CANACOL ENERGY LTD.

INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
THREE AND SIX MONTHS ENDED DECEMBER 31, 2012

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(UNAUDITED)

(in thousands of United States dollars)

As at	Note	December 31, 2012	June 30, 2012
ASSETS			
Current assets			
Cash and cash equivalents		$ 33,253	$ 30,789
Restricted cash	7	17,035	6,072
Trade and other receivables		25,411	32,801
Prepaid expenses and deposits		6,164	4,630
Embedded derivatives asset		3,322	3,156
Crude oil inventory		1,149	8,136
		86,334	85,584
Non-current assets			
Restricted cash	7	2,263	483
Embedded derivatives asset		2,868	3,942
Exploration and evaluation assets	5	129,072	126,295
Property, plant and equipment	6	371,933	187,208
Pipeline investment		2,581	2,690
Deferred tax assets		-	626
		508,717	321,244
Total assets		$ 595,051	$ 406,828
LIABILITIES AND EQUITY			
Current liabilities			
Bank debt	8	$ 85,206	$ 12,000
Trade and other payables		23,783	47,602
Deferred income	18	2,500	-
Commodity contracts	16	2,575	303
Warrants	10	495	-
Equity tax payable		1,888	1,236
Taxes payable		2,799	3,893
		119,246	65,034
Non-current liabilities			
Bank debt	8	14,234	15,986
Commodity contracts	16	-	124
Decommissioning obligations		8,971	6,642
Convertible debentures	9	24,367	25,381
Warrants	10	2,889	896
Phantom warrants	8,16	2,526	-
Equity tax payable		1,127	1,671
Other long term obligations		10,468	-
Deferred tax liabilities		51,635	-
Total liabilities		235,463	115,734
Equity			
Share capital	11	408,760	340,775
Other reserves		35,645	32,053
Accumulated other comprehensive loss		347	347
Deficit		(85,164)	(82,081)
Total equity		359,588	291,094
Total liabilities and equity		$ 595,051	$ 406,828

Commitments and contingencies (note 17); Subsequent event (note 19)

See accompanying notes to interim condensed consolidated financial statements.

CANACOL ENERGY LTD.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

(in thousands of United States dollars, except per share amounts)

	Note	Three months ended December 31, 2012	Three months ended December 31, 2011	Six months ended December 31, 2012	Six months ended December 31, 2011
Revenues					
Petroleum and natural gas revenues, net of royalties	14	**$ 27,350**	$ 55,241	**$ 69,145**	$ 90,571
Expenses					
Production and transportation expenses		**18,369**	23,573	**44,096**	36,842
Pre-license and exploration costs	5	**14,130**	1,699	**14,354**	3,155
General and administrative		**5,910**	4,689	**10,633**	7,230
Stock-based compensation	11	**859**	1,590	**2,040**	4,068
Depletion and depreciation	6	**10,195**	14,516	**23,494**	23,039
(Gain) loss on convertible debentures and warrants	10,16	**(828)**	516	**(1,400)**	(3,979)
Gain on overlifted volumes payable		**-**	-	**-**	(7,088)
Foreign exchange (gain) loss and other		**(813)**	402	**573**	(4,642)
Unrealized loss on embedded derivatives		**871**	-	**908**	-
Unrealized loss on phantom warrants	16	**623**	-	**623**	-
(Gain) loss on commodity contracts	16	**(1,190)**	162	**3,059**	(376)
Gain on business acquisition	4	**(28,147)**	-	**(28,147)**	-
Net loss on sale of assets		**-**	-	**-**	4,170
		19,979	47,147	**70,233**	62,419
Net finance expense	12	**2,409**	747	**2,620**	644
Income (loss) before income taxes		**4,962**	7,347	**(3,708)**	27,508
Income taxes (recovery)					
Current		**(758)**	435	**(1,643)**	4,350
Deferred		**2,589**	9,272	**1,018**	12,032
		1,831	9,707	**(625)**	16,382
Non-controlling interest		**-**	63	**-**	63
Net income (loss)		**3,131**	(2,423)	**(3,083)**	11,063
Other comprehensive income					
Foreign currency translation adjustment		**-**	-	**-**	151
Comprehensive income (loss)		**$ 3,131**	$ (2,423)	**$ (3,083)**	$ 11,214
Earnings (loss) per share					
Basic	13	**$ 0.05**	$ (0.04)	**$ (0.05)**	$ 0.21
Diluted	13	**$ 0.05**	$ (0.04)	**$ (0.05)**	$ 0.20

Effective December 20, 2012, the Corporation completed a 10:1 consolidation of its common shares. Consequently, all the earnings per share information presented above were restated to a post-consolidation basis for comparability.

See accompanying notes to interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(UNAUDITED)

(in thousands of United States dollars, number of shares in thousands)

	Number of Common Shares		Share Capital		Other Reserves		Accumulated Other Comprehensive Income		Deficit		Total Equity
Balance at June 30, 2011	51,164	$	269,732	$	21,286	$	347	$	(100,637)	$	190,728
Issue of common shares, net of costs	10,020		64,493		(240)		-		-		64,253
Conversion of convertible debentures	83		767		-		-		-		767
Stock options exercised	62		374		(161)		-		-		213
Stock-based compensation	-		-		6,266		-		-		6,266
Net loss for the period	-		-		-		151		11,063		11,214
Balance at December 31, 2011	61,329	$	355,366	$	27,151	$	498	$	(89,574)	$	273,441
Balance at June 30, 2012	61,898	$	340,775	$	32,053	$	347	$	(82,081)	$	291,094
Issue of common shares, net of costs	24,601		67,985		-		-		-		67,985
Stock-based compensation	-		-		3,592		-		-		3,592
Net loss for the period	-		-		-		-		(3,083)		(3,083)
Balance at December 31, 2012	**86,499**	**$**	**408,760**	**$**	**35,645**	**$**	**347**	**$**	**(85,164)**	**$**	**359,588**

Effective December 20, 2012, the Corporation completed a 10:1 consolidation of its common shares. Consequently, all previous share information was restated to a post-consolidation basis.

See accompanying notes to interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands of United States dollars)

	Note	Three months ended December 31, 2012	Three months ended December 31, 2011	Six months ended December 31, 2012	Six months ended December 31, 2011
Operating activities					
Net income (loss) for the period		$ 3,131	$ (2,423)	$ (3,083)	$ 11,063
Adjustments for non-cash items:					
Stock-based compensation		859	1,590	2,040	4,068
Depletion and depreciation		10,195	14,516	23,494	23,039
Accretion on decommissioning liabilities	12	77	273	140	417
(Gain) loss on convertible debentures and warrants		(828)	516	(1,400)	(3,979)
Gain on overlifted volumes payable		-	-	-	(7,088)
Net loss on sale of assets		-	-	-	4,170
Unrealized (gain) loss on commodity contracts	16	(1,584)	162	2,148	(454)
Unrealized foreign exchange (gain) loss and other		(927)	574	542	(1,027)
Unrealized loss on embedded derivatives		871	-	908	-
Unrealized loss on phantom warrants		623	-	623	-
Non-cash financing cost	12	1,906	-	1,906	-
Amortization of upfront fees	12	167	-	334	-
Deferred income		-	-	2,500	-
Deferred income tax		2,589	9,272	1,018	12,032
Exploration costs		14,011	-	14,011	-
Gain on business acquisition	4	(28,147)	-	(28,147)	-
Funds from operations		2,943	24,480	17,034	42,241
Changes in non-cash working capital	14	1,674	11,278	(2,013)	23,653
		4,617	35,758	15,021	65,894
Investing activities					
Expenditures on exploration and evaluation assets		(12,854)	(10,941)	(17,635)	(17,664)
Expenditures on property, plant and equipment		(8,294)	(51,484)	(21,606)	(76,117)
Cash paid for business acquisition	4	(40,224)	-	(40,224)	-
Cash acquired in business acquisition	4	8,300	8,419	8,300	8,419
Investment in pipeline		-	(611)	-	(1,013)
Proceeds on sale of Brazilian assets		-	-	-	3,152
Change in restricted cash		(6,592)	1,256	(10,415)	7,759
		(59,664)	(53,361)	(81,580)	(75,464)
Changes in non-cash working capital	14	538	(23,523)	(1,651)	(24,347)
		(59,126)	(76,884)	(83,231)	(99,811)
Financing activities					
Issue of common shares		-	63	-	213
Share issuance costs		(361)	-	(361)	-
Draw on bank debt		60,035	13,100	77,035	13,100
Repayment of bank debt		(3,000)	-	(6,000)	-
		56,674	13,163	70,674	13,313
Change in cash and cash equivalents		2,165	(27,963)	2,464	(20,604)
Cash and cash equivalents, beginning of period		31,088	108,986	30,789	101,627
Cash and cash equivalents, end of period		$ 33,253	$ 81,023	$ 33,253	$ 81,023
Cash and cash equivalents consists of:					
Cash				$ 31,707	$ 44,556
Cash equivalents				1,546	36,467
Cash and cash equivalents, end of period				$ 33,253	$ 81,023

See accompanying notes to interim condensed consolidated financial statements.

NOTE 1 - GENERAL INFORMATION

Canacol Energy Ltd. ("Canacol" or the "Corporation") and its subsidiaries are primarily engaged in petroleum and natural gas exploration and development activities in Colombia, Ecuador, Brazil, Guyana and Peru. The Corporation's head office is located at 4500, 525 - 8th Avenue SW, Calgary, Alberta, T2P 1G1, Canada. The Corporation's shares are traded on the Toronto Stock Exchange under the symbol CNE and the Bolsa de Valores de Colombia under the symbol CNEC.

The Board of Directors approved these interim condensed consolidated financial statements (the "financial statements") for issuance on February 11, 2013.

NOTE 2 - BASIS OF PREPARATION

The financial statements have been prepared by management in accordance with International Accounting Standard 34, "Interim Financial Reporting". These financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Corporation's annual financial statements for the year ended June 30, 2012.

Basis of Measurement

These financial statements have been prepared on a historical cost basis, except for commodity contracts, convertible debentures, embedded derivatives, warrants, phantom warrants and overlifted volumes payable, which are measured at fair value with changes in fair value recorded in profit or loss ("fair value through profit or loss").

These financial statements have been prepared on a going concern basis.

Functional and Presentation Currency

These financial statements are presented in United States dollars, which is both the functional and presentation currency.

NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES

These financial statements are prepared using the same accounting policies and methods of computation as disclosed in note 4 of the annual consolidated financial statements as of and for the year ended June 30, 2012.

NOTE 4 – BUSINESS ACQUISITION

On October 15, 2012, the Corporation entered into an agreement (the "Arrangement Agreement") whereby the Corporation agreed to acquire 100% of the issued and outstanding class "A" common shares ("Shona Common Shares") and series "A" preferred shares ("Shona Preferred Shares") of Shona Energy Company, Inc. ("Shona"), in exchange for common shares of the Corporation ("Canacol Shares") and cash, by way of a statutory plan of arrangement (the "Arrangement"). On December 21, 2012, the closing date of the transaction, the Corporation acquired 100% of the issued and outstanding Shona Common Shares in exchange for 0.10573 Canacol Shares and C$0.0896 cash for each Shona Common Share (the "Consideration") and 100% of the issued and outstanding Shona Preferred Shares in exchange for $100.00 cash for each Shona Preferred Share. Canacol issued an aggregate of 24,600,758 Canacol Shares to Shona Common Shareholders in connection with the Arrangement.

Under the terms of the Arrangement Agreement, all of Shona's outstanding options were surrendered and terminated prior to closing of the Arrangement. In addition, all holders of Shona warrants were entitled to receive, in lieu of the number of Shona Common Shares otherwise issuable upon the exercise thereof, the number of Canacol Shares adjusted for an exchange ratio of 0.12587 of a Canacol Share per Shona Share and the exercise price of the warrants was reduced with respect to the exchange ratio of 0.12587 such that the warrants maintained their economic equivalency.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

Acquisition related costs, other than share issue costs, of approximately $0.2 million have been expensed as period costs in the interim condensed consolidated statement of operations for the three and six months ended December 31, 2012.

From the period of December 21, 2012 to December 31, 2012, the acquired business contributed revenues, net of royalties, of $0.9 million and operating income of $0.8 million to Canacol's operations. If the acquisition had occurred on July 1, 2012, management estimates its pro forma revenues for Shona, net of royalties and operating income would have been approximately $14.7 million and $3.9 million, respectively, for the six months ended December 31, 2012. Operating income includes $4.9 million of transaction and other costs related to the acquisition by Canacol. It is impracticable to derive all amounts necessary to determine contributed net income from the acquired business as operations were immediately merged with Canacol's operations to realize synergies.

The acquisition has been accounted for using the purchase method with the results of Shona's operations included in the Corporation's financial and operating results commencing December 21, 2012. The allocation of net assets acquired was based on the best available information at the time and may be subject to further change. The allocation of the purchase price based on estimated fair values was as follows:

Consideration:		
Issue of common shares	$	68,346
Issue of warrants		2,231
Cash paid to common and preferred shareholders		40,224
	$	**110,801**
Net assets acquired:		
Cash	$	8,300
Restricted cash		2,327
Trade and other receivables		5,337
Other current assets		1,183
Exploration and evaluation assets		6,544
Property, plant and equipment		174,408
Trade and other payables		(5,002)
Other current liabilities		(683)
Decommissioning obligations		(1,961)
Deferred tax liability		(51,244)
Other long term liabilities		(261)
		138,948
Gain on business acquisition		(28,147)
	$	**110,801**

The gain on business acquisition was recognized as a result of change in the Corporation's share price between when the Arrangement Agreement was signed and the closing of the acquisition.

NOTE 5 – EXPLORATION AND EVALUATON ASSETS

Balance at June 30, 2012	$	126,295
Acquisition of Shona (note 4)		6,544
Net additions		17,635
Transferred to property, plant and equipment		(7,391)
Transferred to exploration expense		(14,011)
Balance at December 31, 2012	**$**	**129,072**

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

During the three months ended December 31, 2012, the Corporation has relinquished one of its exploration blocks and consequently, all costs and capitalized interests associated with the block has been transferred to exploration expense. In addition to the $14.0 million of costs transferred to exploration expense, $0.1 million and $0.3 million of pre-license costs were also included in pre-license and exploration costs for the three and six months ended December 31, 2012, respectively.

NOTE 6 – PROPERTY, PLANT AND EQUIPMENT

	Petroleum and Natural Gas Assets	Gas Processing Facilities	Corporate and Other Assets	Total
Cost or deemed cost				
Balance at June 30, 2012	241,582	31,745	5,456	278,783
Acquisition of Shona (note 4)	174,408	-	-	174,408
Net additions	23,048	(30)	945	23,963
Transferred from exploration and evaluation assets	7,391	-	-	7,391
Reclassifications	1,893	-	-	1,893
Balance at December 31, 2012	**$ 448,322**	**$ 31,715**	**$ 6,401**	**$ 486,438**
Accumulated depletion, depreciation and impairment losses				
Balance at June 30, 2012	(88,085)	(847)	(2,643)	(91,575)
Depletion and depreciation	(19,015)	(3,708)	(771)	(23,494)
Reclassifications	(1,893)	-	-	(1,893)
Inventory adjustment and other	2,457	-	-	2,457
Balance at December 31, 2012	**$ (106,536)**	**$ (4,555)**	**$ (3,414)**	**$ (114,505)**
Carrying amounts				
At June 30, 2012	$ 153,497	$ 30,898	$ 2,813	$ 187,208
At December 31, 2012	**$ 341,786**	**$ 27,160**	**$ 2,987**	**$ 371,933**

During the three and six months ended December 31, 2012, $1.2 million and $2.5 million (2011 - $2.9 million and $5.4 million) of compensation and other costs were capitalized, respectively, which reduced general and administrative and stock-based compensation expenses for the periods.

NOTE 7 – RESTRICTED CASH

	December 31, 2012	June 30, 2012
Restricted cash – current	**$ 17,035**	$ 6,072
Restricted cash – long term	**2,263**	483
	$ 19,298	$ 6,555

As at December 31, 2012, restricted cash consisted of: 1) $16.8 million for work commitments and other capital commitments, including $2.3 million related to the Shona acquisition; 2) $0.5 million for future decommissioning obligations with respect to the Entrerrios field; and 3) $2.0 million held in a debt reserve account as required under its Shona term loan described below.

NOTE 8 – BANK DEBT

Syndicated Credit Facility

The Corporation, through its wholly-owned subsidiary Canacol Energy Colombia S.A., has in place a $200 million syndicated credit facility with an approved borrowing base of $33.0 million. The credit facility consists of a reserve-based revolving facility and an amortized term facility.

The revolving facility has a three-year term maturing on June 29, 2015 and is subject to re-determination of the borrowing base semi-annually on April 1 and October 1 each year. The borrowing base is determined based on, among other things, the Corporation's current reserve report, results of operations, the lender's view of the current and forecasted commodity prices and the current economic environment. Advances under the revolving facility bear interest at rates ranging from LIBOR plus 2.50% to 3.25% per annum, depending on utilization. Undrawn amounts under the revolving facility bear a commitment fee of 0.50% per annum.

The term facility bears interest at LIBOR plus 2.50% and is repayable in ten equal principal instalments of $3.0 million plus accrued interest due at the end of each three month period starting on September 1, 2012. Repayments under the term facility result in a corresponding increase in the amounts that are available under the revolving facility such that the total amount available always equals the approved borrowing base.

The combined credit facility is secured by certain of the Corporation's oil and gas assets and reserves. At December 31, 2012, $41.0 million was drawn under the combined credit facility and an additional amount of $5.8 million was guaranteed under a letter of credit.

The borrowing base was re-determined in late December 2012 to $33.0 million, compared to the total amount drawn or guaranteed under the facility at the time of $46.8 million. Consequently, under the credit agreement, the Corporation must cure the deficiency of $13.8 million through equal instalments of $2.3 million per month over the next six months. The repayments have been reclassified to current liabilities on the interim condensed consolidated statement of financial position.

At December 31, 2012, $1.7 million of transaction costs were netted against the carrying value of the syndicated credit facility and are being amortized over the term of the facility.

Shona Term Loan

In connection with the closing of the Shona business acquisition on December 21, 2012, the Corporation entered into a senior secured credit agreement for $45.0 million. This credit facility carries a term of one year, is repayable in full upon maturity, bears interest at 15% per annum, payable quarterly, and is secured by the assets of Shona. In consideration for entering into the credit agreement, the Corporation agreed to a "phantom warrant payment" arrangement such that the Corporation will pay an amount (in cash or Canacol Shares, at the election of the Corporation) equal to the in-the-money amount of 2,697,292 common share purchase warrants of the Corporation at an exercise price of C$4.50 per Canacol Share. The phantom warrant payment may be demanded partially or in full at any time for a period of three years.

At December 31, 2012, $2.5 million of transaction costs were netted against the carrying value of the Shona term loan are being amortized over its term.

Other Colombian Credit Facilities

The Corporation has revolving lines of credit in place in Colombia with an aggregate borrowing base of $21.6 million (COP$ 38.1 billion). These lines of credit have interest rates ranging from 6% to 9% and are unsecured. At December 31, 2012, $17.5 million was drawn under the facilities.

Letters of Credit

At December 31, 2012, the Corporation had letters of credit outstanding totaling $23.8 million to guarantee work commitments on exploration blocks and to guarantee other contractual commitments. The total of these letters of credit reduce the amounts available under the syndicated credit facility ($5.8 million) and the Colombian revolving lines of credit ($4.1 million, net of amounts counter-guaranteed by other financial institutions), each described above.

NOTE 9 – CONVERTIBLE DEBENTURES

Convertible debentures were recorded at fair value through profit or loss. Subsequent to initial recognition, these financial instruments are measured at fair value and changes therein are recognized in profit or loss. A reconciliation of the convertible debentures is provided below.

Balance at June 30, 2012		25,381
Unrealized gain		(1,634)
Foreign exchange loss		620
Balance at December 31, 2012	**$**	**24,367**

NOTE 10 – WARRANTS

	Number (000s)		Amount
Balance at June 30, 2012	329	$	896
Issued on Shona acquisition (note 4)	5,053		2,231
Unrealized loss	-		234
Foreign exchange loss	-		23
Balance at December 31, 2012	**5,382**	**$**	**3,384**

Effective December 20, 2012, the Corporation completed a 10:1 consolidation of its common shares. Consequently, the numbers of warrants as at June 30, 2012 have been restated to reflect such consolidation. The share consolidation was effected prior to the issuance of warrants for the Shona acquisition.

The warrants issued on Shona acquisition are exercisable into common shares of the Corporation at exercise prices ranging from C$3.97 to C$5.96 per share. Of the total 5,053,216 warrants issued, 1,126,479 warrants expire on October 19, 2013, 679,265 warrants expire on January 26, 2015, 1,737,020 warrants expire on February 1, 2015, and the remaining 1,510,452 warrants expire on September 2, 2015.

NOTE 11 – SHARE CAPITAL

Authorized

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

Issued and Outstanding

	Number (000s)	Amount
Balance at June 30 and December 20, 2012 (pre-consolidation)	618,982	$ 340,775
Number of common shares at December 20, 2012 (post-consolidation)	61,898	
Issued on Shona acquisition (note 4)	24,601	68,346
Share issuance costs	-	(361)
Balance at December 31, 2012	**86,499**	**$ 408,760**

Effective December 20, 2012, the Corporation completed a 10:1 consolidation of its common shares. The share consolidation was effected prior to the issuance of common shares for the Shona acquisition.

Stock Options

Effective December 20, 2012, the Corporation completed a 10:1 consolidation of its common shares. Consequently, all the stock option information presented below was restated to a post-consolidation basis.

The number and weighted-average exercise prices of stock options are as follows:

	Number (000s)	Weighted-Average Exercise Price (C$)
Balance at June 30, 2012	5,498	7.90
Granted	405	4.52
Forfeited and cancelled	(104)	9.05
Balance at December 31, 2012	**5,799**	**7.66**

Information with respect to stock options outstanding at December 31, 2012 is presented below.

	Stock Options Outstanding			Stock Options Exercisable	
Range of Exercise Prices	Number of Stock Options	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Stock Options	Weighted-Average Exercise Price
(C$)	(000s)	(years)	(C$)	(000s)	(C$)
$1.00 to $3.50	987	1.55	2.48	987	2.48
$3.60 to $7.00	1,541	3.24	5.34	1,208	5.53
$7.10 to $10.50	2,425	3.37	8.85	1,483	8.84
$10.60 to $14.00	152	2.89	12.09	103	12.20
$14.10 and higher	694	3.06	15.04	430	15.12
	5,799	**2.98**	**7.66**	**4,211**	**7.13**

The fair value of the stock options granted was estimated using the Black-Scholes option pricing model with the following weighted-average inputs:

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

	Three months ended December 31, 2012	Year ended June 30, 2012
Weighted-average fair value at grant date (C$)	**7.44**	4.80
Share price (C$)	**4.50 - 15.00**	5.20 - 10.60
Exercise price (C$)	**4.50 - 15.00**	5.20 - 10.60
Volatility	**90% - 126%**	55% - 82%
Option life	**5 years**	5 years
Dividends	**Nil**	Nil
Risk-free interest rate	**1.17% - 2.78%**	1.36% - 2.32%

A forfeiture rate of 5% (2011 – 5%) was used when recording stock-based compensation for the three and six months ended December 31, 2012. Stock-based compensation expense of $0.9 million and $2.0 million (2011 – $1.6 million and $4.1 million) were expensed and $0.7 million and $1.6 million (2011 – $1.1 million and $2.2 million) were capitalized during the three and six months ended December 31, 2012, respectively.

NOTE 12 – FINANCE INCOME AND EXPENSE

	Three months ended December 31,		Six months ended December 31,	
	2012	2011	**2012**	2011
Finance income				
Interest and other income	**$ (430)**	$ (669)	**$ (699)**	$ (1,204)
Finance expense				
Fair value adjustment on equity tax payable	**28**	6	**62**	32
Accretion on decommissioning obligations	**77**	273	**140**	417
Amortization of upfront fees	**167**	-	**334**	-
Phantom warrants issued on closing of term loan	**1,906**	-	**1,906**	-
Interest and other expense	**661**	1,137	**877**	1,399
	2,839	1,416	**3,319**	1,848
Net finance expense	**$ 2,409**	$ 747	**$ 2,620**	$ 644

NOTE 13 – EARNINGS PER SHARE

Basic and diluted earnings per share were calculated as follows:

	Three months ended December 31,		Six months ended December 31,	
	2012	2011	**2012**	2011
Net income (loss), basic and diluted	**$ 3,131**	$ (2,423)	**$ (3,083)**	$ 11,063
Weighted-average common share adjustments				
Weighted-average common shares outstanding, basic	**64,840**	54,685	**63,369**	52,957
Effect of warrants	**-**	-	**-**	123
Effect of restricted share units	**-**	-	**-**	1,119
Effect of stock options	**284**	-	**-**	19
Weighted-average common shares outstanding, diluted	**65,124**	54,685	**63,369**	54,218

Effective December 20, 2012, the Corporation completed a 10:1 consolidation of its common shares. Consequently, all the earnings per share information presented above were restated to a post-consolidation basis for comparability.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

For the three and six months ended December 31, 2012 and 2011, the effect of the convertible debentures was anti-dilutive. For the six months ended December 31, 2012 and the three months ended December 31, 2011, all items were anti-dilutive due to the net loss.

NOTE 14 – SUPPLEMENTAL INFORMATION

The Corporation records crude oil and natural gas sales net of royalties. Royalties incurred were as follows:

	Three months ended December 31,		Six months ended December 31,	
	2012	2011	**2012**	2011
Petroleum and natural gas royalties	**$ 2,140**	$ 6,092	**$ 5,648**	$ 9,369

Income taxes and interest paid were as follows:

	Three months ended December 31,		Six months ended December 31,	
	2012	2011	**2012**	2011
Income taxes paid	**$ -**	$ -	**$ -**	$ -
Interest paid	**$ 1,400**	$ 1,136	**$ 1,660**	$ 1,146

Changes in non-cash working capital were comprised of:

	Three months ended December 31,		Six months ended December 31,	
	2012	2011	**2012**	2011
Change in:				
Trade and other receivables	**$ 10,531**	$ (12,158)	**$ 12,836**	$ (4,305)
Prepaid expenses and deposits	**672**	3,064	**(364)**	3,387
Crude oil inventory	**(719)**	799	**3,953**	5,202
Trade and other payables	**(17,396)**	26,776	**(27,744)**	22,734
Overlifted volumes payable	**-**	(31,856)	**-**	(31,111)
Equity tax payable	**74**	(43)	**(532)**	(1,013)
Taxes payable	**(1,199)**	1,173	**(2,062)**	4,412
Other long term obligations	**10,249**	-	**10,249**	-
	2,212	(12,245)	**(3,664)**	(694)
Attributable to:				
Operating activities	**1,674**	11,278	**(2,013)**	23,653
Investing activities	**538**	(23,523)	**(1,651)**	(24,347)
	$ 2,212	$ (12,245)	**$ (3,664)**	$ (694)

NOTE 15 – SEGMENTED INFORMATION

The Corporation's reportable segments are Colombia and Ecuador. The accounting policies used for the reportable segments are the same as the Corporation's accounting policies. For the purposes of monitoring segment performance and allocating resources between segments, the Corporation's executive officers monitor the tangible, intangible and financial assets attributable to each segment.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

At June 30, 2012, the Corporation identified "Colombia", "Corporate", and "Other" as its reportable segments. During the six months ended December 31, 2012, "Ecuador" had been added to the composition of the Corporation's reportable segments as operations in Ecuador have become increasingly significant to the Corporation's business and were separately monitored by the Corporation's executive officers. Further, "Corporate" and "Other" have been combined and renamed as "Other Segments" during the six months ended December 31, 2012. The main purpose of "Other Segments" is to reconcile the reportable segments to the Corporation's combined results. "Other Segments" is not a reportable segment. The Corporation's chief operating decision maker is its executive officers.

	Colombia	Ecuador	Other Segments	Total
Three months ended December 31, 2012				
Revenues	$ 26,200	$ 1,150	$ -	$ 27,350
Expenses, excluding income taxes	(16,414)	(307)	(5,667)	(22,388)
	9,786	843	(5,667)	4,962
Income taxes	1,422	-	409	1,831
Net income (loss)	$ 8,364	$ 843	$ (6,076)	$ 3,131
Capital expenditures, net	$ 199,567	$ 3,236	$ 816	$ 203,619
Three months ended December 31, 2011				
Revenues	$ 55,241	$ -	$ -	$ 55,241
Expenses, excluding income taxes	(38,460)	-	(9,434)	(47,894)
	16,781	-	(9,434)	7,347
Income taxes	9,707	-	-	9,707
Non-controlling interest	-		63	63
Net income (loss)	$ 7,074	$ -	$ (9,497)	$ (2,423)
Capital expenditures, net	$ 61,251	$ -	$ 1,174	$ 62,425
Six months ended December 31, 2012				
Revenues	$ 67,792	$ 1,353	$ -	$ 69,145
Expenses, excluding income taxes	(66,479)	(360)	(6,014)	(72,853)
	1,313	993	(6,014)	(3,708)
Income taxes (recovery)	(1,034)	-	409	(625)
Net income (loss)	$ 2,347	$ 993	$ (6,423)	$ (3,083)
Capital expenditures, net	$ 214,409	$ 7,196	$ 945	$ 222,550
Six months ended December 31, 2011				
Revenues	$ 90,571	$ -	$ -	$ 90,571
Expenses, excluding income taxes	(53,910)	-	(9,153)	(63,063)
	36,661	-	(9,153)	27,508
Income taxes	16,382	-	-	16,382
Non-controlling interest	-		63	63
Net income (loss)	$ 20,279	$ -	$ (9,216)	$ 11,063
Capital expenditures, net	$ 90,789	$ -	$ 2,992	$ 93,781

As at December 31, 2012				
Total assets	$ 500,219	$ 22,310	$ 72,522	$ 595,051
Total liabilities	$ 154,738	$ 8,102	$ 72,623	$ 235,463
As at June 30, 2012				
Total assets	$ 314,394	$ 4,357	$ 88,077	$ 406,828
Total liabilities	$ 64,658	$ -	$ 51,076	$ 115,734

NOTE 16 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value of Financial Instruments

The carrying values and respective fair values of financial assets and liabilities at December 31, 2012 are summarized as follows:

	Carrying Value	Fair Value
Fair value through profit or loss		
Cash and cash equivalents	$ 33,253	$ 33,253
Restricted cash	19,298	19,298
Convertible debentures	24,367	25,650
Commodity contracts liabilities	2,575	2,575
Embedded derivatives asset	6,190	6,190
Phantom warrants	2,526	2,526
Warrants	3,384	3,384
Loans and receivables		
Bank debt	99,440	103,615
Trade and other receivables	25,411	25,411
Other liabilities		
Trade and other payables	23,783	23,783
Equity tax payable	3,015	3,015
Other long term obligations	10,468	10,468
Deferred income	2,500	2,500

Phantom Warrants

	Number (000s)	Amount
Issued on closing of Shona Term Loan (note 8)	2,697	$ 1,906
Unrealized loss	-	623
Foreign exchange loss	-	(3)
Balance at December 31, 2012	2,697	**$ 2,526**

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

The fair value of the phantom warrants was estimated using the Black-Scholes option pricing model with the following inputs:

	Three months ended December 31, 2012
Fair value at grant date (C$)	**0.70**
Share price (C$)	**2.76 - 3.19**
Exercise price (C$)	**4.50**
Volatility	**58%**
Warrant life	**3 years**
Dividends	**Nil**
Risk-free interest rate	**1.19% - 1.21%**

Market Risk

Market risk is the risk that changes in market factors, such as commodity prices, foreign exchange rates, and interest rates will affect the Corporation's cash flows, net income or loss, liquidity or the value of financial instruments. The objective of market risk management is to mitigate market risk exposures where considered appropriate and maximize returns.

(i) Commodity Price Risk

Commodity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in commodity prices. Lower commodity prices can also impact the Corporation's ability to raise capital. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. From time to time the Corporation may attempt to mitigate commodity price risk through the use of financial derivatives. The Corporation's policy is to only enter into commodity contracts considered appropriate to a maximum of 50% of forecasted production volumes.

At December 31, 2012, the Corporation had four financial oil collars outstanding under the following terms:

Period	Volume	Type	Price Range
Jul 2012 – Jun 2013	750 bbls/day	Financial Brent Oil Collar	$85.00 – $107.50
Jul 2012 – Jun 2013	750 bbls/day	Financial Brent Oil Collar	$85.00 – $106.80
Jul 2013 – Dec 2013	500 bbls/day	Financial Brent Oil Collar	$85.00 – $107.50
Jul 2013 – Dec 2013	500 bbls/day	Financial Brent Oil Collar	$85.00 – $106.80

Gains and losses on commodity contracts recognized in profit or loss during the period are summarized below:

	Three months ended December 31,		Six months ended December 31,	
	2012	2011	**2012**	2011
Unrealized change in fair value	**$ (1,584)**	$ 162	**$ 2,148**	$ (454)
Realized cash settlement	**394**	-	**911**	78
Total (gain) loss	**$ (1,190)**	$ 162	**$ 3,059**	$ (376)

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

(ii) Foreign Currency Risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. The Corporation is exposed to foreign currency fluctuations as certain expenditures are denominated in Colombian pesos, Brazilian reais, Peruvian sol and Canadian dollars.

The Corporation had no forward exchange rate contracts in place as at or during the three and six months ended December 31, 2012.

(iii) Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates. The Corporation is exposed to interest rate risk on certain variable interest rate debt instruments, to the extent they are drawn. The remainder of the Corporation's financial assets and liabilities are not exposed to interest rate risk. The Corporation had no interest rate swap or financial contracts in place as at or during the three and six months ended December 31, 2012.

Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. The Corporation's approach to managing liquidity is to ensure, within reasonable means, sufficient liquidity to meet its liabilities when due, under both normal and unusual conditions, without incurring unacceptable losses or jeopardizing the Corporation's business objectives. The Corporation prepares annual capital expenditure budgets which are monitored regularly and updated as considered necessary. Petroleum and natural gas production is monitored daily to provide current cash flow estimates and the Corporation utilizes authorizations for expenditures on projects to manage capital expenditures.

The following table outlines the contractual maturities of the Corporation's financial liabilities at December 31, 2012:

	Less than 1 year	1-2 years	Thereafter	Total
Bank debt – principal	88,373	42	15,200	103,615
Trade and other payables	23,783	-	-	23,783
Deferred income	2,500	-	-	2,500
Equity tax payable – undiscounted	1,888	1,248	-	3,136
Other long term obligations	-	10,468	-	10,468
Convertible debentures – principal	-	-	25,650	25,650
Commodity contracts	2,575	-	-	2,575
Phantom warrants	-	-	2,526	2,526
Warrants	495	38	2,851	3,384
	119,614	11,796	46,227	177,637

In addition to the above, the Corporation has issued letters of credit totalling $23.8 million to guarantee certain obligations under its exploration contracts and to guarantee other contractual commitments. Such amounts only become payable should the Corporation not meet those obligations.

Credit Risk

Credit risk reflects the risk of loss if counterparties do not fulfill their contractual obligations. The majority of the Corporation's trade receivable balances relate to petroleum and natural gas sales. The Corporation's policy is to enter into agreements with customers that are well established and well financed entities in the oil and gas industry such that the level of risk is mitigated. To date, the Corporation has not experienced any material credit loss in the collection of trade receivable. In Colombia, a significant portion of crude oil sales and tariff oil revenue are with customers that are directly or indirectly controlled by the government. The Corporation has also entered into sales agreements with certain Colombian private sector companies.

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

The Corporation's trade receivables primarily relate to sales of petroleum and natural gas, which are normally collected within 45 days of the month of production. The Corporation has historically not experienced any collection issues with its customers.

Capital Management

The Corporation's policy is to maintain a strong capital base in order to provide flexibility in the future development of the business and maintain investor, creditor and market confidence. The Corporation manages its capital structure and makes adjustments in response to changes in economic conditions and the risk characteristics of the underlying assets. The Corporation considers its capital structure to include common share capital, convertible debentures, bank debt and working capital, defined as current assets less current liabilities, excluding the current portion of commodity contracts and the current portion of any embedded derivatives asset/liability. In order to maintain or adjust the capital structure, from time to time the Corporation may issue common shares or other securities, sell assets or adjust its capital spending to manage current and projected debt levels.

The Corporation monitors leverage and adjusts its capital structure based on the ratio of net debt to funds from operations. This ratio is calculated as net debt, defined as the principal amount of its outstanding bank debt plus the principal amount of its convertible debentures, unless the debentures are in-the-money or may otherwise be settled in common shares at the option of the Corporation, less working capital, adjusted for the current portion of bank debt and convertible debentures included above, divided by funds from operations. The Corporation uses the ratio of net debt to funds from operations as a key indicator of the Corporation's leverage and to monitor the strength of its financial position. The calculation has been adjusted in the current quarter to include the results of Shona for the full period on a pro forma basis, thereby appropriately matching funds from operations against related debt and providing a more meaningful ratio. Further, adjustments have been made to Shona's funds from operations to remove all transaction costs associated with the acquisition by Canacol ($4.9 million) and to reflect savings to general and administrative expenses that were effective on completion of the acquisition. Shona's adjusted funds from operations for the three months ended December 31, 2012 were $5.6 million, with $0.6 million included in the reported consolidated results of the Corporation.

In order to facilitate the management of this ratio, the Corporation prepares annual budgets, which are updated as necessary depending on varying factors including current and forecast crude oil prices, changes in capital structure, execution of the Corporation's business plan and general industry conditions. The annual budget is approved by the Board of Directors and updates are prepared and reviewed as required.

		December 31, 2012
Bank debt (current and long-term) – principal	$	103,615
Working capital surplus, excluding the current portion of bank debt and derivatives		(52,042)
Net debt		51,573
Pro forma annualized funds from operations (see note above)	$	30,900
Net debt to funds from operations		1.7

(in United States dollars (tabular amounts in thousands) except as otherwise noted)

The Corporation recently experienced a decline in its crude oil production at the Rancho Hermoso field, which impacted overall corporate profitability both through reduced revenues and higher per unit production costs, and also had the effect of reducing the borrowing capacity of the Corporation through its syndicated credit facility, thereby requiring the repayment of the deficiency over a six month period (note 8). As a result, the Corporation undertook initiatives to reverse the impact through reduced and deferred spending, diversification and increases to its production base, and arranging access to additional sources of capital to ensure liquidity. Significantly, the Corporation completed the Shona acquisition on December 21, 2012, which added production and operating cash flows, and also drilled a successful light oil well at LLA 23, which commenced production in early December 2012. As a result, the Corporation has a significantly more diversified production base, which is expected to provide more stable operating cash flows in calendar 2013 and reduce the trailing leverage ratio as calculated above. The Corporation will continue with initiatives into calendar 2013 to increase production and cash flows, to reduce its cost structure and extract cost synergies from the Shona acquisition, and to manage its overall credit facilities to ensure sufficient capital availability, while maintaining a high-impact capital program.

NOTE 17 – COMMITMENTS AND CONTINGENCIES

Presented below are the Corporation's contractual commitments at December 31, 2012:

	Less than 1 year	1-3 years	Thereafter	Total
Exploration contracts	12,317	35,297	-	47,614
Incremental production contract	18,511	61,793	-	80,304
Office lease	1,703	1,813	5,548	9,064
	32,531	98,903	5,548	136,982

Contingencies

In the normal course of operations, the Corporation has disputes with industry participants for which it currently cannot determine the ultimate results. The Corporation has a policy to record contingent liabilities as they become determinable and the probability of loss is more likely than not.

NOTE 18 – DEFERRED INCOME

Pacific Rubiales Energy Corp. ("Pacific Rubiales") has executed an agreement with the Corporation whereby, among other things, the Corporation has agreed to transfer operatorship of the contract to Pacific Rubiales following completion of the next four wells to be drilled on the contract. Under the terms of the agreement, Pacific Rubiales will operate any commercial discoveries made on the contract. In consideration for the transfer of operatorship, Pacific Rubiales has agreed to pay the Corporation the sum of $3,731,000 (the "Consideration") and has agreed to provide the Corporation with the option to participate pro-rata in its interest in the Portofino contract, as well as in all pipelines and transportation infrastructure projects in which Pacific Rubiales participates in respect of the evacuation of crude from the area. As at December 31, 2012, $2.5 million of the Consideration was received and recognized as deferred income.

NOTE 19 – SUBSEQUENT EVENT

On January 30, 2013, the Corporation granted 1,863,000 stock options to its directors, officers and employees. The options have an exercise price of C$3.38, which was the market price of the shares at the close of trading on January 30, 2013.