

CANACOL ENERGY LTD.

**INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
THREE MONTHS ENDED SEPTEMBER 30, 2014**



INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(UNAUDITED)

(in thousands of United States dollars)

As at	Note	September 30, 2014	June 30, 2014
ASSETS			
Current assets			
Cash and cash equivalents		\$ 137,426	\$ 163,729
Restricted cash	6	35,697	7,379
Trade and other receivables		37,236	60,981
Prepaid expenses and deposits		10,997	12,405
Investments	7	3,417	5,254
Crude oil inventory		1,338	1,936
		226,111	251,684
Non-current assets			
Restricted cash	6	68,021	59,448
Exploration and evaluation assets	4	134,160	133,510
Property, plant and equipment	5	328,854	301,398
Investment in joint venture	16	10,372	8,046
Investments	7	2,421	2,501
Deferred tax assets		3,762	-
		547,590	504,903
Total assets		\$ 773,701	756,587
LIABILITIES AND EQUITY			
Current liabilities			
Bank debt		\$ 58,667	44,000
Trade and other payables		81,861	75,814
Commodity contracts	14	-	38
Warrants	14	1,394	2,121
Phantom warrants	14	3,795	-
Convertible debentures	8	23,356	25,395
Restricted share units	14	146	202
Equity tax payable		-	582
Taxes payable		19,596	15,969
		188,815	164,121
Non-current liabilities			
Bank debt		153,145	166,688
Deferred income		3,731	3,731
Decommissioning obligations		10,559	10,518
Restricted share units	14	146	202
Warrants	14	306	2,210
Phantom warrants	14	-	7,557
Other long term obligations		219	219
Deferred tax liabilities		-	1,054
Total liabilities		356,921	356,300
Equity			
Share capital	9	551,590	551,049
Other reserves		50,684	48,842
Accumulated other comprehensive loss		347	347
Deficit		(185,841)	(199,951)
Total equity		416,780	400,287
Total liabilities and equity		\$ 773,701	756,587

Commitments and contingencies (note 15)

Subsequent events (note 17)

See accompanying notes to interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(UNAUDITED)

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

Three months ended September 30	Note	2014		2013
Revenues				
Petroleum and natural gas revenues, net of royalties	12	\$	58,917	\$ 48,222
Share of joint venture profit	16		2,327	170
Expenses				
Production and transportation expenses			20,832	17,761
Pre-license exploration costs			90	27
General and administrative			5,898	5,411
Stock-based compensation	9		1,268	231
Depletion and depreciation	5		19,493	7,298
Foreign exchange loss and other			2,485	1,807
(Gain) loss on derivatives and financial instruments	12		(5,130)	9,717
			44,936	42,252
Net finance expense	10		3,388	1,943
Income before income taxes			12,920	4,197
Income taxes (recovery)				
Current			3,627	1,622
Deferred			(4,817)	(406)
			(1,190)	1,216
Net income and comprehensive income			14,110	2,981
Earnings per share				
Basic and diluted	11	\$	0.13	\$ 0.03

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 June 30, 2013	86,506	\$ 408,770	\$ 40,074	\$ 347	\$ (209,888)	\$ 239,303
Stock options exercised	109	493	(198)	-	-	295
Stock-based compensation	-	-	631	-	-	631
Net income for the period	-	-	-	-	2,981	2,981
Balance at September 30, 2013	86,615	409,263	40,507	347	(206,907)	243,210
Balance as at June 30, 2014	107,736	\$ 551,049	\$ 48,842	\$ 347	\$ (199,951)	\$ 400,287
Stock options and warrants exercised	78	541	11	-	-	552
Stock-based compensation	-	-	1,831	-	-	1,831
Net income for the period	-	-	-	-	14,110	14,110
Balance at September 30, 2014	107,814	551,590	50,684	347	(185,841)	416,780

See accompanying notes to interim condensed consolidated financial statements.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands of United States dollars)

Three months ended September 30	Note	2014	2013
Operating activities			
Net income (loss) for the period		\$ 14,110	\$ 2,981
Adjustments:			
Net financing expense	10	3,388	1,943
Share of joint venture (profit) loss		(2,327)	(170)
Stock-based compensation	9	1,268	231
Depletion and depreciation	5	19,493	7,298
Unrealized (gain) loss on derivatives and financial instruments	12	(5,130)	8,868
Unrealized foreign exchange loss and other		3,383	1,454
Settlement of restricted share units liability		-	(1,321)
Deferred income tax		(4,817)	(406)
Changes in non-cash working capital	12	16,250	(1,154)
		45,618	19,724
Investing activities			
Expenditures on exploration and evaluation assets		(26,541)	(7,036)
Expenditures on property, plant and equipment		(20,420)	(9,632)
Investments		207	(294)
Change in restricted cash		(36,891)	(1,903)
Changes in non-cash working capital	12	13,434	9,505
		(70,211)	(9,360)
Financing activities			
Net financing (expense) income (paid) received	10	(2,144)	(1,326)
Issue of common shares	9	434	295
		(1,710)	(1,031)
Change in cash and cash equivalents		(26,303)	9,333
Cash and cash equivalents, beginning of period		163,729	52,290
Cash and cash equivalents, end of period		\$ 137,426	\$ 61,623
Cash and cash equivalents consists of:			
Cash		\$ 137,426	\$ 61,603
Cash equivalents		-	20
Cash and cash equivalents, end of period		\$ 137,426	\$ 61,623

See accompanying notes to interim condensed consolidated financial statements.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended September 30, 2014 and 2013

(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, with non-core activities in Brazil 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, the OTCQX in the United States of America under the symbol CNNEF, 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 November 11, 2014.

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 annual consolidated financial statements for the year ended June 30, 2014.

Basis of Measurement

These financial statements have been prepared on a historical cost basis, except for commodity contracts, convertible debentures, embedded derivatives, investments, warrants, phantom warrants and restricted share units, 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 3 of the annual consolidated financial statements as of and for the year ended June 30, 2014, except as follows.

Application of New and Revised International Financial Reporting Standards (“IFRS”)

IFRIC 21 – “Levies”

The International Accounting Standards Board released the new standard IFRIC 21 “Levies” which the Corporation has adopted in the current quarter. The interpretation clarifies that an entity recognizes a liability for a levy no earlier than when the activity that triggers payment, as identified by the relevant legislation, occurs. The adoption of IFRIC 21 did not have a significant impact on the financial statements.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

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, 2017, 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 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 entity’s ordinary activities.

The Corporation is in the process of assessing the impact of IFRS 15 on its financial statements.

(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”. 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.

Portions of the standard remain in development and the full impact of the standard on the financial statements will not be known until the project is complete.

NOTE 4 – EXPLORATION AND EVALUATION ASSETS

Balance at June 30, 2013	\$	92,753
Additions		27,108
Property acquisitions		15,000
Transferred to D&P assets (note 5)		(965)
Transferred to exploration expense		(386)
Balance at June 30, 2014		133,510
Additions		27,102
Transferred to D&P assets (note 5)		(26,452)
Balance at September 30, 2014	\$	134,160

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended September 30, 2014 and 2013

(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, 2013	\$	472,997	\$	6,728	\$ 479,725
Property acquisition		40,000		-	40,000
Additions		69,402		1,655	71,057
Transferred from E&E assets (note 4)		965		-	965
Reclassifications		(321)		321	-
Balance at June 30, 2014		583,043		8,704	591,747
Additions		19,850		570	20,420
Derecognition		(221)		-	(221)
Transferred from E&E assets (note 4)		26,452		-	26,452
Balance at September 30, 2014	\$	629,124	\$	9,274	\$ 638,398
Accumulated depletion and depreciation					
Balance at June 30, 2013	\$	(237,316)	\$	(4,131)	\$ (241,447)
Depletion and depreciation		(38,224)		(516)	(38,740)
Impairment		(10,577)		-	(10,577)
Reclassifications and inventory adjustments		388		27	415
Balance at June 30, 2014		(285,729)		(4,620)	(290,349)
Depletion and depreciation		(19,350)		(143)	(19,493)
Derecognition and inventory adjustments		298		-	298
Balance at September 30, 2014	\$	(304,781)	\$	(4,763)	\$ (309,544)
Carrying amounts					
At June 30, 2013	\$	235,681	\$	2,597	\$ 238,278
At June 30, 2014	\$	297,314	\$	4,084	\$ 301,398
At September 30, 2014	\$	324,343	\$	4,511	\$ 328,854

NOTE 6 – RESTRICTED CASH

	September 30, 2014		June 30, 2014	
Restricted cash – current	\$	35,697	\$	7,379
Restricted cash – non-current		68,021		59,448
	\$	103,718	\$	66,827

At September 30, 2014, restricted cash consisted of \$47.4 million of term deposits used as collateral to secure the Ecuador IPC's borrowings (classified as non-current), \$38.6 million for work commitments and other capital commitments (\$35.7 million classified as current; \$2.9 million classified as non-current), and \$17.7 million held in a debt reserve account as required under its senior secured term loan (classified as non-current).

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

NOTE 7 – INVESTMENTS

Balance at June 30, 2013	\$	2,467
Additions		5,821
Unrealized loss		(508)
Foreign exchange loss		(25)
Balance at June 30, 2014		7,755
Net settlement		(207)
Unrealized loss		(1,597)
Foreign exchange loss		(113)
Balance at September 30, 2014	\$	5,838

During the year ended June 30, 2014, the Corporation invested \$5 million in the securities of a company involved in the exploration and development of oil and gas in Latin America. An officer of the Corporation is also a director of such company. During the three months ended September 30, 2014, the counterparty settled a portion of the securities for \$2.5 million while it invested an additional \$2.3 million in that company's shares. Investments of \$3.4 million were classified as current and \$2.4 million were classified as non-current at September 30, 2014.

NOTE 8 – CONVERTIBLE DEBENTURES

Balance at June 30, 2013	\$	22,091
Unrealized loss		3,699
Foreign exchange gain		(395)
Balance at June 30, 2014		25,395
Unrealized gain		(852)
Foreign exchange gain		(1,187)
Balance at September 30, 2014	\$	23,356

NOTE 9 – SHARE CAPITAL

Authorized

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

Issued and Outstanding

	Number		Amount
	(000s)		
Balance at June 30, 2013	86,506	\$	408,770
Issued on equity offering	15,823		115,289
Issued on property acquisition	2,454		15,000
Issued on exercise of stock options and warrants	2,953		10,878
Transfer from other reserves for stock options and warrants exercised	-		6,874
Share issuance costs	-		(5,762)
Balance at June 30, 2014	107,736	\$	551,049
Issued on exercise of stock options and warrants	78		434
Transfer from other reserves for stock options and warrants exercised	-		107
Balance at September 30, 2014	107,814		551,590

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

(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	Weighted-Average Exercise Price
	(000s)	(C\$)
Balance at June 30, 2014	9,689	7.05
Exercised	(3)	3.68
Forfeited and cancelled	(21)	6.62
Balance at September 30, 2014	9,665	7.05

Information with respect to stock options outstanding at September 30, 2014 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	1,605	2.59	3.41	1,182	3.42
\$3.60 to \$7.00	3,059	3.12	6.01	2,131	5.84
\$7.10 to \$10.50	4,340	1.64	8.01	3,201	8.28
\$10.60 to \$14.00	131	1.43	12.10	131	12.10
\$14.10 and higher	530	1.32	14.90	530	14.90
	9,665	2.25	7.05	7,175	7.31

Stock-based compensation of \$1.3 million (2013 – \$0.2 million) was expensed and \$0.6 million (2013 – \$0.4 million) was capitalized during the three months ended September 30, 2014.

NOTE 10 – FINANCE INCOME AND EXPENSE

Three months ended September 30,	2014	2013
Finance income		
Interest and other income	\$ (1,069)	\$ (695)
Finance expense		
Fair value adjustment on equity tax payable	5	10
Accretion on decommissioning obligations	116	128
Amortization of upfront fees	1,124	470
Interest and other financing costs	3,212	2,030
	4,457	2,638
Net finance expense	\$ 3,388	\$ 1,943

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

NOTE 11 – EARNINGS PER SHARE

Basic and diluted earnings per share were calculated as follows:

Three months ended September 30,	2014	2013
Net income, basic and diluted	\$ 14,110	\$ 2,981
Weighted-average common share adjustments		
Weighted-average common shares outstanding, basic	107,812	86,560
Effect of warrants	410	-
Effect of stock options	1,053	549
Weighted-average common shares outstanding, diluted	109,275	87,109

For the three months ended September 30, 2014 and 2013, the effect of the convertible debentures was anti-dilutive.

NOTE 12 – SUPPLEMENTAL INFORMATION

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

Three months ended September 30,	2014	2013
Petroleum and natural gas royalties	\$ 6,666	\$ 4,669

Income taxes and interest paid were as follows:

Three months ended September 30,	2014	2013
Income taxes paid	\$ -	\$ -
Interest paid	\$ 2,657	\$ 1,983

Loss (gain) on derivatives and financial instruments:

Three months ended September 30,	2014	2013
Embedded derivatives – unrealized	\$ -	\$ 412
Convertible debentures – unrealized	(852)	2,295
Warrants – unrealized	(2,335)	2,877
Phantom warrants – unrealized	(3,409)	1,879
Restricted share units – unrealized	(93)	1,347
Restricted share units - realized	-	618
Investments – unrealized	1,597	97
Commodity contracts – unrealized	(38)	(39)
Commodity contracts – realized	-	231
	\$ (5,130)	\$ 9,717

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

Changes in non-cash working capital are comprised of:

Three months ended September 30,	2014	2013
Change in:		
Trade and other receivables	\$ 23,745	\$ (12,209)
Prepaid expenses and deposits	1,408	(1,269)
Crude oil inventory	520	804
Trade and other payables	971	20,454
Equity tax payable	(587)	(712)
Taxes payable	3,627	1,283
	29,684	8,351
Attributable to:		
Operating activities	16,250	(1,154)
Investing activities	13,434	9,505
	\$ 29,684	\$ 8,351

NOTE 13 – 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 (reportable)	Other Segments (non-reportable)	Total
Three months ended September 30, 2014			
Revenues	\$ 58,917	-	58,917
Share of joint venture profits	-	2,327	2,327
Expenses, excluding income taxes	(45,370)	(2,954)	(48,324)
	13,547	(627)	12,920
Income tax expense (recovery)	(1,190)	-	(1,190)
Net income (loss)	\$ 14,737	(627)	14,110
Capital expenditures, net	\$ 47,448	74	47,522
Three months ended September 30, 2013			
Revenues	\$ 48,222	\$ -	\$ 48,222
Share of joint venture loss	-	170	170
Expenses, excluding income taxes	(32,791)	(11,404)	(44,195)
	15,431	(11,234)	4,197
Income tax expense (recovery)	1,216	-	1,216
Net income (loss)	\$ 14,215	\$ (11,234)	\$ 2,981
Capital expenditures, net	\$ 17,268	\$ 140	\$ 17,408

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

	Colombia (reportable)		Other Segments (non-reportable)		Total
As at September 30, 2014					
Total assets	\$	579,046	\$	194,655	\$ 773,701
Total liabilities	\$	201,507	\$	155,414	\$ 356,921
As at June 30, 2014					
Total assets	\$	529,705	\$	226,882	\$ 756,587
Total liabilities	\$	192,923	\$	163,377	\$ 356,300

NOTE 14 – FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value of Financial Instruments

The carrying values and respective fair values of financial assets and liabilities at September 30, 2014 are summarized as follows:

	Carrying Value		Fair Value	
Fair value through profit or loss				
Cash and cash equivalents	\$	137,426	\$	137,426
Restricted cash		103,718		103,718
Convertible debentures		23,356		23,356
Phantom warrants		3,795		3,795
Warrants		1,700		1,700
Restricted share units		292		292
Investments		5,838		5,838
Loans and receivables				
Bank debt		211,812		220,000
Trade and other receivables		37,236		37,236
Other liabilities				
Trade and other payables		81,861		81,861
Other long term obligations		219		219
Deferred income		3,731		3,731

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.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

The Corporation's financial instruments have been assessed on the fair value hierarchy described above. Cash and cash equivalents, restricted cash, restricted share units and convertible debentures are classified as Level 1. Investments are classified as Level 2. Warrants and phantom warrants are classified as Level 3. There has been no reclassification of financial instruments into or out of each fair value hierarchy during the quarter ended September 30, 2014. 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.

Restricted Share Units

	Number	Amount
	(000s)	
Balance at June 30, 2013	1,404	\$ 3,914
Granted	62	366
Settled	(1,404)	(7,232)
Unrealized loss	-	3,647
Foreign exchange gain	-	(291)
Balance at June 30, 2014	62	404
Unrealized gain	-	(93)
Foreign exchange gain	-	(19)
Balance at September 30, 2014	62	292

Warrants

	Number	Amount
	(000s)	
Balance at June 30, 2013	5,382	\$ 1,871
Exercised	(1,776)	(5,329)
Expired	(1,114)	(650)
Unrealized loss	-	8,746
Foreign exchange gain	-	(307)
Balance at June 30, 2014	2,492	\$ 4,331
Exercised	(75)	(99)
Unrealized gain	-	(2,335)
Foreign exchange gain	-	(197)
Balance at September 30, 2014	2,417	\$ 1,700

Information with respect to warrants outstanding at September 30, 2014 is presented below.

Expiry Date	Number of warrants	Exercise price
	(000s)	(C\$)
January 26, 2015	495	5.96
February 1, 2015	1,143	5.96
September 2, 2015	515	3.97
February 9, 2016	264	5.20
	2,417	5.45

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

Phantom Warrants

	Number	Amount
	(000s)	
Balance at June 30, 2013	2,697	\$ 1,866
Unrealized loss	-	5,827
Foreign exchange gain	-	(136)
Balance at June 30, 2014	2,697	7,557
Unrealized gain	-	(3,409)
Foreign exchange gain	-	(353)
Balance at September 30, 2014	2,697	3,795

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

As at	September 30, 2014	June 30, 2014
Fair value at grant date (C\$)	1.58	3.00
Share price (C\$)	5.27	6.95
Exercise price (C\$)	4.50	4.50
Volatility	52.87%	51.84%
Warrant life	1.2 years	1.5 years
Dividends	Nil	Nil
Risk-free interest rate	1.00%	1.01%

Subsequent to September 30, 2014, all 2,697,292 phantom warrant units were settled in cash for \$3.5 million.

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.

At September 30, 2014, the Corporation had one financial oil collar outstanding under the following terms:

Period	Volume	Type	Price Range
Jan 2014 – Dec 2014	500 bbls/day	Financial Brent Oil Collar	\$75.00 – \$123.50

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

(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 and Canadian dollars, and to a lesser extent, Brazilian reais and Peruvian sol.

The Corporation had no forward exchange rate contracts in place as at or during the three months ended September 30, 2014.

(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 months ended September 30, 2014.

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 September 30, 2014:

	Less than 1 year	1-2 years	Thereafter	Total
Bank debt – principal	\$ 58,667	58,667	102,666	\$ 220,000
Trade and other payables	81,861	-	-	81,861
Deferred income	-	3,731	-	3,731
Other long term obligations	-	-	219	219
Convertible debentures – principal	22,786	-	-	22,786
Phantom warrants	3,795	-	-	3,795
Warrants	1,394	306	-	1,700
Restricted share units	146	146	-	292
	\$ 168,649	\$ 62,850	\$ 102,885	\$ 334,384

In addition to the above, the Corporation has issued letters of credit totalling \$26.1 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 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.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

For the three months ended September 30, 2014 and 2013

(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 non-cash items such as the current portion of commodity contracts, warrants, phantom warrants and convertible debentures. 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, as defined above and less the current portion of bank debt, convertible debentures, warrants and phantom warrants, included above, divided by annualized adjusted funds from operations, defined as cash flows from operating activities, excluding changes in non-cash working capital, and adjusted for the Corporation's share of operating funds flows from their interest in the incremental production contract for the Libertador and Atacapi fields in Ecuador (the "Ecuador IPC"), which is accounted for under the equity method (see note 16). The Corporation uses the ratio of net debt to adjusted funds from operations as a key indicator of the Corporation's leverage and to monitor the strength of its financial position.

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.

	September 30, 2014	
Bank debt (current and long-term) – principal	\$	220,000
Working capital surplus, excluding the current portion of bank debt, convertible debentures, warrants, phantom warrants and investment		(124,508)
Net debt	\$	95,492
Annualized adjusted funds from operations ⁽¹⁾	\$	147,140
Net debt to adjusted funds from operations		0.6

(1) Adjusted funds from operations for the three months ended September 30, 2014, annualized, and inclusive of amounts related to the Ecuador IPC.

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

NOTE 15 – COMMITMENTS AND CONTINGENCIES

Presented below are the Corporation's contractual commitments at September 30, 2014:

	Less than 1 year		1-3 years		Thereafter		Total
Exploration and production contracts	\$	21,505	\$	27,390	\$	-	\$ 48,895
Office lease		991		1,674		3,460	6,125

Ecuador Incremental Production Contract

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 is committed to incur project expenditures for a total of \$334 million (\$93.3 million net to the Corporation) over the 15 year term of the contract. As at September 30, 2014, the Corporation had incurred \$64.3 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 is also required to enter into ship-or-pay arrangements with OBC to guarantee pipeline revenues.

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 16 – INVESTMENT IN JOINT VENTURE

The Corporation conducts its operations in Ecuador through a 25% equity interest (27.9% capital participation interest) in the Ecuador IPC, which is reported in these financial statements using the equity method of accounting. Prior to the adoption of IFRS 11, the Ecuador IPC was accounted for using the proportionate consolidation method of accounting. Details of the Ecuador IPC's net assets and net income are shown below with comparative information due to the adoption of IFRS 11.

As at	September 30, 2014		June 30, 2014	
Total Ecuador IPC assets (gross)	\$	247,403	\$	250,255
Total Ecuador IPC liabilities (gross)		219,449		231,607
Ecuador IPC equity (gross)		27,954		18,648
Investment in joint venture		10,372		8,046
For the three months ended	September 30, 2014		September 30, 2013	
Joint venture net income	\$	9,307	\$	682
Corporation's share of joint venture profit	\$	2,327	\$	170

NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the three months ended September 30, 2014 and 2013

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

NOTE 17—SUBSEQUENT EVENTS

On October 29, 2014, the Corporation entered into a \$100 million unsecured floating rate senior note indenture agreement with Apollo Investment Corporation (the “Senior Notes”), with \$50 million drawn and funded on October 29, 2014, and a further \$50 million committed and available to be drawn at any time within 18 months at the sole discretion of Canacol, subject only to customary closing conditions. The Senior Notes are repayable in full on their maturity date of December 31, 2019 and carry interest at LIBOR plus 8.5% per annum (subject to a LIBOR floor of 1.00%), payable quarterly. The Senior Notes may be repaid at any time prior to maturity and are subject to customary financial, performance and legal covenants. Standby fees on the undrawn portion of the Senior Notes are calculated at 1% per annum.

On October 20, 2014, all 2,697,292 phantom warrant units were settled in cash for \$3.5 million.

On October 2, 2014, the Corporation granted 234,781 restricted share units to certain officers and employees with a reference price of C\$4.80 per share.