

CANACOL ENERGY LTD.

**INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
THREE AND SIX MONTHS ENDED JUNE 30, 2016**



INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(UNAUDITED)

(in thousands of United States dollars)

As at	Note	June 30, 2016	December 31, 2015
ASSETS			
Current assets			
Cash		\$ 25,336	\$ 43,257
Restricted cash	6	10,725	8,147
Trade and other receivables		34,820	11,682
Prepaid expenses and deposits		7,246	4,015
Investments	7	2,700	2,800
Crude oil inventory		483	465
		81,310	70,366
Non-current assets			
Restricted cash	6	51,737	53,574
Exploration and evaluation assets	4	152,787	149,906
Property, plant and equipment	5	340,199	331,995
Investment in equity	16,17	16,815	15,802
Investments	7	15,040	13,679
Deferred tax assets		36,897	33,027
		613,475	597,983
Total assets		\$ 694,785	668,349
LIABILITIES AND EQUITY			
Current liabilities			
Trade and other payables		16,343	12,704
Crude oil payable in kind		587	721
Commodity contract		50	-
Deferred income	15	6,172	2,216
Restricted share units	13	3,966	100
Wealth tax payable		571	-
Taxes payable		14,078	8,315
		41,767	24,056
Non-current liabilities			
Bank debt	8	249,443	248,228
Deferred income	15	3,731	3,731
Decommissioning obligations		33,870	39,989
Restricted share units	13	76	55
Other long term obligations		2,873	2,801
Deferred tax liabilities		42,828	46,202
Total liabilities		374,588	365,062
Equity			
Share capital	9	658,385	652,202
Other reserves		59,227	60,206
Accumulated other comprehensive income		343	343
Deficit		(397,758)	(409,464)
Total equity		320,197	303,287
Total liabilities and equity		\$ 694,785	668,349

See accompanying notes to interim condensed consolidated financial statements.

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 June 30,		Six months ended June 30,	
		2016	2015	2016	2015
Revenues					
Petroleum and natural gas revenues, net of royalties	12	\$ 37,135	\$ 27,297	\$ 58,897	\$ 53,726
Take-or-pay natural gas income		1,791	-	2,729	-
Total petroleum and natural gas revenues, net of royalties		38,926	27,297	61,626	53,726
Equity profit	16,17	718	208	1,012	883
Expenses					
Production and transportation expenses		5,175	8,566	9,257	20,373
Pre-license and exploration costs		99	19	139	117
General and administrative		4,203	5,546	7,965	10,396
Stock-based compensation and restricted share units	9	860	825	4,908	2,562
Depletion and depreciation	5	3,671	12,662	9,505	24,951
Foreign exchange loss (gain) and other		22	1,862	(756)	(226)
Loss on derivatives and financial instruments	12	1,020	129	1,137	281
Wealth tax expense		285	(18)	1,135	1,501
Impairment on property, plant and equipment	5	-	44,661	-	44,661
Gain on settlement of decommissioning liability		(346)	-	(346)	-
Loss on disposition of assets		11	38	11	38
		15,000	74,290	32,955	104,654
Net finance expense	10	5,737	13,675	11,060	18,937
Income (loss) before income taxes		18,907	(60,460)	18,623	(68,982)
Income taxes (recovery)					
Current		7,579	2,994	14,161	5,448
Deferred		83	(4,930)	(7,244)	(268)
		7,662	(1,936)	6,917	5,180
Net income (loss) and comprehensive income (loss)		11,245	(58,524)	11,706	(74,162)
Net income (loss) and comprehensive income (loss) per share					
Basic	11	\$ 0.07	\$ (0.50)	\$ 0.07	\$ (0.66)
Diluted	11	\$ 0.07	\$ (0.50)	\$ 0.07	\$ (0.66)

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 as at December 31, 2014	107,814	\$ 551,590	\$ 52,198	\$ 347	\$ (231,811)	\$ 372,324
Issue of common shares, net of costs	18,506	39,294	-	-	-	39,294
Stock options exercised	114	636	(432)	-	-	204
Stock-based compensation	-	-	3,975	-	-	3,975
Net loss for the period	-	-	-	-	(74,162)	(74,162)
Balance at June 30, 2015	126,434	591,520	55,741	347	(305,973)	341,635
Balance as at December 31, 2015	159,266	\$ 652,202	\$ 60,206	\$ 343	\$ (409,464)	\$ 303,287
Stock options exercised	1,607	6,183	(2,858)	-	-	3,325
Stock-based compensation	-	-	1,879	-	-	1,879
Net income for the period	-	-	-	-	11,706	11,706
Balance at June 30, 2016	160,873	658,385	59,227	343	(397,758)	320,197

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		Six months ended	
		2016	June 30, 2015	2016	June 30, 2015
Operating activities					
Net income (loss) and comprehensive income (loss) for the period		\$ 11,245	\$ (58,524)	\$ 11,706	\$ (74,162)
Adjustments:					
Net financing expense	10	5,737	13,675	11,060	18,937
Equity profit	16,17	(718)	(208)	(1,012)	(883)
Stock-based compensation and restricted share units expense		860	825	4,908	2,562
Depletion and depreciation	5	3,671	12,662	9,505	24,951
Unrealized loss on derivatives and financial instruments	12	1,018	102	1,137	247
Unrealized foreign exchange (gain) loss and other		(651)	1,746	(1,409)	(1,440)
Settlement of restricted share units liability	13	(26)	(313)	(61)	(339)
Deferred income tax		83	(4,930)	(7,244)	(268)
Impairment on property, plant and equipment		-	44,661	-	44,661
Gain on decommissioning obligation settlement		(345)	-	(345)	-
Loss on disposition of assets		11	38	11	38
Settlement of decommissioning obligation		(125)	-	(125)	-
Changes in non-cash working capital	12	(6,996)	(20,639)	(7,118)	(27,220)
		13,764	(10,905)	21,013	(12,916)
Investing activities					
Property acquisition	5	-	-	(3,665)	-
Expenditures on exploration and evaluation assets		(3,655)	117	(11,983)	(27,642)
Expenditures on property, plant and equipment		(6,257)	(10,611)	(12,121)	(20,726)
Investments	7	(1,225)	(60)	(1,236)	(225)
Change in restricted cash		(430)	12,529	(742)	12,999
Proceeds on dispositions and farm-outs		9	1,050	9	1,050
Changes in non-cash working capital	12	(6,058)	(13,395)	(4,173)	(35,559)
		(17,616)	(10,370)	(33,911)	(70,103)
Financing activities					
Net financing expense paid		(4,228)	(6,742)	(8,348)	(10,610)
Issue of common shares	9	3,101	83	3,325	206
Draw on bank debt, net of transaction costs	8	-	219,825	-	219,825
Repayment of bank debt	8	-	(190,666)	-	(205,333)
		(1,127)	22,500	(5,023)	4,088
Change in cash		(4,979)	1,225	(17,921)	(78,931)
Cash, beginning of period		30,315	44,540	43,257	124,696
Cash, end of period		\$ 25,336	\$ 45,765	\$ 25,336	\$ 45,765

See accompanying notes to interim condensed consolidated financial statements.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

NOTE 1 - GENERAL INFORMATION

Canacol Energy Ltd. and its subsidiaries (“Canacol” or the “Corporation”) are primarily engaged in petroleum and natural gas exploration and development activities in Colombia and Ecuador. 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 (the “TSX”) under the symbol CNE, the OTCQX in the United States of America under the symbol CNEF 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 August 9, 2016.

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 consolidated financial statements and should be read in conjunction with the Corporation’s audited consolidated financial statements for the six months ended December 31, 2015.

Basis of Measurement

These financial statements have been prepared on a historical cost basis, except for cash, restricted cash, crude oil payable in kind, investments, restricted share units and commodity contracts which are measured at fair value with changes in fair value recorded in profit or loss (“fair value through profit or loss”) and bank debt, which is measured at amortized cost.

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

The Corporation has adopted the newly pronounced amendments to IFRS effective January 1, 2016 as follows: IAS 1 “Presentation of Financial Statements”, IFRS 10 “Consolidated Financial Statements”, IFRS 12 “Disclosure of Interests in Other Entities”, IAS 28 “Investments in Associates and Joint Ventures”, IAS 16 “Property, Plant and Equipment”, IAS 38 “Intangible Assets”, IFRS 11 “Joint Arrangements” and IFRS 27 “Separate Financial Statements”.

The adoption of the newly pronounced amendments to IFRS did not have a significant impact on the Corporation’s financial statements.

Recent Accounting Pronouncements

The following are new IFRS pronouncements that have been issued, although not yet effective and have not been early adopted, and may have an impact on the Corporation in the future as discussed below.

(i) Revenue from Contracts with Customers

On January 1, 2018, the Corporation will be required to adopt IFRS 15 “Revenue from Contracts with Customers”. IFRS 15 was issued in May 2014 and will replace IAS 11 “Construction Contracts”, IAS 18 “Revenue Recognition”, IFRIC 13 “Customer Loyalty Programmes”, IFRIC 15 “Agreements for the Construction of Real Estate”, IFRIC 18 “Transfers of Assets from Customers” and SIC-31 “Revenue – Barter Transactions Involving Advertising Services”. IFRS 15 provides a single, principle-based five-step model that will apply to all contracts with customers with limited exceptions, including, but not limited to, leases within the scope of IAS 17 and financial instruments and other contractual rights or obligations within the scope of IFRS 9 “Financial Instruments”, IFRS 10 “Consolidated Financial Statements” and IFRS 11 “Joint Arrangements”. In addition to the five-step model, the standard specifies how to account for the incremental costs of obtaining a contract and the costs directly

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

related to fulfilling a contract. The standard's requirements will also apply to the recognition and measurement of gains and losses on the sale of some non-financial assets that are not an output of the Corporation's ordinary activities.

(ii) Financial Instruments

On January 1, 2018, the Corporation will be required to adopt IFRS 9 "Financial Instruments", which is the result of the first phase of the International Accounting Standards Board ("IASB") project to replace IAS 39 "Financial Instruments: Recognition and Measurement" and IFRIC 9 "Reassessment of Embedded Derivatives". The new standard replaces the current multiple classification and measurement models for financial assets and liabilities with a single model that has only two classification categories: amortized cost and fair value. Amendments to IFRS 7 "Financial Instruments: Disclosures" will also be required to be adopted by the Corporation simultaneously with IFRS 9.

(iii) Leases

On January 1, 2019, the Corporation will be required to adopt IFRS 16: Leases to replace the existing guidance of IAS 17 "Leases". The standard establishes the principals and disclosure related to the amount, timing and uncertainty of cash flows arising from a lease.

(iv) Amendment to existing standards

On January 1, 2017, the Corporation will be to adopt amendments made to existing standards, IAS 7 "Statement of Cash Flows" and IAS 12 "Income Taxes". The amendment to IAS 7 "Statement of Cash Flows" includes separately disclosing changes in certain liabilities arising from financing activities. The amendment to IAS 12 "Income Taxes" clarifies requirements on the recognition of deferred tax assets for unrealized losses related to debt instruments measured at fair value.

The Corporation will assess the impact of the new IFRS pronouncements on the financial statements by the required implementation dates.

NOTE 4 – EXPLORATION AND EVALUATION ASSETS

Balance at June 30, 2015	\$	152,925
Additions		5,632
Exploration expense		(8,651)
Balance at December 31, 2015	\$	149,906
Additions		11,983
Transferred to D&P assets (note 5)		(9,102)
Balance at June 30, 2016	\$	152,787

During the six months ended June 30, 2016, the Corporation made a natural gas discovery (Oboe-1) on its VIM-5 block and, consequently, \$9.1 million of exploration costs associated with this block have been transferred to D&P assets.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT

	Petroleum and Natural Gas Assets		Corporate and Other Assets		Total
Cost					
Balance at June 30, 2015	\$	777,821	\$	9,440	\$ 787,261
Additions		38,863		198	39,061
Derecognition and other		(56)		(87)	(143)
Balance at December 31, 2015		816,628		9,551	826,179
Property acquisition		3,665		-	3,665
Additions		4,720		248	4,968
Dispositions		-		(22)	(22)
Transferred from E&E assets (note 4)		9,102		-	9,102
Balance at June 30, 2016	\$	834,115	\$	9,777	\$ 843,892
Accumulated depletion and depreciation					
Balance at June 30, 2015	\$	(418,331)	\$	(5,306)	\$ (423,637)
Depletion and depreciation		(26,185)		(294)	(26,479)
Impairment		(44,599)		-	(44,599)
Derecognition and inventory adjustments		488		43	531
Balance at December 31, 2015		(488,627)		(5,557)	(494,184)
Depletion and depreciation		(9,234)		(271)	(9,505)
Derecognition and inventory adjustments		(6)		2	(4)
Balance at June 30, 2016	\$	(497,867)	\$	(5,826)	\$ (503,693)
Carrying value					
At June 30, 2015	\$	359,490	\$	4,134	\$ 363,624
At December 31, 2015	\$	328,001	\$	3,994	\$ 331,995
At June 30, 2016	\$	336,248	\$	3,951	\$ 340,199

In connection with the acquisition of VIM-5 and VIM-19 E&P contracts, the Corporation accrued an additional \$3.7 million in reserves addition related bonus payments during the six months ended June 30, 2016.

NOTE 6 – RESTRICTED CASH

	June 30, 2016		December 31, 2015	
Restricted cash – current	\$	10,725	\$	8,147
Restricted cash – non-current		51,737		53,574
	\$	62,462	\$	61,721

At June 30, 2016, restricted cash consisted of \$48.9 million of term deposits used as collateral to secure the Ecuador IPC's borrowings (\$8.3 million classified as current; \$40.6 million classified as non-current), \$8.8 million for work commitments and other capital commitments (\$2.4 million classified as current; \$6.4 million classified as non-current), and \$4.8 million held in a debt reserve accounts as required under its bank debt (classified as non-current).

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

NOTE 7 – INVESTMENTS

	Pipeline Company Investment	Oil and Gas Company Investments ⁽¹⁾	Power Generation Company Investment	Total Investments
Balance at June 30, 2015	\$ 1,909	\$ 3,051	\$ -	\$ 4,960
Additions	-	365	11,641	12,006
Disposals	(211)	-	-	(211)
Unrealized gain (loss)	227	(61)	-	166
Foreign exchange loss	(436)	(6)	-	(442)
Balance at December 31, 2015	\$ 1,489	\$ 3,349	\$ 11,641	\$ 16,479
Additions	-	-	1,244	1,244
Unrealized loss	-	(102)	-	(102)
Foreign exchange gain	119	-	-	119
Balance at June 30, 2016	\$ 1,608	\$ 3,247	\$ 12,885	\$ 17,740

(1) As at June 30, 2016, \$2.7 million of the investment in convertible notes of an oil and gas company have been classified as current as they are expected to be settled within the next twelve months.

NOTE 8 – BANK DEBT

Balance at June 30, 2015	\$ 267,023
Repayment	(20,000)
Amortization of transaction costs	1,205
Balance at December 31, 2015	248,228
Amortization of transaction costs	1,215
Balance at June 30, 2016	\$ 249,443

The Corporation's bank debt as at June 30, 2016 consisted of a senior secured term loan for a principal amount of \$180 million ("BNP Senior Secured Term Loan") and unsecured senior notes ("Senior Notes") for a principal amount of \$75 million. The carrying value of the BNP Senior Secured Term Loan and Senior Notes included \$3.1 million and \$2.4 million of transaction costs netted against the principal amounts as at June 30, 2016, respectively.

NOTE 9 – SHARE CAPITAL

Authorized

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

Issued and Outstanding

	Number (000's)	Amount
Balance at June 30, 2015	126,434	\$ 591,520
Issued on private placement, net of costs	32,696	60,112
Issued on exercise of stock options	136	225
Transfer from other reserves for stock options	-	345
Balance at December 31, 2015	159,266	\$ 652,202
Issued on exercise of stock options	1,607	3,325
Transfer from other reserves for stock options exercised	-	2,858
Balance at June 30, 2016	160,873	\$ 658,385

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

Stock Options

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

	Number (000's)	Weighted-Average Exercise Price (C\$)
Balance at December 31, 2015	15,335	4.26
Granted	40	2.88
Exercised	(1,607)	2.65
Forfeited and cancelled	(1,305)	9.13
Balance at June 30, 2016	12,463	3.95

Information with respect to stock options outstanding at June 30, 2016 is presented below.

Stock Options Outstanding				Stock Options Exercisable	
Range of Exercise Prices (C\$)	Number of Stock Options (000's)	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price (C\$)	Number of Stock Options (000's)	Weighted-Average Exercise Price (C\$)
\$2.21 to \$3.50	9,218	3.7	2.79	5,424	2.85
\$3.60 to \$7.00	1,960	2.2	6.16	1,950	6.18
\$7.10 to \$10.50	1,265	0.4	8.94	1,265	8.94
\$10.60 to \$14.00	20	-	10.60	20	10.60
	12,463	3.1	3.95	8,659	4.50

Stock-based compensation of \$0.9 million and \$1.9 million (2015 – \$0.8 million and \$2.4 million) were expensed during the three and six months ended June 30, 2016, respectively.

NOTE 10 – FINANCE INCOME AND EXPENSE

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Finance income				
Interest income	\$ 537	\$ 648	\$ 1,166	\$ 1,233
Finance expense				
Accretion on decommissioning obligations	914	201	1,505	376
Amortization of upfront fees	595	6,732	1,215	7,951
Interest and other financing costs	4,765	7,390	9,506	11,843
	6,274	14,323	12,226	20,170
Net finance expense	\$ 5,737	\$ 13,675	\$ 11,060	\$ 18,937

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

NOTE 11 – NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) PER SHARE

Basic and diluted net income (loss) and comprehensive income (loss) per share were calculated as follows:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net income (loss) and comprehensive income (loss)	\$ 11,245	\$ (58,524)	\$ 11,706	\$ (74,162)
Weighted-average common share adjustments				
Weighted-average common shares outstanding, basic	160,271	116,775	159,791	112,921
Effect of stock options	2,669	-	1,637	-
Weighted-average common shares outstanding, diluted	162,940	116,775	161,428	112,921

For the three and six months ended June 30, 2015, stock options were anti-dilutive due to the net loss.

NOTE 12 – SUPPLEMENTAL INFORMATION

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

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Petroleum and natural gas royalties	\$ 5,849	\$ 2,708	\$ 8,078	\$ 5,195

Income taxes and interest paid were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Income taxes paid	\$ 8,893	\$ 9,981	\$ 8,893	\$ 10,544
Interest paid	\$ 4,496	\$ 9,519	\$ 9,065	\$ 13,008

Loss (gain) on derivatives and financial instruments:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Crude oil payable in kind	\$ 94	\$ (23)	\$ 82	\$ 64
Convertible debentures – unrealized	-	(1)	-	(100)
Convertible debentures – realized	-	202	-	202
Warrants – unrealized	-	(127)	-	(80)
Warrants – realized	-	-	-	(27)
Restricted share units – unrealized	874	(10)	903	68
Restricted share units – realized	2	24	-	31
Investments – unrealized	-	59	102	118
Investments – realized	-	5	-	5
Commodity contracts – unrealized	50	-	50	-
	\$ 1,020	\$ 129	\$ 1,137	\$ 281

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

Changes in non-cash working capital are comprised of:

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Change in:				
Trade and other receivables	\$ (14,217)	\$ 3,955	\$ (23,138)	\$ 11,866
Prepaid expenses and deposits	(2,277)	766	(3,231)	5,835
Crude oil inventory	(20)	42	(13)	930
Trade and other payables	1,747	(24,926)	4,935	(69,780)
Crude oil payable in kind	246	671	(134)	6
Deferred income	2,898	-	3,956	-
Wealth tax payable	(314)	(889)	571	630
Taxes payable	(1,117)	(13,653)	5,763	(12,266)
	(13,054)	(34,034)	(11,291)	(62,779)
Attributable to:				
Operating activities	(6,996)	(20,639)	(7,118)	(27,220)
Investing activities	(6,058)	(13,395)	(4,173)	(35,559)
	\$ (13,054)	\$ (34,034)	\$ (11,291)	\$ (62,779)

NOTE 13 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value of Financial Instruments

The carrying values and respective fair values of financial assets and liabilities at June 30, 2016 are summarized as follows:

	Carrying Value	Fair Value
Fair value through profit or loss		
Cash	\$ 25,336	\$ 25,336
Restricted cash	62,462	62,462
Restricted share units	4,042	4,042
Investments	17,740	17,740
Crude oil payable in kind	587	587
Commodity contracts	50	50
Loans and receivables		
Trade and other receivables	34,820	34,820
Other liabilities		
Bank debt	249,443	255,000
Trade and other payables	16,343	16,343
Wealth tax payable	571	571
Other long term obligations	2,873	2,873

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

The Corporation classifies the fair value of financial instruments measured at fair value according to the following hierarchy based on the amount of observable inputs used to value the instrument.

- Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.
- Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

The Corporation's financial instruments have been assessed on the fair value hierarchy described above. Cash, restricted cash, restricted share units and crude oil payable in kind are classified as Level 1. A portion of the Investments are classified as Level 1 (\$2.7 million) and a portion are classified as Level 2 (\$15 million). Commodity contracts are classified as Level 2. There has been no reclassification of financial instruments into or out of each fair value hierarchy during the three and six months ended June 30, 2016. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

The carrying value of the bank debt includes \$5.5 million of transaction costs netted against the principal amount as at June 30, 2016 which is amortized over the term of the underlying bank debt using the effective interest method.

Restricted Share Units

	Number (000's)	Amount
Balance at June 30, 2015	158	\$ 350
Granted	45	94
Settled	(125)	(273)
Realized loss	-	24
Unrealized gain	-	(15)
Foreign exchange gain	-	(25)
Balance at December 31, 2015	78	155
Granted	1,151	3,021
Settled	(28)	(61)
Unrealized loss	-	903
Foreign exchange loss	-	24
Balance at June 30, 2016	1,201	\$ 4,042

On March 31, 2016, the Corporation granted 1,150,615 restricted shares units ("RSUs") with a reference price of C\$3.41 per share. The RSUs vest as to one-half in six months and one-half in one year from the grant date, and will likely be settled in cash.

On January 21, 2016, February 14, 2016, March 31, 2016 and May 30, 2016, 4,667, 11,250, 1,791 and 10,000 RSUs were settled in cash at C\$2.16, C\$2.65, C\$3.31 and C\$3.71 per share, respectively.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

Warrants

	Number (000's)	Amount
Balance at June 30, 2015	779	\$ 67
Expired	(515)	(3)
Unrealized gain	-	(62)
Foreign exchange gain	-	(2)
Balance at December 31, 2015	264	-
Expired	(264)	-
Balance at June 30, 2016	-	\$ -

On February 9, 2016, the remaining 264,192 outstanding warrants expired with an exercise price of C\$5.20.

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, profit 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.

During the three months ended June 30, 2016, the Corporation entered into one financial oil collar under the following terms:

Period	Volume	Type	Price Range
Jul 2016 – Dec 2016	1,000 bbls/day	Financial WTI Oil Collar	\$40.00 – \$58.40

(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 and Canadian dollars. As at June 30, 2016, the United States dollar to Colombian peso exchange rate was 2,916:1 (December 31, 2015 – 3,149:1).

The Corporation had no forward exchange rate contracts in place as at or during the three and six months ended June 30, 2016.

(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 June 30, 2016.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

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 June 30, 2016:

	Less than 1 year	1-2 years	Thereafter	Total
Bank debt – principal	\$ -	67,500	\$ 187,500	\$ 255,000
Trade and other payables	16,343	-	-	16,343
Crude oil payable in kind	587	-	-	587
Taxes payable	14,078	-	-	14,078
Wealth tax payable	571	-	-	571
Deferred income	6,172	-	3,731	9,903
Other long term obligations	-	-	2,873	2,873
Restricted share units	3,966	76	-	4,042
	\$ 41,717	\$ 67,576	\$ 194,104	\$ 303,397

In addition to the above, the Corporation has issued letters of credit totalling \$76.5 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 losses in the collection of its trade receivables. In Colombia, a significant portion of crude oil and natural gas sales 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.

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 share capital, bank debt and working capital, defined as current assets less current liabilities, excluding non-cash items. 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 its net debt level. Net debt is defined as the principal amount of its outstanding bank debt, less working capital, as defined above. In order to facilitate the management of its net debt, 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

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

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.

During the three and six months ended June 30, 2016, the Corporation took certain measures to counteract the continued weakness in crude oil prices and the resulting impact on cash flows. These measures include steps to reduce capital spending and preserve liquidity which, at June 30, 2016, had left the Corporation with \$25.3 million in cash and \$62.5 million in restricted cash. While crude oil prices remain weak in the first half of 2016, new contracted gas sales have commenced in April 2016, thereby increasing revenues and funds from operations for the remainder of 2016. In the meantime, the Corporation maintains a prudent capital spending program and is focused on cost reductions to maximize profitability of the existing producing assets.

On August 2, 2016 and August 5, 2016, the Corporation completed the first and second tranche of a private placement offering of 9,687,670 and 1,800,000 common shares of the Corporation, respectively, issued at C\$4.08 per common share for a total of C\$46.9 million. The private placement offering further enhances the Corporation's liquidity and its ability to explore and develop its 100% operated gas assets for the remainder of 2016.

	June 30, 2016
Bank debt – principal	\$ 255,000
Working capital surplus	(39,593)
Net debt	\$ 215,407

NOTE 14 – COMMITMENTS AND CONTINGENCIES

Presented below are the Corporation's contractual commitments at June 30, 2016:

	Less than 1 year		1-3 years		Thereafter		Total
Exploration and production contracts	\$ 68,977	\$ 24,539	\$ -	\$ 93,516			
Office leases	874	1,742	1,442	4,058			
Finance lease	10,163	19,406	18,733	48,302			

Finance lease

The Corporation entered into a lease agreement with Promisol SAS to construct and operate a natural gas processing plant which is currently expected to commence operation in August 2016. Upon commencement of operation, the Corporation is expected to recognize a finance lease asset and liability of approximately \$27.7 million.

Ecuador Incremental Production Contract ("Ecuador IPC")

In addition to the commitments described above, the Corporation has a non-operated 25% equity participation interest (27.9% capital participation interest) in a joint-venture consortium which in 2012 was awarded an incremental production contract for the Libertador and Atacapi mature oil fields in Ecuador. The consortium plans to incur project expenditures estimated for a total of \$397 million (\$107.6 million net to the Corporation) over the 15 year term of the contract. As at June 30, 2016, the Corporation had incurred \$83.7 million of expenditures in connection with its Ecuador IPC commitment.

Oleoducto Bicentenario de Colombia ("OBC") Pipeline

The Corporation owns a 0.5% interest in OBC, which owns a pipeline system that will link Llanos basin oil production to the Cano Limon oil pipeline system. Under the terms of the OBC agreement, the Corporation may be required to provide financial support or guarantees for its proportionate equity interest in any future debt financings undertaken by OBC. The Corporation has also entered into ship-or-pay arrangements for 550 barrels of oil per day at \$8.54 / barrel with OBC to guarantee its pipeline revenue.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

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 15 – DEFERRED INCOME

During the six months ended June 30, 2016, the Corporation received proceeds for crude oil and natural gas to be delivered at a later date. As at June 30, 2016, undelivered crude oil and natural gas resulted in a deferred income balance of \$6.2 million (including \$4 million of undelivered natural gas for the six months ended June 30, 2016) and has been classified as a current liability as it is expected to be settled within the next twelve months.

Pacific Exploration and Production Corp. (“Pacific”) has executed an agreement with the Corporation whereby, among other things, the Corporation has agreed to transfer operatorship of the Portofino Exploration and Production contract (the “Contract”) to Pacific subject to ANH approval. Under the terms of the agreement, Pacific will operate any commercial discoveries made on the contract. In consideration for the transfer of operatorship, Pacific has paid the Corporation the sum of \$3.7 million (the “Consideration”) and has agreed to provide the Corporation with the option to participate pro-rata in its interest in the Contract, as well as in all pipelines and transportation infrastructure projects in which Pacific participates in respect of the evacuation of crude from the area. As at June 30, 2016, the condition of the Contract has not been met as Pacific has not applied for the transfer of operatorship and, therefore, the consideration remains recognized as deferred income and classified as a non-current liability.

NOTE 16 – INVESTMENT IN INTEROIL

The Corporation holds an effective 25% ownership in InterOil Exploration and Production ASA through its 49% ownership in holding company, Andes InterOil Limited (“InterOil”). As a result, the Corporation has significant influence over InterOil which is accounted for using the equity method. Details of InterOil’s net assets and net income (loss) are shown below, along with the Corporation’s share of the investment, net income (loss) and comprehensive income (loss).

As at	June 30, 2016		December 31, 2015	
InterOil cash and cash equivalents (gross)	\$	13,480	\$	15,558
InterOil bank debt (gross)		42,968		43,892
Total InterOil current assets (gross)	\$	17,743	\$	21,098
Total InterOil non-current assets (gross)		37,803		39,948
Total InterOil current liabilities (gross)		11,570		12,008
Total InterOil non-current liabilities (gross)		40,639		38,685
InterOil equity (gross)		3,337		10,353
Investment in InterOil	\$	2,381	\$	2,491

	Three months ended		Six months ended					
	2016	June 30, 2015	2016	June 30, 2015				
InterOil revenue (gross)	\$	4,004	\$	-	\$	7,927	\$	-
InterOil depletion and depreciation (gross)		1,210		-		2,543		-
InterOil interest expense (gross)		1,847		-		3,088		-
InterOil income tax expense (recovery) (gross)		(1,427)		-		(1,670)		-

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

	Three months ended		Six months ended	
	2016	June 30, 2015	2016	June 30, 2015
Interoil net income (loss) and comprehensive income (loss)	\$ 361	\$ -	\$ (441)	\$ -
Corporation's share of Interoil net income (loss) and comprehensive income (loss)	90	-	(111)	-

NOTE 17 – INVESTMENT IN ECUADOR JOINT VENTURE

The Corporation conducts its operations in Ecuador through a 25% equity interest in the Ecuador IPC, which is reported in these financial statements using the equity method of accounting. Details of the Ecuador IPC's net assets and net income are shown below along with the Corporation's share of the investment and profit.

As at	June 30, 2016		December 31, 2015	
Ecuador IPC cash and cash equivalents (gross)	\$	5,817	\$	7,412
Ecuador IPC bank debt (gross)		179,923		174,065
Total Ecuador IPC current assets (gross)	\$	114,776	\$	91,781
Total Ecuador IPC non-current assets (gross)		144,207		170,717
Total Ecuador IPC current liabilities (gross)		107,607		105,297
Total Ecuador IPC non-current liabilities (gross)		107,666		118,124
Ecuador IPC equity (gross)		43,711		39,078
Investment in Ecuador joint venture	\$	14,434	\$	13,311

	Three months ended		Six months ended	
	2016	June 30, 2015	2016	June 30, 2015
Ecuador IPC revenue (gross)	\$ 25,857	\$ 26,376	\$ 51,054	\$ 51,905
Ecuador IPC depletion and depreciation (gross)	16,273	18,941	31,286	32,930
Ecuador IPC interest expense (gross)	1,293	1,860	4,946	3,776
Ecuador income tax expense (gross)	1,224	73	2,873	596

	Three months ended		Six months ended	
	2016	June 30, 2015	2016	June 30, 2015
Joint venture net income and comprehensive income	\$ 2,511	\$ 836	\$ 4,490	\$ 3,536
Corporation's share of joint venture income	\$ 628	\$ 209	\$ 1,123	\$ 884

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

NOTE 18 – SEGMENTED INFORMATION

The Corporation’s only reportable segment is “Colombia”. The main purpose of “Other Segments” is to reconcile the reportable segment to the Corporation’s combined results. “Other Segments” is not a reportable segment. The Corporation’s chief operating decision maker is its executive officers.

The following tables show information regarding the Corporation’s segments.

	Colombia		Other Segments		Total
	(reportable)		(non-reportable)		
Three months ended June 30, 2016					
Total petroleum and natural gas revenues, net	\$	38,926	\$	-	\$ 38,926
Equity profit		-		718	718
Expenses, excluding income taxes		(7,970)		(12,767)	(20,737)
Net income (loss) before taxes		30,956		(12,049)	18,907
Income tax expense		7,662		-	7,662
Net income (loss)	\$	23,294	\$	(12,049)	\$ 11,245
Capital expenditures, net	\$	4,935	\$	111	\$ 5,046
Three months ended June 30, 2015					
Total petroleum and natural gas revenues, net	\$	27,297	\$	-	\$ 27,297
Equity profit		-		208	208
Expenses, excluding impairments		(21,666)		(21,638)	(43,304)
Impairment on D&P assets		(44,661)		-	(44,661)
Net loss before taxes		(39,030)		(21,430)	(60,460)
Income tax recovery		(1,936)		-	(1,936)
Net loss	\$	(37,094)	\$	(21,430)	\$ (58,524)
Capital expenditures, net	\$	28,885	\$	50	\$ 28,935
Six months ended June 30, 2016					
Total petroleum and natural gas revenues, net	\$	61,626	\$	-	\$ 61,626
Equity profit		-		1,012	1,012
Expenses, excluding income taxes		(23,216)		(20,799)	(44,015)
Net income (loss) before taxes		38,410		(19,787)	18,623
Income tax expense		6,917		-	6,917
Net income (loss)	\$	31,493	\$	(19,787)	\$ 11,706
Capital expenditures, net	\$	20,368	\$	226	\$ 20,594
Six months ended June 30, 2015					
Total petroleum and natural gas revenues, net	\$	53,726	\$	-	\$ 53,726
Equity profit		-		883	883
Expenses, excluding impairments		(48,705)		(30,225)	(78,930)
Impairment on D&P assets		(44,661)		-	(44,661)
Net loss before taxes		(39,640)		(29,342)	(68,982)
Income tax expense		5,180		-	5,180
Net loss	\$	(44,820)	\$	(29,342)	\$ (74,162)
Capital expenditures, net	\$	90,650	\$	767	\$ 91,417

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three and six months ended June 30, 2016 and 2015

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

	Colombia (reportable)		Other Segments (non-reportable)		Total
As at June 30, 2016					
Total assets	\$	609,954	\$	84,831	\$ 694,785
Total liabilities	\$	119,069	\$	255,519	\$ 374,588
As at December 31, 2015					
Total assets	\$	568,672	\$	99,677	\$ 668,349
Total liabilities	\$	113,616	\$	251,446	\$ 365,062

NOTE 19 – JOINT OPERATIONS

The Corporation has the following significant joint operations:

Joint operation	Principal place of business	Working interest %
LLA-23	Colombia	91%
Santa Isabel	Colombia	30% (deep); 100% (shallow)
VMM-2	Colombia	66.9% (deep); 40% (shallow)
VMM-3	Colombia	20%
Ombu/Capella	Colombia	10%
Coati	Colombia	20%
Achapo	Colombia	70%
Portofino	Colombia	40%
Los Picachos	Colombia	37.5%
Macaya	Colombia	37.5%
Serrania	Colombia	37.5%

NOTE 20 – SUBSEQUENT EVENTS

On August 2, 2016, the Corporation completed the first tranche of a private placement offering of 9,687,670 common shares of the Corporation (“Common Shares”) issued at C\$4.08 per Common Share for proceeds of C\$39,525,694 with certain investors, including Cavengas Holding S.R.L (“Cavengas”), a Barbados company (the “First Offering”). Cavengas acquired 1,023,072 Common Shares pursuant to the First Offering and owns a total of 32,613,072 Common Shares as at August 2, 2016. In addition, a director of the Corporation acquired 904,774 Common Shares pursuant to the First Offering. The Corporation engaged an exclusive advisor for this transaction, and will pay a fee of 3.5% of the First Offering, payable entirely in Common Shares, for their services.

On August 5, 2016, the Corporation completed the second and final tranche of the private placement offering of an additional 1,800,000 Common Shares at C\$4.08 per Common Share for proceeds of C\$7,344,000 (the “Second Offering”).

The Common Shares issued in connection with the First Offering and the Second Offering are subject to a four month hold period that expire on December 2, 2016 and December 6, 2016, respectively.