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PACIFIC RUBIALES ENERGY CORP.

MANAGEMENT DISCUSSION AND ANALYSIS

August 8, 2012
Form 51-102 F1
For the three month period ended June 30, 2012

1. Preface

This Management Discussion and Analysis ("**MD&A**") contains forward-looking information and is based on the current expectations, estimates, projections and assumptions of Pacific Rubiales Energy Corp. This information is subject to a number of risks and uncertainties, many of which are beyond the Company's control. Users of this information are cautioned that actual results may differ materially. For information on material risk factors and assumptions underlying our forward-looking information, see page 29.

This MD&A is management's assessment and analysis of the results and financial condition of the Company, and should be read in conjunction with the accompanying consolidated financial statements for the second quarter of 2012, and the 2011 audited annual consolidated financial statements and related notes. The preparation of financial information is reported in United States dollars and is in accordance with International Financial Reporting Standard as issued by the International Accounting Standard Board ("**IASB**") unless otherwise noted. All comparative percentages are between the quarters ended June 30, 2012 and June 30, 2011, unless otherwise stated. The following financial measures: (i) EBITDA; (ii) funds flow from operations; and (iii) adjusted net earnings from operations, as referred to in this MD&A, are not prescribed by International Financial Reporting Standards ("**IFRS**") and are outlined under "Additional Financial Measures" on page 27. All references to net barrels or net production reflect only the Company's share of production after deducting royalties and the partner's working interest. A list of abbreviations for oil and gas terms is provided on page 31.

In order to provide shareholders of the Company with full disclosure relating to potential future capital expenditures, we have provided cost estimates for projects that, in some cases, are still in the early stages of development. These costs are preliminary estimates only. The actual amounts are expected to differ and these differences may be material. For further discussion of the significant capital expenditures, see "Capital Expenditures" on page 16.

References to "**we**", "**our**", "**us**", "**Pacific Rubiales**", "**PRE**", or the "**Company**" mean Pacific Rubiales Energy Corp., its subsidiaries, partnerships and joint venture investments, unless the context otherwise requires. The table and charts in this document form an integral part of this MD&A.

Additional information relating to the Company filed with Canadian securities regulatory authorities, including the Company's quarterly and annual reports and the Annual Information Form, are available on SEDAR at www.sedar.com and on the Company's website at www.pacificrubiales.com. Information contained in or otherwise accessible through our website does not form a part of this MD&A and is not incorporated by reference into this MD&A.

2. Second Quarter Highlights

Management is focused on meeting challenging operational goals, and pursuing its ambitious exploration and production ("**E&P**") program, while delivering on its main strategic focus: sustainable and profitable growth. As part of this plan, a new and more robust company is beginning to take shape, not only by continuing to tackle the challenges of growing production from its existing fields and building on the success of its exploratory program, but also by the strategic acquisition of new and very promising assets. During the second quarter of 2012, the Company has expanded outside of Colombia to acquire producing assets in Peru and exploration assets in offshore in Guyana and Papua New Guinea, in its quest to become an international oil and gas player.

The results for this quarter underline the strength of the Company's assets, operational activity and capacity to increase production and to deliver robust financial results, leveraging its technical know-how and operational prowess.

As a result of the acquisitions in Peru and Colombia, the Company expects to increase its 2P reserves and resource base by year-end 2012 and increase production starting in the third quarter of 2012.

Set out below are the highlights of the Company's activities during the three months ended June 30, 2012:

- **Production continues to grow in 2012**. During the second quarter of 2012, the average net production after royalties in Colombia reached 90,871 boe/d (232,245 boe/d total field production). Net production in Colombia has increased by 3% year-over-year, driven by more than 115 development wells drilled mainly in the Rubiales and Quifa SW fields. Production from the La Creciente field and other producing fields continued to increase by 4%. In Peru, average net production after royalties reached 1,740 bbl/d (3,551 bbl/d total field production) coming from the acquisition of a 49% participating interest in Block Z-1, effective January 1, 2012. Revenue and production from Peru will be recognized on closing of the Block Z-1 transaction, which is subject to approval of the applicable Peruvian authorities.

- **Strong financial results despite lower oil prices.** Despite a 9% reduction in WTI prices, the Company increased revenues to $1,036 million compared to $958 million in the same period of 2011. In addition, revenues for this period were 11% higher as compared to the first quarter of 2012 on higher sales volumes. Consolidated net earnings for the second quarter of 2012 were $224 million or $0.76 per common share, lower by 36% when compared to the net earnings of $349 million or $1.30 per common share during the second quarter of 2011, impacted by higher operating costs, one-off higher Depletion, Depreciation and Amortization, lower gain on hedge contracts and higher taxes. Adjusted net earnings for the second quarter of 2012 were $187 million compared to $267 million in the second quarter of 2011.

- **EBITDA continues to increase.** EBITDA for the second quarter of 2012 totaled $560 million ($1,098 million for the six months of 2012), compared to $558 million for the same quarter in 2011 ($921 million for the six months of 2011). EBITDA for the second quarter of 2012 represented a 54% margin in comparison to total revenues for the period. Funds flow from operations increased to $415 million, compared to $400 million in 2011.

- **Operating netbacks remained strong**. Crude oil operating netback during the second quarter of 2012 remained strong at $66.36/bbl, 1% higher in comparison to the same period in 2011 ($65.82/bbl) despite the recent drop in international oil prices. Oil for trading operating netback was $2.99/bbl, 6% lower in comparison to the second quarter of 2011 ($3.17/bbl). Compared to the first quarter of 2012, crude oil operating netback was lower by 16%, mainly due to a drop in WTI benchmark price. Natural gas operating netback was $34.16/boe, 25% higher in comparison to the second quarter of 2011 ($27.31/boe) and slightly lower in comparison to the first quarter 2012.

- **Total capital expenditures**. Capital expenditures during the second quarter of 2012 totaled $316 million ($308 million in 2011), of which $121 million were invested in the expansion and construction of production infrastructure; $111 million went into exploration activities (including drilling, seismic and other geophysical) in Colombia, Peru and Guatemala; $64 million for development drilling; and $20 million in other projects, including the Company´s Synchronized Thermal Additional Recovery ("**STAR**") technology.

- **Continued active drilling in the Colombian exploration blocks with a success rate of 82%**. During the second quarter of 2012, total net exploration capital expenditure of $111 million consisting of drilling 22 wells, including 6 stratigraphic and 16 appraisal wells, and acquisition of 182 km of 2D seismic.

- **Quifa North commerciality**. In April 2012, the Company submitted to Ecopetrol, S.A. ("Ecopetrol") the request for commerciality for this part of the block. This commerciality is expected to be approved by the Executive Committee of

the Association Contract during the third quarter 2012. This commerciality will allow the company to increase its production from this field by the end of the year.

- **Optimization of the corporate structure:** In order to optimize the corporate structure of the Company, during the second quarter of 2012, the Company started the process to merge three Panamanian companies and their respective Colombian branches (being Meta Petroleum Corp., Tethys Petroleum Corp. and Quifa Petroleum Corp.) into one legal entity, Meta Petroleum Corp.

- **Acquisitions:** In alignment with the long-term growth strategy of the Company, a number of significant acquisitions were made during and subsequent to the second quarter of 2012. These include oil producing assets in Peru from the offshore block Z-1, and light oil and gas producing assets in Colombia from the acquisition of PetroMagdalena Energy Corp ("**PetroMagdalena**"). In addition, the Company acquired significant participating interests in new exploration blocks in offshore Guyana, onshore Colombia and onshore Papua New Guinea, aimed at capturing early stage large resource capture in new or emerging hydrocarbon exploration plays.

- **Continued advancement of STAR tests at Quifa SW**. The pilot project continues with startup of air injection expected in the third quarter of 2012.

- **Credit Agency Updates Outlook to Positive**. On July 16, 2012, Standard and Poors Rating Services ("**S&P**") revised its outlook for the Company from "Stable" to "Positive" while also affirming the Company's BB corporate rating and its BB senior unsecured debt rating. This is a strong endorsement of the Company's financial and operational strength, and continuing execution on its production and reserve growth targets.

- **Cash dividend**. A cash dividend in the aggregate of $32 million or $0.11 per common share was paid on June 29, 2012 to shareholders of record as of June 15 and to holders of Brazilian Depositary Receipts of record as of June 12.

3. Financial and Operating Summary

Financial Summary

A summary of the financial results for the three and six months ended June 30, 2012 and 2011 are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands of US$ except per share amounts or as noted)	**2012**	**2011**	**2012**	**2011**
Oil and gas sales	**$ 1,035,854**	$ 957,509	**$ 1,967,704**	$ 1,541,058
EBITDA [1]	**559,795**	558,339	**1,097,986**	920,866
EBITDA Margin (EBITDA/Revenues)	**54%**	58%	**56%**	60%
Per share - basic ($) [2]	**1.90**	2.08	**3.74**	3.43
- diluted ($)	**1.84**	1.87	**3.62**	3.08
Net earnings [3]	**224,344**	349,375	**482,689**	279,782
Per share - basic ($) [2]	**0.76**	1.30	**1.64**	1.04
- diluted ($)	**0.74**	1.20	**1.59**	1.00
Cash Flow from Operations	**131,906**	116,273	**708,005**	436,076
Per share - basic ($) [2]	**0.45**	0.43	**2.42**	1.63
- diluted ($)	**0.43**	0.39	**2.33**	1.46
Adjusted Net earnings from operations [4]	**187,108**	266,707	**479,876**	400,928
Per share - basic ($) [2]	**0.64**	0.99	**1.64**	1.49
- diluted ($)	**0.62**	0.89	**1.58**	1.34
Non-operating items	**(37,236)**	(82,668)	**(2,813)**	121,146
Funds Flow from Operations [1]	**415,223**	400,202	**807,687**	666,909
Per share - basic ($) [2]	**1.41**	1.49	**2.75**	2.49
- diluted ($)	**1.37**	1.34	**2.66**	2.23

Adjusted Net Earnings from Operations

Net earnings for the second quarter of 2012 totaled $224.3 million and include a number of non-operating items totaling $37.2 million, mainly related to mark-to-market gains on derivatives and foreign exchange gain/losses. These non-operating items may or may not materialize or reoccur in future periods. The adjusted net earnings from operations follow:

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands of US$)	**2012**	**2011**	**2012**	**2011**
Net earnings as reported	**$ 224.344**	$ 349.375	**$ 482.689**	$ 279.782
Non-operating items				
Loss (gain) on risk management contracts	**(42.679)**	(84.896)	**(50.599)**	7.738
Share-based compensation	**619**	705	**31.013**	47.392
Equity tax	**-**	-	**-**	68.446
Foreign exchange loss (gain)	**4.824**	1.523	**16.773**	(2.430)
Total non-operating items	**$ (37.236)**	$ (82.668)	**$ (2.813)**	$ 121.146
Adjusted earning from operations [2]	**$ 187.108**	$ 266.707	**$ 479.876**	$ 400.928

(1) See "Additional Financial Measures" on page 27.
(2) The basic weighted average number of common shares outstanding for the second quarter ended June 30, 2012 and 2011 was 294,561,287 (fully diluted – 304,124,845) and 268,717,010 (fully diluted – 298,832,627), respectively.

(3) Net earnings for the second quarter of 2012 include an impairment of $26.2 million due to the write-down of certain exploration and evaluation assets as required by the IFRS accounting rules. The impairment is recognized in the consolidated statement of income as depletion, depreciation and amortization.

(4) Adjusted earnings from operations are a non-IFRS financial measure that represents net earnings adjusted for certain items of a non-operational nature, including non-cash items. The Company evaluates its performance based on adjusted net earnings from operations. The reconciliation "Adjusted Net Earnings from Operations" lists the effects of certain non-operational items that are included in the Company´s financial results and may not be comparable to similar Measures presented by other companies.

Operating Summary

The Company produces and sells crude oil and natural gas. It also purchases crude oil from third parties as diluents and for trading purposes. The combined crude oil and gas operating netback improved during the second quarter of 2012 to $63.12/boe, 2% higher as compared to the same period of 2011. Crude oil operating netback during the second quarter of 2012 was $66.36/bbl, 1% higher in comparison to the same period in 2011 ($65.82/bbl) and crude oil trading operating netback was $2.99/bbl, 6% lower in comparison to the second quarter of 2011 ($3.17/bbl). Natural gas operating netback was $34.16/boe, 25% higher in comparison to the second quarter of 2011 ($27.31/boe).

Set out below is the operating netback for crude oil, gas and trading volumes the three months ended June 30, 2012.

Combined crude oil and gas (boe)	**Three months ended June 30**			
	2012 Oil	**2012 Gas**	**2012 Combined**	**2011 Combined**
Average daily volume sold (boe/day) [1]	**98,507**	**11,002**	**109,509**	**106,643**
Operating netback ($/boe)				
Crude oil and natural gas sales price	101.26	41.99	95.30	96.19
Production cost of barrels sold [2]	8.13	5.16	7.84	5.29
Transportation (trucking and pipeline) [3]	13.09	0.70	11.84	11.34
Diluent cost [4]	11.07	-	9.95	15.05
Other costs [5]	3.95	2.48	3.80	1.24
Overlift/Underlift [6]	(1.34)	(0.51)	(1.25)	1.32
Operating netback crude oil and gas ($/boe)	**66.36**	**34.16**	**63.12**	**61.95**

Crude oil trading	**Three months ended June 30**	
	2012	**2011**
Average daily volume sold (boe/day)	**7,899**	**2,345**
Operating netback ($/boe)		
Crude oil traded	119.85	112.84
Cost of purchases of crude oil traded [7]	116.86	109.67
Operating netback crude oil trading ($/boe)	**2.99**	**3.17**

(1) Combined operating netback data based on weighted average daily volume sold which includes diluents necessary for the upgrading of the Rubiales blend.

(2) Cost of production mainly includes lifting costs and other production costs such as personnel, energy, fuel consumption, security, insurance and others. Increase in cost for oil was mainly due to higher energy and fuel consumption as compared to prior period of 2011. The increase in cost of gas was mainly due to workovers in La Creciente and Guaduas fields.

(3) Includes the transport costs of crude oil and gas through pipelines and tank trucks incurred by the Company to take the products to the delivery points to customers.

(4) Diluent cost for the second quarter of 2012 was reduced as compared to the same period of 2011 mainly due to the significantly lower blending ratio required to upgrade the 12.5° API crude oil. Net blending cost is estimated at $3.83 per bbl of Rubiales crude ($2.94 per bbl in second quarter of 2011) as indicated in the below table:

Adjusted Net Cost of Diluent	**Three months ended June 30**	
	2012	**2011**
Average diluent purchase price	119.41	106.70
Pipeline fees	11.70	7.76
Average Rubiales blend sales price	102.50	102.19
Net diluent cost per barrel	28.61	12.27
Average blending ratio	13.38%	24%
Net Blend Cost	**3.83**	**2.94**

(5) Other costs mainly correspond to royalties on gas production, external road maintenance at the Rubiales field, inventory fluctuation, storage cost and the net effect of the currency hedges of operating expenses incurred in Colombian pesos during the period.

(6) Corresponds to the net effect of the overlift position for the period amounting to $12.5 million, which generated a reduction in the combined costs of $1.25/boe as explained in "Discussion of 2012 Second Quarter Financial Results– Financial Position – Operating Costs" on page 17.

(7) The increase in trading costs during the second quarter of 2012 over the same period of 2011 is in line with the overall WTI price increase.

The following is a reconciliation of volume produced vs. volume sold during second quarter of 2012:

Production and sales volumes (boe/day) [1]	Three months ended June 30			
	2012			2011
	Oil	Gas	Combined	Combined
Average total field production	220,366	11,879	232,245	221,896
Average gross production (before royalties)	100,253	11,139	111,392	104,141
Begining inventory (ending inventory March 31)	34,972	-	34,972	21,126
Average net production (after royalties and field consumption)	79,732	11,139	90,871	88,092
Purchases of diluents and oil for trading [1]	9,267	-	9,267	22,222
Other inventory movements [1]	(2,407)	(137)	(2,544)	(1,356)
Ending inventory June 30.	(15,158)	-	(15,158)	(21,096)
Average daily volume sold (boe/day)	**106,406**	**11,002**	**117,408**	**108,988**
Breakdown average daily volume sold (boe/day)				
Oil and Gas sold	98,507	11,002	109,509	106,643
Crude Oil Trading Sold	7,899	-	7,899	2,345
Total average daily volume sold	**106,406**	**11,002**	**117,408**	**108,988**

(1) *See additional detail in "Inventory Movements" on page 10.*

Royalties and Volume Allocation

Royalties

Current royalty rates for hydrocarbons produced by the Company's Colombian assets range from 5% to 20% and in Peru 5%. Royalties on production represent the entitlement of the respective governments to a portion of the Company's share of production and are recorded using rates in effect under the terms of contract and applicable laws at the time of hydrocarbon discovery. In Colombia, royalties for oil may be payable in kind while for gas are payable in cash. In Peru, royalties for oil and gas are calculated using a 5% levy on total gross revenues and the government allows the companies to pay either in kind or cash; however, the current practice is to pay the royalties in cash.

Additional Production Share in the Quifa SW field

The Company's share of production before royalties in the Quifa SW field is 60%; however, this participation may decrease from time to time until the high-prices clause (the "**PAP**"), stipulated in the Quifa Association Contract, is triggered.

On September 27, 2011, Ecopetrol and the Company agreed on an arbitration process to settle differences in the interpretation of this PAP clause in the Quifa Association Contract and its effect on the production division. On April 12, 2012, the Company initiated the arbitration process before the Bogotá Chamber of Commerce. This arbitration process is estimated to take between six to twelve months in order to conclude.

While the arbitration runs its course, both companies have agreed to apply the formula of the Agencia Nacional de Hidrocarburos (the "**ANH**") to assign the additional share to Ecopetrol, as from the activation of the additional production clause in April 2011, until the arbitration is concluded. Based on this formula, the additional production share to Ecopetrol between April 2011 and September 2011 totaled 542,697 bbl, all of which have been already delivered to Ecopetrol as of June 30, 2012.

The volumes corresponding to Ecopetrol as per the ANH formula from October 1, 2011 to June 30, 2012 have been completely delivered to Ecopetrol via reduced net production share.

4. Discussion of 2012 Second Quarter Operating Results

Acquisitions

During and subsequent to the second quarter, the Company entered into and/or completed a significant number of acquisitions including both producing assets in Peru and Colombia, and exploration assets in Colombia, Peru, offshore Guyana and onshore Papua New Guinea. These acquisitions represent an important transformational move for the Company from a local Colombian producer only to a more global E&P company, but with its key core assets focused in

Latin America. The acquisitions are expected to add growing production volumes through the second half of 2012 and into 2013, as well as significant volumes of 2P reserves and un-risked resource in the year-end 2012 certified reserves and resource evaluations.

Producing Assets

On April 27, 2012, the Company announced that it had reached an agreement to acquire a 49% participating interest in the Peru offshore block Z-1 from BPZ Resources Inc. ("**BPZ**"). Under the terms of the agreement, Pacific Rubiales paid $65 million up front and will pay an additional $85 million on closing, plus fund $185 million of BPZ's share of capital and exploratory expenditures from an effective date of January 1, 2012. Closing of the deal is expected by year-end and is subject to the approval of Peruvian government and regulatory authorities. As part of the deal, the Company will be directing the operations of the field under a technical services agreement and has placed some technical staff into the Peru operations to date.

Net oil production in the first half of 2012 attributed to its 49% interest in block Z-1 was 1,722 bbl/d from the Corvina and Albacora fields. Certified 100% net 2P reserves at 2011 year-end on the block were 93.9 MMbbl (46 MMbbl attributed to the Company's 49% interest). The Company believes that the 2P reserves support its expectation to significantly increase production from the block through additional development work. The first development will come from the new $77 million CX-15 drilling and production platform that is expected to be in place by September and which will provide 24 well slots, including injection and production wells.

A 3D seismic program covering approximately 80% of block Z-1 has been completed and a second phase 3D program is expected to commence this month. The seismic program is designed to evaluate three exploration prospects and six leads, which have an estimated resource exceeding 2 billion boe. The Company's block Z-1 interest underpins its plans to advance its investments in Peru and complements its other extensive exploration acreage in the country.

On June 5, the Company entered into a definitive agreement with PetroMagdalena pursuant to which the Company agreed to acquire all the issued and outstanding common shares in the capital of PetroMagdalena for an estimated cash outlay of approximately C$253 million. The acquisition was approved by shareholders of PetroMagdalena and closed on July 27.

PetroMagdalena has working interests in 19 properties in five basins in Colombia producing approximately net 4 Mboe/d and with year-end 2011 net 2P certified reserves of 22.9 MMboe (58% oil and liquids). The Company can apply its financial and technical expertise to the acquired assets to unlock and accelerate exploration and development and achieve a reduction in some G&A costs as a result of the consolidation. The acquired production provides the Company with a strategic and reliable supply of diluent required for its heavy oil production in Colombia and adds bolt-on exploration acreage.

Exploration Assets

The Company has decided to expand its international portfolio through exploration acquisitions in major new or emerging hydrocarbon provinces such as the Equatorial Atlantic Margin and in Southeast Asia.

On April 29, the Company signed a binding agreement with InterOil Corporation ("**InterOil**") whereby it acquired a 10% net participating interest in the PPL237 Petroleum Prospect License and the Triceratops structure located within PPL237, onshore in Papua New Guinea for an estimated total investment of up to approximately $345 million over four years. The investment will be comprised of an up-front down payment of $116 million cash, funding of an agreed exploration work program, and cash payments based on the independently certified resources of the Triceratops structure. The farm-in agreement was signed on July 30, and are subject to the approval of the Papua New Guinea regulatory authorities.

Subsequent to the initial signed agreement, InterOil announced it had tested gas and condensate at rates of 17.6 MMcf/d with condensate rates of 13.6 to 16.3 bbl per MMcf from an upper section of drilled reservoir with indicated total vertical net pay of approximately 1,500 feet in the Triceratops-2 exploration well. These test rates compare favourably with equivalent test intervals in the Elk/Antelope structure along trend. The Elk/Antelope structure has independently certified best case contingent resources of 8.6 tcf gas and 129 MMbbl condensate. In addition to the Triceratops structure, there are up to seven additional structures identified by InterOil that remain undrilled at the current time.

On May 28, 2012, the Company announced that it had agreed to purchase an additional interest in CGX Energy Inc. ("**CGX**") for an aggregate investment of C$30 million, which along with interests acquired in October 2011 provides the Company with approximately 35% of the issued and outstanding common shares of CGX on a non-fully diluted basis, which could increase to as much as 41% if additional warrants are fully exercised.

At the same time, the Company has entered into a technical services agreement with CGX whereby Pacific Rubiales will provide technical assistance to CGX in respect of its operations and is entitled to nominate up to three directors on its board of directors. In addition, the Company will have an option to participate in each of the next wholly-owned commitment wells to be drilled on the Corentyne and Annex offshore Petroleum Production Licences ("**PPL**"), in Guyana, by funding 50% of the exploration well costs and certain seismic costs, in exchange for a 33% interest in the respective PPL's.

CGX also has a 25% participating interest in the Repsol operated Jaguar-1 exploration well drilled on the Georgetown PPL offshore Guyana. The well encountered light oil shows but was plugged and abandoned due to safety concerns, prior to reaching total depth and the primary reservoir target. The well will be re-drilled for the primary target within the next year.

Both the InterOil and CGX ventures should be viewed in the context of early stage large resource capture for the future. The Company views both as representing world class hydrocarbon basins capable of hosting very large resources. In the case of onshore Papua New Guinea, large natural gas and condensate resource sitting on the doorstep of the world's fastest growing primary energy markets, and in the case of offshore Guyana an offshore basin with analogous geology to west Africa and Brazil that have produced giant oil discoveries. It is a similar strategy that led to the Company's large resource capture and rapidly rising production along the heavy oil trend in Colombia.

On July 24, 2012, the Company announced the acquisition of a 40% participation interest in the Portofino Block, onshore Colombia. The transaction consists of a $23.5 million cash payment to Petrolera Monterrico S.A. Sucursal Colombia ("**Petromont**") which includes payment for past exploration costs, plus a $2.2 million carry of Petromont´s obligations related to an approved exploration work program. As part of the agreement, there is an additional carry obligation to finance certain production facilities and activities required up to $45 million. This last carry obligation will be recovered from the proceeds of production. In a separate agreement, the Company will pay Canacol Energy Ltd.cash consideration of $3.7 million to assume operatorship of the block following the drilling of the next four wells. The transaction is subject to government and regulatory approvals.

The Company is already the largest operator and producer of heavy oil in Colombia and the acquisition of the Portofino block fits the Company´s strategy to increase its exploration portfolio within the heavy oil trend that hosts the giant producing fields of Rubiales/Quifa and Castilla/Chichemene, and the block is adjacent and on trend with the developing Capella heavy oil field. The Portofino block contains one prospect with a management estimated P50 resource potential of 140 MMbbl and up to four additional leads with approximately 160 MMbbl.

All of these acquisitions and investments will be funded by cash on hand and the associated exploration and development capital is expected to be funded by internally generated cash flow of the Company.

Exploration

During the second quarter of 2012, the Company drilled a total of 22 exploratory wells (including 16 appraisal and 6 stratigraphic), of which 18 wells were successful (3 stratigraphic and 15 appraisal). Of the appraisal wells, 13 wells were drilled as horizontal wells in the Quifa and Sabanero blocks, with the objective of both delineating the reservoir and increasing early production in these two areas. This represents a success rate of 82%. The table below summarizes the results of the drilling campaign for the three months ended June 30, 2012 and 2011:

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Succesful exploratory wells	-	-	1	2
Succesful appraisal wells (1)	15	11	26	20
Succesful stratigraphic wells	3	1	7	4
Dry wells	4	1	7	6
Total	22	13	41	32
Sucess rate	**82%**	**92%**	**83%**	**81%**

(1) Includes horizontal appraisal wells.

Detail of Exploratory/Appraisal Wells drilled during the second Quarter of 2012

No. of wells	Block	Area / Field / Prospect	Well Name	Type [2]	Total Depth TVDSS (feet)	Net Pay (feet) [2]
1	QUIFA	QUIFA NORTH	AMBAR-18H	Appraisal HZ	-2,556	1,063
2	QUIFA	QUIFA NORTH	OPALO-10H	Appraisal HZ	-2,648	953
3	QUIFA	QUIFA NORTH	OPALO-12H	Appraisal HZ	-2,665	140
4	QUIFA	QUIFA NORTH	OPALO-13H	Appraisal HZ	-2,639	1,250
5	QUIFA	QUIFA NORTH	OPALO-14H	Appraisal HZ	-2,662	557
6	QUIFA	QUIFA NORTH	OPALO-11HST2	Appraisal HZ	-2,662	885
7	QUIFA	QUIFA NORTH	AMBAR-19H	Appraisal HZ	-2,603	1,176
8	QUIFA	QUIFA NORTH	AMBAR-20H	Appraisal HZ	-2,598	980
9	QUIFA	QUIFA NORTH	AMBAR-21H	Appraisal HZ	-2,608	833
10	SABANERO [1]	SABANERO PROSPECT	SAB STRAT 12A	Stratigraphic	-2,548	8
11	SABANERO [1]	SABANERO PROSPECT	SAB STRAT 14	Stratigraphic	-2,600	11
12	SABANERO [1]	SABANERO PROSPECT	SAB STRAT 8 ST	Stratigraphic	-2,573	5
13	SABANERO [1]	SABANERO PROSPECT	SAB 1ST	Appraisal	-2,529	20
14	SABANERO [1]	SABANERO PROSPECT	SAB 4	Appraisal	-2,419	245
15	SABANERO [1]	SABANERO PROSPECT	SAB SE2ST2	Appraisal	-2,379	2
16	SABANERO [1]	SABANERO PROSPECT	SABANERO 3Hz1ST2	Appraisal HZ	-2,454	19
17	SABANERO [1]	SABANERO PROSPECT	SAB 2Hz1ST	Appraisal HZ	-2,463	135
18	SABANERO [1]	SABANERO PROSPECT	SAB 3Hz3ST2	Appraisal HZ	-2,407	16
19	SABANERO [1]	SABANERO PROSPECT	SAB 5Hz2	Appraisal HZ	-2,449	13
20	CPE-1	TOPO	TOPO-1S	Stratigraphic	-2,300	0
21	CPE-1	LIPA SUR	LIPA SUR-1S	Stratigraphic	-3,950	0
22	CPE-1	CHILACOA	CHILACOA-1S	Stratigraphic	-6,750	0

(1) The Company holds a 49.999% participation in Maurel et Prom Colombia B.V. ("Maurel et Prom Colombia"), which indirectly owns a 49.999% working interest in the Sabanero block.

(2) *Wells labeled "HZ" are horizontally drilled wells. "Net Pay" represents the total estimated net pay encountered in the horizontal (HZ) or vertical drilled sections.*

During the second quarter of 2012, the Company continued its exploration drilling activity in the Quifa and Sabanero blocks, and also drilled the remaining three planned stratigraphic wells on the CPE-1 TEA block. This activity resulted in a total of 22 wells (including wells drilled by Maurel et Prom Colombia) during the second quarter. The Company also completed a 2D seismic survey in the CR-1 block and commenced seismic and hyper-spectral surveys in the N-10-96 and O-10-96 blocks in Guatemala.

In the Quifa North exploration area, the Company drilled a total of nine appraisal wells. All these wells were successful and are currently under extended production testing. In April 2012, the Company submitted the request of commerciality for this part of the block. This commerciality is expected to be approved by the Executive Committee of the Association of the Quifa block during the third quarter of 2012.

On the Sabanero block, Maurel et Prom Colombia (the operator of the block), continued exploration activity drilling three stratigraphic and seven appraisal wells. All the appraisal wells are on long term production test.

On the CPE-1 TEA block, the Company finished drilling the Topo-1S well and drilled the Lipa Sur-1S and Chilacoa-1S stratigraphic wells. All the three wells were declared non prospective, as only marginal oil and gas shows were observed before plugging and abandonment. With these wells the Company has completed its commitment to drill four stratigraphic wells in the TEA contract. The Company has an additional exploration commitment to acquire 540 km of 2D seismic, which will be completed during the second half of 2012.

In the Guama block, during June 2012, a successful fracture stimulation was carried out at the Cotorra-1X well on four sand intervals of the Porquero Formation. Short tests following stimulation flowed at rates between 3 and 4 MMcf/d of gas and 150 to 200 bbl/d of 56° API condensate with chokes 12/64" and 16/64", respectively.

In the LLA-7 and LLA-55 E&P blocks, the Company started permitting activities to acquire two 440 km 2D seismic surveys.

In the CR-1 block, the first phase of 128 km of 2D seismic was completed. The remainder of the planned survey for a total of 319 km will be acquired during the second half of 2012.

On the Tacacho block, the Company continued with the permitting process required to drill a stratigraphic well in the western portion of the block. The Company expects to drill this well in the third quarter of 2012.

On block 138 in Peru, the Company is still working on the approval of the Environmental Management Plan required to drill the Yahuish 1 exploratory well.

On block 135 in Peru, the Company is currently in the last phase to get the environmental permits approval in order to start the acquisition of a 789 km 2D seismic survey, expecting to start during the third quarter of 2012.

On block Z-1 in Peru, the Company is processing and interpreting approximately 1,400 km of 3D seismic data acquired recently by BPZ. An adition 470 km of additional 3D seismic data will be acquired during the third and fourth quarter of 2012 covering the whole block.

In the Guatemala blocks (N-10-96 and O-10-96) the Company, through the operator of the blocks (Compañía Petrolera del Atlántico S.A. ("**CPA**")), completed aerogravity and aeromagnetic surveys, and started the acquisition of 324 km of 2D seismic and a remote sensing survey. These programs are expected to be completed during the second half of 2012.

Production

Average Daily Oil and Gas Production– Net Volumes Before and After Royalties

Colombia

Average net production after royalties reached 90,871 boe/d (232,245 boe/d total field production) representing approximately 3% growth year-over-year, with production growth driven by the drilling of 74 producing wells at the Rubiales field and 41 producing wells at the Quifa SW field during the same period, as well as an increase in the capacity of production facilities at Rubiales and Quifa. Net production at Rubiales and Quifa increased 3% and the La Creciente natural gas field increased by 4% as compared to 2011, the latter due to an increase in domestic gas demand.

Production from the La Creciente field and other producing fields continued to increase offsetting the decrease in production at the Rubiales and Quifa fields in comparison to the first quarter of 2012, due to environmental license limitations. Rubiales has an environmental permit for water disposal approximately.to 1.9 million barrels of water per day, most of them re-injected to the subsurface, and has submitted a license modification for an additional 1.4 million barrels of water per day, of which 400 thousand barrels per day are expected to be licensed early and the remaining 1.0 millon barrels at the end of the year. At the Quifa block, a license to build the required production facilities is expected to be received by the fourth quarter, including water disposal permits.

Peru

Production shown in the following table corresponds to the 49% deemed participating share of production attributable to the Company from Block Z-1 for the period commencing January 1, 2012 to June 30, 2012, pursuant to a Stock Purchase Agreement ("**SPA**") signed on April 27, 2012 between the Company and BPZ Resources, Inc. ("**BPZ**"). Under the terms of the SPA: (i) at closing, operating revenues and expenses will then be allocated to each partner's respective participating interest; and (ii) once approvals by the relevant Peruvian authorities are granted, the Company shall receive a 49% interest in the production of hydrocarbons from the Z-1 Block effective as of January 1, 2012. No revenues or costs have been recognized yet in the Company´s financial results with respect to the production from Block Z-1 as its full entitlement is subject to approval of the applicable Peruvian authorities.

Net production after royalties for the second quarter of 2012 attributed from block Z-1, averaged 1,740 bbl/d (total gross field 3,551 bbl/d). Production is expected to increase during the second half of 2012 through a program of five workovers in the Corvina field, starting in August. A new drilling and operation platform (CX15), is expected to arrive in Peru at the end of September. The operator, BPZ, is in the process to obtain the environmental permits to begin its operation in the fourth quarter. Upon the approvals of the applicable Peruvian authorities, revenues, expenses and production will be reflected in the Company's results according to the respective ownership interest basis.

The following table sets out the average production for the of three months ended June 30, 2012, at all of the Company's producing fields located in Colombia and Peru:

	Average Q2 Production (in boe/d)					
	Total field production		Share before royalties[1]		Net share after royalties	
Producing Fields - Colombia	**Q2 2012**	**Q2 2011**	**Q2 2012**	**Q2 2011**	**Q2 2012**	**Q2 2011**
Rubiales / Piriri	171,226	169,232	71,607	69,955	57,286	55,964
Quifa[2]	44,542	36,010	26,584	21,487	20,826	19,698
La Creciente [3]	11,085	10,674	10,901	10,449	10,898	10,447
Abanico	1,721	2,286	492	673	472	646
Rio Ceibas	-	1,778	-	480	-	384
Dindal / Rio Seco	983	1,376	635	755	524	627
Other producing fields [4]	2,688	540	1,173	342	865	326
Total Production - Colombia	**232,245**	**221,896**	**111,392**	**104,141**	**90,871**	**88,092**
Producing Fields - Peru (See note below)						
Block Z-1 [5]	3,551	-	1,740	-	1,740	-
Total Production - Peru	**3,551**	**-**	**1,740**	**-**	**1,740**	**-**
Total Production Colombia and Peru	**235,796**	**221,896**	**113,132**	**104,141**	**92,611**	**88,092**

(1) *Share before royalties is net of internal consumption at the field.*
(2) *Includes Quifa SW field and early production from Quifa North prospects. The Company's share before royalties in the Quifa SW field is 60% and decreases according to a high-prices clause that assigns additional production to Ecopetrol.*
(3) *Royalties on the gas production from La Creciente field are payable in cash and accounted as part of the production cost. Royalties on the condensates are paid in kind, representing a small impact in the net share after royalties. The Company started activities to increase the process capacity to 120 MMcf/d at La Creciente Station.*
(4) *Other producing fields corresponds to producing assets located in Cerrito, Puli, Moriche, Las Quinchas, Arrendajo, Guasimo, Sabanero (the Company holds a 49.999% participation in Maurel et Prom Colombia B.V., which indirectly owns a 49.999% working interest in the block), and Buganviles blocks. Subject to Ecopetrol´s and ANH´s approval, the Company has divested its participation in the Moriche, Las Quinchas, Guasimo, and Chipalo blocks.*
(5) *Block Z-1 includes Corvina and Albacora fields which are operated by BPZ in which the Company acquired a 49% undivided participating interest on April 27, 2012. Once closing of the transaction occurs, the Company or any of its subsidiaries will be the technical operations manager under an Operating Services Agreement. The applicable royalties in Peru are paid in cash and are accounted as part of the production cost.*
(6) *The term "boe" is used in this MD&A. Boe may be misleading, particularly if used in isolation. A boe conversion ratio of cubic feet to barrels is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. In this MD&A we have expressed boe using the Colombian conversion standard of 5.7 Mcf: 1 bbl required by the Colombian Ministry of Mines and Energy.*

Current net production as of August 7, 2012 continued to increase, reaching an average daily production of over 100.000 boe/d including volumes coming from PetroMagdalena and Peru BPZ block Z1 acquisitions or 8% higher than the production volume reported as of June 30, 2012.

Supply and Sales Balance

The following is the Company´s reconciliation of boe produced vs. boe sold for the three months ended June 30, 2012:

	Q2	
Inventory Movements	**Total boe Net**	**Aver. day Net**
Ending inventory as of March 31, 2012	3.182.419	
Transactions in Q2 2012		
Net oil and gas production	8.269.209	90.871
Settlement of overlift position from March 31, 2012 [1]	(25.761)	(283)
Purchases of diluents	585.780	6.437
Purchases of oil for trading	257.501	2.830
Total sales [2]	(10.709.594)	(117.688)
Overlift position as of June 30, 2012 [3]	18.540	204
Settlement PAP	(145.417)	(1.598)
Volumetric compensation and operational gains (losses)	(2.921)	(32)
Ending inventory as of June 30, 2012 [4]	1.429.756	

(1) This volume corresponds to the settlement of the overlift position for crude oil as of March 31, 2012, which resulted in a lower volume of sales during the period it was settled.
(2) Includes the sales of crude oil and gas from producing fields plus diluents as well as crude oil produced from successful exploratory wells under extended testing. The sale of the extended testing volume is booked as a lower amount of the investment according to IFRS accounting rules.
(3) This volume corresponds to a net overlift position of 18,540 boe of crude oil and gas as of June 30, 2012, which will be settled during future periods.
(4) Corresponds to crude oil inventory in tanks as of the end of June 30, 2012 at the fields and Coveñas Terminal as well as permanent inventory in the pipeline systems.

Commercial Activity

2012 Second Quarter Market Overview

- In the second quarter of 2012, crude oil prices were pressured downward due to weaker global economic growth outlook prompted by increased concerns about the debt crisis in Europe and indications of slowing growth in China, both of which could have an effect on other economies. On the other hand, weak employment macroeconomic data in the USA led the Federal Reserve to ease its monetary policy through the end of the year to reduce borrowing costs to spur the economy.

- According to a recent OPEC report, the oil and gas market was affected by: high stock builds in the Atlantic Basin; lower demand levels in OECD economies, with the exception of Japan, where the shut-down of most of the country's nuclear power plants led to higher crude, LNG and fuel oil use; rising Libyan crude output; and moderate US sweet crude purchases linked to increments in domestic shale oil production.

- During the second quarter of 2012 there was also great expectation over the effects of the EU sanctions on Iran. The market believes that most of the effects of the sanctions have already been priced into the global oil market. However, the upside price risks still persist, particularly if negotiations with Iran fail to progress. According to the OPEC´s report, secondary sources stated a decrease in Iran's crude oil production in the second quarter of 2012 from 3.4 MMbbl/d in the first quarter of 2012 to 3.1 MMbbl/d.

- Despite the reversal of the Seaway pipeline in the USA during June, Cushing stocks continued to expand, which may have prompted pipeline operator Enbridge to announce that it expects to complete the 400 Mbbl/d expansion of the Seaway pipeline by late this year. The 150 Mbbl/d link, which pumps crude from the Cushing storage hub to the US Gulf Coast ("**USGC**"), was originally slated for expansion by first quarter of 2013; but growing Cushing inventories may have rushed the pipeline operator's plans.

Prices and Sales Volume

Average benchmark crude oil and natural gas prices for the three months ended June 30, 2012 were as follows:

Average Crude Oil and Gas Prices	Q2		Q1	°API
	2012 ($/bbl)	2011 ($/bbl)	2012 ($/bbl)	
Domestic Market	$93.23	$98.57	$107.45	12.5
WTI NYMEX (Weighted Average of PRE Cargoes)	$93.70	$102.13	$103.80	38
Vasconia (Weighted Average of PRE Cargoes and Parcels) (1)	$104.68	$110.52	$113.96	24
Castilla (Weighted Average of 9 Cargoes PRE) (2)	$102.50	$102.19	$110.34	19
Rubiales Export. 12.5º (Weighted Average of PRE Cargoes) (3)	$91.60	$96.60	$101.04	12.5
Bunker (380 - 500) (4)	$104.15	-	$103.90	
Combined Realized International Oil Sales Price	**$102.36**	**$103.39**	**$110.89**	
PRE Natural Gas Sales ($/MMBTU) (5)	**$7.38**	**$5.60**	**$7.26**	
Combined Realized Oil and Gas Sales Price	**$96.95**	**$96.54**	**$103.53**	
WTI NYMEX ($/bbl)	$93.35	$102.34	$103.03	
BRENT ICE ($/bbl)	$108.76	$116.99	$118.45	
Regulated Gas Price ($/MMBTU) (5)	$5.80	$4.26	$5.81	
Henry Hub average Natural Gas Price ($/MMbtu)	$2.35	$4.35	$2.50	

(1) Weighted average price of 3 cargoes and 16 parcels of Vasconia crude oil through third parties during second quarter of 2012.
(2) Weighted average price of 7 Castilla crude oil cargoes during the second quarter of 2012.
(3) Weighted average price of 10 Rubiales blend (Rubiales-Sabanero- Trading) small cargoes during the second quarter of 2012.
(4) Weighted average price of 3 Bunkers of MPC and 10 of CIPF small parcels (Rubiales-Sabanero-Trading) during the second quarter of 2012.
(5) The domestic natural gas sales price is referenced to MRP for gas produced in La Guajira field. The MRP is modified every six months based on the previous half-year variation of the US Gulf Coast Residual Fuel No.6 1% sulphur, Platts.

- As a consequence of all of the above, WTI prices decreased by -$9.68/bbl to $93.35/bbl in the second quarter of 2012 from $103.03/bbl in first quarter of 2012. In addition, WTI prices decreased by $8.99/bbl as compared to the second quarter of 2011. Brent ICE prices had a similar decline in the second quarter of 2012 of $9.69/bbl to $108.76/bbl as compared to $118.45/bbl in the first quarter of 2012 as well as a reduction of $8.23/bbl as compared to the second quarter of 2011. The WTI Nymex - Brent ICE spread had no changes during this quarter as it remained at $15.41/bbl vs. the first quarter of 2012.

- Latin American crudes and USGC crudes prices slightly diminished it vs. WTI. Maya crude oil, which is used as a heavy crude reference, weakened its relationship vs. WTI in the second quarter of 2012 to WTI +$5.80/bbl vs. WTI +$6.00/bbl in the first quarter of 2012, but increased +$5.30/bbl vs. WTI +$0.50/bbl in the second quarter of 2011.

- For the purpose of securing diluents for blending Rubiales crude oil, the Company purchased 6,437 bbl/d during the second quarter of 2012 vs. 14,348 bbl/d in the same period of 2011. The Company increased purchases of natural gasoline (82.1° API) to 5,711 bbl/d and continued local purchases of light crude oils (40° API average). Blending cost was $3.83 per bbl of Rubiales crude (vs. $2.94/bbl in the same period of 2011).

- In the second quarter of 2012, natural gas sales reached an average of 62.3 MMcf/d. These sales were mainly from La Creciente field, at an average price of $7.38/MMBtu (equivalent to $7.37/MMcf), representing a premium of 27% over the weighted domestic regulated price of $5.80/MMbtu.

Export Sales Volume

Following is a detail of crude oil exported to international markets during the second quarter of 2012:

Export Destination

Destination	Volume (MMbbl)	%
Europe	3.00	31%
LATAM / Caribbean	0.67	7%
USA	4.08	42%
Asia	1.98	20%
Total Export	**9.73**	**100%**

Export Oil Reference

Type Oil	Volume (MMbbl)	%
Castilla Blend	6.85	70%
Vasconia Blend	2.16	22%
Bunkers	0.15	2%
Rubiales	0.57	6%
Total Export	**9.73**	**100%**

Higher level of sales helped to compensate the drop in international oil prices and the slight reduction in oil production during this period, allowing the Company to increase the revenues as compared to the first quarter of 2011. Total volume of export sales during the second quarter of 2012 reached 9.7 million barrels, 24% higher than the first quarter of 2011. This was achieved by strong commercial activity, as compared to the prior period; another factor was the increase of the Company's sales premium over the actual WTI market prices.

Transport of Hydrocarbons

- During the second quarter of 2012, the Company transported 112,286 bbl/d through the different pipelines and trucking systems, including 7,223 bbl/d of diluents; 1,737 bbl/d of third party crude oil through the Guaduas Facility; 66,780 bbl/d transported via ODL-OCENSA pipeline system; and 16,999 bbl/d through the ODC pipeline.

- Also, during the second quarter of 2012, the Company transported through the trucking system 31,304 bbl/d with no injuries or environmental incidents.

- The Guaduas Facility handled and transported 24,851 bbl/d of crude oil from the Company and third parties. This operation handled 11,190 bbl/d, from third companies, generating an operational profit of $2.5/bbl for the Company and totaling profits of $6 million, without operational or environmental incidents during this quarter.

5. Project Status

STAR Project in the Quifa Field

In March 2011, Pacific Rubiales and Ecopetrol agreed to advance with the STAR pilot project in the Quifa SW field as a preliminary step to expanding the technology in the future. The project will utilize existing production facilities and infrastructure. A pilot test is currently underway in the field under the existing terms and conditions of the Ecopetrol Association Contract in Quifa.

Production and air compression facilities have been completed in the Quifa pilot area. Fluid treatment facilities are being commissioned. The production facilities are composed of two production pads and individual gas separators, and are fully operational. Numerical simulations continue in parallel with this progress.

A cluster of nine wells has been completed and two key tests have been carried out. The steam test was done to determine the response of the reservoir to thermal process and a nitrogen test to create a minimum gas saturation in the wellbore in order to facilitate the upcoming air injection. Both tests showed an excellent response of the reservoir, in both the injector well and the producer wells.

As of the date hereof, the Company finished construction of the safety systems and is close to initiating the air injection thermal phase of operations.

ODL Pipeline

The Company has a 35% interest in the ODL Pipeline with the balance of 65% owned by Ecopetrol. As of June 2012, a total of 172 MMbbl of diluted crude have been transported from the Rubiales field to the Monterrey and Cusiana Stations.

In November 2009, the ODL board of directors approved an expansion of the pipeline from 170,000 bbl/d to 340,000 bbl/d. As of June 2012 all mechanical construction was completed and tested. The booster stations are operated manually. Automation is expected to be completed in the second half of the year.

During the first half of 2012, the pipeline system pumped a total of 40 MMbbl and 35% of this volume corresponds to the Company's crude oil share. On January 21, 2012, a pumping capacity test of the pipeline was completed reaching 357,600 bbl/d.

Carmentea – Araguaney Pipeline Project

This new project involves an extension of the existing pipeline and comprises a new 85 km and 36 inch diameter pipeline with capacity to transport up to 460,000 bbl/d between Cusiana and Araguaney. This will allow additional volumes of oil transportation between the ODL Pipeline and the Bicentenario Pipeline (OBC).

As of June of 2012, the basic engineering for the pipeline was completed. Purchase of pipe is expected to take place in the second half of 2012. Environmental permits are still ongoing.

Dilution Process in Cusiana

ODL has started construction of facilities that will allow dilution from 15° API to 18° API at the Cusiana OCENSA station, optimizing transportation costs. Basic engineering is completed, the purchase order for major equipment was placed and the construction contract has been awarded. The project will be operational in the second half of 2012.

New off-loading facilities in Rubiales

In order to transport early production from neighboring fields currently under exploration, the ODL board of directors approved the construction of truck off-loading facilities for heavy oil in the Rubiales pumping station. The conceptual and basic engineering is completed. The first phase of this project will be able to handle 6,000 bbl/d of heavy crude from CPE-6 and other fields during the second half of this year. Subsequent phases are under study depending on well testing in these fields.

Bicentenario Pipeline ("OBC")

In December 2010, the Company acquired a 32.88% equity interest in OBC. OBC is a special purpose company promoted by Ecopetrol, which has a 55.97% interest in the company, and with the participation of other oil producers operating in Colombia who control the remaining 11.15% interest. OBC will be responsible for the financing, design, construction and operation of Colombia's newest oil pipeline transportation system, which will run from Araguaney, in the Casanare Department of central Colombia, to the Coveñas Export Terminal in the Caribbean.

The new pipeline will eventually add 450,000 bbl/d to the capacity of the existing pipeline systems, connecting the Eastern Llanos Basin to the export markets. The project, which will be constructed in phases, includes a new pipeline from Araguaney Station to Coveñas export terminal. Total extension of this new pipeline is estimated to be 976 km with different sections of 30, 36 and 42 inch diameter line.

Phase 1, which comprises a 42 inch 230 km pipeline from Araguaney to Banadía, is under construction. As of June 2012, 133 km of the pipeline have already been welded, the pumping station in Araguaney is currently under expansion and two tanks of 600,000 bbl capacity are under construction in the Coveñas terminal. The construction progress for phase 1 is 55% as of June 2012. OBC is expected to start pumping during the first quarter of 2013.

On May 11, 2012 the Company announced the closing of the first round of financing for this project. The financing comprises a syndicate loan facility from Colombian local banks for a total amount of COP 2,100,000 million with a term of 12 years. The capital structure aims at a 70/30% debt to equity ratio.

Petroeléctrica de los Llanos ("PEL") – Power Transmission Line Project

The Company incorporated PEL, a wholly-owned subsidiary, in 2010. PEL is responsible for constructing and operating a new power transmission line of 230 kilovolts to connect the Rubiales Field with Colombia´s electrical grid. The new transmission line will originate at the Chivor Substation and will extend 260 km to the Rubiales Field. The line includes two substations to supply power to the booster stations of the ODL pipeline, as well as substations for the Rubiales and Quifa fields. The new power line will be able to supply up to 192 MVA that will be used in oil production and transportation activities. Field construction started in May 2012 and is expected to be completed in the third quarter of 2013, and will lead to reduction of operating costs by an estimated $0.07 per KWh.

Small Scale LNG project

The Company is actively looking for alternate ways to monetize its existing gas reserves in the La Creciente field, as well as exploiting its other extensive gas exploration resources. The Company has initiated a small scale liquefied natural gas ("**LNG**") project that will be developed jointly with Exmar NV ("**Exmar**"), an experienced LNG transportation and regasification company based in Belgium. The project is targeting LNG supply for power generation in Central America and the Caribbean.

The project comprises a planned 88 km 18 inch gas pipeline from La Creciente to Tolú (Colombian Atlantic Coast, 15 km north east from Coveñas) and a Floating, Liquefying, Regasification and Storage Unit (FLRSU). The FLRSU in Colombia will be connected to a Floating Storage Unit (FSU) in order to allow FOB exports to standard carriers (145,000 CBM).

In March 2012, the Company signed a tolling agreement with Exmar. Under the terms of this agreement, the first gas liquefaction is targeted for late 2014. Environmental permitting for the onshore portion of the gas pipeline was granted. Construction of the FLRSU equipment is underway in mainland China. Environmental licenses for the offshore pipeline (3.5 km) and port concessions are in progress. Basic engineering for the gas pipeline and offshore jetty will start in the third quarter of 2012.

6. Capital Expenditures

Capital expenditures during the second quarter of 2012 totaled $316.5 million ($307.7 million in 2011), of which $121 million were invested in the expansion and construction of production infrastructure in order to ensure and increase the production capacity in Quifa and Rubiales fields; $110.6 million went into exploration activities (including drilling, seismic and other geophysical) in Colombia, Peru and Guatemala; $64.6 million for development drilling; and $20.3 million in other projects including the STAR project. Details on the capital expenditure program for 2012 and 2011 are as follows:

	Three Months Ended June 30		**Six Months Ended June 30**	
(in thousands of US$)	**2012**	**2011**	**2012**	**2011**
Production facilities	$ 120,993	$ 109,011	$ 223,156	$ 170,354
Exploration drilling including seismic acquisition (1)	110,608	117,225	200,945	158,751
Development drilling	64,544	49,956	120,973	106,014
Other projects (STAR, Gas export, PEL)	20,338	31,513	38,470	34,076
Total Capital Expenditures	**316,483**	**307,705**	**583,544**	**469,195**

(1) Includes the exploration investment of $34 million in Maurel et Prom Colombia, in which the Company holds a 49.999% participation and indirectly owns a 49.999% working interest in the Sabanero block.

7. Discussion of 2012 Second Quarter Financial Results

Revenues

(in thousands of US$)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Net crude oil and gas sales	$ 949,704	$ 933,433	$ 1,776,502	$ 1,514,833
Trading revenue	86,150	24,076	191,202	26,225
Total Revenue	**1,035,854**	**957,509**	**1,967,704**	**1,541,058**
$ per boe oil and gas	95.30	96.19	98.50	88.44
$ per boe Trading	119.85	112.84	115.95	110.34
$ Total average Revenue per boe	**96.95**	**96.54**	**99.96**	**89.98**

Net crude oil and gas sales in the second quarter of 2012 were $1,035.9 million, which 8% or $78.3 million higher than those for the same period of 2011. Net sales continued to grow mainly due to the 3% increase in net production, and a net drawdown in inventories. For more detail related to oil and gas sales, please refer to section 4 – Commercial Activities. The drivers of the revenue increase during the second quarter of 2012 are explained in the table below:

	Q2 2012	Q2 2011	Differences	% Change
Total of boe sold (Mboe)	10,684	9,918	766	8%
Avg. Combined Price - oil & gas and trading ($/bbl)	96.95	96.54	0.41	0%
Total Revenue (000$)	1,035,854	957,509	78,345	8%

Revenue increase due to the change in volume and price for the second quarter of 2012 in comparison to the same period of 2011 is as follows:

Drivers for the revenue increase (000$):		
Increase due to Volume	73,980	94%
Increase due to Price	4,365	6%
	78,345	

Operating Costs

(in thousands of US$)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Oil and Gas Operating Costs	$ 333,151	$ 319,516	$ 583,776	$ 525,277
Trading Operating Costs	84,003	23,403	184,066	25,483
(Underlift) Overlift	(12,490)	12,772	(29,905)	(5,292)
Total Cost	**404,664**	**355,691**	**737,937**	**545,468**
$ per boe crude oil and gas	33.43	32.92	32.37	30.67
$ per boe Trading Operating Costs	116.86	109.67	111.63	107.22
$ per boe Under/Overlift	(1.25)	1.32	(1.66)	(0.31)
$ Total average Cost per boe	**37.88**	**35.86**	**37.49**	**31.41**

Operating costs per boe for the second quarter of 2012 increased 6% to $37.88 in comparison to the same period of 2011. The increase is primarily due to:

- Increase in energy and fuel consumption cost due to the increase of the water disposal, currently over 2.5 million bbl of water are being treated at Rubiales and Quifa fields.
- Hiring of new personnel directly allocated to the operation and increase in salaries by an 8.9% average on March, 2012.

- Transportation costs during the second quarter of 2012 increased by 4% in comparison to the same period of 2011 primarily attributed to higher volumes required to be transported by land due to current pipeline capacity limitations and an increase in the overall trucking and pipeline transport costs in Colombia.
- Increase of crude oil trading sales in 505,467 bbl in comparison to the second quarter of 2011 (213,373 bbl).

Depletion, Depreciation and Amortization

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands of US$)	2012	2011	2012	2011
Depletion, depreciation and amortization	$ 223,354	$ 178,124	$ 390,102	$ 327,184
$ per boe	20.91	17.96	19.82	18.84

Depletion, depreciation and amortization costs for the second quarter of 2012 were $223.4 million ($178.1 million in the same period of 2011). The increase of 25% over 2011 was primarily due to additions to oil and gas properties that are subject to depletion, the increase in production and the expensing of $26.2 million of certain exploration and evaluation assets.

General and Administrative

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands of US$)	2012	2011	2012	2011
General and administrative costs	$ 71,395	$ 43,479	$ 131,781	$ 74,724
$ per boe	6.68	4.38	6.69	4.30

General and administrative expenses for the second quarter of 2012 were $71.4 million, representing a $27.9 million increase from the same period in 2011. The increase in G&A costs were primarily due to:

- The number of direct and indirect employees in 2012 increased 18% to a total of 1,870 compared to 1,588 in the same period in 2011 to handle the significant increase in the exploratory and producing activities of the Company. Also wages and salaries were adjusted according to market standards (which increased by a 8.9% average) in 2012.
- Increase in the cost of back office, office rental, field personnel and technical assistance to support the growth of production and exploration activities and additional professional fees related to asset acquisitions.

Share-Based Compensation

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands of US$)	2012	2011	2012	2011
Share-based compensation	$ 619	$ 705	$ 31,013	$ 47,392
$ per boe	0.06	0.07	1.58	2.73

Share-based compensation decreased by $0.1 million or 12.2% to $0.6 million as compared to $0.7 million for 2011.

Finance Cost

(in thousands of US$)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Finance costs	$ 19,751	$ 23,781	$ 40,332	$ 46,930
$ per boe	1.85	2.40	2.05	2.70

Finance cost includes interest on bank loans, Debentures, Senior Notes, revolving credit commitment fees, finance leases and fees on letters of credit. For the second quarter of 2012, interest expense totaled $19.8 million compared to $23.8 million for the same period of 2011. The reduction in the finance costs as compared to the same period of 2011, is mainly due to $1.9 million income interest on the loan made to OBC during the fourth quarter of 2011, and additional $2 million interest income earned on cash investment activities.

Equity Tax Expense

(in thousands of US$)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Equity Tax	$ -	$ -	$ -	$ 68,446
$ per boe	-	-	-	3.94

On December 29, 2010, the Colombian Congress passed a law that imposes a surcharge on the existing equity tax levied on Colombian companies. This surcharge increased the equity tax rate for the Company from 4.8% to 6% and is applied on the net taxable equity as of January 1, 2011. The Company's total equity tax payable for the years 2012 to 2014 is $56.6 million, to be paid in five equal installments. Nevertheless, the Company has recognized the full equity tax payable on the consolidated statement of financial position with a corresponding expense in 2011. The amount recognized is calculated by discounting the eight future equity tax payments by the Company's weighted cost of capital at 10.8%.

Foreign Exchange

(in thousands of US$)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Foreign exchange (loss) gain	$ (4,824)	$ (1,523)	$ (16,773)	$ 2,430
$ per boe	(0.45)	(0.15)	(0.85)	0.14

Foreign exchange gains or losses primarily result from the translation of monetary assets or liabilities that are denominated in a foreign currency.

The foreign exchange loss incurred for the second quarter 2012 was due to the appreciation of the Colombian peso against the U.S. dollar, as a result of the net Colombian peso liability exposure.

Income Tax Expense

(in thousands of US$)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Current income tax	$ 134,595	$ 140,714	$ 263,707	$ 218,371
Deferred income tax	(12,987)	(58,423)	(82,729)	(86,706)
Total	**121,608**	**82,291**	**180,978**	**131,665**
$ per boe	11.38	8.30	9.19	7.58

The income tax rate in Canada was lowered to 26.5% for 2012 compared to 28.25% for 2011, and the tax rate remained at 33% in Colombia.

Income tax expense increased during the second quarter of 2012, which is in line with the increase in revenues and operating income. The effective tax rate of 35.15% is in line with the statutory rate of 33% in the second quarter of 2012. The effective tax rate of 27% for the six months ended June 30, 2012 is lower than the statutory rate primarily due to permanent foreign exchange effect in the deferred income tax and non-deductible costs for tax purposes and gain on risk management contracts.

Current income tax represents the estimated cash income taxes paid and payable for the period. Current income tax decreased slightly to $134.6 million from $140.7 million during the same period of 2011.

Net Earnings

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands of US$)	2012	2011	2012	2011
Net earnings	$ 224,344	$ 349,375	$ 482,689	$ 279,782
$ per boe	21.00	35.23	24.52	16.11

Net earnings for the second quarter of 2012 totaled $224.3 million compared to a profit of $349 million in 2011. Net earnings for the second quarter of 2012 were impacted by a number of non-cash items totaling $37.2 million. These non-cash items are related to share-based compensation of $0.6 million, foreign exchange loss of $4.8 million and gain on risk management contracts of $42.7 million. These non-cash items may or may not materialize in future periods. Excluding these items, the Company's adjusted net earnings were $187.1 million ($266.7 million in 2011) or $0.64 per basic common share ($0.99 in 2011).

Cash Flow from Operations

	Three Months Ended June 30		Six Months Ended June 30	
(in thousands of US$)	2012	2011	2012	2011
Cash flow from operations	$ 131,906	$ 116,273	$ 708,005	$ 436,076
$ per share, basic	0.45	0.43	2.42	1.63
$ per share, diluted	0.43	0.39	2.33	1.46

The Company continued to generate positive cash flow from operations as a result of the increase in production together with the increase in the combined realized oil and gas price. The cash flow from operations during the second quarter of 2012 totaled $131.9 million. This increase is primarily attributable to the 2% increase in the combined net back in 2012 as compared to the same period in 2011 ($63.12 per boe in 2012 versus $61.95 per boe in 2011), as well as the increase in the volume of sales to domestic and international markets.

Financial Position

EBITDA

Despite the drop in international crude oil prices, the Company continues to deliver strong EBITDA.

EBITDA for the second quarter of 2012 totaled $559.8 million, which represents an increase of 0.3% compared to $558.3 million in 2011. The increase is attributable to increased revenue, mainly generated from international sales (90%); EBITDA from gas and domestic sales contributed 9% and 1%, respectively. EBITDA in the second quarter of 2012 represents a 54% margin in comparison to total revenues for the period (58% margin in 2011); the lower margin can be attributed to higher general and administrative costs.

Cumulative EBITDA for the six months of 2012 totals $1,098 million, which is 19% higher than the EBITDA reported for the same period in 2011 of $920.9 million.

Debts and Credit Instruments

During the fourth quarter of 2011, the Company restructured its convertible debentures and senior notes, lowering the overall cost of borrowing and also providing the flexibility and capacity required for the Company to continue executing its business strategies. The Company was compliant with all of its debt covenants during the second quarter of 2012. The following debts are outstanding as at June 30, 2012.

2009 Senior Notes

The 2009 Senior Notes are direct, unsecured subordinated obligations with maturity dates of November 10, 2014 (33.3%), November 10, 2015 (33.3%), and November 10, 2016 (33.4%) and an interest rate of 8.75% payable semi-annually. The 2009 Senior Notes are on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. The principal amount outstanding on the 2009 Senior Notes as at June 30, 2012 was $91 million.

2011 Senior Notes

The 2011 Senior Notes, due December 12, 2021, are direct, unsecured, subordinated obligations with an interest rate of 7.25% payable semi-annually. The 2011 Senior Notes are on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. As the June 30, 2012 the principal outstanding on the 2011 Senior Notes was $712 million.

Revolving Credit Facility

The Company has a $350 million unsecured revolving credit facility with an interest rate determined in accordance with the ratings assigned to the Company's senior debt securities by Standard & Poor's Ratings Group and Fitch Inc. Based on the Company's credit rating as at December 31, 2011 and March 31, 2012, the interest rate was LIBOR plus 2.25%. In addition, the Company is required to pay commitment fees of 0.75% on the unutilized portion of any outstanding commitments under the facility. As at June 30, 2012, the Company has drawn down $193 million on the revolving credit facility.

Convertible Debentures

The Company has outstanding convertible unsecured subordinated debentures due August 29, 2013 (the "**Debentures**") of C$2.7 million in face amount as at June 30, 2012. The Debentures bear interest at 8% annually and are payable semi-annually. The outstanding Debentures are convertible into common shares of the Company at the rate of C$12.83 (2010 – C$12.83) per share, being equivalent to 77.9423 (2010 – 77.9423) common shares per C$1,000 face amount of Debentures, subject to adjustments pursuant to the indenture. As at June 30, 2012 the principal outstanding on the Debentures was C$2.7 million.

Letters of Credit

As at June 30, 2012, the Company has issued letters of credit and guarantees for exploration and operational commitments for a total of $203 million.

Outstanding Share Data

Common Shares

As at June 30, 2012, 294,867,113 common shares were issued and outstanding.

The Company does not have shares subject to escrow restrictions or pooling agreements.

Stock Options and Warrants

As at June 30, 2012, 6,684 warrants to acquire an equal number of common shares were outstanding and exercisable and 25,609,909 stock options were outstanding, of which all were exercisable.

Liquidity and Capital Resources

Liquidity

Funds provided by operating activities for the second of quarter of 2012 totaled $131.9 million ($116.3 million in 2011). The increase in cash flow in 2012 was the result of the increase in production and higher combined crude oil and gas sale prices. The Company has been generating cash flows from operations from the sale of crude oil and natural gas and continues to plan for increased future production.

As of June 30, 2012, the Company had working capital of $451.3 million, mainly comprised of $566.3 million of cash and cash equivalents, $724.8 million of account receivables, $86.7 million of inventory, $31.6 million of income tax receivable, $0.9 million of prepaid expenses, $695.7 million of accounts payable and accrued liabilities, $52.1 million of income tax payable, $191.9 million of current portion of long term debt and $19.3 million of finance lease obligations.

As at June 30, 2012, the Company has drawn down $193 million under the available $350 million Revolving Credit Facility.

The Company believes it has adequate resources to fund its capital plan for 2012, with the Company's cash flows from operations and current debt facilities. With respect to the Company's broader integration strategy, the Company will pay for the expansion plan with its own cash flow. However, if additional resources are required, there are possible sources of funds available to the Company to finance additional capital expenditures and operations including the revolving credit facility, existing working capital and incurring new debt, and the issuance of additional common shares, if necessary.

8. Commitments and Contingencies

As part of the Company's normal course of business, the Company entered into arrangements that will impact the Company's future operations and liquidity. The principal commitments of the Company are ship or pay arrangements on crude oil and gas transportation, asset retirement obligations, debt repayments, service contracts with suppliers in relation to the exploration and operation of oil properties and engineering and construction contracts, among others.

Disclosure concerning the Company's significant commitments can be found in Note 18 to the interim consolidated financial statements. The Company has no off-balance sheet arrangements.

9. Risk Management Contracts

The Company enters into derivative financial instruments to reduce the exposure to unfavorable movements in commodity prices, interest rates and foreign exchange rates. The Company has established a system of internal controls to minimize risks associated with its derivative program and does not intend to use derivative financial instruments for speculative purposes.

Commodity price risk

Commodity price risk is the risk that the cash flows and operations of the Company will fluctuate as a result of changes in commodity prices. Significant changes in commodity prices can also impact the Company's ability to raise capital or obtain additional debt financing. Commodity prices for crude oil are impacted by world economic events that dictate the levels of supply and demand. From time to time the Company may attempt to mitigate commodity price risk through the use of financial derivatives. The Company recognizes the fair value of its derivative instruments as assets or liabilities on the statement of financial position. None of the Company's commodity price derivatives currently qualify as fair value hedges or cash flow hedges, and accordingly, changes in their fair value are recognized in earnings.

The Company has the following commodity price risk management contracts outstanding (000$):

As at June 30, 2012

Asset

Instrument	Term	Volume (bbl)	Floor/ceiling or strike price ($/bbl)	Benchmark		Fair value
Zero cost collars	July to December 2012	6,233,292	70-75 / 121.50	WTI		12,068
Swap	July 2012	1,900,000	(14.35)	WTI		3,366
	Total				$	15,434
	Current					15,434
	Total				$	15,434

Liabilities

Instrument	Term	Volume (bbl)	Floor/ceiling or strike price ($/bbl)	Benchmark		Fair value
Call option	August to December 2012	5,350,000	120	WTI	$	(1,135)
Sold put	August to December 2012	5,350,000	61.5-64	WTI		(2,636)
	Total				$	(3,771)
	Current					(3,771)
	Total				$	(3,771)

As at December 31, 2011

Instrument	Term	Volume (bbl)	Floor/ceiling or strike price ($/bbl)	Benchmark		Fair value
Call option	February 2012 to December 2012	8,790,000	109.50 -120	WTI	$	(29,353)
Sold put	August 2012 to December 2012	5,350,000	61.5 - 64	WTI		(8,732)
Zero cost collars	January 2012 to December 2012	10,051,404	70-80 / 115-121	WTI		(1,798)
	Total				$	(39,883)
	Current				$	(39,883)
	Total				$	(39,883)

For the three and six months ended June 30, 2012, the Company recorded a gain of $42.7 million and $50.6 million (2011: gain of $84.9 million and loss of $7.7 million) on commodity price risk management contracts in net earnings. Included in these amounts were $42.7 million and $51.5 million of unrealized gain (2011: unrealized gain of $86.2 million and unrealized loss of $5.4 million) representing the change in the fair value of the contracts, nil and $1 million of realized loss resulting from premiums paid (2011:$1.3 million and $2.5 million of realized losses).

If the forward WTI crude oil price estimated at June 30, 2012 had been $1/bbl higher or lower, the unrealized gain or loss on these contracts would change by approximately $3 million (2011: $5.8 million).

Foreign currency exchange risk

The Company is exposed to foreign currency fluctuations against the U.S. dollar, the Company's functional currency. Such exposure arises primarily from expenditures that are denominated in currencies other than the functional currency. The Company monitors its exposure to foreign currency risks. To reduce its foreign currency exposure associated with operating expenses incurred in Colombian pesos ("**COP**"), the Company may enter into foreign currency derivatives to manage such risks. The Company has the following currency risk management contracts outstanding that qualify for cash flow hedge accounting (000$):

As at June 30, 2012

Asset

Instrument	Term		Notional amount	Floor-ceiling (COP/$)		Fair value
Currency collar	July to December 2012	$	325,200	1805-1975	$	7,819
Currency collar	January to December 2013		300,000	1825-1930		5,917
		$	625,200		$	13,736
			Current		$	11,951
			Non-current			1,785
			Total		$	13,736

Liabilities

Instrument	Term		Notional amount	Floor-ceiling (COP/$)		Fair value
Currency collar	January to December 2013		135,000	1825-1887		(740)
		$	135,000		$	(740)
			Current			(116)
			Non-current			(624)
			Total		$	(740)

As at December 31, 2011

Instrument	Term		Notional amount	Floor-ceiling (COP/$)		Fair value
Currency collar	January to December 2012	$	650,400	1805 - 1975	$	(27,504)
Currency collar	January to December 2013		120,000	1870 - 1930		(5,397)
		$	770,400		$	(32,901)
			Current		$	(27,504)
			Non-current			(5,397)
			Total		$	(32,901)

The effective portion of the change in the fair value of the above currency hedges is recognized in other comprehensive income as unrealized gains or losses on cash flow hedges. The effective portion is reclassified as production and operating expenses in net earnings in the same period as the hedged operating expenses are incurred. During the three and six months ended June, 2012, $13.1 million and $63.3 million respectively (2011: $12.9 million and $20 million) of unrealized gains were initially recorded in other comprehensive income, and $5.3 million and $10.4 million (2011: $7.1 million and $7.6 million) were subsequently transferred to production and operating cost when the gains became realized. The Company excludes changes in fair value due to the time value of the investments and records these amounts along with hedge ineffectiveness in foreign exchange gains or losses in the period that they arise. During the three and six months ended June 30, 2012, $11.1 million and 17.4 million (2011: $3 million and $4.9 million) of ineffectiveness was recorded as foreign exchange loss.

10. Selected Quarterly Information

	2012		2011				2010	
(in thousands of US$)	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Financials:								
Net sales	$ 1,035,854	$ 931,850	$ 1,011,476	$ 828,285	$ 957,509	$ 583,549	$ 516,731	$ 408,534
Net earnings (loss) for the period	224,344	258,345	80,834	193,720	349,375	(69,593)	61,370	113,152
Earnings (loss) per share								
- basic	0.76	0.88	0.29	0.71	1.30	(0.26)	0.23	0.43
- diluted	0.74	0.85	0.28	0.65	1.17	(0.26)	0.22	0.41

11. Related-Party Transactions

Parties are considered related if one party has the ability to control (financially or by share capital) the other party or have significant influence (management) on the other party in making financial, commercial and operational decisions.

Related party transactions are measured at the carrying amount, unless it is in the normal course of business and has commercial substance or, if it is not in the normal course of business, the change in the ownership of interests in the item transferred or the benefit of a service provided is substantive and the exchange amount is supported by independent evidence. In these instances, related party transactions are measured at the exchange amount ($ thousands, or unless otherwise stated):

a) The Company leases office space in Bogota from an entity controlled by Blue Pacific Assets Corp ("**Blue Pacific**"). Three directors and officers of the Company control, or provide investment advice to the holders of, 67.2% of the shares of Blue Pacific. The monthly rent under the lease agreement is $0.4 million.

   The Company does not have any outstanding accounts receivable from Blue Pacific as at June 30, 2012 (December 31, 2011: nil). In addition, the Company paid $0.2 million and $0.4 million to Blue Pacific during the three and six months ended June 30, 2012 (2011: $0.5 million and $1.1 million) for air transportation services.

b) As at June 30, 2012, the Company had trade accounts receivable of $3.4 million (December 31, 2011: $2.4 million) from Proelectrica, in which the Company has a 20.2% indirect interest and which is 31.49% owned by Blue Pacific. The Company's and Blue Pacific's indirect interests are held through Pacific Power. Revenue from Proelectrica in the normal course of the Company's business was $10 million and $19 million for the three and six months ended June 30, 2012 (2011: $6.3 million and $10.2 million).

c) During the three and six months ended June 30, 2012, the Company paid $6 million and $16.3 million (2011 $13.4 million and $24.3 million) to Transportadora Del Meta S.A.S. ("**Transmeta**") in crude oil transportation costs. In addition the Company has accounts receivable of $2.8 million (December 31, 2011: $3.2 million) from Transmeta and accounts payable of $8.9 million (December 31, 2011: $5.5 million) to Transmeta as at June 30, 2012. Transmeta is controlled by a director of the Company.

d) Loans receivable in the aggregate amount of $374 (December 31, 2011: $490) are due from three management directors and three officers of the Company as at June 30, 2012. The loans are non-interest bearing and payable in equal monthly payments over 48 months. The loans were issued to these individuals in connection with costs incurred by them as a result of their relocation.

e) The Company has entered into aircraft transportation agreements with Petroleum Aviation Services S.A.S., a company controlled by a director of the Company. During the three and six months ended June 30, 2012, the Company paid $3.8 million and $7.3 million (2011: $2.4 million and $3.8 million) in fees as set out under the transportation agreements. As at June 30, 2012 the Company has accounts payable of $0.1 million to Petroleum Aviation Services S.A.S. (December 31, 2011: $0.2 million).

f) During the three and six months ended June 30, 2012, the Company paid $17.7 million and $45.4 million to ODL (2011: $14.4 million and $20.3 million) for crude oil transport services under the pipeline take or pay agreement, and has accounts payable of $5.6 million to ODL as at June 30, 2012 (December 31, 2011: nil). The Company received $0.1 million and $0.4 million from ODL during the three and six months ended June 30, 2012 (2011: $0.3 million and $0.6 million) with respect to certain administrative services and rental equipment and machinery.

g) During the fourth quarter of 2011, the Company, along with the other shareholders of OBC, entered into certain subordinated loan agreements with OBC. Pursuant to the agreement, the Company will make loans to OBC of up to $237.3 million, with the principal being repaid in 10 equal semi-annual installments over a five-year term. The loans carry an annual interest rate of 7.32% with semi-annual interest payments. As at June 30, 2012, the balance of loans outstanding to the Company under the agreement is $160.7 million (December 31, 2011: $102.3 million), of which $128.2 million has been paid on July 9, 2012. Interest of nil and $1.9 million was paid on the loans during the three and six months ended June 30, 2012.

h) The Company has accounts receivable of $0.5 million as at June 30, 2012 (December 31, 2011: $0.5 million) from Oil Aviation Services, a company controlled by a director of the Company, for aircraft transportation expenses.

i) As at June 30, 2012, the Company does not have any outstanding accounts payable (December 31, 2011: $0.4 million) to Helicol with respect to air transportation services and paid during the three and six months ended June 30, 2012 $1 million and $1.7 million for this service (2011: nil). Helicol is controlled by a director of the Company.

12. Internal Controls over Financial Reporting ("ICFR")

In accordance with National Instrument 52-109 ("NI 52-102") of the Canadian Securities Administrators ("**CSA**"), quarterly the Company issues a "Certification of Interim Filings" ("**Certification**"). The Certification requires certifying officers to state that they are responsible for establishing and maintaining Disclosure Controls and Procedures (DC&P) and Internal Control Over Financial Reporting (ICFR).

The Certification requires certifying officers to state that they designed DC&P, or caused it to be designed under their supervision, to provide reasonable assurance that: (i) material information relating to the Company is made known to the certifying officers by others; (ii) information required to be disclosed by the Company in reports filed with, or submitted to, securities regulatory authorities is recorded, processed, summarized and reported within the time periods specified under Canadian securities legislation. In addition, the Certification requires certifying officers to state that they have designed ICFR, or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes.

The Company's corporate internal audit department provides support to the Board of Directors, Audit Committee, and management, and contributes to the continuous improvement strategies of the organization. The corporate audit process provides reasonable assurance over the:

- Evaluation of design and operating effectiveness of internal controls over financial reporting and disclosure controls and procedures as promulgated by NI 52-109 as issued by the CSA,
- Effectiveness and efficiency of operations,
- Reliability of internal and external reporting, and
- Compliance with applicable laws and regulations.

On a quarterly basis, Corporate Audit evaluates the effectiveness of the DC&P and ICFR, encompassed within the requirements of NI 52-109. During this quarter the evaluation was performed for 325 controls over 27 processes.

From this evaluation the Company concluded that there are no material weaknesses or significant deficiencies in the design and effectiveness of the controls evaluated. The identified control deficiencies and opportunities to improve the ICFR are in the following main areas:

- Contracting bidding procedures
- Sales – Client Analysis
- Maintenance Process
- Financial Investments

During the second quarter of 2012, Corporate Audit continued activities focused on identifying, evaluating, and addressing critical and material risks for the organization. Following are some of the most significant risks reviewed, as well as the actions initiated by management to mitigate them:

- Regulatory compliance: Some of the activities included the review and update of the governance programs, which included the Corruption of Foreign Public Officials Act ("**CFPOA**"), anti-money laundering training program, and the update of all regulatory obligations the Company has with government regulation applicable in different countries.
- Price and exchange rate volatility: The review was focused on hedging process and strategies, improving the automated environment to gain greater control of the Cash Flows at Risk.
- Potential increased fraud risk: Fraud risk assessment was performed to identify fraud risks schemes related to asset misappropriation, corruption and financial fraud and included employee fraud awareness training to help maintain fraud-resistance. The results were used to prioritize fraud detection efforts toward key current fraud risks, and review of segregation of duties controls and other fraud controls.
- Data security and privacy protection: The review was focused on the implementation of tools to protect the access to the network and the implementation of application security, the use of tools for continuous auditing and monitoring, and the strengthening of the IT control environment in accordance with the standards.
- Stakeholder relations: The Company has established a secure support and understanding among multiple stakeholders preparing and managing emerging issues.

Security: The analysis and understanding of the security issues that has increased in different areas where the Company has operations initiated the implementation of programs to mitigate them.

13. Outlook

The Company will continue working on increasing its reserves base, production and transportation capacity. Capital spending in 2012 is focused on: (1) expanding the Company's production in its flagship Rubiales/Piriri and Quifa SW oil fields; (2) growing production at the newly commissioned Quifa North and Sabanero oil blocks; (3) advancing its CPE-6 and Quifa North property toward commercial oil production; (4) acquisition of exploration and production assets in Colombia; (5) continuing drilling and seismic activities on its extensive high impact exploration portfolio in Colombia, Peru and Guatemala.

Highlights of the second half 2012 program include:

- An expected ramp-up of oil production in the Rubiales and Quifa North fields driven by the receipt of the environmental license for increased water injection at Rubiales and commerciality approval at Quifa North, which will allow the development of this part of the block.

- Total capital expenditures of $591.2 million, a small increase over 2011, with exploration accounting for approximately 26% of the total budget. The capital program is expected to be entirely funded from internally generated funds and cash on hand in an expected oil price environment of $85 WTI.

- Exploration expenditures for second half 2012 of $156 million, includes drilling additional 23 exploratory wells, seismic data acquisition and early facilities. In the total drill program, approximately 9 gross exploration wells are targeting high impact prospects, including wells in the CPO-1, CPE-6, CPO-12, CPO 17, Quifa and Sabanero blocks.

- $241 million drilling a planned 285 gross (141.75 net) development wells, a significant increase over 2011, with activity driven by development of the Quifa SW field, the Quifa North and Sabanero blocks, and on-going infill drilling at Rubiales/Piriri.

- $293 million facilities expenditure, with approximately 35% directed to Quifa, 29% to Rubiales/Piriri, 8% to Sabanero, 7% to CPE6; 6% to Project Star and the remainder to other projects.

14. Additional Financial Measures

This report contains the following financial terms that are not considered Measures under IFRS: operating netback, net adjusted net earnings from operations, funds flow from operations, adjusted earnings from operations and EBITDA. These non-IFRS Measures do not have any standardized meaning and therefore are unlikely to be compared to similar Measures presented by other companies. These non-IFRS financial Measures are included because management uses the information to analyze operating performance, leverage and liquidity. Therefore, these non-IFRS financial Measures should not be considered in isolation or as a substitute for Measures of performance prepared in accordance with IFRS.

a) Funds Flow

The following table shows the reconciliation of funds flow from operations to cash flow from operating activities for the three and six month periods ended June 30, 2012 and 2011:

	Three Months Ended June 30		**Six Months Ended June 30**	
(in thousands of US$)	**2012**	**2011**	**2012**	**2011**
Cash flow from operating activities	131,906	116,273	708,005	436,076
Changes in non-cash working capital	(283,317)	(283,929)	(99,682)	(230,833)
Funds flow from operations	**415,223**	**400,202**	**807,687**	**666,909**

b) EBITDA

A reconciliation of Net Earnings to EBITDA follows:

(in thousands of US$)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Net earnings	**$ 224.344**	**$ 349.375**	**$ 482.689**	**$ 279.782**
Adjustments to net earnings				
Income taxes expense	121.608	82.291	180.978	131.665
Foreign exchange loss (gain)	4.824	1.523	16.773	(2.430)
Finance cost	19.751	23.781	40.332	46.930
(Gain) Loss on risk management contracts	(42.679)	(84.896)	(50.599)	7.738
Loss from equity investment	6.862	7.701	4.105	11.089
Other expense (income)	1.112	(265)	2.593	3.070
Share-based compensation	619	705	31.013	47.392
Equity tax	-	-	-	68.446
Depletion, depreciation and amortization	223.354	178.124	390.102	327.184
EBITDA	**559.795**	**558.339**	**1.097.986**	**920.866**

c) Adjusted Earnings

Adjusted earnings from operations are a non-IFRS financial measure that represents net earnings adjusted for certain items of a non-operational nature including non-cash items. The Company evaluates its performance based on adjusted net earnings from operations. The reconciliation "Adjusted Net Earnings from Operations", lists the effects of certain non-operational items that are included in the Company´s financial results and may not be comparable to similar measures presented by other companies.

15. Sustainability Policies

The Company has established guidelines and management systems to comply with the laws and regulations of Colombia and other countries in which it operates, and to ensure that sustainable development is one of the Company's priorities. In the past, the Company has engaged with various stakeholders to ensure that as the Company grows, its consideration for the environment, its employees and other stakeholders also continues. The Company devotes significant time and resources to achieve its environmental and safety performance goals. The Company has a full-time work force responsible for all matters affecting the environment and local communities. The Company has instituted social programs specific to the areas in which it operates, which are carried out by employees or staff in the operating areas. The Company continuously monitors the areas where it operates to determine each community's needs so as to formulate the appropriate programs. The Company is also involved in the provision of educational and health supplies, the building of schools, the funding of hospitals, and the sponsorship of other local, cultural, and sporting events.

In June 2011, the Company announced its support for the Extractive Industries Transparency Initiative (the "**EITI**"). The EITI is an international non-profit organization formed in 2002 at the World Summit for Sustainable Development in South Africa. The EITI supports improved governance in resource-rich countries through the verification and full publication of company payments and government revenues from oil, gas and mining. The EITI standards are implemented by governments with an international multi-stakeholder structure at the core of the initiative. Currently, more than fifty of the largest oil, gas and mining companies have chosen to become EITI supporting companies. The EITI's initiatives aim for good governance so that the exploitation of resources can generate revenues to foster growth and reduce poverty.

Pacific Rubiales was the first company in Colombia to implement the EITI standards and is committed to taking a leading role in the implementation of EITI in Colombia by collaborating with all stakeholders within the EITI. In Canada, which is an EITI supporting country, and Peru and Guatemala, which are EITI candidate countries, Pacific Rubiales is committed to actively supporting EITI processes.

With respect to how the Company manages the impacts of climate change, Pacific Rubiales aims to implement the Carbon Disclosure Project in 2012. Accordingly, Pacific Rubiales would integrate into its business strategy the need to document, control and eventually reduce carbon emissions.

In 2012, the Board of Directors appointed a Sustainability Committee to assist the Board of Directors in carrying out the Company's corporate sustainability policies, including environmental, social, health, safety and ethical matters. This Committee is responsible for advising the Board of Directors, committees of the Board of Directors and executive management on such matters.

For further details regarding the Company's sustainability policies, please see our Sustainability Report, which is available on our website.

16. Legal Notice – Forward-Looking Information and Statements

Certain statements in this MD&A constitute forward-looking statements. Often, but not always, forward-looking statements use words or phrases such as: "expects", "does not expect" or "is expected", "anticipates" or "does not anticipate", "plans" or "planned", "estimates" or "estimated", "projects" or "projected", "forecasts" or "forecasted", "believes", "intends", "likely", "possible", "probable", "scheduled", "positioned", "goal", "objective" or state that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved. Such forward-looking statements, including but not limited to statements with respect to anticipated levels of production, the estimated costs and timing of the Company's planned work programs and reserves determination involve known and unknown risks, uncertainties and other factors which may cause the actual levels of production, costs and results to be materially different from estimated levels of production, costs or results expressed or implied by such forward-looking statements. The Company believes the expectations reflected in these forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements should not be unduly relied upon. Factors that could cause actual results to differ materially from those anticipated in these forward-looking statements are described under the caption "Risks and Uncertainties". Although the Company has attempted to take into account important factors that could cause actual costs or operating results to differ materially, there may be other unforeseen factors to cause costs to the Company's program and results may not to be as anticipated, estimated or intended.

Statements concerning oil and gas reserve estimates may also be deemed to constitute forward-looking statements to the extent they involve estimates of the oil and gas that will be encountered if the property is developed. The estimated values disclosed in this MD&A do not represent fair market value. The estimates of reserves and future net revenue for individual properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties, due to the effects of aggregation.

17. Risks and Uncertainties

The business and operations of the Company will be subject to a number of risks. The Company considers the risks set out below to be the most significant to potential investors in the Company, but does not include all of the risks associated with an investment in securities of the Company:

- Fluctuating oil and gas prices;
- Cash flows and additional funding requirements;
- Global financial conditions;
- Exploration and development;
- Operating hazards and risks;
- Reserve estimates;
- Transportation costs;
- Disruptions in production;
- Political risk;
- Environmental factors;
- Title matters;
- Dependence on management;
- Changes in legislation;
- Repatriation of earnings;
- Enforcement of civil liabilities;
- Competition;
- Payment of dividends;
- Environmental licenses & required permits;
- Security;

- Partner relationship;
- Oil & gas transportation;
- Availability of diluents;
- Water disposal;
- Talent attraction & retention;
- Labor relations;
- HSE works;
- Community relations;
- Fraud;
- Foreign exchange rate fluctuation;
- Business continuity;
- Regulatory compliance; and
- Shareholder relations.

If any of these risks materialize into actual events or circumstances or other possible additional risks and uncertainties of which the Company is currently unaware or which it considers not to be material in relation to the Company's business, actually occur, the Company's assets, liabilities, financial condition, results of operations (including future results of operations), business and business prospects, are likely to be materially and adversely affected. In such circumstances, the price of the Company's securities could decline and investors may lose all or part of their investment. For more information, please see the Company's Annual Information Form which is available at www.sedar.com.

18. Advisories

Finding Costs

The aggregate of the finding costs incurred in the most recent financial year and the change during that year in estimated future finding costs generally will not reflect total finding costs related to reserves additions for that year.

Boe Conversion

The term "boe" is used in this MD&A. Boe may be misleading, particularly if used in isolation. A boe conversion ratio of cubic feet to barrels is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. In this MD&A we have expressed boe using the Colombian conversion standard of 5.7 Mcf: 1 bbl required by the Colombian Ministry of Mines and Energy.

19. Abbreviations

The following list of abbreviations is used in this document

1P Proved reserves (also known as P90).

2P Proved reserves + Probable reserves.

3P Proved reserves + Probable reserves + Possible reserves.

Bbl Barrels
bbl/d Barrels per day
Bcf Billion cubic feet
boe Barrels of oil equivalent
boe/d Barrels of oil equivalent per day
Btu British thermal units
Bwpd Barrels of water per day

ESP Electro-Submersible Pump
km Kilometers
Mbbl thousand barrels
include millions MMbbl
Mboe thousand barrels of oil equivalent

include millions (MMboe)
Mcf/d thousand cubic feet per day

MMcf/d Million cubic feet per day

Mcf thousand cubic feet

MD Measured depth
OOIP Original oil in place

MMbbl million barrels
Mmboe Million barrels of oil equivalent
MMBtu million British thermal units
MMcf million cubic feet
MMcf/d million cubic feet per day

Mmscf/d Million standard cubic feet per day
Mw Megawatts

NGL natural gas liquids

Tcf trillion cubic feet

TD Total depth

TVDSS True vertical depth below sea level

CBM Cubic Billion Meter

KWh Kilowatt Hour

WTI West Texas Intermediate index

USGC US Gulf Coast