

Management's Discussion and Analysis

Summary of annual results

(All references to \$ are United States dollars unless otherwise noted)

	2008	2007	2006
Financial			
(\$000s, except where noted)			
Crude oil revenue	343,182	124,761	43,676
Funds flow from operations ⁽¹⁾	234,534	85,883	28,789
Per share – basic (\$)	2.34	0.89	0.33
– diluted (\$)	2.25	0.88	0.33
Net income	131,144	47,551	14,798
Per share – basic (\$)	1.31	0.49	0.17
– diluted (\$)	1.28	0.49	0.17
Capital expenditures	268,153	143,022	73,365
Total assets	565,705	441,462	181,407
Working capital surplus ⁽¹⁾	48,899	106,691	11,469
Common shares outstanding, end of year (000s)			
Basic	99,399	100,289	95,000
Diluted ⁽²⁾	108,619	108,854	98,051
Operations			
Operating netback (\$/bbl) ⁽³⁾			
Crude oil revenue ⁽⁴⁾	82.27	70.00	54.54
Royalties	8.02	6.55	4.38
Production expenses	8.46	7.16	6.87
Operating netback	65.79	56.29	43.29
Average daily crude oil production (bbls)	10,967	4,767	2,194

⁽¹⁾ Non-GAAP measure. See "Non-GAAP Measures" section within MD&A.

⁽²⁾ Assumes the Company's convertible debentures, issued in December 2007, are converted into common shares (2008 – 2,987,367 shares, 2007 – 3,656,508 shares, 2006 – nil).

⁽³⁾ Excludes hedging activities.

⁽⁴⁾ Net of transportation expenses.

The following MD&A is dated March 1, 2009 and should be read in conjunction with the consolidated financial statements and accompanying notes of Petrominerales Ltd. ("Petrominerales" or the "Company") as at and for the years ended December 31, 2008 and 2007. The consolidated financial statements and comparative information have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). Additional information for the Company, including the Annual Information Form ("AIF") can be found on SEDAR at www.sedar.com or at www.petrominerales.com. All amounts are in United States dollars, unless otherwise stated and all tabular amounts are in thousands of United States dollars, except share amounts or as otherwise noted.

Forward-looking statements

In addition to historical information, the MD&A contains forward-looking statements that are generally identifiable as any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events of performance (often, but not always, through the use of words or phrases such as "will likely result," "expected," "is anticipated," "believes," "estimated," "intends," "plans," "projection" and "outlook"). These statements are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such forward-looking statements. Actual results achieved during the forecast period will vary from the information provided herein as a result of numerous known and unknown risks and uncertainties and other factors. Such factors include, but are not limited to: general economic, market and business conditions; fluctuations in oil and gas prices; the results of exploration and development drilling and related activities; fluctuation in foreign currency exchange rates; the uncertainty of reserve estimates; changes in environmental and other regulations; risks associated with oil and gas operations, timing of completion of the Monterrey facility and expected trucking cost savings and other factors, many of which are beyond the control of the Company. Accordingly, there is no representation by Petrominerales that actual results achieved during the forecast period will be the same in whole or in part as those forecasted. Except to the extent required by law, Petrominerales assumes no obligation to publicly update or revise any forward-looking statements made in this MD&A or otherwise, whether as a result of new information, future events or otherwise. All subsequent forward-looking statements, whether written or oral, attributable to Petrominerales or persons acting on the Company's behalf, are qualified in their entirety by these cautionary statements.

Non-GAAP measures

This report contains financial terms that are not considered measures under Canadian generally accepted accounting principles (“GAAP”), such as funds flow from operations, funds flow per share, working capital surplus and operating netback. These measures are commonly utilized in the oil and gas industry and are considered informative for management and shareholders. Specifically, funds flow from operations and funds flow per share reflect cash generated from operating activities before changes in non-cash working capital. Management considers funds flow from operations and funds flow per share important as they help evaluate performance and demonstrate the Company’s ability to generate sufficient cash to fund future growth opportunities and repay debt. Working capital surplus includes current assets less accounts payable and accrued liabilities and bank debt, and is used to evaluate the Company’s financial leverage. Management considers operating netback important as it is a measure of profitability per barrel of production. Funds flow from operations, funds flow per share, working capital surplus and operating netbacks may not be comparable to those reported by other companies nor should they be viewed as an alternative to cash flow from operations, net income or other measures of financial performance calculated in accordance with GAAP.

Highlights and significant transactions

(annual comparisons are 2008 compared to 2007 and quarterly comparisons are fourth quarter 2008 compared to the fourth quarter of 2007 unless otherwise noted)

- Crude oil production increased by 130%, averaging 10,967 barrels per day (“bopd”) in 2008, mainly due to production additions from our Corcel and Orito drilling programs.
- Production increased to an average of 15,344 bopd in the fourth quarter of 2008 and to 25,897 bopd in February 2009, mainly due to continued drilling success at Corcel.
- Operating netbacks increased by 17% to \$65.79 per barrel in 2008.
- Funds flow from operations increased by 173% to \$234.5 million in 2008.
- Net income increased by 176% to \$131.1 million in 2008.
- Strong financial position with net working capital of \$48.9 million, an undrawn \$80 million credit facility, strong cash flows and operating netbacks combined with significant production growth.
- Drilled 26 wells, increased capacity of the Corcel central processing facility and began construction on a strategic oil offloading station in 2008.
- Repurchased 1,326,000 common shares.
- Repurchased convertible debentures with a face value of \$18.3 million at a 39% discount.
- Acquired a 55% working interest in Block 126 (2,636,506 gross acres) in the Ucayali Basin of east central Peru.
- Awarded two new highly prospective blocks in Colombia, Blocks 25 and 31 (333,708 acres), north of Corcel.

Nature of business

Petrominerales Ltd. (“Petrominerales” or the “Company”), is a public company listed on the Toronto Stock Exchange and was incorporated in the Bahamas on April 20, 2006. Petrominerales is involved in the exploration, development and production of crude oil in Colombia and Peru. Petrominerales is owned 76.5% by Petrobank Energy and Resources Ltd. (“Petrobank”) (TSX:PBG).

Financial and operational review

Average daily crude oil production (bopd)	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Orito	1,844	2,601	(29%)	2,946	2,454	20%
Corcel	13,023	6,545	99%	7,562	1,925	293%
Neiva and others	477	429	11%	459	388	18%
Total	15,344	9,575	60%	10,967	4,767	130%

In 2008, production increased to 10,967 bopd primarily due to drilling success at Corcel, along with drilling success at Orito and Neiva. Corcel production began in the third and fourth quarters of 2007 from the A-1 and A-2 wells, and has increased through 2008 with additional production from the A-4, C-1, C-3 and D-1 wells.

The Company continues to truck all Corcel production to various offloading stations. Access to this infrastructure is critical to growing Corcel production. The Company continues to evaluate and secure additional alternatives to increase offloading capacity which includes the construction of additional offloading facilities close to Corcel. As a major step in this strategy, the Company is constructing a key Llanos Basin facility at Monterrey that will give Petrominerales up to an initial 20,000 barrels per day of incremental offloading capacity. Start-up of this facility is targeted for the second quarter of 2009. Monterrey will be the closest offloading station to Corcel resulting in significant savings on trucking costs.

The fourth quarter production increased to 15,344 bopd due to new production from Corcel offset by a 29% decrease in Orito production caused by a general strike in the Putamayo region that resulted in production being shut-in from November 20, 2008 to January 5, 2009.

Production has continued to increase subsequent to year-end, averaging 25,897 bopd in February 2009. The increase relates to production additions from the Corcel-D2 well and drilling success at Neiva.

Crude oil prices	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
WTI (\$/bbl)	59.08	90.50	(35%)	99.75	72.41	38%
Realized price per bbl (\$/bbl)	45.57	77.87	(41%)	82.27	70.00	18%
Discount as a percent of WTI	23%	14%	64%	18%	3%	500%

The volatile financial and commodity markets have resulted in a sharp decline in crude oil prices in the fourth quarter of 2008. The Company's 2008 average realized oil price increased to \$82.27 per barrel due to higher average crude oil prices offset by a larger discount to WTI. The Company's fourth quarter average realized oil price decreased 41% from the comparable 2007 period to \$45.57 per barrel due to the sharp decline in crude oil prices and a larger discount to WTI. The discounts compared to WTI increased in 2008 mainly due to higher trucking costs associated with Corcel production additions and fixed costs that increase on a percent basis when oil prices are lower. Fixed costs include marketing fees and pipeline fees that are charged on a flat per barrel basis.

Oil revenue	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Oil revenue	70,610	71,325	(1%)	343,182	124,761	175%
Transportation expenses	6,276	2,725	130%	12,962	2,959	338%
Oil revenue, net of transportation, ("plant gate revenue")	64,334	68,600	(6%)	330,220	121,802	171%
\$ per bbl	45.57	77.87	(41%)	82.27	70.00	18%

Oil revenue in 2008 increased due to a 130% production increase and 18% higher realized crude oil prices. Fourth quarter oil revenue, net of transportation, decreased 6% due to the sharp decline in crude oil prices that was largely offset by a 60% increase in production over the comparable quarter.

Transportation costs relate to trucking sales oil at Corcel to various offloading stations. Transportation expenses increased in 2008 due to higher production at Corcel.

Royalties	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Royalties	5,510	6,940	(21%)	32,201	11,402	182%
\$ per bbl	3.90	7.88	(51%)	8.02	6.55	22%
Royalties as a percent of plant gate revenue	9%	10%	(10%)	10%	9%	11%

Colombian government royalties are fixed at a rate of eight percent until the Company's net production per field exceeds 5,000 bopd, and then increase by one percent for each incremental 10,000 bopd of production per field. In addition, the Company paid a three percent overriding royalty on Corcel production that was converted to an eight percent net profits interest ("NPI") upon payout in the year. The NPI account is a cumulative balance that includes capital investments such that when negative, no amount is payable.

Royalties increased in 2008 from higher production and crude oil prices. Royalties as a percent of plant gate revenue increased to 10% in 2008 due to more production coming from Corcel that is subject to an overriding royalty. Royalties decreased in the fourth quarter primarily from 41% lower realized crude oil prices offset by higher production. Royalties as a percent of plant gate revenue decreased to 9% in the fourth quarter due to lower overriding royalties and NPI costs. Lower oil prices and ongoing capital investments at Corcel decreased the NPI account resulting in lower NPI costs.

Interest income	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Interest income	411	564	(27%)	2,379	656	263%

In 2008, interest income on cash and cash equivalents increased to \$2.4 million due to higher cash balances resulting from record funds flow from operations and the proceeds from \$100 million of convertible debentures issued on December 6, 2007. The fourth quarter interest income decreased to \$0.4 million due to lower cash balances and interest rates.

Gain (loss) on risk management contracts	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Realized gain (loss)	1,228	–	–	(8,569)	–	–
Unrealized gain (loss)	2,129	(5,242)	–	5,797	(5,797)	–
Gain (loss) on risk management contracts	3,357	(5,242)	–	(2,772)	(5,797)	52%
\$ per bbl	2.38	(5.95)	–	(0.69)	(3.33)	79%

The realized gain (loss) on risk management contracts relates to actual monthly settlements incurred. The unrealized gain (loss) on risk management contracts represents the change in fair value of the contracts in relation to the expected future settlements. The Company had the following risk management contracts during 2008:

Term	Volume (bopd)	Price (\$/bbl)	Benchmark
Jan. 1, 2008 – Dec. 31, 2008	500	65.00 floor / 80.00 ceiling	WTI
Jan. 1, 2008 – Dec. 31, 2008	500	75.25 fixed	WTI

Production expenses	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Production expenses	9,101	6,600	38%	33,995	12,463	173%
\$ per bbl	6.45	7.49	(14%)	8.46	7.16	18%

The Company completed the first-phase expansion of the Corcel central processing facilities in July 2008 to increase fluid handling capacity to 70,000 barrels of fluid per day. These permanent facilities replaced higher cost, less efficient temporary facilities causing production expenses to decrease during the course of 2008. In addition, as a portion of the Company's production expenses are fixed, when combined with higher production, has resulted in lower per barrel production expenses.

In 2008, production expenses increased 173% primarily due to 130% higher production. Production expenses on a per barrel basis increased 18% to \$8.46 due to higher Corcel production being processed through temporary facilities during the first half of the year which resulted in higher water handling costs. The Colombian national oil company, Ecopetrol, is responsible for primary production operations at Orito and Neiva at a cost (subject to annual inflation, currency, and other adjustments) of \$4.89 per barrel and \$2.67 per barrel, respectively, in 2008.

The fourth quarter production expenses were \$9.1 million mainly due to a 60% increase in production offset by operating efficiencies achieved from the Corcel production facilities expansion, which resulted in per barrel production expenses decreasing 14% to \$6.45.

General and administrative expenses	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
General and administrative expenses	2,413	2,145	12%	10,076	6,443	56%
\$ per bbl	1.71	2.44	(30%)	2.51	3.70	(32%)

The 2008 increase in general and administrative expenses was primarily due to additional personnel as a result of expanding operations. On a unit of production basis these costs have decreased due to higher production levels.

Stock-based compensation expenses	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Stock-based compensation expenses	792	413	92%	2,631	1,381	91%

Stock-based compensation expenses relate to stock options and the deferred common shares granted. The calculation of this non-cash expense is based on the fair value of stock options and deferred common shares granted, amortized over the vesting period of the option, or immediately upon grant of the deferred common shares.

In December 2008, the Company modified the terms of certain non-executive stock options to enhance employee retention while balancing the interests of shareholders. Employees were given the option to reduce the exercise price on outstanding options in exchange for forfeiting 25% of their options and extending the vesting period of retained options. The modifications resulted in the exercise price on 1,382,961 options being reduced from a weighted average of Cdn.\$14.58 to Cdn.\$7.48 and the forfeiture of 460,975 options with a weighted average exercise price of Cdn.\$14.58. The incremental fair value attributed to the modification will be recorded as stock-based compensation over the vesting period of the modified options.

Interest expense	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Interest expense	2,527	1,233	105%	10,711	2,826	279%

Interest expense includes interest on bank debt and convertible debentures, fees on letters of credit and amortization of deferred financing costs. Interest expense increased in 2008 due mainly to the \$100 million, 3.375% annual coupon, convertible debentures issued in December 2007. Of the total 2008 interest expense, \$4.7 million relates to accretion on convertible debentures and \$0.5 million relates to amortization of deferred financing charges. In the fourth quarter of 2008, the Company repurchased \$18.3 million of the convertible debentures at 61% of face value or \$11.1 million, which will result in interest savings in future periods.

Foreign exchange (gain) loss	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Foreign exchange (gain) loss	773	(30)	–	956	446	114%

The devaluation of the Colombian peso relative to the U.S. dollar on Colombian peso working capital balances resulted in a \$1.0 million foreign exchange loss in 2008. The Colombian peso to U.S. dollar exchange rate changed from 2,015:1 at January 1, 2008 to 2,244:1 at December 31, 2008, an 11% devaluation. Changes in this exchange rate impact the Company's U.S. dollar denominated costs as approximately 60% of the Company's expenditures are incurred in Colombian pesos.

Depletion, depreciation and accretion ("DD&A") expenses	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
DD&A expenses	28,834	17,214	68%	83,302	31,695	163%
\$ per bbl	20.42	19.54	5%	20.75	18.22	14%

DD&A expenses increased in 2008 due mainly to production increases. The rate per barrel increased by 14%, despite a 22% increase in gross working interest total proved reserves to 25.2 million barrels, due to 2008 capital expenditures of \$268.2 million and \$133.9 million of future development costs associated with proved undeveloped reserves.

The fourth quarter DD&A expenses increased 68%, mainly due to a 60% production increase.

Tax expense	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Equity and presumptive income tax	443	887	(50%)	2,057	3,533	42%
Current income tax (recovery)	(11,355)	–	–	4,736	–	–
Future income tax (recovery)	13,731	5,029	173%	22,964	(1,079)	–
Tax expense	2,819	5,916	(52%)	29,757	2,454	1,113%
Effective tax rate	14%	20%	(30%)	19%	5%	280%

Equity tax is based on equity capitalization levels in Colombia. Presumptive income tax is charged in periods where taxable income is below certain thresholds, and when paid, can be carried forward for five years and be recovered against income taxes in future periods. The Company's pre-tax income is subject to the Colombian statutory income tax rate of 33%. The Company had an effective tax rate of 14% in the fourth quarter of 2008 and 19% for entire year. The effective tax rates are lower than the Colombian statutory income tax rate largely as a result of enhanced tax allowances for the acquisition of fixed assets.

Net income	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Net income	20,278	23,491	(14%)	131,144	47,551	176%
\$ per share, diluted	0.20	0.23	(13%)	1.28	0.49	161%

In 2008, net income and net income per share increased due to substantially higher production and realized crude prices, higher interest income and gain on convertible debenture repurchases, partially offset by higher royalties, production expenses, general and administrative expenses, stock-based compensation costs, interest expenses, depletion, depreciation and accretion expenses and taxes.

In the fourth quarter, net income and net income per share decreased primarily due to lower realized crude prices, higher production expenses, general and administrative expenses, stock-based compensation costs, interest expenses, depletion, depreciation and accretion expenses offset by higher production, lower royalties, taxes and gains on risk management contracts and repurchase of convertible debentures.

Funds flow from operations	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Funds flow from operations	57,811	51,778	12%	234,534	85,883	173%
\$ per share, diluted	0.56	0.50	12%	2.25	0.88	156%

In 2008, funds flow from operations and funds flow from operations per share increased significantly primarily from higher production and realized crude oil prices, partially offset by higher royalties, realized losses on risk management contracts, production expenses, cash taxes and cash interest expense.

In the fourth quarter, funds flow from operations and funds flow from operations per share increased primarily due to higher production and realized gains on risk management contracts, partially offset by lower realized crude oil prices, higher royalties, production expenses and cash interest expenses.

The following table shows the reconciliation of funds flow from operations to cash flow from operating activities for the periods noted:

	Three months ended December 31,			Years ended December 31,		
	2008	2007	Change	2008	2007	Change
Funds flow from operations: Non-GAAP	57,811	51,778	12%	234,534	85,883	173%
Changes in non-cash working capital	61,173	30,719	99%	(25,171)	18,724	-
Cash flow from operating activities: GAAP	118,984	82,497	44%	209,363	104,607	100%

Capital expenditures (Year ended December 31, 2008)	Drilling and Completions	Seismic	Facilities and Infrastructure	Total
Corcel	82,951	5,186	40,750	128,887
Orito	65,002	168	8,365	73,535
Neiva	8,928	45	661	9,634
Exploration	28,256	16,605	11,236	56,997
Total	185,137	22,004	61,012	268,153

Capital expenditures at Corcel included drilling six oil wells, drilling two disposal wells, completing seven wells, acquisition of 100 square kilometres of 3D seismic, central processing facility construction and expansion and related civil works. Orito expenditures included drilling nine oil wells and completing seven wells. Neiva expenditures included drilling four oil wells and completing one well. Exploration activity included drilling five wells resulting in three oil wells (one well at Joropo and two wells at Mapache) and two abandoned wells (one at Castor and Casanare Este). The Company also acquired and interpreted 199 km of 3D seismic data on its heavy oil and Llanos blocks.

Summary of quarterly results

	2008				2007			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Financial (\$000s except where noted)								
Crude oil revenue	70,610	125,065	77,915	69,592	71,325	29,292	14,977	9,167
Funds flow from operations	57,813	78,343	53,225	45,153	51,778	20,201	8,708	5,196
Per share – basic (\$)	0.58	0.78	0.53	0.45	0.52	0.21	0.09	0.05
– diluted (\$)	0.56	0.75	0.51	0.43	0.50	0.20	0.09	0.05
Net income	20,278	57,951	30,687	22,228	23,491	10,242	12,143	1,675
Per share – basic (\$)	0.20	0.58	0.31	0.22	0.23	0.11	0.13	0.02
– diluted (\$)	0.20	0.57	0.30	0.21	0.23	0.10	0.13	0.02
Capital expenditures	46,861	73,080	79,714	68,498	37,216	39,895	38,342	27,569
Operations								
Operating netback (\$/bbl)								
WTI benchmark price	59.08	118.22	123.80	97.82	90.50	75.15	65.02	58.23
Realized oil price, net of transportation	45.57	105.90	114.57	86.19	77.87	69.85	57.79	49.88
Royalties	3.90	11.22	10.83	8.22	7.88	6.07	4.64	3.99
Production expenses	6.45	8.02	10.75	10.82	7.49	7.16	6.15	7.04
Operating netback	35.22	86.66	92.99	67.15	62.50	56.62	47.00	38.85
Average daily crude oil production (bbls/d)	15,344	12,485	7,339	8,635	9,575	4,522	2,848	2,042

Significant factors influencing quarterly results were:

- Production increased significantly in the last half of 2007 due to additions from the Corcel-A1 discovery well in the third quarter of 2007, and the follow up Corcel-A2 well in the fourth quarter of 2007.
- Second quarter 2008 production was impacted by the Corcel-A1 and A2 wells being offline for 24 and 15 days, respectively, for workover operations.
- Third quarter 2008 production increased due to production additions from the Corcel-A4 and C1 wells.
- Fourth quarter 2008 production increased due mainly to new production additions from the Corcel-C3 and D1 wells, offset by a temporary suspension of operations at the Orito field from November 20, 2008 to January 5, 2009 due to a general strike.
- High crude oil prices over the past two years have contributed to higher crude oil revenues, funds flow from operations and net income. In the fourth quarter of 2008, crude oil prices have declined significantly, which has negatively affected crude oil revenues, funds flow from operations and net income.

Commitments

Pursuant to exploration contracts, the Company has work commitments totalling \$48.6 million to be completed in 2009 and 2010. The work commitments are normal course of business exploration activities that include acquisition and processing of seismic data and drilling exploration wells in Colombia (\$39.1 million) and property and seismic acquisition in Peru (\$9.5 million). The Company has secured drilling and completion rigs in support of its exploration and development programs. A minimum commitment totalling \$9.1 million is required to be spent utilizing these rigs by May 2009. These rig commitments will be used to satisfy a portion of the exploration work commitments. Petrominerales plans to fund these costs with existing cash balances, cash flow from operations, and available credit facilities. The Company has \$4.5 million in restricted cash and has issued letters of credit totalling \$7.9 million to guarantee the obligations on these exploration contracts.

The Company has entered into an agreement to construct a crude oil offloading facility at Monterrey, 77 kilometres from the Corcel block, in exchange for preferential rights to deliver up to an initial 20,000 barrels of oil per day to the facility. Over the 15 year term of the agreement Petrominerales' rights to deliver oil will decrease in stages ultimately to 10,000 barrels of oil per day at the earlier of ten years or once 22.9 million barrels of oil have been delivered to the facility. The Company's portion of the construction costs is estimated to be \$17.4 million, of which \$15.3 million remains to be spent.

The following is a summary of the estimated costs required to fulfill the Company's remaining contractual commitments as at December 31, 2008:

Type of obligation	Total	< 1 Year	1-3 Years
Convertible debentures ⁽¹⁾	81,700	–	81,700
Colombia – exploration contracts	39,100	32,500	6,600
Peru – Block 126	9,500	2,100	7,400
Drilling rigs ⁽²⁾	9,100	9,100	–
Monterrey – offloading facility	15,300	15,300	–
Total	154,700	59,000	95,700

⁽¹⁾ The convertible debentures mature on December 6, 2010.

⁽²⁾ These contractual commitments will be used to satisfy work commitments on the Company's exploration contracts.

Liquidity and capital resources

The current economic slowdown and recent volatile financial and commodity markets have impacted the Company's operations and plans for 2009. The Company believes it is well positioned with a strong balance sheet that includes \$48.9 million of cash and working capital and an \$80 million undrawn credit facility, assets that are providing strong production growth, operating netbacks and an inventory of exploration prospects. The current economic environment, while challenging, is opening up opportunities and has resulted in lower costs and more availability of equipment and services. In 2009, the Company will continue to balance future capital spending with existing cash balances, expected future cash flows and judicious use its undrawn debt facility.

At December 31, 2008 the Company had cash and cash equivalents of \$82.2 million and \$4.5 million of restricted cash, offset by \$37.8 of accounts payable and accrued liabilities in excess of accounts receivable, resulting in net working capital of \$48.9 million.

Petrominerales also has a revolving credit facility with an \$80 million borrowing base that is undrawn. The borrowing base is reviewed with the lender semi-annually. The Company is in compliance with the covenants contained in its convertible debenture and credit facility agreements. In its credit facility agreement, the financial covenants are to maintain a ratio of bank debt to trailing twelve month earnings before interest, tax, depletion, depreciation and amortization under 2.0 and to maintain a current ratio greater than 1.0 (current assets divided by current liabilities less unused bank debt). In its convertible debenture agreement, the financial covenants are to maintain a ratio of equity to total assets of at least 30% and to limit the amount of security and encumbrances the Company has on its total assets to 27.5%. The Company also maintains local Colombian operating lines of credit that are primarily used to issue letters of credit to guarantee exploration work commitments. On January 22, 2009 the Colombian operating line of credit was increased to \$18.8 million.

Sources of additional funds include the following:

- The Company could raise funds through the issuance of additional common shares.
- Petrominerales may sell producing or non-producing assets to raise funds in the short term. Incremental cash resources generated as a result would be reduced by any resulting decreases in future cash flows and any required debt payments.
- An alternative financing vehicle is pre-export financing or a pre-sale of a portion of future crude oil production in Colombia. Petrominerales currently sells the majority of its production to the national oil company, Ecopetrol, but can elect to export the crude oil directly. There is no requirement for crude oil revenues to be remitted back to Colombia.
- Borrowing base increases on the Company's secured credit facility or other debt offerings, convertible or otherwise.

During 2008, the Company repurchased and cancelled a total of 1,326,000 common shares at an average cost of \$8.77 (Cdn.\$9.89) per share pursuant to a Normal Course Issuer Bid ("NCIB") approved by the Toronto Stock Exchange ("TSX"). Under the NCIB, the Company can purchase up to 24,977 common shares daily until August 18, 2008 to a maximum of 5,032,719 common shares, except for the period November 3, 2008 to March 30, 2009, where the Company may purchase up to 49,954 common shares daily pursuant to a temporary policy adopted by the TSX. For every share purchased on the open market one share is also purchased from Petrobank, the Company's 76.5% shareholder. Accordingly, Petrobank's ownership interest is increasing as it is participating for less than its prorated ownership interest. Common shares acquired under the NCIB are cancelled.

In October and November 2008, the Company repurchased convertible debentures with a face value of \$18.3 million at 61% of face value for \$11.1 million. At December 31, 2008, the principal balance of the debentures is \$81.7 million, due December 6, 2010. The debentures are convertible into common shares of the Company at a conversion price of \$27.3485 per share and have an annual coupon of 3.375%, payable semi-annually in cash or common shares. If converted, a total of 2,987,367 common shares would be issued, subject to normal provisions for adjustments of the conversion price such as a special distribution to shareholders or upon a change of control of the Company. Petrominerales has an option to force conversion of the debentures at the prevailing conversion price after December 6, 2009, should the price of the Company's common shares exceed 130% of the prevailing conversion price of the debentures for 20 trading days within a period of 30 consecutive trading days. Alternatively, if the share price is below the prevailing conversion price at maturity, the Company will be required to re-finance any remaining principal with new debt, equity and/or accumulated cash flows.

Outstanding share data

The number of Petrominerales shares outstanding at December 31, 2008 of 99,399,431 was unchanged as of the date of this MD&A.

Transactions with related parties

The Company pays Petrobank a monthly fee of Cdn.\$75,000 pursuant to a Management Services Agreement providing for the services of the President and Chief Executive Officer, Vice-President Finance and Chief Financial Officer, as well as other services, including corporate, administration, financial, treasury, accounting, information technology, human resources support and office space for Petrominerales employees located in Calgary, Alberta. The fee is based on a negotiated value for services provided. Costs under this agreement totalled \$0.8 million for the year ended December 31, 2008 (2007 – \$0.8 million) and were recorded as general and administrative expense.

Risks and uncertainties

Petrominerales is exposed to a variety of risks including, but not limited to, competitive, operational, political, environmental and financial risks.

The oil and gas industry is intensely competitive. Competition is particularly intense in the acquisition of prospective oil and gas properties and reserves. Petrominerales' competitive position depends on its geological, geophysical and engineering expertise, its financial resources and its ability to efficiently acquire and develop its reserves. Petrominerales competes with a substantial number of other companies having larger technical staffs and greater financial and operational resources. Many such companies not only engage in the acquisition, exploration, development and production of oil and gas reserves, but also carry on refining operations and market refined products. Petrominerales also competes with state oil and other major and independent oil companies and other industries supplying energy and fuel in the marketing and sale of oil and gas to transporters, distributors and end users, including industrial, commercial and individual consumers. Petrominerales also competes with other oil and gas companies in attempting to secure drilling rigs and other equipment necessary for drilling and completion of wells. Such equipment may be in short supply from time to time. In addition, equipment and other materials necessary to construct production and transmission facilities may be in short supply from time to time. Finally, companies not previously investing in the oil and gas industry may choose to acquire reserves providing additional competition for Petrominerales.

Petrominerales is exposed to a number of operational risks inherent in the industry including accidents, well blowouts, uncontrolled flows, labour strikes and environmental risks. Operational risks are managed using prudent field operating procedures. The Company has a detailed emergency response plan to deal with potential incidents and maintains a comprehensive insurance program to reduce the risk of significant economic loss; however, not all risks can be eliminated. Losses resulting from the occurrence of these risks could have a material adverse impact on the Company's operations.

Petrominerales currently has operations in Colombia and Peru and from time to time may evaluate additional projects internationally. To help mitigate the risks associated with operating in foreign jurisdictions, the Company seeks to operate in regions where the petroleum industry is a key component of the economy. Petrominerales believes that management's experience operating both in Colombia and in other international jurisdictions helps reduce these risks. Some countries in which the Company may operate may be considered politically and economically unstable. In Colombia and Peru, the governments have a long history of democracy and an established legal framework that, in Petrominerales' opinion, minimizes political risks. Colombia and Peru have a publicized history of security problems associated with certain narco-terrorist groups. The Company and its personnel are subject to these risks, but through effective security and social programs, Petrominerales believes these risks can be effectively managed. It is difficult to obtain insurance coverage to protect against terrorist incidents and as a result the Company's insurance program excludes this coverage. Consequently, incidents like this in the future could have a material adverse impact on the Company's operations.

The Company is subject to extensive governmental and environmental approvals and regulations in its operating jurisdictions. Delays in obtaining regulatory approvals could result in project delays and our inability to meet contractual obligations. Changes to these regulations could increase the costs of conducting business in these jurisdictions. Environmental risks inherent in the oil and gas industry are subject to increasingly stringent legislation and regulation. The Company operates in accordance with all relevant environmental legislation and strives to minimize the environmental impact of its operations by providing for safety and environmental issues in all of its business plans.

The Company is exposed to normal financial risks inherent within the oil and gas industry, including commodity price risk, exchange rate risk, interest rate risk and credit risk. Management believes it is neither appropriate nor possible to eliminate 100 percent of the Company's exposure to these risks. As described in Note 13 to the Company's 2008 consolidated financial statements, the Company monitors market conditions, and may periodically utilize derivative instruments to mitigate these risks.

Crude oil prices are the Company's most significant financial risk. Crude oil prices are influenced by global supply and demand, OPEC policy and worldwide political events. Fluctuations in crude oil prices not only affect the Company's cash flows, but may also result in changes to the borrowing capacity under the Company's credit facilities. Management believes it is neither appropriate nor possible to eliminate 100 percent of the Company's exposure to fluctuations in crude oil prices. The Company monitors market conditions and may selectively utilize derivative instruments to reduce exposure to crude oil price movements.

Portions of the Company's expenditures are denominated in Colombian pesos and Canadian dollars. To the extent revenues and expenditures denominated in or strongly linked to the United States dollar are not equivalent, the Company is exposed to exchange rate risk. The Company is not currently using exchange rate derivatives to manage exchange rate risks.

Petrominerales is exposed to fluctuations in short-term interest rates on amounts drawn under its secured credit facilities and its Colombian peso-based bank facility, as well as any additional future floating rate debt. The Company has not hedged these rates as the facility is currently undrawn and to remain flexible in borrowing and repaying outstanding balances, if any.

Credit markets throughout the world have tightened recently which could limit the Company's ability to access incremental debt. The Company has positive cash flows from operations, working capital of \$48.9 million and an undrawn \$80 million credit facility.

Sensitivities

The Company's earnings and cash flow are sensitive to changes in the price of crude oil. The following factors demonstrate the expected impact on annualized before tax cash flow:

Change of:		(millions)
Crude oil	\$1.00/bbl WTI reference price (assuming 20,000 bopd)	\$ 6.3
	500 bopd of production @ \$50/bbl WTI	\$ 5.6

Critical accounting policies and estimates

The Company's financial statements are prepared in accordance with Canadian GAAP, which require management to make judgements, estimates and assumptions, which may have a significant impact on the financial statements. A summary of the Company's significant accounting policies can be found in Note 2 to the Company's 2008 consolidated financial statements. The following is a discussion of those accounting policies and estimates that are considered critical in the determination of the Company's financial results.

Capital assets – full cost accounting

The Company follows the full cost method of accounting and alternatively, could follow the successful efforts method of accounting whereby all costs related to non-productive wells are expensed in the period in which they are incurred.

Under the full cost method of accounting, capitalized costs are subject to a country-by-country cost centre impairment test. Under the successful efforts method of accounting, the costs are aggregated on a property-by-property basis and the carrying value of each property is subject to an impairment test. These policies may result in a different carrying value for capital assets and a different net income. The full cost method is the method most commonly followed by Petrominerales' peer group of companies.

Under full cost accounting, a limit is placed on the carrying value of the net capitalized costs in each cost centre in order to test impairment. Impairment exists when the carrying value of developed properties of a cost centre exceeds the estimated undiscounted future net cash flows associated with the cost centre's proved reserves. Costs relating to undeveloped properties are subject to individual impairment assessments until it can be determined whether or not proved reserves exist. If impairment is determined to exist, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the cost centre's proved plus probable reserves are charged to income.

Reserve estimates

Reserve estimates can have a significant impact on net income and the carrying value of capital assets. The process of estimating reserves requires significant judgement based on available geological, geophysical, engineering, and economic data, projected rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to interpretation and uncertainty. Reserve estimates impact net income through depletion expense and the application of impairment tests. Revisions or changes in reserve estimates can have either a positive or a negative impact on net income and can impact the carrying amount of capital assets.

Creditors also use reserve estimates to assess the allowable borrowing base under secured credit facilities. Changes to the reserve estimates can result in borrowing base increases or decreases, which could impact the Company's financial position.

Future income taxes

The Company recognizes a future income tax liability based on estimates of temporary differences between the book and tax value of its assets. An estimate is also used for both the timing and tax rate upon reversal of the temporary differences. Actual differences and the timing of reversals may differ from estimates, impacting the future income tax balance and net income.

Changes in accounting policies

Capital disclosures

Effective January 1, 2008, the Company prospectively adopted the Canadian Institute of Chartered Accountants (“CICA”) Section 1535, “Capital Disclosures” which establishes standards for disclosing information about the Company’s capital and how it is managed. It requires disclosures of the Company’s objectives, policies and processes for managing capital, the quantitative data about what the Company regards as capital, whether the Company has complied with any capital requirements and if it has not complied, the consequences of such non-compliance. The only effect of adopting this standard are disclosures on the Company’s capital and how it is managed and are included Note 12 to the consolidated financial statements.

Financial instruments disclosures and presentation

Effective January 1, 2008, the Company prospectively adopted Section 3862, “Financial Instruments Disclosures” and Section 3863, “Financial Instruments Presentations.” These new accounting standards replaced Section 3861, “Financial Instruments – Disclosure and Presentation.” Section 3862 requires additional information regarding the significance of financial instruments for the entity’s financial position and performance, and the nature, extent and management of risks arising from financial instruments to which the entity is exposed. The additional disclosures required under these standards are included in Note 13 to the consolidated financial statements.

Recent accounting pronouncements

In February 2008, the CICA issued Section 3064, “Goodwill and Intangible Assets,” replacing Section 3062, “Goodwill and Other Intangible Assets” and Section 3450, “Research and Development Costs.” Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. The Company adopted these standards for its fiscal year beginning January 1, 2009 with no impact on its consolidated financial statements.

In January 2009, the CICA issued Section 1582, “Business Combinations”, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company plans to adopt this standard prospectively effective January 1, 2009 and does not expect the adoption of this statement to have a material impact on our results of operations or financial position.

In January 2009, the CICA issued Sections 1601, “Consolidated Financial Statements”, and 1602, “Non-controlling Interests”, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company plans to adopt these standards effective January 1, 2009 and does not expect the adoption will have a material impact on the results of operations or financial position.

International financial reporting standards

In February 2008, the AcSB confirmed the convergence of Canadian GAAP with International Financial Reporting Standards (“IFRS”) will be required for interim and annual financial statements effective for fiscal years beginning on or after January 1, 2011, including comparatives for 2010.

The International Accounting Standards Board (“IASB”) has also issued an exposure draft relating to certain amendments and exemptions to IFRS 1, *First-time Adoption of International Financial Reporting Standards*. It is anticipated that this exposure draft will not result in an amended IFRS 1 standard until late 2009. The amendment, if implemented, will permit the Company to apply IFRS prospectively by utilizing its current reserves at the transition date to allocate the Company’s full cost pool, with the provision that a ceiling test, under IFRS standards, be conducted at the transition date.

Although the amended IFRS 1 standard would provide relief, the changeover to IFRS represents a significant change in accounting standards and the transition from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Company’s reported financial position and reported results of operations.

In response, the Company has completed its high-level IFRS impact study and established a preliminary timeline for the execution and completion of the conversion project. The impact study included a preliminary assessment of the differences between Canadian GAAP and IFRS and the potential effects of IFRS to accounting and reporting processes, information systems, business processes and external disclosures. This assessment has provided insight into what are anticipated to be the most significant areas of difference applicable to the Company.

During the next phase of the project, scheduled to take place during 2009, the Company will perform an in-depth review of the significant areas of difference, identified during the preliminary assessment, in order to identify all specific Canadian GAAP and IFRS differences and select ongoing IFRS policies. Key areas addressed will also be reviewed to determine any information technology issues, the impact on internal controls over financial reporting and the impact on business activities including the effect, if any, on covenants. Where required, external advisors will be retained and assist management with the project on an as needed basis. Staff training programs will commence in 2009 and be ongoing as the project unfolds.

The Company will also continue to monitor standards development as issued by the IASB and the AcSB as well as regulatory developments as issued by the Canadian Securities Administrators (CSA), which may affect the timing, nature or disclosure of its adoption of IFRS.

Regulatory policies

Certification of disclosures in annual filings

In accordance with Multilateral Instrument 52-109 of the Canadian Securities Administrators, the Company annually issues a "Certification of Annual 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 Petrominerales is made known to the certifying officers by others; (ii) information required to be disclosed by Petrominerales 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 certifying officers have evaluated, or caused to be evaluated under their supervision, the effectiveness of the Company's DC&P and ICFR and, based on such evaluation, concluded that the Company maintained effective DC&P and ICFR as of December 31, 2008.

During the year ended December 31, 2008, there has been no change in the Company's ICFR that has materially affected, or is reasonably likely to materially affect, the Company's ICFR. The Company has continually had in place systems relating to DC&P and ICFR and will continue to monitor such procedures as the Company's business evolves.

Outlook

In addition to the plans discussed in this MD&A, please see the Company's 2008 Annual Report.

Management's Report

Management is responsible for the integrity and objectivity of the information contained in this report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in this report. The accompanying consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Company's financial position, results of operations and changes in financial position, within Canadian generally accepted accounting principles. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The Company's external auditors, Deloitte & Touche LLP, have examined the consolidated financial statements. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported financial results and the financial condition of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.



John D. Wright
President & Chief Executive Officer

Calgary, Canada
February 27, 2009



Corey C. Ruttan
Vice-President Finance & Chief Financial Officer



COREY RUTTAN
VICE-PRESIDENT FINANCE
AND CHIEF FINANCIAL OFFICER

Auditors' Report

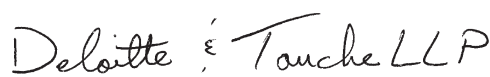
TO THE SHAREHOLDERS OF PETROMINERALES LTD.:

We have audited the consolidated balance sheets of Petrominerales Ltd. (the "Company") as at December 31, 2008 and 2007 and the consolidated statements of operations and retained earnings, comprehensive income and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Petrominerales Ltd. as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
February 27, 2009


Chartered Accountants

Consolidated Balance Sheets

(Thousands of United States dollars)

As at December 31,	2008	2007
Assets		
Current assets		
Cash and cash equivalents	\$ 82,174	\$ 171,096
Restricted cash (Note 7)	4,481	–
Accounts receivable	24,968	7,011
	111,623	178,107
Other assets (Note 4)	2,657	–
Capital assets (Note 5)	451,425	262,276
Future income tax assets (Note 10)	–	1,079
Total assets	\$ 565,705	\$ 441,462
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 62,724	\$ 62,107
Risk management liability (Note 13)	–	5,797
	62,724	67,904
Bank debt (Note 7)	–	9,309
Future income tax liabilities (Note 10)	21,885	–
Convertible debentures (Note 8)	72,403	83,700
Asset retirement obligations (Note 9)	5,412	1,482
	162,424	162,395
Shareholders' equity		
Convertible debentures (Note 8)	10,407	12,738
Common shares (Note 6)	194,859	195,214
Contributed surplus (Note 6)	4,191	1,698
Accumulated other comprehensive income (Note 6)	16,024	16,024
Retained earnings	177,800	53,393
	403,281	279,067
Total liabilities and shareholders' equity	\$ 565,705	\$ 441,462

Commitments and contingencies (Note 15)

See accompanying notes to these consolidated financial statements.

Signed on behalf of the Board:



Jerald L. Oaks
Chairman



Kenneth R. McKinnon
Director

Consolidated Statements of Operations and Retained Earnings

(Thousands of United States dollars, except per share amounts)

Years ended December 31,	2008	2007
Revenues		
Oil	\$ 343,182	\$ 124,761
Royalties	(32,201)	(11,402)
Loss on risk management contracts (Note 13)	(2,772)	(5,797)
Interest income	2,379	656
	310,588	108,218
Expenses		
Production	33,995	12,463
Transportation	12,962	2,959
General and administrative	10,076	6,443
Stock-based compensation (Note 6)	2,631	1,381
Interest (Note 8)	10,711	2,826
Foreign exchange loss	956	446
Gain on repurchase of convertible debentures (Note 8)	(4,946)	–
Depletion, depreciation and accretion	83,302	31,695
	149,687	58,213
Income before taxes	160,901	50,005
Tax expense (Note 10)	29,757	2,454
Net income	131,144	47,551
Retained earnings, beginning of year	53,393	5,842
Repurchase of common shares (Note 6)	(9,037)	–
Repurchase of convertible debentures (Note 8)	2,300	–
Retained earnings, end of year	\$ 177,800	\$ 53,393
Basic earnings per share (Note 6)	\$ 1.31	\$ 0.49
Diluted earnings per share (Note 6)	\$ 1.28	\$ 0.49

See accompanying notes to these consolidated financial statements.

Consolidated Statements of Comprehensive Income

(Thousands of United States dollars)

Years ended December 31,	2008	2007
Net income	\$ 131,144	\$ 47,551
Other comprehensive income	–	–
Comprehensive income	\$ 131,144	\$ 47,551

See accompanying notes to these consolidated financial statements.

Consolidated Statements of Cash Flow

(Thousands of United States dollars)

Years ended December 31,	2008	2007
Operating activities		
Net income	\$ 131,144	\$ 47,551
Depletion, depreciation and accretion	83,302	31,695
Amortization of deferred financing costs	475	218
Gain on repurchase of convertible debentures	(4,946)	–
Stock-based compensation	2,631	1,381
Unrealized (gain) loss on risk management contracts	(5,797)	5,797
Accretion on convertible debentures	4,761	320
Future income taxes (recovery)	22,964	(1,079)
	234,534	85,883
Changes in non-cash working capital (Note 14)	(25,171)	18,724
	209,363	104,607
Financing activities		
Issuance of convertible debentures (repurchase) – net of costs	(11,143)	96,118
Issuance of common shares – net of costs	1,715	56,094
Issuance (repayment) of bank debt	(10,000)	10,000
Financing costs	(300)	(909)
Repurchase of common shares (Note 6)	(11,636)	–
	(31,364)	161,303
Investing activities		
Expenditures on capital assets	(267,763)	(143,022)
Expenditures on other assets	(2,141)	–
Changes in restricted cash	(4,481)	–
Changes in non-cash working capital (Note 14)	7,464	19,574
	(266,921)	(123,448)
Net change in cash and cash equivalents	(88,922)	142,462
Cash and cash equivalents, beginning of year	171,096	28,634
Cash and cash equivalents, end of year	\$ 82,174	\$ 171,096
Cash and cash equivalents consist of:		
Cash	\$ 4,873	\$ 955
Cash equivalents	\$ 77,301	\$ 170,141
Other cash flow information:		
Cash taxes paid	\$ 3,964	\$ 3,361
Cash interest paid	\$ 5,155	\$ 1,867
Cash interest received	\$ 2,193	\$ 250

See accompanying notes to these consolidated financial statements.

Notes to the Consolidated Financial Statements

As at and for the years ended December 31, 2008 and 2007

(All tabular amounts are expressed in thousands of United States dollars, except share amounts or as otherwise noted)

NOTE 1 – FORMATION OF THE COMPANY AND BASIS OF PRESENTATION

Petrominerales Ltd. (“Petrominerales” or the “Company”), is a public company listed on the Toronto Stock Exchange and was incorporated in the Bahamas on April 20, 2006. Petrominerales is involved in the exploration, development and production of crude oil in Colombia and Peru. As at December 31, 2008, Petrominerales is owned 76.5 percent by Petrobank Energy and Resources Ltd. (“Petrobank”).

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“GAAP”) as described in Note 2.

NOTE 2 – SIGNIFICANT ACCOUNTING POLICIES

Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries as at and for the years ended December 31, 2008 and 2007. Inter-company transactions and balances are eliminated upon consolidation.

Measurement uncertainty

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the balance sheets as well as the reported amounts of revenues, expenses, and cash flows during the periods presented. Such estimates relate primarily to unsettled transactions and events as of the date of the financial statements. Actual results could differ materially from estimated amounts.

Amounts recorded for depletion, depreciation and accretion costs and amounts used for ceiling test calculations are based on estimates of crude oil reserves and future costs required to develop those reserves. Stock-based compensation is based upon expected volatility and option life estimates. Asset retirement obligations are based on estimates of abandonment costs, timing of abandonment, inflation and interest rates. The provision for income taxes is based on judgements in applying income tax law and estimates on the timing, likelihood and reversal of temporary differences between the accounting and tax bases of assets and liabilities. These estimates are subject to measurement uncertainty and changes in these estimates could materially impact the financial statements of future periods.

Capital assets

All costs related to the acquisition of crude oil properties are capitalized. Such costs include land and lease acquisition costs, annual charges on non-producing properties, geological and geophysical costs, and costs of drilling and equipping productive and non-productive wells.

Gains and losses are not recognized upon disposition of crude oil properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of more than 20 percent.

Capitalized costs are accumulated in cost centres on a country-by-country basis and are depleted and depreciated using the unit-of-production method based upon estimated proved reserves before royalties as determined by independent engineers. The Company has two cost centres, Colombia and Peru. Included in costs subject to depletion are estimated costs to develop proved reserves. Costs relating to undeveloped properties are excluded from the depletion base until it is determined whether or not proved reserves exist or if impairment of such costs has occurred. These properties are assessed at least annually to determine whether impairment has occurred.

Depreciation of corporate and other fixed assets is calculated using the straight-line method over the estimated life of the asset.

A limit is placed on the carrying value of the net capitalized costs in each cost centre in order to test impairment. The Company is required to perform this impairment test at least annually. An impairment loss may be indicated when the carrying value of a cost centre exceeds the estimated undiscounted future net cash flows associated with the cost centre's proved reserves. If there is indication of an impairment loss, the costs carried on the balance sheet in excess of the discounted future net cash flows associated with the cost centre's proved plus probable reserves are charged to depletion, depreciation and accretion on the statement of operations. Reserves are determined pursuant to the Canadian Securities Administrators' National Instrument 51-101 “Standards of Disclosure for Oil and Gas Activities”.

The Company does not capitalize indirect general and administrative overhead or interest.

Asset retirement obligations

The Company recognizes the estimated fair value of future retirement obligations associated with capital assets as a liability in the period in which they are incurred, normally when the asset is purchased or developed. The fair value is capitalized and amortized over the same period as the underlying asset. The Company estimates the liability based on the estimated costs to abandon and reclaim the wells and well sites that are either expected to be inactive upon expiration of the Incremental Production Contract's (“IPC's”) on June 6, 2023, or are required to be abandoned under the terms of the exploration contracts. Only wells and well sites that the Company has constructed, drilled, completed workovers on, or performed enhancements to, are included in the estimate. This estimate is evaluated on a periodic basis and any adjustment to the estimate is applied prospectively. The change in net present value of the future retirement obligation due to the passage of time is expensed as accretion. Actual retirement obligations settled during the period reduce the asset retirement liability.

Joint operations

The majority of the Company's crude oil operations are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

Revenue recognition

Revenues from the sale of crude oil are recognized when title passes to the customer.

Foreign currency translation

The United States dollar is the functional currency of the Company and its subsidiaries. Monetary assets and liabilities denominated in a currency other than the functional currency are translated at the exchange rate in effect at the balance sheet date. Non-monetary assets, liabilities, revenues and expenses are translated at transaction date exchange rates. Exchange gains or losses are included in the determination of net income as foreign exchange loss.

Earnings per share

The Company computes basic earnings per share using net income divided by the weighted-average number of common shares outstanding. The Company computes diluted earnings per share using net income adjusted for interest expense on the convertible debentures, if dilutive, divided by the weighted-average number of diluted common shares outstanding. The Company uses the treasury stock method in computing the weighted-average number of diluted common shares outstanding. This method assumes that the proceeds on exercise of in-the-money stock options and deferred common shares are used to repurchase the Company's common shares at the average market price during the relevant period. The number of diluted common shares outstanding also reflects the potential dilution that would occur if the convertible debentures were converted into common shares at the beginning of the period, or when they were issued.

Stock-based compensation

The Company accounts for stock-based compensation using the fair-value method of accounting for stock options and deferred common shares (collectively referred to as "Rights") granted to directors, officers, employees and consultants using the Black-Scholes option-pricing model. Stock-based compensation expense is recorded and reflected as stock-based compensation expense over the vesting period with a corresponding amount reflected in contributed surplus. Stock-based compensation expense is calculated as the estimated fair value for the related Rights at the time of grant, amortized over their vesting period. When Rights are exercised, the associated amounts previously recorded as contributed surplus are reclassified to common share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest, rather, the Company accounts for actual forfeitures as they occur.

Income taxes

The Company accounts for income taxes using the liability method. Under this method, the Company records a future income tax asset or liability to reflect any difference between the accounting and tax bases of assets and liabilities, using substantively enacted income tax rates. The effect on future tax assets and liabilities of a change in tax rates is recognized in net income in the period in which the change occurs. Future income tax assets are only recognized to the extent it is more likely than not that sufficient future taxable income will be available to allow the future income tax asset to be realized.

Convertible debentures

The Company presents outstanding convertible debentures in their debt and equity component parts on the consolidated balance sheet. The debt component represents the total discounted present value of the semi-annual interest obligations to be satisfied by cash and the principal payment due at maturity, using the rate of interest that would have been applicable to a non-convertible debt instrument of comparable term and risk at the date of issue. This results in an accounting value assigned to the debt component of the convertible debentures which is less than the principal amount due at maturity. The debt component presented on the balance sheet increases over the term of the debenture to the full face value of the outstanding debentures at maturity. The difference, accretion on convertible debentures, is reflected as increased interest expense with the result that adjusted interest expense reflects the effective yield of the debt component of the convertible debentures.

The equity component of the convertible debentures is presented under shareholders' equity in the consolidated balance sheet. The equity component represents the fair value of the conversion right granted to the holder, which remains a fixed amount over the term of the related debentures. Upon conversion of the debentures into common shares by the holders, the debt and equity components would be transferred to common share capital.

Cash and cash equivalents

Cash and cash equivalents include investments and deposits with a maturity of three months or less when purchased.

Financial instruments

Financial instruments are measured at fair value on initial recognition of the instrument, into one of the following five categories: held-for-trading, loans and receivables, held-to-maturity investments, available-for-sale financial assets or other financial liabilities.

Subsequent measurement of financial instruments is based on their initial classification. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. The remaining categories of financial instruments are recognized at amortized cost using the effective interest rate method.

All risk management contracts are recorded in the balance sheet at fair value unless they qualify for the normal sale and normal purchase exemption. All changes in their fair value are recorded in net income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income until the underlying hedged transaction is recognized in net income. Any hedge ineffectiveness is immediately recognized in net income. The Company has elected not to use cash flow hedge accounting on its risk management contracts with financial counterparties resulting in all changes in fair value being recorded in net income.

Cash and cash equivalents and restricted cash are classified as held-for-trading and are measured at fair value which equals the carrying value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and bank debt are classified as other financial liabilities, which are measured at amortized cost.

The convertible debentures are classified as other financial liabilities. Upon issuance, the convertible debentures were classified into equity and financial liability components on the balance sheet at their fair value. The financial liability, net of issuance costs, is accreted, which is included within interest expense over the maturity of the debentures using the effective interest rate method.

For financial assets and financial liabilities that are not classified as held-for-trading, the transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability are adjusted to the fair value initially recognized for that financial instrument. These costs are expensed using the effective interest rate method and are recorded within interest expense.

Risk management contracts

The Company is exposed to market risks resulting from fluctuations in crude oil prices, foreign currency exchange rates and interest rates in the normal course of its business. The Company may use a variety of instruments to manage these exposures. For transactions where hedge accounting is not applied, the Company accounts for such instruments using the fair value method by initially recording an asset or liability, and recognizing changes in the fair value of the instruments in income as gains or losses on risk management contracts. Fair values of financial instruments are determined from third party quotes or valuations provided by independent third parties. Any realized gains or losses on risk management contracts are recognized in income in the period they occur.

The Company may elect to use hedge accounting when there is a high degree of correlation between the price movements in the financial instruments and the items designated as being hedged and has documented the relationship between the instruments and the hedged item as well as its risk management objective and strategy for undertaking hedge transactions. During the years ended December 31, 2008 and 2007, the Company did not designate any of its financial instruments as hedges. There are no risk management contracts outstanding as at December 31, 2008.

NOTE 3 – CHANGES IN ACCOUNTING POLICIES

Capital disclosures

Effective January 1, 2008, the Company prospectively adopted the Canadian Institute of Chartered Accountants (“CICA”) Section 1535, “Capital Disclosures” which establishes standards for disclosing information about the Company’s capital and how it is managed. It requires disclosures of the Company’s objectives, policies and processes for managing capital, the quantitative data about what the Company regards as capital, whether the Company has complied with any capital requirements and if it has not complied, the consequences of such non-compliance. The only effect of adopting this standard are disclosures on the Company’s capital and how it is managed and are included Note 12.

Financial instruments disclosures and presentation

Effective January 1, 2008, the Company prospectively adopted Section 3862, “Financial Instruments Disclosures” and Section 3863, “Financial Instruments Presentations.” These new accounting standards replaced Section 3861, “Financial Instruments – Disclosure and Presentation.” Section 3862 requires additional information regarding the significance of financial instruments for the entity’s financial position and performance, and the nature, extent and management of risks arising from financial instruments to which the entity is exposed. The additional disclosures required under these standards are included in Note 13.

Recent accounting pronouncements

In February 2008, the CICA issued Section 3064, “Goodwill and Intangible Assets,” replacing Section 3062, “Goodwill and Other Intangible Assets” and Section 3450, “Research and Development Costs.” Various changes have been made to other sections of the CICA Handbook for consistency purposes. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. The Company adopted these standards for its fiscal year beginning January 1, 2009 with no impact on its consolidated financial statements.

In January 2009, the CICA issued Section 1582, “Business Combinations”, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company plans to adopt this standard prospectively effective January 1, 2009 and does not expect the adoption of this statement to have a material impact on our results of operations or financial position.

In January 2009, the CICA issued Sections 1601, “Consolidated Financial Statements”, and 1602, “Non-controlling Interests”, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. The Company plans to adopt these standards effective January 1, 2009 and does not expect the adoption will have a material impact on the results of operations or financial position.

The Accounting Standards Board has confirmed the convergence of Canadian GAAP with International Financial Reporting Standards (“IFRS”) will be effective January 1, 2011. The Company has performed an initial scoping process in order to ensure successful implementation within the required timeframe. The impact on the Company’s consolidated financial statements is not reasonably determinable at this time. Key information will be disclosed as it becomes available during the transition period.

NOTE 4 – OTHER ASSETS

	Prepaid Pipeline Tariffs	Deferred Financing Charges	Total Other Assets
Balance at December 31, 2006 and 2007	\$ –	\$ –	\$ –
Reclassification from Bank Debt	–	691	691
Additions	2,141	300	2,441
Less: amortization	–	(475)	(475)
Balance at December 31, 2008	\$ 2,141	\$ 516	\$ 2,657

The Company has entered into an agreement to construct a crude oil offloading facility adjacent to the Corcel block in exchange for preferential rights to deliver up to an initial 20,000 barrels of oil per day to the facility. The term of the agreement is 15 years, over which Petrominerales’ rights to deliver oil will decrease in stages, ultimately to 10,000 barrels of oil per day, at the earlier of ten years from commencement of facility operations or once 22.9 million barrels of oil have been delivered to the facility. The Company’s portion of the construction costs is estimated to be \$17.4 million. Once the facility is complete, the costs will be amortized using the unit of production method based on the barrels of oil delivered to the facility.

NOTE 5 – CAPITAL ASSETS

December 31, 2008	Cost	Accumulated Depletion and Depreciation	Net Book Value
Crude oil assets	\$ 609,781	\$ 161,523	\$ 448,258
Corporate and other	5,510	2,343	3,167
	\$ 615,291	\$ 163,866	\$ 451,425

December 31, 2007	Cost	Accumulated Depletion and Depreciation	Net Book Value
Crude oil assets	\$ 340,818	\$ 79,402	\$ 261,416
Corporate and other	2,539	1,679	860
	\$ 343,357	\$ 81,081	\$ 262,276

At December 31, 2008, crude oil assets included \$72.1 million (2007 – \$44.3 million) relating to unproved properties that have been excluded from the depletion calculation. Substantially all of the unproved properties are in Colombia except for \$1.5 million in Peru (2007 – \$nil). The Peruvian unproved properties represent the Company’s entire investment in Peru at December 31, 2008.

An impairment test calculation was performed for the Colombian cost centre at December 31, 2008 in which the estimated undiscounted future net cash flows associated with the proved reserves exceeded the carrying amounts. In determining the undiscounted future net cash flow the Company utilized the following benchmark prices:

Year	WTI Crude Oil ⁽¹⁾ – \$/bbl
2009	57.00
2010	69.53
2011	76.38
2012	86.99
2013	94.74
Thereafter inflation % change	2.5%

⁽¹⁾ Actual prices used in the impairment tests were adjusted for crude oil quality differentials, transportation and marketing costs specific to the Company’s operations.

NOTE 6 – SHARE CAPITAL

Authorized

The Company has authorized capital of 200,000,000 common shares, with a par value of \$1.00 per common share.

Common shares

Common share continuity	Number	Amount
Balance at December 31, 2006	95,000,000	\$ 138,906
Issued ⁽¹⁾	5,060,000	58,137
Share issue costs	–	(2,903)
Exercise of stock options	228,775	860
Transfer from contributed surplus related to stock options exercised	–	214
Balance at December 31, 2007	100,288,775	\$ 195,214
Repurchased and cancelled common shares	(1,326,000)	(2,599)
Exercise of stock options	423,031	1,714
Exercise of deferred common shares	13,625	1
Transfer from contributed surplus related to stock options and deferred common shares exercised	–	529
Balance at December 31, 2008	99,399,431	\$ 194,859

⁽¹⁾ In September 2007, the Company issued 5,060,000 common shares at a price of Cdn.\$12.05 per common share for gross proceeds of Cdn.\$61.0 million (\$58.1 million).

Normal course issuer bid

Pursuant to the Company's Normal Course Issuer Bid ("NCIB"), as approved by the Toronto Stock Exchange ("TSX") on August 14, 2008, the Company is authorized to purchase up to 5,032,718 common shares, representing approximately five percent of the issued and outstanding common shares. The Company is authorized to make purchases to August 17, 2009, or until the NCIB is completed or terminated by the Company. On any trading day, the Company will not purchase more than 24,977 common shares on the open market except for the period November 3, 2008 to March 30, 2009, where the Company may purchase up to 49,954 common shares pursuant to a temporary exemption granted by the TSX. For every share purchased on the open market one share is also purchased from Petrobank, the Company's 76.5 percent shareholder, accordingly, Petrobank's ownership interest is increasing as a result of the NCIB as it is participating for less than its prorated ownership interest. Common shares acquired under the NCIB are cancelled.

During the year ended December 31, 2008, the Company repurchased 1,326,000 common shares under the NCIB at an average cost of \$8.77 (Cdn.\$9.89) per share. Of the amount paid, \$2.6 million reduced the book value of the common shares and the remaining \$9.0 million has been recorded as a reduction to retained earnings.

Contributed surplus

Changes in contributed surplus	Amount
Balance at December 31, 2006	\$ 531
Stock-based compensation	1,381
Transfer to common shares related to stock options exercised	(214)
Balance at December 31, 2007	\$ 1,698
Stock-based compensation	2,631
Stock-based costs related to property acquisition	391
Transfer to common shares related to stock options exercised	(529)
Balance at December 31, 2008	\$ 4,191

Accumulated other comprehensive income

There has been no change to accumulated other comprehensive income as at and for the years ended December 31, 2007 and 2008.

Stock options

The Company has established a stock option plan for directors, officers, employees and consultants. The plan allows for the issuance of up to 10 percent of the outstanding shares of the Company, less shares reserved under other Company stock-based compensation plans such as the deferred common share compensation plan. The exercise price is no less than the market price of the Company's stock on the date of the grant. Stock option terms are determined by the Company's Board of Directors but typically, options vest evenly over a period of four years from the date of grant and expire between five and 10 years after the date of grant.

The following is a continuity of stock options outstanding:

	2008		2007	
	Stock Options	Weighted-Average Exercise Price (Cdn.\$)	Stock Options	Weighted-Average Exercise Price (Cdn.\$)
Opening	4,870,784	4.99	3,051,126	3.78
Granted	2,640,470	13.19	2,307,183	6.33
Exercised	(423,031)	4.14	(228,775)	3.78
Forfeited	(895,500)	10.82	(258,750)	3.79
Closing	6,192,723	6.11	4,870,784	4.99

In December 2008, the Company modified the terms of certain non-executive stock options that resulted in the exercise price on 1,382,961 options being reduced from a weighted average of Cdn.\$14.58 to Cdn.\$7.48 and the forfeiture of 460,975 options with a weighted average exercise price of Cdn.\$14.58. The incremental fair value attributed to the modification will be recorded as stock-based compensation over the vesting period of the modified options.

The following summarizes information about stock options outstanding as at December 31, 2008:

Range of Exercise Prices (Cdn.\$)	Stock Options Outstanding			Stock Options Exercisable	
	Number	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price (Cdn.\$)	Number	Weighted-Average Exercise Price (Cdn.\$)
3.11 – 3.99	1,984,376	4.6	3.74	847,500	3.75
4.00 – 4.99	1,657,375	6.1	4.41	301,250	4.40
5.00 – 7.64	1,676,522	5.2	7.40	28,812	7.46
7.65 – 12.43	628,700	5.6	10.42	74,050	8.27
12.44 – 19.56	245,750	8.1	17.02	14,125	18.56
	6,192,723	5.4	6.11	1,265,737	4.42

Deferred common share compensation plan

At December 31, 2008, there were 39,263 (2007 – 37,500) deferred common shares outstanding under the Company's deferred share compensation plan whereby the Company may grant deferred common shares to its directors, officers and employees. The plan allows holders to receive one common share upon payment of \$0.05 per share. The deferred common shares vest after three years or upon the recipient leaving the Company, and expire 10 years from the date of grant. Up to 0.5 million deferred common shares have been approved for issuance under this plan.

Deferred common share continuity

	Number
Balance at December 31, 2006 and 2007	37,500
Granted	15,388
Exercised	(13,625)
Balance at December 31, 2008	39,263

Stock-based compensation

The fair value of stock options and deferred common shares granted have been estimated on their respective grant dates using the Black-Scholes option-pricing model using the following assumptions:

Years ended December 31,	2008	2007
Risk free interest rate	1.5% – 3.25%	4.0% – 4.5%
Dividend rate	0%	0%
Expected life – options (years)	3.3 – 4.0	3.3
Expected life – deferred common shares (years)	8	8
Expected volatility	37.5% – 42.5%	30% – 37.5%

The average fair value per stock option granted during the year was \$3.34 (2007 – \$1.74) as at the date of grant. The average fair value per deferred common share granted during the year was \$16.53 (2007 – \$3.58) as at the date of grant.

Stock-based compensation expense for the year ended December 31, 2008 totalled \$2.6 million (2007 – \$1.4 million).

Earnings per share

The following tables summarize the weighted average number of common shares used in calculating basic and diluted earnings per share. No adjustments were required to net income.

Years ended December 31,	2008	2007
Weighted average common share adjustments		
Weighted average common shares outstanding, basic	100,253,508	96,561,235
Effect of stock options and deferred common shares	1,831,073	1,506,140
Weighted average common shares outstanding, diluted	102,084,581	98,067,375

The convertible debentures were not included in the diluted number of weighted average common shares outstanding as they were anti-dilutive.

NOTE 7 – BANK DEBT AND RESTRICTED CASH

At December 31, 2008, the Company had no bank debt outstanding under its secured credit facility. The borrowing base under this facility is \$80.0 million, secured against all assets of the Company and is reviewed with the lender semi-annually.

The Company has a \$13.9 million operating line of credit under which the Company can borrow at the fixed term deposit rate set by the Central Bank of Colombia plus six percent. Advances under the facility are collateralized by a promissory note provided by the Company. The Company has used \$7.9 million of its Colombian operating line of credit for letters of credit to guarantee work commitments under exploration blocks. On January 22, 2009, the operating line of credit was increased to \$18.8 million.

As at December 31, 2008, the Company had restricted cash of \$4.5 million (2007 – \$nil), consisting of cash deposited to guarantee work commitments under exploration contracts expected to be completed in 2009.

NOTE 8 – CONVERTIBLE DEBENTURES

On December 6, 2007, the Company issued \$100 million of convertible debentures due December 6, 2010. The debentures are convertible into common shares of the Company at a conversion price of \$27.3485 per share, which represented a 38 percent premium to the share price when initially priced, and have an annual coupon of 3.375 percent. Interest on the debentures is payable semi-annually in cash or common shares.

The debentures have been classified into their debt and equity components based on fair values. On issuance, this resulted in \$83.4 million being classified as a liability and \$12.7 million being classified as equity. The liability portion will accrete up to the principal balance over the term of the debentures. The accretion, and the interest accrued are expensed as interest expense in the consolidated statement of operations, creating an effective yield of 9.7 percent.

In October and November 2008, the Company repurchased debentures with a face value of \$18.3 million for \$11.1 million. As a result, the Company recorded a gain settling the liability portion of \$4.9 million and an increase to retained earnings on the equity portion of \$2.3 million.

As at December 31, 2008, the principal balance of the debentures is \$81.7 million. Upon conversion, a total of 2,987,367 common shares may be issued, subject to normal provisions for adjustments of the conversion price such as a special distribution to shareholders or upon a change of control of the Company. Petrominerales has an option to force conversion of the debentures at the prevailing conversion price after December 6, 2009, should the price of the Company's common shares exceed 130 percent of the prevailing conversion price of the debentures for 20 trading days within a period of 30 consecutive trading days.

The following table summarizes the changes in convertible debentures:

	Amount
Gross proceeds	\$ 100,000
Costs	(3,882)
Net proceeds	\$ 96,118
Fair value of equity component on issuance	12,738
Value attributed to liability component on issuance	83,380
Accretion	320
Balance of liability component, December 31, 2007	\$ 83,700
Accretion	4,761
Carrying amount of liability repurchased	(16,058)
Balance of liability component, December 31, 2008	\$ 72,403

Interest expense for the year includes \$5.4 million of cash interest expense, \$4.8 million of accretion on convertible debentures and \$0.5 million of amortization related to deferred financing costs.

NOTE 9 – ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations were estimated by management based on the estimated costs to reclaim and abandon the wells, well sites and certain facilities based on the Company's contractual requirements.

Changes to asset retirement obligations were as follows:

	2008	2007
Asset retirement obligations, beginning of year	\$ 1,482	\$ 930
Obligations incurred	1,492	352
Accretion expense	150	104
Changes in estimate	2,288	96
Asset retirement obligations, end of year	\$ 5,412	\$ 1,482

The obligations have been calculated using an inflation rate of four percent and discounted using a credit-adjusted risk free rate of nine percent per annum. The majority of these obligations are expected to be paid before the end of the related IPC, approximately 14 years in the future, or are required to be abandoned under the terms of the exploration contract; and are expected to be funded from the Company's general resources available at the time of settlement. The total undiscounted amount of estimated cash flows required to settle the obligations at December 31, 2008 is \$26.2 million (2007 – \$6.5 million).

NOTE 10 – TAXES

The provision for income taxes differs from the amount that would have been expected by applying statutory corporate income tax rates to income before taxes. The Company does not pay tax in the Bahamas. The principal reasons for this difference are as follows:

Years ended December 31,	2008	2007
Income before taxes	\$ 160,901	\$ 50,005
Statutory income tax rate	33.0%	34.0%
Expected tax expense	\$ 53,097	\$ 17,002
Increase (decrease) in income tax provision resulting from:		
Non-deductible expenses	2,352	2,951
Enhanced tax allowances	(31,960)	(13,282)
Stock-based compensation	868	470
Change in estimates and others	3,343	(8,220)
Future and current income tax expense (recovery)	27,700	(1,079)
Consisting of:		
Current income tax expense	4,736	–
Future income tax expense (recovery)	22,964	(1,079)
	27,700	495
Presumptive income and equity taxes	2,057	3,533
Tax expense	\$ 29,757	\$ 2,454

Presumptive income and equity taxes are based on equity levels in Colombia. Presumptive income tax paid can be carried forward for five years and recovered against income taxes in future periods. The Company's pre-tax income is subject to Colombian income tax at a statutory rate of 33%.

The components of the Company's future income tax assets and liabilities arising from temporary differences are as follows:

As at December 31,	2008		2007	
	Future Income Tax Assets	Future Income Tax Liabilities	Future Income Tax Assets	Future Income Tax Liabilities
Loss carry forwards	\$ 901	\$ –	\$ 6,326	\$ –
Capital assets	–	25,036	3,945	–
Asset retirement obligations	1,786	–	489	–
Provisions and others	464	–	–	–
	3,151	25,036	10,760	–
Valuation allowance	–	–	(9,681)	–
Net future tax asset (liability)	\$ –	\$ (21,885)	\$ 1,079	\$ –

As at December 31, 2008, non-capital losses in Colombia totalled \$2.7 million that can be carried forward indefinitely.

NOTE 11 – RELATED PARTY TRANSACTIONS

The Company pays Petrobank a monthly fee of Cdn.\$75,000 pursuant to a Management Services Agreement providing for the services of the President and Chief Executive Officer, Vice-President Finance and Chief Financial Officer, as well as other services, including corporate, administration, financial, treasury, accounting, information technology, human resources support and office space for Petrominerales employees located in Calgary, Alberta. The fee is based on a negotiated value for services provided. Costs under this agreement totalled \$0.8 million for the year ended December 31, 2008 (2007 – \$0.8 million) and were recorded as general and administrative expense.

NOTE 12 – CAPITAL MANAGEMENT

The Company's policy is to maintain a strong capital base in order to provide flexibility in the future development of the business, and to maintain investor, creditor and market confidence.

The Company manages its capital structure and makes adjustments in response to changes in economic conditions and the risk characteristics of the underlying assets. The Company's capital structure includes common share capital, convertible debentures and working capital (current assets minus current liabilities) or net debt. From time to time, in order to maintain or adjust the capital structure, the Company may issue common shares or other securities, sell assets or adjust its capital spending to manage current and projected debt levels. The Company may also repurchase common shares when the Company believes the market price does not reflect the underlying values of the common shares. The purchase of common shares for cancellation is considered to be advantageous to shareholders by increasing the value of the remaining common shares. The Company is also monitoring current market conditions for its outstanding convertible debentures and in October and November, 2008 the Company repurchased \$18.3 million face value of convertible debentures for \$11.1 million. The principal balance of convertible debentures is \$81.7 million due on December 6, 2010.

As at December 31,	2008	2007
Bank debt	\$ –	\$ (9,309)
Accounts payable and accrued liabilities	(62,724)	(62,107)
Less: current assets	111,623	178,107
Total working capital (net debt)	\$ 48,899	\$ 106,691
Convertible debentures – face value	\$ 81,700	\$ 100,000
Common share capital	\$ 194,859	\$ 195,214

The Company monitors leverage and adjusts its capital structure based on the ratio of net debt to annualized cash flow. This ratio is calculated as net debt, a non-GAAP measure the Company defines as outstanding bank debt plus current liabilities (excluding risk management liabilities) less current assets, divided by cash flow from operations before changes in non-cash working capital for the most recent calendar quarter, annualized. The Company uses the ratio of net debt to cash flow as a key indicator of the Company's leverage and to monitor the strength of the balance sheet. In order to facilitate the management of this ratio, the Company prepares annual capital expenditure budgets, which are updated as necessary, depending on varying factors including current and forecast crude oil prices, changes in capital structure, successful capital deployment and general industry conditions. The annual budget is approved by the Board of Directors and updates are prepared and reviewed as required.

Due to long lead times of several of the Company's exploration and development projects, from time to time the Company secures capital to fund the investments in advance which results in a net working capital balance. Therefore, the net debt to annualized cash flow ratio is positive at December 31, 2008 and in line with the Company's expectations. As these projects are advanced throughout the year, the Company anticipates the net working capital balance to decrease from current levels.

The Company is in compliance with the covenants contained in its convertible debenture and credit facility agreements. In its credit facility agreement, the financial covenants are to maintain a ratio of bank debt to trailing twelve month earnings before interest, tax, depletion, depreciation and amortization under 2.0 and to maintain a current ratio greater than 1.0 (current assets divided by current liabilities less unused bank debt). In its convertible debenture agreement, the financial covenants are to maintain a ratio of equity to total assets of at least 30% and to limit the amount of security and encumbrances the Company has on its total assets to 27.5%.

The Company has not paid or declared any dividends since the date of incorporation.

The repurchase of common shares and repurchase of convertible debentures have been the only significant changes to the Company's approach to capital management during 2008.

Credit markets throughout the world have tightened recently which could limit the Company's ability to access incremental debt. The Company has positive cash flows from operations, working capital of \$48.9 million and an undrawn \$80 million credit facility.

NOTE 13 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company has exposure to the following risks from its use of financial instruments: credit risk, liquidity risk and market risk. This Note presents information about the Company's exposure to each of the above risks, and the Company's objectives, policies and processes for measuring and managing risk. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's financial risk management framework and monitors risk management activities. The Company identifies and analyzes the risks faced by the Company and may utilize financial instruments to mitigate these risks.

Credit risk

Crude oil production is sold, as determined by market based prices adjusted for quality differentials, to three main counterparties: Ecopetrol, the Colombian state oil company, and two international oil companies. Typically, the Company's maximum credit exposure to customers is up to two months' sales revenue except for the production month of December where sales proceeds from our main oil purchaser are received by the end of December. The Company does not anticipate non-performance by any of the counterparties. At December 31, 2008, the Company's receivables consisted of \$11.5 million (2007 – \$1.0 million) of receivables from crude oil customers, \$8.2 tax receivable and \$5.3 million (2007 – \$6.0 million) of other trade receivables.

Receivables from crude oil customers are normally collected approximately 45 days after the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers, negotiate early payment, obtain credit guarantees and or credit insurance. The Company historically has not experienced any collection issues with its crude oil customers.

Cash and cash equivalents and restricted cash consist of cash bank balances and short term deposits maturing in less than 90 days. The Company manages the credit exposure related to short term investments by selecting counterparties based on credit ratings and monitors all investments to ensure a stable return, avoiding complex investment vehicles with higher risk such as asset backed commercial paper.

The carrying amount of accounts receivable, cash and cash equivalents and restricted cash represent the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2008, and did not provide for any doubtful accounts nor was it required to write-off any receivables during the years ended December 31, 2008 or 2007.

The Company's accounts receivables are aged as follows:

As at December 31,	2008	2007
Not past due (less than 45 days)	\$ 23,894	\$ 5,711
Past due 0-30 days	738	688
Past due 31-120 days	336	612
Total	\$ 24,968	\$ 7,011

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, within reasonable means, sufficient liquidity to meet its liabilities when due, under both normal and unusual conditions, without incurring unacceptable losses or jeopardizing the Company's business objectives.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Crude oil production is monitored daily to provide current cash flow estimates and the Company utilizes authorizations for expenditures on projects to manage capital expenditures. To facilitate the capital expenditure program, the Company has a revolving reserve based credit facility, as outlined in Note 7, which is reviewed at least semi-annually by the lender. The Company also attempts to match its payment cycle with collection of crude oil revenues. Currently, the Company is not borrowed against the credit facility as existing cash balances and production levels have been providing adequate funds to execute the Company's capital expenditure program and pay for any other expenses.

The following are the contractual maturities of financial liabilities as at December 31, 2008:

Financial liability	< 1 Year	1-2 Years	Thereafter	Total
Accounts payable and accrued liabilities	\$ 62,724	\$ –	\$ –	\$ 62,724
Convertible debentures – principal	–	81,700	–	81,700
Total	\$ 62,724	\$ 81,700	\$ –	\$ 144,424

Market risk

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

The Company may utilize derivative instruments to manage market risk. The Board of Directors periodically reviews the results of all risk management activities and all outstanding positions.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. The Company is exposed to foreign currency fluctuations as certain expenditures are denominated in Colombian pesos and Canadian dollars. As at December 31, 2008, if the U.S. dollar had appreciated five percent against the Colombian peso with all other variables held constant, net income and other comprehensive income for the year would have been \$0.9 million higher (2007 – \$1.4 million higher), due primarily to peso denominated accounts payable.

The Company had no forward exchange rate contracts in place as at or during the year ended December 31, 2008.

Commodity price risk

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

The Company had the following risk management contracts during 2008:

Term	Volume (bopd)	Price (\$/bbl)	Benchmark
Jan. 1, 2008 – Dec. 31, 2008	500	65.00 floor / 80.00 ceiling	WTI
Jan. 1, 2008 – Dec. 31, 2008	500	75.25 fixed	WTI

The \$2.8 million loss on risk management contracts consisted of an \$8.6 million realized loss (2007 – \$nil) offset by a \$5.8 million unrealized gain (2007 – \$5.8 million loss). The realized loss relates to actual monthly settlements incurred during the year and the unrealized gain (loss) represents the change in fair value of the contracts related to estimated future settlements.

The fair value of these risk management liabilities at December 31, 2008 was \$nil (2007 – \$5.8 million).

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate cash flow risk on floating interest rate bank debt, to the extent it is drawn, due to fluctuations in market interest rates and interest rate risk on fixed rate convertible debentures. The remainder of the Company's financial assets and liabilities are not exposed to interest rate risk. The Company's sensitivity to interest rates is currently immaterial.

The Company had no interest rate swap or financial contracts in place as at or during the year ended December 31, 2008.

Fair value of financial instruments

The Company's financial instruments are classified as cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities, bank debt and convertible debentures on the balance sheet. The carrying value and fair value of these financial instruments at December 31, 2008 is disclosed below by financial instrument category, as well as any related gain and interest expense for the year ended December 31, 2008:

Financial instrument	Carrying Value	Fair Value	Interest Expense
Assets held for trading			
Cash and cash equivalents ⁽¹⁾	82,174	82,174	–
Restricted cash	4,481	4,481	–
Loans and receivables			
Accounts receivable	24,968	24,968	–
Other liabilities			
Accounts payable and accrued liabilities	62,724	62,724	–
Bank debt	–	–	2,668 ⁽²⁾
Convertible debentures	72,403	50,654 ⁽³⁾	8,043 ⁽⁴⁾

(1) The effective yield on cash equivalents at December 31, 2008 was 0.56% (December 31, 2007 – 4.0%).

(2) Included in interest expense on the statement of operations. The amortization of deferred financing costs of \$0.5 million in relation to the Company's bank debt is included on the statement of cash flow.

(3) The fair value of the convertible debentures debt and equity components are difficult to measure reliably due to lack of active trading information. The Company repurchased \$18.3 million of debentures in October and November 2008 at 61% of the principal amount. The Company estimated the fair value of the convertible debentures based on recent market transactions. The principal amount of the convertible debentures at December 31, 2008 was \$81.7 million.

(4) Included in interest expense on the statement of operations. The non-cash interest expense relating to the accretion of the initial discount and transaction costs that are netted against this liability are included in accretion on convertible debentures on the statement of cash flow. The effective yield of the convertible debentures is 9.7%.

When drawn, bank debt bears interest at a floating rate and accordingly the fair value approximates the carrying value. Due to the short term nature of cash and cash equivalents, restricted cash, accounts receivable and accounts payable and accrued liabilities, their carrying values approximate their fair values.

NOTE 14 – CHANGES IN NON-CASH WORKING CAPITAL

Years ended December 31,	2008	2007
Change in:		
Accounts receivable	\$ (17,957)	\$ (5,002)
Accounts payable and accrued liabilities	617	42,933
Depletion related to other current assets	(367)	367
	\$ (17,707)	\$ 38,298
Changes relating to:		
Attributable to operating activities	\$ (25,171)	\$ 18,724
Attributable to investing activities	\$ 7,464	\$ 19,574

NOTE 15 – COMMITMENTS AND CONTINGENCIES

Pursuant to exploration contracts, the Company has work commitments totalling \$48.6 million to be completed by the end of 2010. The work commitments are normal course of business exploration activities that include acquisition and processing of seismic data and drilling exploration wells in Colombia (\$39.1 million) and property acquisition and seismic in Peru (\$9.5 million). The Company has secured drilling and completion rigs in support of its exploration and development programs. A minimum commitment totalling \$9.1 million is required to be spent utilizing these rigs by May 2009. These rig commitments will be used to satisfy a portion of the exploration work commitments. The Company has \$4.5 million in restricted cash and has issued letters of credit totalling \$7.9 million to guarantee the obligations on these exploration contracts.

As discussed in Note 4, the Company has entered into an agreement to construct a crude oil offloading facility. The Company's remaining portion of construction costs are estimated to be \$15.3 million which will be incurred in 2009.