-2 well net to Canacol is \$8 million, and upon completion of drilling operations operatorship will be transferred from Groundstar to Canacol. The Corporation intends to drill the Rewa exploration prospect, with net mean unrisks recoverable resources of 111 million barrels of oil, prior to Q3 of calendar 2011.

Brazil E&P

Effective January 5, 2006, Canacol through its wholly owned subsidiary, Brazalta Brazil Norte, 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 all 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. Canacol has recently entered into negotiations to sell its working interest in the concession to a private Brazilian party.

Reconcavo Basin

Block 170 (37.5% non-operated working interest)

Canacol was granted an extension by the ANH to March 12, 2011 for the drilling of the Catu exploration prospect located on Block 170 due to issues with access to the lands, and anticipates drilling the first half of calendar 2011. The prospect contains three prospective stacked reservoir sandstones that management estimates may contain up to 6 million barrels of gross mean unrisks 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)

Canacol acquired 100 km of 2D seismic during Q3-F2010. This data has been processed and interpreted.

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 United State dollars (\$) or US\$. All discussions under the financial highlights section relate to oil and gas exploration and production operations of the Corporation.

Quarterly Information - Recurring Operations <i>(US\$000s, except production data and per share)</i>	F2011		F2010				F2009	
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Petroleum and natural gas sales ⁽²⁾								
Colombia ⁽¹⁾	14,360	4,486	3,721	2,063	2,196	1,926	1,067	747
Brazil	859	845	1,270	585	546	68	658	739
Total production revenue	15,219	5,331	4,991	2,648	2,742	1,994	1,725	1,486
Tariff revenue ⁽³⁾	1,579	1,874	1,607	1,611	1,244	858	917	832
Interest and other	251	212	165	265	615	425	105	290
Total operating revenue	17,049	7,417	6,763	4,524	4,601	3,277	2,747	2,608
Total production (bbl)	166,230	141,905	77,219	40,797	40,427	37,855	40,635	28,845
Total tariff production (bbl)	112,788	104,839	139,370	151,907	126,673	92,367	104,101	82,600
Cash from (used in) operating activities	2,076	3,799	(4,560)	1,610	(994)	(3,584)	(2,097)	4,864
Per share	0.00	0.01	(0.02)	0.01	(0.00)	(0.02)	(0.02)	0.01
Net (loss) gain	(2,602)	(11,648)	(5,130)	(4,157)	(1,329)	(4,500)	(4,330)	(7,586)
Per share	(0.01)	(0.04)	(0.02)	(0.01)	(0.01)	(0.03)	(0.03)	(0.07)
Total assets	179,149	158,762	96,066	102,728	80,633	73,299	75,416	76,401
Total long term liabilities	33,314	11,908	17,537	21,573	23,413	23,191	11,856	26,399

⁽¹⁾ Colombian operations commenced October 30, 2008.

⁽²⁾ Under the terms of one of Canacol's crude oil marketing agreement ("the Hocol agreement"), Canacol retains ownership of oil in transit until it reaches the export pipeline which can take several days at which point the ownership of the oil transfers from Canacol to Hocol. At the end of September 30, 2010, the 57,000 bbls of oil in inventory as at June 30, 2010 was delivered to Hocol and the respective revenues and expenses were recognized during the quarter ended September 30, 2010. At as September 30, 2010, 7,000 bbls of crude oil was held in inventory.

⁽³⁾ Includes tariff revenue of \$11.11 for the months of July and August 2010 and \$13.89 for the month of September 2010 plus transportation reimbursement.

Petroleum and Natural Gas Sales (Net of Royalties)

The Corporation has three types of sales agreements in Colombia:

- Tariff (Rancho Hermoso Field - Mirador formation) - a risk service contract with Ecopetrol where the Corporation receives a fix tariff price per barrel;
- Production revenue (Rancho Hermoso and Entrerrios Field - all other formations) - a risk participation contract where the Corporation is entitled to approximately 25% of the production after Ecopetrol's share and ANH royalties; and
- Production revenue (Capella Field) - based on the WTI less ANH royalties.

The operating revenue from continuing operations for the three months ended September 30, 2010 totalled \$17,049 (Q1-F2010 - \$4,601), representing an increase of \$12,448 or 271% compared to Q1-F2010.

The operating revenue consists of production revenue (non-tariff production), tariff production and interest and other revenue. The production revenue during Q1-F2011 totalled \$15,219 (Q1-F2010 - \$2,742) representing an increase of \$12,477 or 455% compared to Q1-F2010. The tariff revenue during Q1-F2011 totalled \$1,579 (Q1-F2010 - \$1,244) representing an increase of \$335 or 27% compared to Q1-F2010. Interest and other income are discussed below.

The increases in the operating revenue and tariff revenue for Q1-F2011 compared to Q1-F2010 are due to higher production volumes and prices achieved by the Corporation.

In Colombia, sales volumes of crude oil achieved during the three months ended September 30, 2010 totalled 210,000 bbls (2,283 bbl/d) (Q1-F2010 - 15,000 bbls (163 bbls/d)). The average price achieved in Colombia in Q1-F2011 was \$72.77/bbl compared to \$63.06/bbl in Q1-F2010.

In Colombia, tariff sales volumes during Q1-F2011 totalled 115,302 bbls (1,253 bbl/d) (Q1-F2010 - 123,665 bbls (1,344 bbl/d)). The decrease was due to natural production declines. The average tariff price for Q1-F2011 was \$13.70/bbl (including \$1.48 of transportation revenue per tariff barrel); Q1-F2010 was \$11.81/bbl (including \$1.52 of transportation revenue per tariff barrel).

The increase in the sales volume for Q1-F2011 compared to Q1-F2010 was due to the start up of RH-4, RH-5 and RH-6 and the sale of oil inventory with a total net sales of approximately 125,000 bbls.

Brazil production volumes during Q1-F2011 totalled 11,342 bbls of light oil (123 bbl/d); (Q1-F2010 - 10,100 bbls (110 bbl/d)). The average price achieved per bbl in Brazil in the Q1-F2011 was \$85.51/bbl (Q1-F2010 - \$50.59/bbl) including transportation reimbursement.

Sales Volumes (bbls)	For the three months ended	
	September 30, 2010	
	2010	2009
Colombia	210,000	15,000
Brazil	11,342	10,100
Total net sales	221,342	25,100
Tariff sales	115,302	123,665
Total	336,644	148,765

Production /Sales Volumes (Non Tariff) - Colombia

<i>(bbls)</i>	As at September 30, 2010
Opening inventory in tanks	1,400
Inventory hold by Hocol	57,002
Production - Q1 F2011	136,362
Volumetric Compensation	8,324
Sales	(210,000)
Closing inventory	(6,912)

Royalties as a percentage of gross petroleum and natural gas revenues by geographic region for the three months ended September 30, 2010 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 three months ended September 30, 2010 in Brazil was 7.5% compared to 12.7% during Q1-F2010. 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 Q1-F2011 Colombian royalties averaged 8%.

Royalties	Three months ended September 30,	
	2010	2009
Colombia ⁽¹⁾	8.0%	8.0%
Brazil	7.5%	12.7%

⁽¹⁾ There are no royalties on the tariff production.

Brazil oil sales are subject to non-refundable sales taxes. This totalled \$40 during three months ended September 30, 2010 (Q1-F2010 - \$24). This has been recorded and netted against revenue for the three months ended September 30, 2010.

Interest and Other Revenue

During the three months ended September 30, 2010 interest and other revenue of \$251 (Q1-2010 - \$615) was recorded. The decrease in the interest and other revenue compared to Q1-F2010 was due to decrease in interest earned on cash investments.

Operating Expenses - Petroleum and Natural Gas

For the three months ended September 30, 2010, operating expenses totalled \$7,334 (Q1-F2010 - \$2,807). Colombian operating expenses relate to both tariff and non-tariff oil production. Details by operating segment are outlined in the table below.

Operating Expenses (\$000s)	Three months ended September 30,	
	2010	2009
Operating expenses		
Colombia ⁽¹⁾⁽²⁾	5,804	2,365
Brazil ⁽²⁾	373	300
	6,177	2,665
Colombia transportation & processing charges	845	433
Colombia well workover & repair	180	3
Brazil transportation & processing charges	132	124
Brazil well workover & repair	-	-
MEP work unit provision	-	(418)
	7,334	2,807
Operating expenses per boe		
Colombia ⁽²⁾	16.68	13.25
Brazil ⁽¹⁾	32.85	29.34
Weighted Average	17.34	13.90

⁽¹⁾ Colombian operations commenced October 30, 2008. Colombian operating expenses relate to both tariff and non-tariff oil production volumes.

⁽²⁾ 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 the MEP work unit provision are also shown separately.

Depletion, Depreciation, and Amortization (DD&A)

For the three months ended September 30, 2010, DD&A totalled \$6,052 (Q1-F2010 - 2,108). The respective increases are a result of an increase in the production volumes.

General and Administrative

For the three months ended September 30, 2010, general and administrative (G&A) expenses were \$2,850 (Q1-F2010 - \$1,530). The increase in the G&A is primarily due to increase in personnel and professional fees costs to support expanding operations. 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 growing operations. Canacol did not capitalize any indirect overhead costs.

Interest and Financial Expense

For the three months ended September 30, 2010, interest and financial expense was \$1,374 (Q1-F2010 - \$814). Interest and financial expense is comprised of interest on the Corporation's long-term debt facilities, lines of credit, 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, the non-cash interest charged on the 8% and 12% convertible debentures and the accretion of the 8% and 12% convertible debentures. Non-cash interest charges for Q1-F2011 totalled \$540 (Q1-F2010 - \$283).

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 line of credit facilities are denominated in Colombian Pesos.

For the three months ended September 30, 2010, the Corporation incurred a net foreign exchange gain of \$667 (Q1-F2010 - gain \$1,374). The foreign exchange gain for the three months September 30, 2010 is a result of the appreciation of the Canadian dollar relative to the US dollar due to Canadian dollar cash balances, and the corresponding impact on the translation of the Brazilian operations from the Brazilian Real to U.S. Dollars.

The Corporation has not entered into any foreign currency derivative contracts to manage its exposure to the Brazilian Real, Colombian Peso, or the Canadian Dollar; such contracts may be considered in future periods. Refer to the Risk Factors Section below for additional details.

Commodity Contracts

For the three months ended September 30, 2010, the Corporation had two commodity contracts in place. Both WTI oil financial option collars have an expiry date in August 2011. The Corporation has not designated these embedded derivatives as a hedge and has therefore recorded the unrealized gain on the contract on the balance sheet with changes in its fair value recorded in the net earnings for the period. Refer to the Risk Factors section for specific details of the current financial derivative contract that remains outstanding as of September 30, 2010.

At September 30, 2010, the Corporation had a total net commodity contract liability of \$213 (F2010 - asset of \$227) relating to the oil financial option collars.

For the three months ended September 30, 2010, the Corporation had a net realized loss on commodity contracts of \$443 (Q1-F2010 - gain of \$73) on its oil collar.

Stock Based Compensation

For the three months ended September 30, 2010, a total of \$2,988 (Q1-F2010 - \$141) was expensed relating to the vesting of stock options. The year-over-year increase can primarily be attributed to a combination of the relative timing of options granted during the year, the vesting of previously granted options, and the assessed value of the options issued.

Income Taxes

Canacol is subject to taxation in Canada, Brazil, and Colombia. The current income tax expense for Q1-F2011 was a recovery of \$168 (Q1-F2010 - expense of \$286) 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 the three months ended September 30, 2010.

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

As at September 30, 2010, the Company had a deferred income tax liability relating to the book value in excess of the tax basis value on its petroleum and natural gas assets acquired through the acquisition of Canacol Energy Inc. The future income tax liability recorded in conjunction with the acquisition totalled \$11,382. During the three months ended September 30, 2010, future income tax recovery was \$555, resulting in an outstanding future income tax liability of \$8,419 at September 30, 2010 (June 30, 2010 - \$7,864).

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

Operating

For the three months period ending September 30, 2010, cash flow from operating activities before changes in non-cash working capital totalled an inflow of \$7,351 (Q1-F2010 - outflow of \$924).

Financing

For the three months ended September 30, 2010, the Corporation recorded net cash inflow from financing activities of \$40,509 (Q1-F2010 - \$8,218). Cash inflow from financing activities for the three months ended September 30 2010 primarily relates to an issuance of share capital and 8% convertible debentures.

Investing

For the three months ended September 30, 2010, cash flows from investing activities totalled an outflow of \$26,589 (Q1-F2010 - \$358). For the three months ended September 30, 2010, the Corporation incurred \$8,241 in capital expenditures. The majority of the capital spent was related to the Corporation's Colombian operations.

LIQUIDITY AND CAPITAL RESOURCES

Working Capital

Funding for the Corporation's expenditures during the three months ended September 30, 2010 was provided by cash on hand, from issuance of 8% convertible debentures and cash generated from operating activities. At September 30, 2010, the Corporation had positive working capital of \$72,201 (June 30, 2010 -\$34,315).

Management believes that a combination of cash on hand, plus the cash generated from operating activities plus funding through debt or equity financing or potential farm-outs will allow the Corporation to execute its planned drilling programs and exploration commitments in Colombia, Guyana and Brazil.

Cash Flow From Operating Activities

The Corporation in the three months ended September 30, 2010 generated cash flow from operations of \$2,076 and anticipates positive quarterly cash flow going forward.

COMMITMENTS, GUARANTEES, AND OFF-BALANCE SHEET ARRANGEMENTS

Minimum exploration program (Brazil)

As at September 30, 2010, the Corporation had minimum exploration program ("MEP") work unit commitments to complete negotiated exploration work on its onshore blocks awarded by the Agência Nacional do Petróleo, Gás Natural e Biocombustível ("ANP"), Brazil's National Petroleum Agency. MEP work units are satisfied through completion of exploration wells, seismic programs, and other exploration survey methods all of which have prescribed work units for completion. Therefore, although actual dollars spent on projects do not directly correlate to reducing the MEP work units, the financial guarantees related to non-performance are shown in the table below. The commitment is reduced as work is performed.

Bid Round	Basin	Commitment Date	Extension	Gross Remaining MEP		Net Remaining MEP		Net Financial Guarantee ¹
				Work Units	Gross Financial Guarantee	Work Units	Gross Financial Guarantee	
						\$1,766		\$565
9	Recôncavo ²	June 5, 2010	March 12, 2011	1,000	BRL \$3,000		320	BRL \$960
						\$1,801		\$720
9	Espirito Santo ³	March 12, 2011	March 12, 2011	1,020	BRL \$3,060		408	BRL \$1,224

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

² The ANP has granted an extension until March 12, 2011 to the Corporation to obtain permission to access the area.

³ The ANP has granted an extension until March 12, 2011 to complete the first exploration period of the block EST - 318.

The round 9 (Reconcavo Basin) commitments are planned to be satisfied through a combination of the execution of an exploration drilling program and through financial settlement of MEP work units and the round 9 (Espirito Santo Basin) commitments are planned to be satisfied through a combination of seismic acquisition and through financial settlement of MEP work units.

Work program commitments (Colombia)

Round 10

The Corporation has secured two Exploration and Production Contracts ("E&P Contracts") in the Upper Magdalena Basin of Colombia via its wholly owned subsidiary Rancho Hermoso S.A.. Canacol secured 100% operated working interest in each of COR-11 and COR 39 E&P contracts which were won from ANH. Each of the four blocks has a six year exploration term divided into two 36 month exploration phases. The phase 1 work program commitments associated with each of blocks are summarized below:

Bid Round	Basin	Commitment Date	Block	Working Interest	Work program commitments	Financial Guarantee ¹
10	Upper Magdalena Basin	July 1, 2013	COR-11	100%	155 kms of 2D seismic and 1 exploration well	\$ 12,200
10	Upper Magdalena Basin	July 1, 2013	COR-39	100%	90 kms of 2D seismic and 2 exploration well	\$ 15,600

¹ The Corporation will place a total of \$13.3M in letters of credit with ANH.

The Corporation was the successful bidder on 4 blocks in Round 10 in Colombia. The Corporation was subsequently notified by the ANH that 2 of the 4 blocks, COR 11 and 39, would be awarded due to a conflict with the Terms of Reference applying to the bid round. The Corporation, along with all of the other successful bidders in Round 10, is waiting to sign the E&P contracts.

Cedrela E&P Contract

On May 2010, the Corporation was awarded the Cedrela Exploration and Production Contract ("Cedrela E&P Contract") by the ANH of Colombia. The Cedrela E&P contract is located in the Putumayo-Caguan Basin, and is approximately 50 kilometres directly southwest of the Ombu E&P contract which contains Capella heavy oil discovery. The Corporation has a 100% working interest in the Cedrela E&P Contract, which is 129,418 hectares (319,799 acres) in size. The terms of the 6 year contract are as follows:

Phase	Basin	Commitment Date	Working Interest	Work program commitments	Financial Guarantee
1	Putumayo-Caguan Basin	December 31, 2011	100%	250 kms of 2D seismic	\$ 5,400
2	Putumayo-Caguan Basin	June 30, 2013	100%	Drill 1 exploration well	\$2,000
3	Putumayo-Caguan Basin	December 31, 2014	100%	60 kms of 3D seismic	\$3,000
4	Putumayo-Caguan Basin	June 30, 2016	100%	Drill 1 exploration well	\$2,000

Based upon the results of the Phase 1 exploration activities, the Corporation has the option to proceed to the Phase 2 exploration period and associated activities or relinquish the contract.

Other Commitments

In Guyana, the Corporation has work program commitments totalling approximately \$12,000 due within a year or less.

The Capella capital budget for calendar 2011 has not yet been finalized with the operator.

In addition, the Corporation has commitments for leases and its office premises. As of September 30, 2010, the payments required in each of the next five calendar years on these lease are as follows:

<u>Leases</u>	<u>\$</u>
2010	24
2011	97
2012	97
2013	97
2014	102

The Corporation is currently disputing certain amounts claimed by a joint venture operator. As adequate supporting financial documents have not been provided by the operator, the Corporation continues to record revenues, expenses and any amounts receivable from or payable to the operator using the Corporation's best estimates as of and for the three months ended September 30, 2010. Any adjustments required upon final settlement in the joint venture operation will be recorded in the period as amounts owing to or receivable from the operator.

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 \$9 million, to be used to fund portions of the Corporation's development and appraisal programs in Colombia.

In return, Gemini was 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 had no obligation to repay these funds if the underlying properties defined in the transaction had no revenues.

In July 2010, Canacol used \$18,000 of the net proceeds from an 8% convertible debenture offering to acquire the royalties on its Rancho Hermoso, Entrerrios, and Capella oil fields in Colombia from Gemini. This transaction was effective as of June 30, 2010. In addition, the Corporation issued 4,421,260 common shares at a price of \$0.78 (C\$0.82) per common share in connection with the termination. These common shares were issued on July 16, 2010.

PENDING LAND AUCTION AWARD 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.

No capital commitments are currently included in Canacol's capital budget for the round 8 lands.

SUBSEQUENT EVENTS

Discussed in relevant sections in the MD&A.

TRANSACTIONS WITH RELATED PARTIES

During the period ended September 30, 2010 and 2009 there have been no transactions with 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 December 31, 2010, subject to completion of planning drilling programs on schedule.

The Corporation completed flow testing of the three zones in the Rancho Hermoso 6 ("RH6") well, the first of five development wells planned for calendar year 2010, with a total gross flow rate of 12,847 bbl/d. The RH 6 well encountered 115 feet ("ft") of net oil pay within 5 different reservoir intervals, which include, from top to bottom, the C7, Mirador, Los Cuervos - Barco, Guadalupe, and Ubaque.

The Corporation completed drilling the Rancho Hermoso 7 well ("RH7"), which tested a flow rate of 5,019 bbl/d from the Los Cuervos reservoir. The Los Cuervos - Barco reservoir at RH 7ST contains 34 ft of net oil pay. The Los Cuervos - Barco was perforated between 9,206 and 9,217 ft md and flowed at a final gross rate of 5,019 bbl/d (1,255 bbl/d net) of 34° API light gravity oil with 4% water cut using an electrical submersible pump set to a frequency of 35 Hz during a 24 hour flow period.

The Corporation plans to drill 2 additional new infill development wells in the Rancho Hermoso field during the remainder of 2010, subject to completion of planning drilling programs on schedule, 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 Capella reserves increased by 100% from F2009 to F2010 in net after royalty proven and probable reserves from 2.1 to 4.2 million net barrels and resulted in a 227% increase in net associated NPV10 to US\$64.7 million. The Corporation's proven, probable and possible net reserves after royalty increased by 279% from 3.6 to 9.9 million net barrels, with net associated NPV10 increasing 644% to US\$182 million. The Corporation has acquired the Pacarana, Tamarin and Cedrela contracts adjacent to the Capella oil field and has won two additional blocks in the bid Round 10 in Colombia. The Corporation has also completed a seismic program on the Tamarin E&P contract, and has completed an airborne magnetic gravity survey on the Pacarana TEA. The 2 new E&P contracts secured from the ANH in Round 10, the COR 11 and COR 39 blocks are expected to be drilled in 2012.

The Capella capital budget for calendar 2011 has not yet been finalized with the operator.

In Guyana, the Corporation has a 65% 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 with the K2 exploration well, expected to spud before the end of 2010, and to drill the Rewa prospect in the first half of 2011.

SHARES OUTSTANDING (as at November 11, 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, September 30, 2010	438,726,582
Issued to consultants for services	40,678
Warrants exercised	1,622,000
Stock options exercised	883,966
Debentures converted	5,991,650
Interest on debentures paid through issuance of shares	2,266
<hr/>	
Number of shares issued and outstanding, November 11, 2010	447,267,142

Subsequent to the three months ended September 30, 2010, 883,966 shares were issued on exercise of options, 1,622,000 shares were issued on exercise of warrants, 40,678 shares were issued to consultants for services, C\$6,307,000 in debentures were converted, resulting in the issuance of 5,991,650 common shares and 2,266 shares were issued as payment of interest on 12% convertible debentures.

OPTIONS OUTSTANDING (as at November 11, 2010)

The following are the outstanding stock options issued by the Corporation and their respective exercise prices and expiry dates. At November 11, 2010, vested stock options totalling 12,659,108 options were exercisable at a weighted average exercise price of \$0.42 per common share and a total of 31,477,103 options were issued and outstanding at a weighted average exercise price of \$0.58.

Stock Options Outstanding

	Number	Weighted Average	
		Exercise Price	Expiry Date Range
Balance, September 30, 2010	31,861,069	\$0.56	
Option Grants	100,000	\$1.19	October 14, 2015
	500,000	\$1.63	November 2, 2015
Cancelled & Expired Options	(100,000)	\$0.85	July 20, 2015
Exercised	300,000	\$0.19	March 1, 2013
	399,966	\$0.35	January 6, 2014
	184,000	\$0.60	March 4, 2014
	883,966		
Balance, November 11, 2010	31,477,103	\$0.58	

WARRANTS OUTSTANDING (as at November 11, 2010)

Warrants Outstanding	Number	Weighted Average	
		Exercise Price	Expiry Date
Warrants Outstanding at September 30, 2010	6,557,500	\$0.17	May 14, 2011
	2,440,000	\$0.18	May 28, 2011
	684,824	\$0.28	July 23, 2011
	9,682,324		
Exercised Warrants	260,000	\$0.17	May 14, 2011
	1,240,000	\$0.18	May 28, 2011
	122,000	\$0.28	July 23, 2011
Warrants Outstanding at November 11, 2010	8,060,324	\$0.25	6 months

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 \$0.17 (C\$0.20) until May 14, 2011 (first closing) and May 28, 2011 (second closing). 16,502,500 of these warrants have been exercised as of November 11, 2010.

On July 23, 2009, the Corporation issued 1,109,524 warrants in connection with a private placement at an exercise price of \$0.28 (C\$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 \$0.28 (C\$0.30) for 18 months. 2,046,700 of these warrants have been exercised as of November 11, 2010.

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; substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the long-term for which additional financings may be required to implement Canacol's 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 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 Canadian dollar (C\$) as well as its debt balances which are denominated in US\$.

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 ongoing adverse conditions, the Brazilian Real and the Colombian Peso have seen significant variation against the US\$ during 2010 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 reduce its exposure to fluctuations between the US dollar, Colombian Peso, or the Brazilian Real. Such derivatives may be considered in future periods.

The line of credit in Colombia bears interest at the Deposit a Termino Fijo ("DTF") interest rate, a Colombian benchmark interest rate, plus 2% per annum on the balance outstanding resulting in an average rate of 6.2%.

In addition to the lines of credit discussed above, the Corporation, through its subsidiary Rancho Hermoso, also obtained three additional unsecured revolving lines of credit with an aggregate borrowing base of \$5,877 (COP\$ 10.6 billion). The lines of credit have similar interest rates as described above. The Corporation has not drawn down any amounts under these lines of credit.

Fluctuations in energy prices will not only impact 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 in the global economic environment has resulted in 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.

The Corporation entered into two oil price financial derivative collars with the following terms.

WTI crude oil financial option collar:

Period	Volume	Type	Price Range
Jan 2010 – Dec 2010	140 bbls/day	Financial WTI Oil Collar	\$55.00 - \$80.25
Jan 2011 – Aug 2011	114 bbls/day	Financial WTI Oil Collar	\$55.00 - \$80.25
May 1, 2010 – August 31, 2011	500 bbls/day	Financial WTI Oil Collar	\$70.00 - \$100.45

Effective on November 1, 2010, the Corporation entered into another financial WTI oil collar under the following terms:

Period	Volume	Type	Price Range
Nov 2010 – Oct 2011	500 bbls/day	Financial WTI Oil Collar	\$70.00 - \$100.00

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 commodity contracts activities may have opportunity costs when realized prices exceed commodity contract 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, Ecopetrol and Hocol). Management continuously reviews its relationships with its customers to minimize any exposure risks.

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, 2010.

Currency translation

The accounts of the self-sustaining Canadian parent 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. ("RHSA") has signed with Ecopetrol are "risk contracts" because RHSA makes all investments and is in charge of producing at its own cost and risk. RHSA takes the risk regardless of the outcome. However, there are differences depending how the contract rewards RHSA. There are two cases:

In the case of Mirador in the RHSA field, it is a service contract because all of the crude belongs to Ecopetrol and RHSA gets paid through a tariff per barrel. RHSA 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 RHSA is entitled to a proportion of the production. Therefore, RHSA 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 does not expect the adoption of this statement to have a material impact on its 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 its 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.

The Corporations' June 30 fiscal year end requires IFRS financial statements for its fiscal year beginning on July 1, 2011.

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, TSX Venture Exchange policies and BVC 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.

No material changes in maintenance of disclosure controls and procedures and internal control over financial reporting were required due to the BVC listing.

ADDITIONAL INFORMATION

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

Corporate Information

Management Team

Charle Gamba – President & Chief Executive Officer
Mark Holliday – Chief Operating Officer
Mark Teare – Vice President Exploration
Brian Hearst – Chief Financial Officer

Board of Directors

Michael Hibberd, Chairman
Luis Baena
Alvaro Barrera
Jason Bednar
Charle Gamba
Stuart Hensman
David Winter

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Auditors

Deloitte & Touche LLP Calgary, Alberta

Bankers

HSBC Bank Canada – Calgary, Canada
HSBC Bank Brasil - Rio de Janeiro, Brazil
Citibank, Bogota, Colombia

Independent Reserve Engineers

Ryder Scott Company LP
DeGolyer and MacNaughton Canada Limited.

Legal Counsel

Davis LLP - Canada
Schmidt, Valois, Miranda, Ferreira & Agel – Brazil
Salazar Asociados Abogados - Colombia

Stock Exchange Listings

TSX Venture Exchange: CNE
BVC Colombia: CNEC
TSX Venture Exchange (Debentures): CNE.D

Transfer Agent & Registrar

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