



2010 financial report



PETROMINERALES



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Abbreviations

| | |
|-----------------|--|
| ANH | National Hydrocarbon Agency (Colombia) |
| bb1(s) | barrel(s) |
| bopd | barrels of oil per day |
| Cdn.\$ | Canadian dollars |
| IPC | Incremental Production Contract |
| km | kilometres |
| km ² | square kilometres |
| \$ | United States Dollars |



Management's Discussion And Analysis

Summary of Annual Results

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

| | 2010 | 2009 | 2008 |
|--|------------------|---------|---------|
| Financial | | | |
| (\$000s, except where noted) | | | |
| Crude oil revenue | 1,048,699 | 463,655 | 343,182 |
| Funds flow from operations ⁽¹⁾ | 597,817 | 283,824 | 234,534 |
| Per share – basic (\$) | 6.00 | 2.89 | 2.34 |
| – diluted (\$) | 5.44 | 2.78 | 2.25 |
| Net income | 239,695 | 100,146 | 131,144 |
| Per share – basic (\$) | 2.41 | 1.02 | 1.31 |
| – diluted (\$) | 2.29 | 1.00 | 1.28 |
| Dividends declared | 37,303 | - | - |
| Per share | 0.38 | - | - |
| Capital expenditures | 506,433 | 280,879 | 268,153 |
| Total assets | 1,764,882 | 720,116 | 565,705 |
| Total long-term financial liabilities | 558,563 | 41,472 | 99,700 |
| Net working capital surplus ⁽¹⁾ | 580,213 | 13,509 | 48,899 |
| Common shares outstanding, end of year (000s) | | | |
| Basic | 103,392 | 98,611 | 99,399 |
| Diluted ⁽²⁾ | 126,970 | 104,789 | 105,631 |
| Operations | | | |
| Operating netback (\$/bbl) ⁽¹⁾ | | | |
| WTI benchmark price | 79.63 | 61.80 | 99.75 |
| Crude oil revenue ⁽³⁾ | 66.84 | 50.43 | 82.27 |
| Royalties | 8.49 | 5.14 | 8.02 |
| Production expenses | 8.18 | 7.09 | 8.46 |
| Operating netback | 50.17 | 38.20 | 65.79 |
| Average daily crude oil production (bopd) ⁽⁴⁾ | 37,027 | 22,360 | 10,967 |

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

(2) Consists of common shares, stock options, deferred common shares and incentive shares outstanding, and potential shares issuable from the conversion of convertible debentures in-the-money as at the year-end date.

(3) Net of transportation and excludes revenue from purchased oil.

(4) Actual production sold for the year ended December 31, 2010 was 36,612 bopd (2009 – 22,490 bopd; 2008 – 10,967 bopd).

The following Management's Discussion and Analysis ("MD&A") is dated March 2, 2011 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, 2010 and 2009. 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 contained in this MD&A are in United States dollars, unless otherwise stated and all tabular amounts are in thousands of United States dollars, except as otherwise noted.

Forward-Looking Statements

Certain information provided in this report constitutes forward-looking statements. Specifically, this report contains forward-looking statements relating to the timing of capital projects, financial results and results of operations. The forward looking information is based on key expectations and assumptions made by Petrominerales, including assumptions concerning the success of future drilling activities, the performance of existing wells, prevailing commodity prices, availability of labour and services, receipt of required permits and regulatory approvals and performance of expected activities by industry partners. The reader is cautioned that assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be incorrect. 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. A discussion of those risks and uncertainties can be found in the Company's Canadian securities filings. Such factors include, but are not limited to: general economic, market and business conditions; fluctuations in oil prices; the results of exploration and development drilling, recompletions and related activities; timing and rig availability, outcome of high price participation contract negotiations; fluctuation in foreign currency exchange rates; the uncertainty of reserve estimates; changes in environmental and other regulations; risks associated with oil and gas operations and other factors; many of which are beyond the control of the Company. 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 forecast. Except as may be required by applicable securities laws, Petrominerales assumes no obligation to publicly update or revise any forward-looking statements made herein or otherwise, whether as a result of new information, future events or otherwise.

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, net 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 dividends. Net working capital surplus includes current assets less current liabilities and the current amount of convertible debentures (when they are out of the money and not repayable in shares at maturity) and is used to evaluate the Company's financial leverage. Operating netback is determined by dividing oil sales less royalties, transportation and operating expenses by sales volume of produced oil. Management considers operating netback important as it is a measure of profitability per barrel sold and reflects the economic quality of production. Funds flow from operations, funds flow per share, net 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 during the year

(All dollar amounts are denominated in United States dollars unless otherwise noted, annual comparisons are 2010 compared to 2009)

- We increased average crude oil production to 37,027 bopd, a 66 percent gain over 2009.
- We generated a strong operating netback of \$50.17 per barrel in 2010, a 31 percent increase over 2009.
- We generated record funds flow from operations of \$597.8 million (\$6.00 per basic share) and net income of \$239.7 million (\$2.41 per basic share), 111 and 139 percent increases over 2009 respectively.
- We had numerous exploration successes in 2010 with significant discoveries at Candelilla, Yatay, Caruto and Yenac.
- We initiated a ten-well exploration program on our heavy oil acreage targeting a number of separate structures and play types highlighted by a 600 bopd production test from our Mochelo-1 well.
- We were the most active exploration company in Colombia in 2010, drilling 16 exploration wells representing 15 percent of all exploration wells drilled in Colombia in 2010.
- We grew our reserves base, increasing proved developed producing reserves by 46 percent to 27.1 million barrels of oil, total proved reserves by 22 percent to 44.0 million barrels of oil and proved plus probable reserves by 13 percent to 60.2 million barrels of oil.
- Total proved plus probable NPV 10 (before tax) increased 21 percent to US\$2.5 billion.
- We significantly increased our exploration acreage in Peru to 5.4 million net acres.
- We raised \$550 million through a convertible bond issuance in August. The bonds are convertible into common shares of Petrominerales at a conversion price of \$34.746, subject to adjustments for dividends paid, and have an annual interest rate of 2.625 percent.
- The liquidity of our shares has significantly increased following the completion of our re-organization on December 31, 2010 pursuant to which Petrobank distributed its 65 percent ownership of Petrominerales to Petrobank shareholders.
- Starting in the second quarter of 2010 we initiated a quarterly dividend of Cdn.\$0.125 per share (Cdn.\$0.50 per share annualized).

Highlights and Significant Transactions during the Fourth Quarter

(Quarterly comparisons are fourth quarter 2010 compared to the fourth quarter of 2009 unless otherwise noted)

- We had three significant exploration successes in the quarter, Caruto on the Corcel Block, Mochelo on the Rio Ariari Block and Yatay on the Candelilla Block.
- Production was 33,142 bopd in the fourth quarter of 2010, a 35 percent increase. Production has further increased in 2011 to average 37,582 bopd in January and 42,501 bopd in February, mainly due to production additions from our Yatay and Mantis discoveries.
- We recorded funds flow from operations of \$153.3 million (\$1.52 per basic share) and net income of \$49.7 million (\$0.49 per basic share).
- To support our Llanos Basin growth objectives, we have committed to a 9.65 percent interest in the Oleducto Bicentenario de Colombia (“OBC”) pipeline project.

Nature Of Business

Petrominerales Ltd. (“Petrominerales” or the “Company”) is involved in the exploration, development and production of crude oil in Colombia and Peru. Petrominerales is a public company listed on the Toronto Stock Exchange incorporated in Alberta, Canada. Effective December 31, 2010, the Company completed a re-organization (the “Reorganization”) whereby the legal jurisdiction of the parent company of Petrominerales changed from the Bahamas to Canada. In addition, the Company’s former controlling shareholder, Petrobank Energy and Resources Ltd. (“Petrobank”) distributed its 65 percent ownership in Petrominerales to its shareholders.

Financial And Operational Review

Average Daily Crude Oil Production⁽¹⁾

| Block | Three months ended December 31, | | | Year ended December 31, | | |
|--------------|---------------------------------|--------|--------|-------------------------|--------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Guatiquia | 14,447 | - | 100% | 19,901 | - | 100% |
| Corcel | 9,747 | 17,558 | (44%) | 9,336 | 15,537 | (40%) |
| Neiva | 3,883 | 2,658 | 46% | 3,432 | 2,346 | 46% |
| Orito | 2,532 | 3,201 | (21%) | 2,825 | 3,338 | (15%) |
| Casimena | 1,417 | - | 100% | 1,027 | - | 100% |
| Others | 1,116 | 1,138 | (2%) | 506 | 1,139 | (56%) |
| Total (bopd) | 33,142 | 24,555 | 35% | 37,027 | 22,360 | 66% |

(1) Represents crude oil produced in the period. Sales volumes are different due to crude oil in transit at the period-end date and volumes sold on behalf of third parties. Sales volumes of produced oil were 32,138 bopd in the fourth quarter of 2010 (2009 – 25,607 bopd) and 36,612 bopd for the year ended December 31, 2010 (2009 – 22,490 bopd), as detailed in the following Sales Volume Reconciliation table.

Production for the fourth quarter and the year increased 35 and 66 percent, respectively, primarily due to drilling successes on our Guatiquia, Casimena and Neiva acreage offset by natural production declines at Corcel and Orito.

At the start of 2010, we discovered the Candelilla field on the Guatiquia Block. We immediately placed the Candelilla-1 discovery well on production and drilled two follow-up wells in the first quarter (Candelilla-2 and 3), and one follow-up well in the third quarter (Candelilla-4).

Corcel production decreased 44 percent in the fourth quarter and 40 percent for the year mainly due to natural declines, as we only added three producing wells (C2, Boa-2, Caruto-1) to the field during the past 15 months. In addition, water handling restrictions during July and August resulted in certain wells operating at a lower pump frequency and, in some cases, being shut-in.

Neiva production increased 46 percent in the fourth quarter and 40 percent for the year due to the success of our on-going development drilling program. For the year ended December 31, 2010, 26 wells were drilled and 27 were completed and placed on production.

Orito production decreased 21 and 15 percent for the quarter and the year respectively, as no wells were drilled at Orito since early 2009.

Casimena production is from our Yenac discovery. The Yenac-1 discovery well was placed on production in April at 1,800 bopd. We drilled a follow-up well, Yenac-2, that was placed on production on December 7, 2010 at rate of 2,936 bopd. Since both of these wells are producing from the same formation, we can only produce one Yenac well until we obtain the necessary exploitation permits. We expect to obtain these permits in the third quarter of 2011.

Other consists of production from our Mapache, Rio Ariari and Castor blocks.

Sales Volume Reconciliation (bopd)

| | Three months ended December 31, | | Years ended December 31, | |
|-------------------------------|---------------------------------|--------|--------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Production | 33,142 | 24,555 | 37,027 | 22,360 |
| Inventory changes and other | (1,004) | 1,052 | (415) | 130 |
| Sales volumes of produced oil | 32,138 | 25,607 | 36,612 | 22,490 |
| Purchased oil | 1,741 | - | 2,522 | - |
| Sales volumes | 33,879 | 25,607 | 39,134 | 22,490 |

The purchased oil relates to oil purchased from and marketed on behalf of third parties.

Average Benchmark and Realized Prices (\$/bbl)

| | Three months ended December 31, | | | Years ended December 31, | | |
|------------------------------|---------------------------------|-------|--------|--------------------------|-------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| WTI | 85.34 | 76.19 | 12% | 79.63 | 61.80 | 29% |
| Sales price | 80.40 | 68.19 | 18% | 73.48 | 56.49 | 30% |
| Transportation | 6.51 | 4.57 | 42% | 6.64 | 5.24 | 27% |
| Other | - | 1.87 | (100%) | - | 0.82 | (100%) |
| Realized oil price | 73.89 | 61.75 | 20% | 66.84 | 50.43 | 33% |
| Discount as a percent of WTI | 13% | 19% | (32%) | 16% | 18% | (11%) |

The majority of the Company's production is priced in relation to the Colombian Vasconia crude oil stream. The discount between Vasconia and WTI narrowed from seven percent of WTI in 2009 to four percent in 2010, consistent with the general narrowing of heavy crude oil differentials. The Company's 2010 average realized oil price of \$66.84 per barrel increased 33 percent mainly due to a 29 percent increase in the benchmark WTI price and the narrowing of the Vasconia crude discount to WTI. The fourth quarter realized oil price of \$73.89 per barrel increased 20 percent due to a 12 percent increase in WTI combined with lower Vasconia crude discount and lower pipeline and marketing fees. In the first two months of 2011, due to the large differential between WTI and Brent crude oil, the Vasconia blend has moved in relation to Brent oil, and as a result has traded at a premium to WTI.

The majority of the Company's oil production is trucked to various offloading stations for sale except for the Orito and Neiva fields that are connected to pipelines. Transportation costs increased to \$6.51 per barrel in the fourth quarter and to \$6.64 per barrel for the year, a 42 and 27 percent increase respectively. Per barrel trucking costs increased mainly due to trucking higher sales volumes and restricted capacity at certain offloading stations and pipeline segments in the Llanos Basin that resulted in oil deliveries to multiple and sometimes more distant offloading stations.

Other costs in 2009 relate to third party oil purchases made on a short-term basis to meet oil specifications at one offloading station.

Oil Revenue

Oil revenue in 2010 increased 126 percent due to a 63 percent increase in sales volumes of produced oil and 33 percent increase in realized crude oil prices. Fourth quarter oil revenue increased 56 percent over the comparable quarter due to a 26 percent increase in sales volume of produced oil and a 20 percent increase in crude oil prices.

| | Three months ended December 31, | Year ended December 31, |
|--|---------------------------------|-------------------------|
| Oil revenue, December 31, 2009 | 160,646 | 463,655 |
| Sales volume variance | 40,971 | 291,236 |
| Price variance | 36,095 | 226,976 |
| Oil revenue from third party oil purchases | 12,859 | 66,832 |
| Oil revenue, December 31, 2010 | 250,571 | 1,048,699 |
| \$ change in revenue | 89,925 | 585,044 |
| % change in revenue | 56% | 126% |

Royalties

| | Three months ended December 31, | | | Years ended December 31, | | |
|--|---------------------------------|--------|--------|--------------------------|--------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Royalties | 35,660 | 15,923 | 124% | 113,416 | 42,159 | 169% |
| \$ per bbl | 12.06 | 6.76 | 78% | 8.49 | 5.14 | 65% |
| Royalties as a percent of realized oil price | 16% | 11% | 45% | 13% | 10% | 30% |

GENERAL ROYALTY FRAMEWORK

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, a high price participation payment is applied under certain Colombian exploration contracts when the cumulative production in an exploitation area within a block exceeds five million barrels. To date, only the Candelilla exploitation area within the Guatiquia Block has reached the five million barrel threshold. The high price participation payment is payable to the Agencia Nacional de Hidrocarburos (National Hydrocarbon Agency) ("ANH") and is calculated as a percentage of the difference between the realized oil price and a threshold oil price set by the ANH, multiplied by a contractual rate. The contractual rate is generally 30 percent for Petrominerales' contracts.

Lastly, production from the Corcel Block is subject to an eight percent net profits interest ("NPI"). The NPI account is a cumulative balance that includes the deduction of capital investments such that when negative, no amount is payable.

COMPARATIVE ANALYSIS

Royalties increased 124 percent in the fourth quarter and 169 percent in the year primarily due to higher production, higher world oil prices combined with the start of high price participation payments on Candelilla production in August 2010. As a result, royalties on a per barrel basis and as a percentage of realized oil prices increased in both the fourth quarter and the year.

HIGH PRICE PARTICIPATION DISPUTE

Petrominerales currently has a dispute with the ANH related to the interpretation of the Corcel Block exploration contract ("Corcel Contract") entered into between Petrominerales and the ANH on June 2, 2005.

The Corcel Contract requires a high price participation payment to be paid by Petrominerales to the ANH once an exploitation area has cumulatively produced more than five million barrels of oil, determined before the deduction of royalties. The high price participation payment is paid at 30 percent of the price received above certain threshold prices, based on the oil quality produced.

The ANH has indicated their view that exploitation areas under the Corcel Contract should be combined for the purposes of determining when the high price participation payment is payable. As combined production from all of the Corcel exploitation areas has exceeded five million barrels of oil, the ANH asserts that Petrominerales is required to pay the high price participation payment with respect to production from the Corcel Block from April 2009 onwards. Based on their view, the ANH has requested additional payments aggregating to \$68.9 million to date. As at December 31, 2010, although total production from the Block was 12.5 million barrels, none of the individual exploitation areas on the Corcel Block have cumulatively produced more than five million barrels of oil.

Petrominerales disagrees with the ANH interpretation and views the Corcel Contract as providing that payment of the high price participation payment is required once each exploitation area has cumulatively produced more than five million barrels of oil.

The dispute is currently in a conflict resolution process as provided for in the Corcel Contract. Petrominerales believes that the resolution of this dispute will be in favour of the Company, and accordingly, no additional royalty provision has been made in these financial statements.

Production Expenses

| | Three months ended December 31, | | | Years ended December 31, | | |
|---------------------|---------------------------------|--------|--------|--------------------------|--------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Production expenses | 38,621 | 17,945 | 115% | 109,348 | 58,203 | 88% |
| \$ per bbl | 13.06 | 7.62 | 71% | 8.18 | 7.09 | 15% |

In 2010, production expenses increased 115 percent during the quarter and 88 percent for the year, primarily due to higher production levels and increased per barrel costs. On a per barrel basis production expenses increased to \$13.06 and to \$8.18 per barrel for the fourth quarter and the year ended. The 2010 increase is primarily related to higher water handling costs and a one-time charge for historical cost over-runs at Orito by the field operator. Without these one-time adjustments fourth quarter operating costs would have been \$8.15 per barrel.

General and Administrative Expenses

| | Three months ended December 31, | | | Years ended December 31, | | |
|-------------------------------------|---------------------------------|-------|--------|--------------------------|--------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| General and administrative expenses | 7,918 | 3,859 | 105% | 24,402 | 12,091 | 102% |
| \$ per bbl | 2.68 | 1.64 | 63% | 1.83 | 1.47 | 24% |

The increases in general and administrative expenses for the fourth quarter and the year were primarily due to higher staff levels, inflation in Colombia combined with the appreciation of the Colombian Peso, office costs associated with our expanding operations and professional fees associated with our Colombian stock exchange listing.

Stock-Based Compensation Expenses

| | Three months ended December 31, | | | Years ended December 31, | | |
|----------------------------------|---------------------------------|-------|--------|--------------------------|-------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Stock-based compensation expense | 3,037 | 1,094 | 178% | 11,274 | 4,513 | 150% |

Stock-based compensation expense is a non-cash expense that is based on the fair value of stock options, deferred common shares and incentive shares granted, amortized over the vesting period of the option or incentive share, or immediately upon grant of the deferred common shares. The 2010 expense increased over 2009 mainly due to higher grants during the year, combined with an increase in the fair value per grant as a result of a higher Petrominerales stock price.

Interest Income

| | Three months ended December 31, | | | Years ended December 31, | | |
|-----------------|---------------------------------|------|--------|--------------------------|------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Interest income | 454 | 15 | 2,927% | 1,001 | 348 | 188% |

In 2010, interest income on cash and cash equivalents increased due to higher cash balances, specifically in the fourth quarter due to the proceeds received from the \$550 million convertible debentures issued in August of 2010.

Interest Expense

| | Three months ended December 31, | | | Years ended December 31, | | |
|--|---------------------------------|-------|--------|--------------------------|-------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Cash interest and other charges | 6,123 | 1,191 | 414% | 13,610 | 4,866 | 180% |
| Accretion on convertible debentures | 4,935 | 1,156 | 326% | 10,329 | 4,426 | 133% |
| Amortization of deferred financing costs | 338 | 129 | 162% | 1,351 | 517 | 161% |
| Interest expense | 11,396 | 2,476 | 360% | 25,290 | 9,809 | 158% |

Interest expense for the fourth quarter and the year was higher mainly due to higher standby fees associated with the Company's \$150 million secured bank facility (effective December 30, 2009) and higher expenses from the \$550 million convertible debentures issued on August 25, 2010.

Foreign Exchange Gain (Loss)

| | Three months ended December 31, | | | Years ended December 31, | | |
|------------------------------|---------------------------------|-------|--------|--------------------------|---------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Foreign exchange gain (loss) | 8,256 | 2,033 | 306% | (7,153) | (8,274) | (14%) |

The Colombian peso devaluated 6 percent relative to the U.S. dollar in the fourth quarter, from 1,800:1 at September 30, 2010 to 1,914:1 at December 31, 2010. This change in exchange rates resulted in an \$8.3 million foreign exchange gain primarily on Colombian peso denominated accounts payable and future income tax liabilities. During the year ended December 31, 2010, the Colombian peso appreciated 6 percent relative to the U.S. dollar which resulted in a \$7.2 million foreign exchange loss. Changes in the Colombian peso exchange rate also impact the Company's U.S. dollar denominated expenses and expenditures as approximately 65 percent 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, | | |
|---------------|---------------------------------|--------|--------|--------------------------|---------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| DD&A expenses | 63,375 | 42,797 | 48% | 270,070 | 159,609 | 69% |
| \$ per bbl | 21.43 | 18.17 | 18% | 20.20 | 19.44 | 4% |

DD&A expense in the fourth quarter increased 48 percent due to a 35 percent production increase and a 18 percent increase in the per barrel depletion rate. On a per barrel basis, the depletion rate was higher due to higher finding and development costs related to proved reserves. For the year, DD&A expenses increased 69 percent mainly due to a 66 percent increase in production as the per barrel depletion rate was consistent with 2009.

Tax Expense

| | Three months ended December 31, | | | Years ended December 31, | | |
|-------------------------------|---------------------------------|--------|--------|--------------------------|--------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Equity | 531 | 503 | 6% | 2,119 | 1,869 | 13% |
| Current income tax (recovery) | (18,248) | 2,098 | - | 32,432 | 7,336 | 342% |
| Future income tax | 35,585 | 9,605 | 270% | 59,881 | 10,251 | 484% |
| Tax expense | 17,868 | 12,206 | 46% | 94,432 | 19,456 | 385% |
| Effective tax rate | 26% | 19% | 37% | 28% | 16% | 75% |

The Company's pre-tax income is subject to the Colombian statutory income tax rate of 33 percent. In addition, an equity tax is charged on equity capitalization levels in Colombia. The Company had an effective tax rate of 26 percent in the fourth quarter of 2010 and 28 percent for the 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 and immediate tax deductions available from the Company's significant exploration program. The 2010 effective tax rates are higher than 2009 primarily due to a lower rate for enhanced tax allowances (2010 rate was 30 percent, 2009 rate was 40 percent).

The Colombian government approved new legislation in December 2010 that obligates Colombian corporations and branches of foreign corporations to pay an equity tax based on net equity as of January 1, 2011. The rate of tax applicable to Petrominerales is 6.8% of net equity. The tax is payable evenly over four years starting in 2011.

Net Income

In 2010, net income increased 139 percent to \$239.7 million primarily due to higher sales volumes and commodity prices offset by higher DD&A and tax expense. Fourth quarter net income decreased 3 percent to \$49.7 million mainly due to higher royalties, operating costs and DD&A offset by higher sales volumes and commodity prices. The following table summarizes the changes in net income and net income per share.

Reconciliation of Changes in Net Income

| | Three months ended December 31, | | Years ended December 31, | |
|---|---------------------------------|-------------|--------------------------|-------------|
| | Per share, basic | | Per share, basic | |
| Net income, December 31, 2009 | 51,211 | 0.52 | 100,146 | 1.02 |
| Increase (decrease) due to: | | | | |
| Sales volumes | 40,971 | 0.40 | 291,236 | 2.92 |
| Realized oil prices | 36,095 | 0.35 | 226,976 | 2.27 |
| Oil revenue less purchases from third parties | 381 | 0.01 | 2,080 | 0.02 |
| Royalties | (19,738) | (0.20) | (71,257) | (0.73) |
| Operating expenses | (20,676) | (0.21) | (51,145) | (0.51) |
| Transportation and other expenses | (4,078) | (0.04) | (38,935) | (0.39) |
| Operating Netback | 32,955 | 0.31 | 358,955 | 3.58 |
| General and administrative expenses | (4,059) | (0.04) | (12,311) | (0.12) |
| DD&A | (20,578) | (0.20) | (110,461) | (1.11) |
| Taxes | (5,662) | (0.06) | (74,976) | (0.75) |
| Interest expense | (8,920) | (0.09) | (15,481) | (0.16) |
| Other ⁽¹⁾ | 4,718 | 0.05 | (6,177) | (0.05) |
| Net income, December 31, 2010 | 49,665 | 0.49 | 239,695 | 2.41 |

(1) Other includes interest income, stock-based compensation expenses, foreign exchange (gain) loss and acquisition expenses.

Funds Flow from Operations

In 2010, funds flow from operations increased 111 percent to \$597.8 million primarily due to higher sales volumes and higher commodity prices offset by higher royalties and operating costs. For the fourth quarter, funds flow from operations increased 45 percent to \$153.3 million mainly due to higher sales volumes and commodity prices offset by higher royalties and operating costs. The following table summarizes the changes in funds flow from operations.

Reconciliation of Changes in Funds Flow From Operations

| | Three months ended Dec. 31, | | Years ended Dec. 31, | |
|---|-----------------------------|-------------|----------------------|-------------|
| | Per share, basic | | Per share, basic | |
| Funds flow from operations, 2009 | 106,171 | 1.08 | 283,824 | 2.89 |
| Increase (decrease) due to: | | | | |
| Sales volumes | 40,971 | 0.41 | 291,236 | 2.92 |
| Realized oil prices | 36,095 | 0.36 | 226,976 | 2.27 |
| Oil revenue less purchases from third parties | 381 | 0.01 | 2,080 | 0.02 |
| Royalties | (19,738) | (0.20) | (71,257) | (0.72) |
| Operating expenses | (20,676) | (0.21) | (51,145) | (0.52) |
| Transportation and other expenses | (4,078) | (0.04) | (38,935) | (0.40) |
| Operating Netback | 32,955 | 0.33 | 358,955 | 3.57 |
| General and administrative expenses | (4,059) | (0.05) | (12,311) | (0.13) |
| Acquisition expenses | (1) | (0.00) | (1,190) | (0.01) |
| Foreign exchange | 2,965 | 0.02 | (18) | (0.00) |
| Interest | (5,037) | (0.06) | (6,097) | (0.06) |
| Taxes | 20,318 | 0.20 | (25,346) | (0.26) |
| Funds flow from operations, 2010 | 153,312 | 1.52 | 597,817 | 6.00 |

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, | | |
|---|---------------------------------|---------|--------|--------------------------|---------|--------|
| | 2010 | 2009 | Change | 2010 | 2009 | Change |
| Funds flow from operations: Non-GAAP | 153,312 | 106,171 | 44% | 597,817 | 283,824 | 111% |
| Changes in non-cash working capital | 6,252 | 43,708 | - | (14,662) | (4,809) | 812% |
| Cash flow from operating activities: GAAP | 159,564 | 149,879 | (13%) | 583,155 | 279,015 | 99% |

Capital Expenditures

| Three months ended Dec. 31, 2010 | Drilling and Completions | Facilities and Infrastructure | Seismic | Health, Safety, Environmental, & Community | Total |
|----------------------------------|--------------------------|-------------------------------|---------------|--|----------------|
| Corcel/Guatiquia/South Block 31 | 46,647 | 33,295 | 5,395 | 1,621 | 86,958 |
| Central Llanos | 10,988 | 19,015 | 761 | 1,736 | 32,500 |
| Heavy Oil | 8,847 | 6,800 | 4,422 | 432 | 20,501 |
| Neiva | 11,647 | 5,771 | 24 | 656 | 18,098 |
| Peru | - | - | 3,668 | - | 3,668 |
| Orito | 433 | 62 | 62 | 33 | 590 |
| Foothills | 77 | 296 | 1 | 121 | 495 |
| Total | 78,639 | 65,239 | 14,333 | 4,599 | 162,810 |

Corcel, Guatiquia and South Block 31 capital expenditures relate to:

- drilling and completion costs for the Caruto-1, Boa-2, Arion-1 and Yatay-1 exploration wells and initial drilling cost of Cardenal-1 and Celeste-1 exploration wells;
- facilities costs relate to the Corcel central processing facility to increase fluid handling and installation of flow-lines to connect Guatiquia production to the Corcel central processing facility;
- infrastructure costs include civil construction costs related to the wells drilled in the quarter and initial locations in the 2011 drilling program; and
- seismic costs related to the acquisition of 148 square kilometres of 3D seismic on the Guatiquia Block.

Central Llanos capital expenditures relate to:

- drilling and completion costs for the Yenac-2 and Mantis-1 exploration wells;
- facilities costs related to increasing the fluid handling capacity for the Yenac discovery and increasing water handling capacity at Mapache; and
- infrastructure costs include civil construction costs related to the Zorro-1, Disa-1 and Paloma-1 exploration wells on the Mapache Block that are expected to be drilled in 2011.

Heavy oil capital expenditures relate to:

- drilling and related completion and facilities costs for the Asarina-1 and Mochelo-1 exploration wells on the Rio Ariari Block;
- infrastructure costs include civil construction costs related to the Borugo-1 well and other 2011 drilling locations on the Rio Ariari block; and
- seismic costs related to the 85 square kilometre 3D seismic program on the Chiguiro Este Block.

Neiva expenditures relate to drilling six wells and related completion and facilities costs for five wells.

Peru costs relate to acquiring an additional interest in Block 126 and initial costs related to our three well drilling program starting in 2011.

Capital Expenditures

| Year ended December 31, 2010 | Drilling and Completions | Facilities and Infrastructure | Seismic | Health, Safety, Environmental, & Community | Total |
|---------------------------------|--------------------------|-------------------------------|---------------|--|----------------|
| Corcel/Guatiquia/South Block 31 | 118,644 | 125,166 | 21,743 | 5,238 | 270,791 |
| Central Llanos | 37,275 | 62,965 | 1,553 | 5,500 | 107,293 |
| Heavy Oil | 21,387 | 16,406 | 5,677 | 1,761 | 45,231 |
| Neiva | 54,895 | 12,507 | 611 | 1,453 | 69,466 |
| Peru | - | - | 9,665 | - | 9,665 |
| Orito | 1,925 | 1,123 | 105 | 191 | 3,344 |
| Foothills | 110 | 308 | 22 | 203 | 643 |
| Total | 234,236 | 218,475 | 39,376 | 14,346 | 506,433 |

Corcel, Guatiquia and South Block 31 capital expenditures relate to:

- drilling and completion costs associated with drilling ten and completing nine oil wells and drilling two water disposal wells;
- facilities costs relate to the Corcel central processing facility to increase fluid handling and water disposal capacity, temporary production facilities on the Guatiquia Block for the Candelilla discovery and the installation of flow-lines to connect Guatiquia production to the Corcel central processing facility;
- infrastructure costs include civil construction costs related to the 2010 drilling program and initial locations in the 2011 drilling program and
- seismic costs relate to the acquisition of 3D seismic on the southern portion of Block 31, the northwest and southeast portion of the Corcel Block and 148 square kilometres of 3D seismic on the Guatiquia Block.

Central Llanos capital expenditures relate to:

- drilling and completion costs for six exploration wells (Yenac-2 and Mantis-1 on Casimena Block, Manzanillo-1 and Mapana-1 on the Mapache Block, Cerillo-1 on the Casanare Este Block and Capybara-1 on the Castor Block);
- facilities costs related to increasing the fluid handling capacity for the Yenac discovery and increasing water handling capacity at Mapache; and
- infrastructure costs include civil construction costs related to future exploration wells on the Mapache Block (Altea-1, Tucuso-1, Godetia-1, Zorro-1, Disa-1 and Paloma-1).

Heavy oil block expenditures relate to:

- drilling and related completion and facilities costs of the Rio Ariari-2, Avellana-1, Asarina-1 and Mochelo-1 exploration wells;
- infrastructure costs include initial civil costs on future locations (Calandria-1, Anturo-1 and Borugo-1) on the Rio Ariari block; and
- seismic costs related to the 85 square kilometre 3D seismic program on the Chiguiro Este Block.

Peru costs relate to the acquisition of 150 square kilometres of 3D seismic on Block 126, acquiring an additional interest in Block 126 and initial costs related to our three well drilling program starting in 2011.

Neiva expenditures relate to drilling 26 wells and related completion and facilities costs for 27 wells. In addition, 17 well optimizations were performed. Orito expenditures included workovers performed and facilities costs related primarily to a water flood pilot project.

Summary Of Quarterly Results

| | 2010 | | | | 2009 | | | |
|--|----------------|---------|---------|---------|---------|---------|---------|--------|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Financial (\$000s except where noted) | | | | | | | | |
| Crude oil revenue | 250,571 | 231,506 | 318,776 | 247,846 | 160,646 | 121,833 | 104,823 | 76,352 |
| Funds flow from operations | 153,312 | 128,430 | 175,989 | 140,086 | 106,171 | 71,709 | 64,098 | 41,846 |
| Per share – basic (\$) | 1.52 | 1.29 | 1.77 | 1.42 | 1.08 | 0.73 | 0.65 | 0.42 |
| – diluted (\$) | 1.29 | 1.17 | 1.68 | 1.33 | 1.03 | 0.71 | 0.63 | 0.42 |
| Net income | 49,665 | 35,436 | 81,218 | 73,376 | 51,211 | 26,224 | 15,323 | 7,388 |
| Per share – basic (\$) | 0.49 | 0.36 | 0.82 | 0.74 | 0.52 | 0.27 | 0.16 | 0.07 |
| – diluted (\$) | 0.46 | 0.35 | 0.78 | 0.71 | 0.51 | 0.26 | 0.15 | 0.07 |
| Capital expenditures | 162,810 | 119,132 | 112,697 | 111,792 | 81,983 | 53,998 | 79,527 | 65,371 |
| Operations | | | | | | | | |
| Operating netback (\$/bbl) ⁽¹⁾ | | | | | | | | |
| WTI benchmark price | 85.34 | 76.15 | 78.06 | 79.08 | 76.19 | 68.19 | 59.79 | 43.08 |
| Crude oil sales price ⁽²⁾ | 73.89 | 64.54 | 63.53 | 66.68 | 61.75 | 56.29 | 47.96 | 33.79 |
| Royalties | 12.06 | 9.09 | 6.35 | 7.37 | 6.76 | 5.52 | 4.30 | 3.67 |
| Production expenses | 13.06 | 7.63 | 6.25 | 6.71 | 7.62 | 8.02 | 6.76 | 5.92 |
| Operating netback | 48.77 | 47.82 | 50.93 | 52.60 | 47.37 | 42.75 | 36.90 | 24.20 |
| Crude oil production (bopd) | 33,142 | 32,667 | 44,203 | 38,199 | 24,555 | 21,546 | 21,548 | 21,771 |

Significant factors influencing quarterly results were:

- Production in 2010 was higher than 2009 mainly due to the Candelilla discovery that came on production at the beginning of 2010.
- Second quarter 2010 production averaged 44,203 bopd, higher than other quarters, due to having all three high-rate Candelilla wells on production;
- Third and fourth quarter royalties per barrel increased due to the start of high price participation payments on Candelilla production in August 2010;
- Fourth quarter 2010 operating costs were higher primarily due to a one-time charge for historical cost over-runs at Orito by the field operator;
- Crude oil prices in 2010 were higher than 2009 contributing to higher oil sales; and
- Capital expenditures have been increasing, consistent with the Company's growing production and reserve base.

Commitments

The following is a summary of the Company's contractual commitments as at December 31, 2010:

| Type of Obligation | Total | < 1 Year | 1-3 Years | 4-5 Years |
|---|----------------|----------------|---------------|--------------|
| Exploration contracts ⁽¹⁾⁽²⁾ | 53,300 | 47,200 | 6,100 | - |
| Transportation contract | 2,040 | 2,040 | - | - |
| OBC Pipeline commitment ⁽³⁾ | 99,600 | 99,400 | 200 | - |
| Oil Storage | 900 | 400 | 500 | - |
| Office lease | 8,100 | 2,100 | 4,000 | 2,000 |
| Total⁽⁴⁾ | 163,940 | 151,140 | 10,800 | 2,000 |

- (1) Pursuant to exploration contracts, the Company has work commitments totaling \$53.3 million to be completed during the next three years. The work commitments are normal course of business activities that include property costs, acquisition and processing of seismic data and drilling exploration wells. The Company has issued letters of credit totaling \$25.4 million to guarantee the obligations under these exploration contracts.
- (2) Following the Colombian Open Bid Round 2010, Petrominerales was awarded Block 59 and Block 15. Our first phase work commitments on Block 59 will include spending of \$24.2 million over three years to acquire 300 square kilometres of 3D seismic and drilling four exploration wells. Our first phase work commitments on Block 15 will include spending \$10.0 million over three years to acquire 100 square kilometres of 3D seismic and drilling two exploration wells. These additional commitments will be added to the schedule once the contracts are signed.
- (3) We have entered into an agreement to acquire and participate in 9.65 percent of the Oleducto Bicentenario de Colombia pipeline project ("OBC"). Phase zero of the project will add 40,000 bopd of oil offloading capacity at Banadia, connecting to the Cano Limon export pipeline system. Phase one of the project will connect Llanos Basin production from Araguaney to Banadia. This phase is expected to cost approximately \$1.0 billion (\$96.5 million net) and add approximately 120,000 bopd (11,580 bopd net) of offloading capacity by the first quarter of 2012. Ultimately, phases two and three of the project are expected to be completed by the end of 2013 and will add a further 330,000 bopd of gross takeaway capacity at a total incremental gross cost of approximately \$4.4 billion. Petrominerales has an option to participate in phases two and three.
- (4) The Colombian government approved new legislation in December 2010 that obligates Colombian corporations and branches of foreign corporations to pay an equity tax based on net equity as of January 1, 2011. The rate of tax applicable to Petrominerales is 6.8% of net equity. The tax is payable evenly over four years starting in 2011.

Liquidity And Capital Resources

Petrominerales' 2010 capital program was funded internally from operating cash flows. The 2011 capital program will be funded through a combination of existing cash balances, operating cash flows, and credit facilities. At December 31, 2010, Petrominerales had cash and cash equivalents of \$723.3 million and an undrawn \$150 million borrowing base. The Company believes it is well positioned financially with significant available credit capacity, assets that are providing strong production growth and operating netbacks along with an extensive inventory of exploration prospects.

Petrominerales has a revolving credit facility with a \$150 million borrowing base that is undrawn. The borrowing base is reviewed with the lender semi-annually. The Company also has \$550 million of convertible debentures outstanding that mature on August 25, 2016. The debentures are convertible into common shares of the Company at the option of the holder at a conversion price of \$34.746 per share, subject to the adjustment for dividends. The Company also had \$81.7 million principal value of convertible debentures mature on December 6, 2010. The debentures were converted into 2,987,367 common shares at the contractual conversion rate of US\$27.3485 per share. In addition, Petrominerales also maintains local Colombian operating lines of credit of \$32.9 million that are primarily used to issue letters of credit to support exploration contracts. At December 31, 2010, letters of credit issued against the Colombian operating lines of credit totalled \$23.0 million.

The Company is in compliance with the covenants contained in our credit facility and convertible debenture agreements. The credit facility contains financial covenants to maintain a ratio of bank debt to trailing twelve month earnings before interest, tax, depletion, depreciation and amortization under 3.0 times and to maintain a current ratio greater than 1.0 time (current assets divided by current liabilities less unused bank debt and the liability portion of convertible debentures). The convertible debentures have financial covenants to maintain a ratio of book value of equity to total assets of at least 30 percent and to limit the amount of security and encumbrances the Company has on the book value of its total assets to 35 percent.

Petrominerales' assets provide significant funds flow from operations and are the Company's largest source of liquidity. The Company has a history of generating positive funds flow from operations, and recorded funds flow from operations of \$153.3 million in the fourth quarter of 2010 and \$597.8 million for the year ended December 31, 2010.

Petrominerales initiated a quarterly dividend payment of Cdn.\$0.125 per share starting in the second quarter of 2010. The total amount of dividends declared in 2010 was \$37.3 million, of which \$24.3 million was paid prior to December 31, 2010 (2009 – \$nil). Petrominerales' strategy is to provide a reasonable dividend yield to shareholders while executing an accretive growth-oriented, exploration focused business plan.

During the year ended December 31, 2009, the Company repurchased 1,991,000 common shares under a Normal Course Issuer Bid ("NCIB") at an average cost of \$9.20 (Cdn.\$10.94) per share at a total cost of \$18.3 million. All common shares acquired under the NCIB were cancelled.

Outstanding Share Data

The aggregate number of Petrominerales common shares, stock options, deferred common shares and incentive shares outstanding at March 2, 2011 was 111,093,397 (common shares – 103,598,324, stock options – 6,510,179, deferred common shares – 131,390, incentive shares – 853,504).

Transactions With Related Parties

Prior to December 31, 2010 and the Reorganization, the Company was party to a Management Services Agreement with Petrobank, whereby Petrobank provided certain services, including administration, legal, financial, treasury, accounting, information technology, human resources and office space for Petrominerales employees located in Calgary, Alberta. The monthly fee was based on a negotiated amount that represented the fair value of the services provided. Amounts paid to Petrobank under this agreement totalled \$1.6 million for the year ended December 31, 2010 (2009 - \$1.3 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, crude oil price risk, exploration risk, competitive risks within the oil and gas industry, availability of infrastructure to sell oil, location risks, operational risks, government approval and permitting risks and other financial 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 use derivative instruments to reduce exposure to crude oil price movements.

The Company is exposed to a high level of exploration risk. The volume of production from oil and natural gas properties generally declines as reserves are produced, with the rate of decline depending on reservoir characteristics. The Company's proved reserves will decline as reserves are produced from its properties unless it is able to acquire or develop new reserves. The business of exploring for, developing or acquiring reserves is capital intensive and is subject to numerous estimates and interpretations of geological and geophysical data. There can be no assurance the Company's future exploration, development and acquisition activities will result in additional proved reserves. To manage this risk, Petrominerales employs highly experienced geologists and geophysicists, uses technology and 3D seismic as primary exploration tools and focuses exploration efforts in known hydrocarbon producing basins. In addition, Petrominerales takes a portfolio approach to exploration drilling by having drilling locations spread out among different exploration blocks, geological basins and targeting multiple play-types.

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 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.

Due to overall increased crude oil production in the Llanos region, pipeline capacity can be constrained. When this occurs, some producer's ability to transport oil through the pipeline system may be restricted. In order to mitigate the risk of reducing production, Petrominerales has participated in the construction of the Monterrey offloading station and in the Oleducto Bicentenario de Colombia ("OBC") project that is being operated by Ecopetrol. These investments are expected to provide strategic access to key offloading capacity and help maintain high realized sales prices and per barrel profitability.

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. The Company and its personnel may be subject to security 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.

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.

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

Sensitivites

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 funds flow from operations:

| Change of: | | (millions) |
|------------|---|------------|
| Crude oil | \$1.00/bbl WTI reference price (assuming 35,000 bopd) | \$10.7 |
| | 1,000 bopd of production @ \$75/bbl WTI | \$17.9 |

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. 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

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 and an opening balance sheet at January 1, 2010 showing the changes from Canadian GAAP to IFRS.

IFRS uses a conceptual framework similar to Canadian GAAP, but prescribes certain differences for recognition, measurement and disclosure principles which are outlined below under “Potential Impacts of IFRS Adoption”.

Petrominerales commenced its IFRS Conversion Project in late 2008 by completing an initial scoping phase, and has established a project plan and project team, which includes key finance staff, management, external advisors and audit committee.

The Company’s project plan is broken out by accounting policies and procedures, financial statement preparation, training and communication, business impacts, IT systems and control environment is as follows:

| Key Activity | Milestones | Status |
|--|---|--|
| Accounting policies and procedures: <ul style="list-style-type: none"> Identify differences between Canadian GAAP and IFRS Revise and finalize accounting policies under IFRS Identify potential adjustments to initial and subsequent IFRS financial statements Develop IFRS-compliant financial statements, including transition period disclosures | <ul style="list-style-type: none"> Approval of IFRS policies and opening balance sheet by senior management Senior management approval and audit committee review of policy decisions Revised accounting policy and procedures manuals in place by first IFRS reporting period | <ul style="list-style-type: none"> Accounting policy alternatives have been analyzed and key accounting policy decisions reviewed by management Finalization of opening balance sheet adjustments is near completion |
| Financial statement preparation: <ul style="list-style-type: none"> Prepare first-time adoption reconciliation required under IFRS 1 Prepare financial statements and note disclosures in compliance with IFRS Quantify the effects of converting to IFRS Prepare quarterly financial statements with 2010 IFRS comparative figures | <ul style="list-style-type: none"> Senior management approval and audit committee review of pro forma financial statements | <ul style="list-style-type: none"> Draft opening balance sheet and transition note disclosure under review The Company is in the process of finalizing transition year impacts of IFRS IFRS compliant financial statements and notes are under review Comparative 2010 quarterly IFRS figures are currently under review |
| Training and communication: <ul style="list-style-type: none"> Develop and deliver targeted IFRS training to employees and management Ensure internal and external stakeholders receive ongoing appropriate communications Provide Company-specific training on revised policies and procedures to affected personnel | <ul style="list-style-type: none"> Training to be provided to relevant employees prior to changeover date Impacts on converting to IFRS communicated | <ul style="list-style-type: none"> Key employees involved with implementation have completed sufficient and ongoing training throughout the year Quarterly disclosure of project status in MD&A |
| Business Impacts: <ul style="list-style-type: none"> Identify impacts of conversion on contracts including financial covenants and compensation arrangements Identify impacts of conversion on taxation | <ul style="list-style-type: none"> Assess impacts of contracts identified Assess impacts of tax filings | <ul style="list-style-type: none"> Adoption of IFRS is not expected to have a significant impact on current material contracts Taxation impact is currently under review |

| | | |
|---|---|--|
| IT Systems: | | |
| <ul style="list-style-type: none"> Identify changes required to IT systems and implement solutions Implement as solution for capturing financial information under Canadian GAAP and IFRS during the year of transition to IFRS | <ul style="list-style-type: none"> Necessary changes to IT systems implemented by changeover date Solution for capturing financial information under multiple sets of accounting principles implemented | <ul style="list-style-type: none"> Required changes to IT systems are identified and tracked as IFRS work progresses Consultants have been engaged to assist in transitioning current system to accommodate IFRS |
| Control Environment: | | |
| <ul style="list-style-type: none"> For all changes to policies and procedures identified, assess effectiveness of internal controls over financial reporting ('ICFR') and disclosure controls and procedures ('DC&P') and implement any necessary changes Design and implement internal controls over the IFRS changeover process | <ul style="list-style-type: none"> Internal controls over IFRS changeover process in place and tested prior to changeover | <ul style="list-style-type: none"> Relevant internal controls are being assessed as work progresses Specific controls have been designed in relation to the IFRS changeover process |

Significant differences that have been identified between Canadian GAAP and IFRS that will impact Petrominerales are: property, plant and equipment, exploration and evaluation assets, depletion and depreciation, impairment testing, share based payments, decommissioning liabilities as well as increased disclosure requirements. The majority of adjustments required on transition to IFRS will be made retrospectively against opening retained earnings at the date of transition. Certain IFRS standards may be modified, and as a result, the impact may be different than Petrominerales' current expectations. The financial statement impact of these standards is currently in the final stages of review. The precise impact on the consolidated financial statements cannot be reasonably determined at this time.

First-time Adoption of IFRSs ("IFRS 1")

The transition to IFRS requires the Company to apply IFRS 1, which prescribes requirements for preparing IFRS-compliant financial statements in the first reporting period after the changeover date (January 1, 2010). IFRS 1 includes a requirement for retrospective application of each IFRS as if they were always in effect. IFRS 1 also mandates certain exemptions for retrospective application and provides optional exemptions from retrospective application to ease the transition to IFRS in the transition year. The most significant IFRS 1 exemptions that are expected to apply to the Company upon adoption are summarized in the following table:

| Area of IFRSs | Summary of Exemption Available |
|-------------------------------|---|
| Property, Plant and Equipment | <ul style="list-style-type: none"> The Company may elect to report items of property, plant and equipment, in its opening balance sheet on transition date at deemed cost instead of the actual cost that would be determined under IFRS. The deemed cost of an item may be either its fair value at the date of transition to IFRS or an amount determined by a previous revaluation under Canadian GAAP (as long as that amount was close to either its fair value, cost or adjusted cost). The exemption can be applied on an asset-by-asset basis. Oil and gas assets that were part of the full cost pool and determined to be development or producing assets are able to be allocated to Cash Generating Units (CGU's) on date of transition pro rata using reserve values or volumes, subject to an impairment test on date of transition. |
| Share-Based Payments | <ul style="list-style-type: none"> The Company may elect to not apply IFRS 2, "Share-Based Payments", to equity instruments which vested before the Company's date of transition to IFRS. The Company may also elect not to apply IFRS 2 to liabilities arising from share-based payment transactions which settled before the date of transition to IFRS. It is expected that the Company will not apply IFRS 2 to equity instruments granted which vested before the Company's date of transition to IFRS. The Company will also elect to not apply IFRS 2 to liabilities arising from share-based payment transactions which settled before the date of transition to IFRS. |
| Decommissioning Liabilities | <ul style="list-style-type: none"> In accounting for changes in obligations to dismantle, remove and restore items of property, plant and equipment, the guidance in IFRSs requires changes in such obligations to be added to or deducted from the cost of the asset to which it relates. The adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. Rather than recalculating the effect of all such changes throughout the life of the obligation, the Company may elect to measure the liability and the related depreciation effects at the date of transition to IFRS. The Company intends to elect to measure any decommissioning liabilities and the related depreciation effects at the date of transition to IFRS. |

Expected Areas of Significance

The key areas where we expect accounting policies may differ and where accounting policy decisions are necessary that may impact the Company's consolidated financial statements are set out in the following table. Note that this does not include impact of transition policy choices made under IFRS 1, described above.

| Accounting Policy Area | Impact of Policy Adoption |
|--|---|
| Impairment of Assets ('IAS 36') | <ul style="list-style-type: none"> IFRS uses the concept of cash generating units to accumulate asset carrying costs to test and measure impairment. IFRS will require impairment testing to be performed at the cash generating unit level, which is lower than the current cost center level. In addition, IAS 36 uses a one-step approach for testing and measuring asset impairments, with asset carrying values being compared to the higher of: value-in-use and fair value less costs to sell. Value in use is defined as the amount equal to the present value of future cash flows expected to be derived from the asset. In the absence of an active market, fair value less costs to sell may also be determined using discounted cash flows. The use of discounted cash flows under IFRS to test and measure asset impairment differs from Canadian GAAP, which uses undiscounted cash flows to test and measure impairment. This may result in more frequent write-downs in the carrying amounts of assets under IFRS because the asset carrying amounts previously supported under Canadian GAAP were based on undiscounted cash flows. However, under IAS 36, impairment losses that were previously recognized may be reversed where circumstances change such that the impairment is reduced. This differs from Canadian GAAP, which prohibits the reversal of previously recognized impairment losses The Company does not expect to recognize impairment on its assets on the IFRS opening balance sheet |
| Exploration and Evaluation Expenditures ('IFRS 6') | <ul style="list-style-type: none"> Oil and gas companies are required to account for exploration and evaluation expenditures in accordance with IFRS 6, which permits a number of accounting policy choices. For example, this standard addresses the recognition, measurement, presentation and disclosure requirements for costs incurred in the exploration phase. Unlike Canadian GAAP, IFRS requires the identification and presentation of exploration and evaluation expenditures to be separated from developed and producing assets. In addition, Petrominerales will be required to perform an impairment test on exploration and evaluation expenditures when there is a determination that the expenditures have resulted in a technically feasible and commercially viable project. At that time, the expenditures would be tested for impairment, and then transferred to the developed and producing assets category On transition, the Company expects the exploration and evaluation asset balance to primarily consist of undeveloped land, to be between \$80 and \$90 million. IFRS 6 will also require additional disclosure in the notes to the financial statements |
| Property, Plant, and Equipment ('IAS 16') | <ul style="list-style-type: none"> IFRS and Canadian GAAP contain the same basic principles of accounting for property, plant and equipment. However IAS 16 requires costs recognized as property plant and equipment to be allocated to the significant parts of the asset and to amortize each significant component separately. This is a departure from Canadian GAAP for full cost oil and gas companies, and may increase the number of components to be amortized separately, and could impact the amount of amortization expense. Under IAS 16, companies have the choice to account for property, plant and equipment under the cost model, or the revaluation model. Petrominerales will choose and apply the cost model to account for its property, plant and equipment after transition to IFRS |
| Share-Based Payments ('IFRS 2') | <ul style="list-style-type: none"> There are two main differences that will have an effect on how the Company accounts for share-based payments. The first difference is that share based awards are amortized using graded vesting (under Canadian GAAP the Company used straight-line vesting). Graded vesting requires that each instalment of an award be accounted for as a separate arrangement with its own distinct fair value measurement and service life, which will result in an accelerated amount of expense per award in comparison to Canadian GAAP. The second difference requires that share-based payment transactions be measured on the number of awards expected to vest at the end of each reporting period. These amounts are adjusted prospectively if subsequent information indicates that the initial estimates were not accurate. Some impact expected on transition and we will implement the graded vesting expense method in future periods. |
| Decommissioning Liabilities ('IAS 37') | <ul style="list-style-type: none"> IFRS and Canadian GAAP contain the same basic principles of accounting for decommissioning liabilities except under IFRS the Company will be required to use a risk-free rate for discounting the cash outflows of the related liability, which differs from Canadian GAAP that required the use of a credit-adjusted risk-free rate. The change in discount rate used is expected to increase the amount of the liability and capital assets between \$8 to \$12 million on adoption of IFRS, than would have been recognized under Canadian GAAP. Some impact expected on transition and in future periods. |

The related impact of these significant changes to IFRS is expected to result in an increase in deferred income tax liabilities between \$6 to \$10 million on initial 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, 2010.

During the year ended December 31, 2010, 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 press release outlining the Company’s 2011 capital program, issued on December 14, 2010.

Management's Report

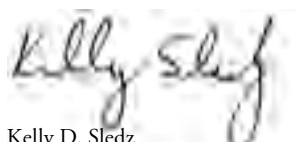
Management is responsible for the integrity and objectivity of the information contained in this report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in this report. The accompanying consolidated financial statements have 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 audited the consolidated financial statements. Their audit 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.



Corey C. Ruttan
President & Chief Executive Officer



Kelly D. Sledz
Chief Financial Officer

Calgary, Canada
March 2, 2011

Independent Auditor's Report

To the Shareholders of Petrominerales Ltd.:

We have audited the accompanying consolidated balance sheets of Petrominerales Ltd. (the "Company") as at December 31, 2010 and 2009 and the consolidated statements of operations and retained earnings, comprehensive income and cash flow for the years then ended, and the notes to the consolidated financial statements.

Management's Responsibility For The Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2010 and 2009 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
March 2, 2011



Deloitte & Touche LLP
Chartered Accountants

Consolidated Balance Sheets

(Thousands of United States dollars)

| As at December 31, | 2010 | 2009 |
|---|--------------|------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 723,277 | \$ 62,975 |
| Accounts receivable (Note 14) | 155,595 | 47,530 |
| Income tax receivable (Note 11) | 4,259 | 8,462 |
| Inventory | 6,077 | 1,376 |
| | 889,208 | 120,343 |
| Other assets (Note 4) | 25,398 | 26,594 |
| Capital assets (Note 6) | 845,261 | 573,179 |
| Goodwill (Note 5) | 5,015 | - |
| Total assets | \$ 1,764,882 | \$ 720,116 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | \$ 308,995 | \$ 106,834 |
| Convertible debentures (Note 8) | - | 76,829 |
| | 308,995 | 183,663 |
| Future income tax liabilities (Note 11) | 104,427 | 34,724 |
| Convertible debentures (Note 8) | 441,384 | - |
| Asset retirement obligations (Note 10) | 12,752 | 6,748 |
| | 867,558 | 225,135 |
| Shareholders' equity | | |
| Convertible debentures (Note 8) | 97,396 | 10,407 |
| Common shares (Note 7) | 301,941 | 197,709 |
| Contributed surplus (Note 7) | 16,058 | 7,328 |
| Accumulated other comprehensive income (Note 7) | 16,024 | 16,024 |
| Retained earnings | 465,905 | 263,513 |
| | 897,324 | 494,981 |
| Total liabilities and shareholders' equity | \$ 1,764,882 | \$ 720,116 |

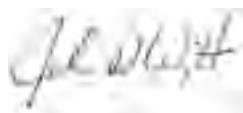
Bank Debt (Note 9)

Commitments (Note 16)

Contingencies (Note 17)

See accompanying notes to these consolidated financial statements.

Signed on behalf of the Board:



John D. Wright
Chairman



Kenneth R. McKinnon
Director & Chairman of the Audit Committee

Consolidated Statements Of Operations And Retained Earnings

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

| Years ended December 31, | 2010 | 2009 |
|---|-------------------|-------------------|
| Revenues | | |
| Oil | \$ 1,048,699 | \$ 463,655 |
| Royalties | (113,416) | (42,159) |
| Interest | 1,001 | 348 |
| | 936,284 | 421,844 |
| Expenses | | |
| Production | 109,348 | 58,203 |
| Transportation | 88,678 | 49,743 |
| Purchased oil | 64,752 | - |
| Acquisition costs (Note 5) | 1,190 | - |
| General and administrative | 24,402 | 12,091 |
| Stock-based compensation (Note 7) | 11,274 | 4,513 |
| Interest (Note 8) | 25,290 | 9,809 |
| Foreign exchange loss | 7,153 | 8,274 |
| Depletion, depreciation and accretion | 270,070 | 159,609 |
| | 602,157 | 302,242 |
| Income before taxes | 334,127 | 119,602 |
| Tax expense (Note 11) | 94,432 | 19,456 |
| Net income | 239,695 | 100,146 |
| Retained earnings, beginning of year | 263,513 | 177,800 |
| Cash dividends paid or declared (Note 7) | (37,303) | - |
| Repurchase of common shares (Note 7) | - | (14,433) |
| Retained earnings, end of year | \$ 465,905 | \$ 263,513 |
| Basic earnings per share (Note 7) | \$ 2.41 | \$ 1.02 |
| Diluted earnings per share (Note 7) | \$ 2.29 | \$ 1.00 |

See accompanying notes to these consolidated financial statements.

Consolidated Statements Of Comprehensive Income

(Thousands of United States dollars)

| Years ended December 31, | 2010 | 2009 |
|-----------------------------|-------------------|-------------------|
| Net income | \$ 239,695 | \$ 100,146 |
| Other comprehensive income | - | - |
| Comprehensive income | \$ 239,695 | \$ 100,146 |

See accompanying notes to these consolidated financial statements.

Consolidated Statements Of Cash Flow

(Thousands of United States dollars)

| Years ended December 31, | 2010 | 2009 |
|---|-------------------|------------------|
| Operating Activities | | |
| Net income | \$ 239,695 | \$ 100,146 |
| Depletion, depreciation and accretion | 270,070 | 159,609 |
| Future income taxes | 59,881 | 10,251 |
| Accretion on convertible debentures | 10,329 | 4,426 |
| Stock-based compensation | 11,274 | 4,513 |
| Unrealized foreign exchange loss | 1,448 | 2,588 |
| Amortization of other assets | 5,120 | 2,291 |
| | 597,817 | 283,824 |
| Changes in non-cash working capital (Note 15) | (14,662) | (4,809) |
| | 583,155 | 279,015 |
| Financing Activities | | |
| Dividends paid (Note 13) | (24,311) | - |
| Issuance of common shares (Note 7) | 9,581 | 5,365 |
| Financing costs | (123) | (5,421) |
| Repurchase of common shares (Note 7) | - | (18,324) |
| Issuance of convertible debentures, net of costs (Note 8) | 533,322 | - |
| Changes in non-cash working capital (Note 15) | 12,992 | - |
| | 531,461 | (18,380) |
| Investing Activities | | |
| Expenditures on capital assets | (506,433) | (280,879) |
| Expenditures on other assets | (3,801) | (20,696) |
| Corporate acquisition (Note 5) | (28,797) | - |
| Changes in non-cash working capital (Note 15) | 84,717 | 17,260 |
| | (454,314) | (284,315) |
| Net change in cash and cash equivalents | 660,302 | (23,680) |
| Cash and cash equivalents, beginning of year | 62,975 | 86,655 |
| Cash and cash equivalents, end of year | \$ 723,277 | \$ 62,975 |
| Cash and cash equivalents consist of: | | |
| Cash | \$ 1,894 | \$ 5,121 |
| Cash equivalents | \$ 721,383 | \$ 57,854 |
| Other cash flow information: | | |
| Taxes paid | \$ 34,550 | \$ 9,205 |
| Interest paid | \$ 8,320 | \$ 5,039 |
| Interest received | \$ 870 | \$ 347 |

See accompanying notes to these consolidated financial statements.

Notes To The Consolidated Financial Statements

As at and for the years ended December 31, 2010 and 2009

(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 involved in the exploration, development and production of crude oil in Colombia and Peru. Petrominerales is a public company listed on the Toronto Stock Exchange incorporated in Alberta, Canada. Effective December 31, 2010, the Company completed a re-organization (the “Reorganization”) whereby the legal jurisdiction of the parent company of Petrominerales group changed from the Bahamas to Canada. In addition, the Company’s former controlling shareholder, Petrobank Energy and Resources Ltd. (“Petrobank”) distributed its 65 percent ownership in Petrominerales to its shareholders.

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, 2010 and 2009. Inter-company transactions and balances are eliminated upon consolidation.

Measurement Uncertainty

The preparation of financial statements in accordance 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.

Specific amounts and disclosures affected by estimates and assumptions are: (i) amounts recorded for depletion, depreciation and accretion expense and amounts used for ceiling test calculations are based on estimates of crude oil reserves and future costs required to develop those reserves; (ii) stock-based compensation is based upon expected volatility and option life estimates; (iii) asset retirement obligations are based on estimates of abandonment costs, timing of abandonment, inflation and interest rates; (iv) 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; (v) the amounts allocated to the assets and liabilities acquired from PanAndean are based on estimates of the fair value of exploration assets acquired; (vi) the equity component of the convertible debentures is based on estimates of expected volatility; and (vii) the amounts recorded for contingencies are based on estimates of the probability of outcomes and estimates of the future cash flows. 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, exploration and development of crude oil properties are capitalized. These 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.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of net identifiable assets on the acquisition of a business. Goodwill has been recorded at cost and is not amortized. Potential impairment is identified when the carrying value of the reporting unit, including allocated goodwill, exceeds its fair value. Goodwill impairment is tested annually, or when indications of impairment exist and is measured as the excess of the carrying amount of the reporting unit's allocated goodwill over the implied fair value of the goodwill based on the fair value of the assets and liabilities of the reporting unit. The impairment loss is recorded in the statement of operations.

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

A portion 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. Oil revenue includes the sales of produced oil and purchased oil.

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, deferred common shares and incentive 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 of in-the-money convertible debentures that would be 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, deferred common shares and incentive 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 is substantively enacted. 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 balance sheet. The equity component represents the fair value of the conversion right granted to the holder on issuance, which remains a fixed amount over the term of the related debentures. The debt component is calculated as the residual between the principal amount of the debenture plus expenses, less the fair value of the equity component. 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 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 balance sheet. 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 includes highly liquid investments and deposits with a maturity of three months or less when purchased.

Inventory

Inventory consists of crude oil in transit or in storage tanks and is valued at the lower of cost, using the weighted average cost method, or net realizable value. Costs include direct and indirect expenditures incurred in bringing the crude oil to its existing condition and location.

Financial Instruments

Financial instruments are measured at fair value on initial recognition of the instrument, and classified 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.

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. 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. 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.

Cash and cash equivalents 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 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.

Note 3 – Changes in Accounting Policies

Recent Accounting Pronouncements

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 executed a significant portion of its project plan and expects to complete a successful implementation within the required timeframe. The impact on the Company’s consolidated financial statements is being assessed by management and will be completed during the first quarter of 2011.

Note 4 – Other Assets

| | Prepaid Pipeline Tariffs | Deferred Charges | Total Other Assets |
|-------------------------------------|--------------------------------|---------------------|-----------------------|
| Balance at December 31, 2008 | \$ 2,141 | \$ 516 | \$ 2,657 |
| Additions | 20,807 | 5,421 | 26,228 |
| Less: amortization | (1,774) | (517) | (2,291) |
| Balance at December 31, 2009 | 21,174 | 5,420 | 26,594 |
| Additions | 3,801 | 123 | 3,924 |
| Less: amortization | (3,769) | (1,351) | (5,120) |
| Balance at December 31, 2010 | \$ 21,206 | \$ 4,192 | \$ 25,398 |

Costs invested in the Monterrey crude oil offloading facility are treated as prepaid pipeline tariffs for the first 24 million barrels delivered to the facility. The costs are being amortized using the unit-of-production method based on the barrels of oil delivered to the facility since it was commissioned in 2009. Deferred charges consist of costs related to the \$150 million secured credit facility that are being amortized using the straight-line method over the term of the credit facility agreement.

Note 5 – Corporate Acquisition

On April 14, 2010, Petrominerales acquired 100 percent of the issued and outstanding common shares of PanAndean Resources plc (“PanAndean”) for \$29.6 million in cash by way of Scheme of Arrangement under U.K. Law. At the acquisition date, PanAndean was a public company listed on the AIM exchange with exploration stage properties in Colombia and Peru. This acquisition was completed to facilitate Petrominerales’ strategy to increase its presence in Peru and build on existing acreage in the Ucayali Basin. As such, goodwill consists largely of the strategic benefit that an increased presence in the Ucayali Basin of Peru will bring to the Company. None of the goodwill recognized is expected to be deductible for income tax purposes. The Company incurred \$1.2 million of costs related to the acquisition that have been expensed in the statement of operations.

The statement of operations includes PanAndean’s results of operations since April 14, 2010. These amounts have not been disclosed separately as the amounts are not significant since PanAndean has no production or revenue.

This transaction has been accounted for using the purchase method whereby the assets acquired and the liabilities assumed, excluding goodwill, are recorded at fair values. The following table summarizes the recognizable assets acquired and consideration transferred pursuant to the acquisition:

Consideration paid net of cash acquired

| | Amount |
|--|------------------|
| Cash paid | \$ 29,555 |
| Cash acquired | (758) |
| Total consideration paid net of cash acquired | \$ 28,797 |

Assets acquired and liabilities assumed

| | Amount |
|----------------------------------|------------------|
| Net financial assets | \$ 199 |
| Capital assets | 31,957 |
| Goodwill | 5,015 |
| Future income tax liability | (8,374) |
| Total net assets acquired | \$ 28,797 |

Note 6 – Capital Assets

| December 31, 2010 | Cost | Accumulated Depletion and Depreciation | Net Book Value |
|---------------------|---------------------|--|-------------------|
| Crude oil assets | \$ 1,421,004 | \$ 588,965 | \$ 832,039 |
| Corporate and other | 19,637 | 6,415 | 13,222 |
| | \$ 1,440,641 | \$ 595,380 | \$ 845,261 |

| December 31, 2009 | Cost | Accumulated Depletion and Depreciation | Net Book Value |
|---------------------|-------------------|--|-------------------|
| Crude oil assets | \$ 880,509 | \$ 320,244 | \$ 560,265 |
| Corporate and other | 16,490 | 3,576 | 12,914 |
| | \$ 896,999 | \$ 323,820 | \$ 573,179 |

At December 31, 2010, crude oil assets included \$202.8 million (2009 – \$84.7 million) relating to unproved properties that have been excluded from the depletion calculation. The majority of unproved properties are in Colombia except for \$50.2 million in Peru (2009 – \$11.3 million). The Peruvian unproved properties together with the \$5.0 million of goodwill arising from the PanAndean acquisition represent the Company's significant assets in Peru at December 31, 2010.

An impairment test calculation was performed for the Colombian cost centre at December 31, 2010 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 |
|-------------------------------|--|
| 2011 | 88.00 |
| 2012 | 90.78 |
| 2013 | 93.64 |
| 2014 | 96.57 |
| 2015 | 99.58 |
| Thereafter inflation % change | 2.0% |

(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 7 – Share Capital

Authorized

The Company is authorized to issue an unlimited number of common shares with no par value.

Common Shares

| Common Share Continuity | Number | Amount |
|---|--------------------|-------------------|
| Balance at December 31, 2008 | 99,399,431 | 194,859 |
| Repurchased and cancelled common shares | (1,991,000) | (3,891) |
| Exercise of stock options | 1,224,786 | 5,365 |
| Exercise of deferred common shares | (22,300) | - |
| Transfer from contributed surplus related to stock options, deferred common shares and incentive shares exercised | - | 1,376 |
| Balance at December 31, 2009 | 98,610,917 | 197,709 |
| Exercise of stock options | 1,764,899 | 9,577 |
| Exercise of deferred common shares | 25,625 | 1 |
| Exercise of incentive shares | 2,947 | - |
| Share issuance for dividends attributable to exercised deferred common shares | 123 | 3 |
| Conversion of convertible debentures | 2,987,367 | 92,107 |
| Transfer from contributed surplus related to stock options, deferred common shares and incentive shares exercised | - | 2,544 |
| Balance at December 31, 2010 | 103,391,878 | \$ 301,941 |

Normal Course Issuer Bid

During 2009, the Company repurchased 1,991,000 common shares under a Normal Course Issuer Bid (“NCIB”) at an average cost of \$9.20 (Cdn. \$10.94) per share for a total cost of \$18.3 million. All common shares acquired under the NCIB were cancelled.

Contributed Surplus

| Changes in Contributed Surplus | Amount |
|--|------------------|
| Balance at December 31, 2008 | \$ 4,191 |
| Stock-based compensation | 4,513 |
| Transfer to common shares related to stock options exercised | (1,376) |
| Balance at December 31, 2009 | \$ 7,328 |
| Stock-based compensation | 11,274 |
| Transfer to common shares related to stock options exercised | (2,544) |
| Balance at December 31, 2010 | \$ 16,058 |

Accumulated Other Comprehensive Income

There has been no change to accumulated other comprehensive income as at and for the years ended December 31, 2010 and 2009.

Dividends

Petrominerales initiated a quarterly dividend payment of Cdn.\$0.125 per share starting with the second quarter of 2010. The total amount of dividends declared was \$37.3 million of which \$24.3 million was paid prior to December 31, 2010 (2009 – \$nil).

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 common shares reserved under other Company stock-based compensation plans such as the deferred common share and incentive share compensation plans. The exercise price can be 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:

| | 2010 | | 2009 | |
|-------------------------|---------------|--|---------------|--|
| | Stock Options | Weighted Average Exercise Price (Cdn.\$) | Stock Options | Weighted Average Exercise Price (Cdn.\$) |
| Opening | 6,046,182 | 7.98 | 6,192,723 | 6.11 |
| Granted | 2,823,300 | 27.27 | 1,389,684 | 13.06 |
| Exercised | (1,764,899) | 5.51 | (1,224,786) | 4.78 |
| Forfeited and cancelled | (339,431) | 11.92 | (311,439) | 6.15 |
| Closing | 6,765,152 | 16.47 | 6,046,182 | 7.98 |

The following summarizes information about stock options outstanding as at December 31, 2010:

| Stock Options Outstanding | | | | Stock Options Exercisable | |
|-----------------------------------|------------------|---|--|---------------------------|--|
| Range of Exercise Prices (Cdn.\$) | Number | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price (Cdn.\$) | Number | Weighted Average Exercise Price (Cdn.\$) |
| 3.11 – 4.50 | 1,206,480 | 4.00 | 4.25 | 633,230 | 4.16 |
| 4.51 – 10.00 | 1,414,324 | 3.26 | 7.76 | 264,879 | 7.60 |
| 10.01 – 15.00 | 810,685 | 4.96 | 12.30 | 130,401 | 12.22 |
| 15.01 – 25.00 | 978,413 | 5.98 | 20.01 | 49,476 | 18.04 |
| 25.01 – 28.00 | 1,569,110 | 5.80 | 26.92 | - | - |
| 28.01 – 33.54 | 786,140 | 4.54 | 29.95 | - | - |
| | 6,765,152 | 4.73 | 16.47 | 1,077,986 | 6.62 |

Deferred Common Share Plan

The Company has a deferred common share 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 Cdn. \$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.

Changes in Deferred Common Shares Outstanding

| | Number |
|-------------------------------------|----------------|
| Balance at December 31, 2008 | 39,263 |
| Granted | 58,581 |
| Balance at December 31, 2009 | 97,844 |
| Granted | 59,171 |
| Exercised | (25,625) |
| Balance at December 31, 2010 | 131,390 |

Incentive Share Plan

The Company has established an incentive share plan for directors, officers and employees. The plan allows the holder to receive one common share upon the vesting and payment of Cdn. \$0.05 per share exercise price. The terms of the incentive shares granted are determined by the Company's Board of Directors but typically, incentive shares 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. Up to 3 million incentive shares have been approved for issuance under this plan.

Changes in Incentive Shares Outstanding

| | Number |
|-------------------------------------|----------------|
| Balance at December 31, 2008 | - |
| Granted | 34,130 |
| Balance at December 31, 2009 | 34,130 |
| Granted | 838,036 |
| Exercised | (2,947) |
| Forfeitures and cancellations | (16,600) |
| Balance at December 31, 2010 | 852,619 |

At December 31, 2010, there were 142,150 incentive shares exercisable (2009 - nil) with a remaining contractual life of nine years (2009 - ten years).

Stock-Based Compensation

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

| Years ended December 31, | 2010 | 2009 |
|--|---------------|---------------|
| Risk free interest rate | 2.25% | 1.75% - 2.25% |
| Dividend rate | 1.50% | - |
| Expected life - options (years) | 3.0 - 4.0 | 3.0 - 4.0 |
| Expected life - deferred common shares (years) | 8 | 8 |
| Expected life - incentive shares (years) | 4 | 4 |
| Expected volatility | 27.5% - 42.5% | 37.5% - 42.5% |
| Fair value of stock options granted | \$ 6.93 | \$ 3.64 |
| Fair value of deferred common shares granted | \$ 27.63 | \$ 9.29 |
| Fair value of incentive shares granted | \$ 24.77 | \$ 16.30 |

Stock-based compensation expense for the year ended December 31, 2010 totalled \$11.3 million (2009 - \$4.5 million).

Earnings Per Share

The following table summarizes the weighted average number of common shares used in calculating basic and diluted earnings per share.

| Years ended December 31, | 2010 | 2009 |
|--|-------------|------------------|
| Net income adjustments | | |
| Net income, basic | 239,695 | 100,146 |
| Interest expense on convertible debentures | 8,785 | - ⁽¹⁾ |
| Net income, diluted | 248,480 | 100,146 |
| Weighted average common share adjustments | | |
| Weighted average common shares outstanding, basic | 99,575,620 | 98,378,521 |
| Effect of stock options, deferred common shares and incentive shares | 2,975,029 | 1,609,888 |
| Effect of convertible debentures | 6,019,129 | - ⁽¹⁾ |
| Weighted average common shares outstanding, diluted | 108,569,778 | 99,988,409 |

(1) Convertible debentures were considered anti-dilutive for the year ended December 31, 2009.

Note 8 – Convertible Debentures

2010 Convertible Debentures

The 2010 convertible debentures were originally issued for \$100 million on December 6, 2007. In 2008, \$18.3 million principal value of the debentures was repurchased by the Company. On the expiry date, December 6, 2010, the remaining convertible debentures, having a principal amount of \$81.7 million, were converted into 2,987,367 common shares at the contractual conversion rate of US\$27.3485 per share. On the date of conversion, both the principal and equity components of the convertible debentures totalling \$92.1 million, were transferred to share capital. The accretion recorded in 2010 related to these debentures was \$4.9 million (2009 - \$4.4 million).

2016 Convertible Debentures

On August 25, 2010, Petrominerales issued \$550 million of convertible debentures maturing on August 25, 2016. The debentures are convertible into common shares of Petrominerales at a conversion price of US\$34.746 per share, subject to adjustment for dividends, and have an annual coupon rate of 2.625 percent. Upon conversion, a total of 15,828,978 common shares may be issued, however the Company has an option to repay the debentures in cash. In addition, the bondholders have a one-time put option right of prepayment of the debentures for 100 per cent of the par value plus accrued interest on August 25, 2013. The bondholders must exercise their put option within a 30 day period between June 10 and July 10, 2013. The debentures have been classified as a liability net of the fair value of the conversion feature, or call option, which has been classified as shareholders' equity. On issuance, \$435.9 million was classified as a liability and the remaining \$97.4 million was classified as equity. The liability portion will accrete up to the principal balance at maturity. Accretion and the interest paid are expensed as interest expense in the statement of operations. If the debentures are converted into common shares, the relative portion of the value of the conversion feature under shareholders' equity will be reclassified to common share capital along with the principal amounts converted.

The following table summarizes the allocation of the convertible debentures at December 31, 2010:

| | Amount |
|--|-------------------|
| Gross proceeds | \$ 550,000 |
| Costs | (16,678) |
| Net proceeds | 533,322 |
| Fair value of equity component on issuance | 97,396 |
| Amount attributed to liability component on issuance | 435,926 |
| Accretion | 5,458 |
| Balance of liability component, December 31, 2010 | \$ 441,384 |

Interest Expense

Interest expense consists of:

| Years ended December 31, | 2010 | 2009 |
|--|------------------|-----------------|
| Cash interest and standby charges | \$ 13,610 | \$ 4,866 |
| Accretion on convertible debentures | 10,329 | 4,426 |
| Amortization of deferred financing costs | 1,351 | 517 |
| Interest expense | \$ 25,290 | \$ 9,809 |

Note 9 – Bank Debt

At December 31, 2010, the Company had an undrawn \$150 million secured credit facility. The facility is secured against all assets of the Company, is reviewed semi-annually with the lender and expires on December 30, 2013.

The Company also has lines of credit available in Colombia totalling \$32.9 million. Advances under the facility are collateralized by a promissory note provided by the Company.

At December 31, 2010, the Company had letters of credit totalling \$25.4 million outstanding to guarantee work commitments under exploration blocks. The majority of the letters of credit have been issued against the Colombian operating line of credit, which reduces the amounts available under the facility.

Note 10 – Asset Retirement Obligations

The 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:

| Years ended December 31, | 2010 | 2009 |
|---|-----------|----------|
| Asset retirement obligations, beginning of year | \$ 6,748 | \$ 5,412 |
| Obligations incurred | 5,388 | 1,132 |
| Accretion expense | 759 | 508 |
| Change in estimates | (143) | (304) |
| Asset retirement obligations, end of year | \$ 12,752 | \$ 6,748 |

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 Incremental Production Contracts ("IPC") or exploration contract, between 13 and 20 years in the future. These obligations 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, 2010 is \$86.8 million (2009 – \$38.1 million). The credit adjusted risk free rate for the 2010 obligations incurred was 9 percent (2009 – 9 percent).

Note 11 – Taxes

The 2010 and 2009 provision for income taxes differs from the amount that would have been expected by applying Colombian statutory corporate income tax rates to income before taxes. The principal reasons for this difference are as follows:

| Years ended December 31, | 2010 | 2009 |
|---|------------|------------|
| Income before taxes | \$ 334,127 | \$ 119,602 |
| Statutory income tax rate in Colombia | 33.0% | 33.0% |
| Expected tax expense | \$ 110,262 | \$ 39,468 |
| Increase (decrease) in income tax provision resulting from: | | |
| Non-deductible expenses | 1,492 | 5,830 |
| Colombian enhanced tax allowances | (21,432) | (28,475) |
| Stock-based compensation | 3,720 | 1,489 |
| Change in estimates and others | 390 | 1,144 |
| Future and current income tax expense | 94,432 | 19,456 |
| Consisting of: | | |
| Current income tax expense | 32,432 | 7,336 |
| Future income tax expense | 59,881 | 10,251 |
| | 92,313 | 17,587 |
| Equity taxes | 2,119 | 1,869 |
| Tax expense | \$ 94,432 | \$ 19,456 |

The Company's pre-tax income is subject to Colombian income tax at a statutory rate of 33 percent. Equity taxes are based on equity levels in Colombia.

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

| As at December 31, | 2010 | | 2009 | |
|------------------------------|--------------------------|-------------------------------|--------------------------|-------------------------------|
| | Future Income Tax Assets | Future Income Tax Liabilities | Future Income Tax Assets | Future Income Tax Liabilities |
| Loss carry forwards | \$ 590 | \$ - | \$ 650 | \$ - |
| Capital assets | - | 116,199 | - | 40,077 |
| Asset retirement obligations | 4,208 | - | 2,172 | - |
| Provisions and others | 6,974 | - | 2,531 | - |
| | 11,772 | 116,199 | 5,353 | 40,077 |
| Valuation allowance | - | - | - | - |
| Net future tax liability | \$ - | \$ (104,427) | \$ - | \$ (34,724) |

As at December 31, 2010, non-capital losses in Colombia totalled \$1.7 million that can be carried forward indefinitely.

Note 12 – Related Party Transactions

Prior to December 31, 2010 and the Reorganization, the Company was party to a Management Services Agreement with Petrobank, whereby Petrobank provided certain services, including administration, legal, financial, treasury, accounting, information technology, human resources and office space for Petrominerales employees located in Calgary, Alberta. The monthly fee was based on a negotiated amount that represented the fair value of the services provided. Amounts paid to Petrobank under this agreement totalled \$1.6 million for the year ended December 31, 2010 (2009 - \$1.3 million) and were recorded as general and administrative expense.

Note 13 – 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 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 considers its capital structure to include common share capital, convertible debentures, bank debt and working capital surplus (a non-GAAP measure defined as accounts payable and accrued liabilities less current assets). In order to maintain or adjust the capital structure, from time to time the Company may issue common shares or other securities, sell assets or adjust its capital spending to manage current and projected debt levels.

| As at December 31, | 2010 | 2009 |
|--|------------|------------|
| Bank debt ⁽¹⁾ | \$ - | \$ - |
| Working capital surplus | \$ 580,213 | \$ 13,509 |
| Convertible debentures – principal amount ⁽²⁾ | \$ 550,000 | \$ 81,700 |
| Common share capital | \$ 301,941 | \$ 197,709 |

(1) Petrominerales has a revolving credit facility with a \$150 million borrowing base that is undrawn and a Colombian operating line of credit of \$32.9 million.

(2) The debentures mature August 25, 2016, are convertible into common shares or their cash equivalent at \$34.746 per share and have an annual coupon of 2.625 percent, payable semi-annually in cash or common shares.

The Company monitors leverage and adjusts its capital structure based on the ratio of net debt to cash flow from operations before non-cash working capital. This ratio is calculated as net debt, a non-GAAP measure the Company defines as outstanding bank debt plus the principal amount of convertible debentures, unless the debentures are in-the-money, and working capital deficiency, divided by cash flow from operations before changes in non-cash working capital for the most recent calendar quarter, annualized. At December 31, 2010, net debt was negative since the Company had a working capital surplus. Petrominerales 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 budgets, which are updated as necessary depending on varying factors including current and forecast crude oil prices, changes in capital structure, execution of the Company's business plan and general industry conditions. The annual budget is approved by the Board of Directors and updates are prepared and reviewed as required.

The Company is in compliance with the covenants contained in its convertible debenture and credit facility agreements. The credit facility has financial covenants to maintain a ratio of bank debt to trailing twelve month earnings before interest, tax, depletion, depreciation and amortization under 3.0 times and to maintain a current ratio greater than 1.0 time (current assets divided by current liabilities less unused bank debt). The convertible debentures have financial covenants to maintain a ratio of equity to total assets of at least 30 percent and to limit the amount of security and encumbrances the Company has on its assets to 35% of the book value of total assets.

Petrominerales initiated a quarterly dividend payment of Cdn.\$0.125 per share starting with the second quarter of 2010. The total amount of dividends declared was \$37.3 million of which \$24.3 million was paid prior to December 31, 2010 (2009 – \$nil). Petrominerales' strategy is to provide a reasonable dividend yield to shareholders while executing an accretive growth-oriented, exploration focused business plan.

Note 14 – 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.

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 five main counterparties. The majority of crude oil production is sold to Ecopetrol, the Colombian state oil company, and the remainder to four 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 November sales and part of December sales from our main oil purchaser are received before the end of the year. The Company does not anticipate non-performance by any of the counterparties. In addition, the Company reduced its credit risk to certain counterparties in 2010 through credit insurance.

The following is the Company's accounts receivables breakdown:

| As at December 31, | 2010 | 2009 |
|---------------------|------------|-----------|
| Crude oil customers | \$ 144,563 | \$ 37,712 |
| Other receivables | 11,032 | 9,818 |
| Total | \$ 155,595 | \$ 47,530 |

Receivables from crude oil customers are normally collected approximately 45 days after the month of 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 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 and cash and cash equivalents represent the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at December 31, 2010, and did not provide for any doubtful accounts nor was it required to write-off any receivables during the years ended December 31, 2010 or 2009.

The Company's accounts receivables are aged as follows:

| As at December 31, | 2010 | 2009 |
|----------------------------------|------------|-----------|
| Not past due (less than 45 days) | \$ 148,166 | \$ 45,652 |
| Past due 0-30 days | 698 | 77 |
| Past due 31-120 days | 3,069 | 1,801 |
| Past due > 120 days | 3,662 | - |
| Total | \$ 155,595 | \$ 47,530 |

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. At December 31, 2010, the Company had cash balances of \$723.3 million that provide significant liquidity.

The Company prepares annual capital expenditure budgets, which are monitored regularly 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 9, 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. At December 31, 2010, the credit facility was undrawn 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, 2010:

| Financial Liability | Total | < 1 Year | 1-2 Years | Thereafter |
|--|------------|------------|-----------|------------|
| Accounts payable and accrued liabilities | \$ 308,995 | \$ 308,995 | \$ - | \$ - |
| Letters of credit | 25,399 | 9,998 | 15,401 | - |
| Convertible debentures – principal | 550,000 | - | - | 550,000 |
| Total | \$ 884,394 | \$ 318,993 | \$ 15,401 | \$ 550,000 |

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, 2010, 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 \$14.2 million higher (2009 – \$5.0 million higher), due primarily to peso denominated accounts payable and future income tax liabilities.

The Company had no forward exchange rate contracts in place as at or during the year ended December 31, 2010.

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. For the year ended December 31, 2010, if West Texas Intermediate oil ("WTI") was one dollar per barrel higher, with all the other variables held constant, net income and other comprehensive income for the year would have been \$10.7 million higher. 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 did not have any risk management contracts outstanding during the years ended December 31, 2010 and 2009.

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 price 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, 2010.

Financial Instruments Classification, Measurement and Fair Value

The Company's financial instruments are cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, bank debt and convertible debentures on the balance sheet. The carrying value, fair value and interest expense associated with these financial instruments as at and for the year ended December 31, 2010 is disclosed below by financial instrument category:

| Financial Instrument | Carrying Value | Fair Value | Interest Expense |
|--|----------------|------------------------|-----------------------|
| Assets Held For Trading | | | |
| Cash and cash equivalents ⁽¹⁾ | 723,277 | 723,277 | - |
| Loans and Receivables | | | |
| Accounts receivable | 155,595 | 155,595 | - |
| Other Liabilities | | | |
| Accounts payable and accrued liabilities | 308,995 | 308,995 | - |
| Bank debt | - | - | 7,142 ⁽²⁾ |
| Convertible debentures | 441,384 | 634,563 ⁽³⁾ | 18,148 ⁽⁴⁾ |

(1) The effective yield on cash equivalents at December 31, 2010 was 0.31%.

(2) Included in interest expense on the statement of operations. Amount includes interest, commitment and other fees associated with credit facilities and amortization of deferred financing costs of \$1.4 million in relation to the Company's bank debt.

(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 estimated the fair value of the convertible debentures based on recent market transactions. The principal amount of the convertible debentures at December 31, 2010 was \$550 million.

(4) Included in interest expense on the statement of operations. The effective yield of the convertible debentures is 6.84%.

Petrominerales classifies the fair value of these transactions according to the following hierarchy based on the amount of observable inputs used to value the instrument.

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

The Company's financial instruments have been assessed on the fair value hierarchy described above. Cash and cash equivalents are classified as Level 1. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement within the fair value hierarchy level.

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, accounts receivable and accounts payable and accrued liabilities, their carrying values approximate their fair values.

Note 15 – Changes in Non-Cash Working Capital

| Years ended December 31, | 2010 | 2009 |
|--|--------------|-------------|
| Change in: | | |
| Accounts receivable | \$ (108,065) | \$ (31,024) |
| Accounts payable and accrued liabilities | 202,161 | 44,110 |
| Dividends declared but not paid in retained earnings | (12,992) | - |
| Income tax receivable | 4,203 | - |
| Acquisition of non-cash working capital | 199 | - |
| Inventory | (4,701) | (1,376) |
| Depletion included in inventory | 2,242 | 741 |
| | \$ 83,047 | \$ 12,451 |
| Changes relating to: | | |
| Attributable to operating activities | \$ (14,662) | \$ (4,809) |
| Attributable to financing activities | \$ 12,992 | \$ - |
| Attributable to investing activities | \$ 84,717 | \$ 17,260 |
| | \$ 83,047 | \$ 12,451 |

Note 16 – Commitments

The following is a summary of the Company's contractual commitments as at December 31, 2010:

| Type of Obligation | Total | < 1 Year | 1-3 Years | 4-5 Years |
|---|-------------------|-------------------|------------------|-----------------|
| Exploration contracts ⁽¹⁾⁽²⁾ | \$ 53,300 | \$ 47,200 | \$ 6,100 | \$ - |
| Transportation contract | 2,040 | 2,040 | - | - |
| OBC Pipeline commitment ⁽³⁾ | 99,600 | 99,400 | 200 | - |
| Oil Storage | 900 | 400 | 500 | - |
| Office lease | 8,100 | 2,100 | 4,000 | 2,000 |
| Total⁽⁴⁾ | \$ 163,940 | \$ 151,140 | \$ 10,800 | \$ 2,000 |

- (1) Pursuant to exploration contracts, the Company has work commitments totaling \$53.3 million to be completed during the next three years. The work commitments are normal course of business activities that include property costs, acquisition and processing of seismic data and drilling exploration wells. The Company has issued letters of credit totaling \$25.4 million to guarantee the obligations under these exploration contracts.
- (2) Following the Colombian Open Bid Round 2010, Petrominerales was awarded Block 59 and Block 15. Our first phase work commitments on Block 59 will include spending of \$24.2 million over three years to acquire 300 square kilometres of 3D seismic and drilling four exploration wells. Our first phase work commitments on Block 15 will include spending \$10.0 million over three years to acquire 100 square kilometres of 3D seismic and drilling two exploration wells. These additional commitments will be added to the schedule once the contracts are signed.
- (3) We have entered into an agreement to acquire and participate in 9.65 percent of the Oleducto Bicentenario de Colombia pipeline project ("OBC"). Phase zero of the project will add 40,000 bopd of oil offloading capacity at Banadia, connecting to the Cano Limon export pipeline system. Phase one of the project will connect Llanos Basin production from Araguaney to Banadia. This phase is expected to cost approximately \$1.0 billion (\$96.5 million net) and add approximately 120,000 bopd (11,580 bopd net) of offloading capacity by the first quarter of 2012. Ultimately, phases two and three of the project are expected to be completed by the end of 2013 and will add a further 330,000 bopd of gross takeaway capacity at a total incremental gross cost of approximately \$4.4 billion. Petrominerales has an option to participate in phases two and three.
- (4) The Colombian government approved new legislation in December 2010 that obligates Colombian corporations and branches of foreign corporations to pay an equity tax based on net equity as of January 1, 2011. The rate of tax applicable to Petrominerales is 6.8% of net equity. The tax is payable evenly over four years starting in 2011.

Note 17 – Contingencies

In the normal course of operations, Petrominerales has disputes with industry participants for which the Company currently cannot determine the ultimate result. Petrominerales records costs as they are incurred or become determinable. Management believes the resolution of these matters would not have a material adverse effect on the Company's consolidated financial position or results from operations.

High Price Participation Dispute

Petrominerales currently has a dispute with the Colombian Agencia Nacional de Hidrocarburos (National Hydrocarbon Agency) ("ANH") related to the interpretation of the Corcel Block exploration contract ("Corcel Contract") entered into between Petrominerales and the ANH on June 2, 2005.

The Corcel Contract requires a high price participation payment to be paid by Petrominerales to the ANH once an exploitation area has cumulatively produced more than five million barrels of oil, determined before the deduction of royalties. The high price participation payment is paid at 30 percent of the price received above certain threshold prices, based on the oil quality produced.

The ANH has indicated their view that all exploitation areas under the Corcel Contract should be combined for the purposes of determining when the high price participation payment is payable. As combined production from all of the exploitation areas on the Corcel Block has exceeded five million barrels of oil, the ANH asserts that Petrominerales is required to pay the high price participation payment with respect to production from the Corcel Block from April 2009 onwards. Based on their view, the ANH has requested additional payments aggregating to \$68.9 million to date. Although cumulative production from the Block was 12.5 million barrels to December 31, 2010, none of Petrominerales' individual exploitation areas on the Corcel Block have cumulatively produced more than five million barrels of oil.

Petrominerales disagrees with the ANH interpretation and views the Corcel Contract as providing that payment of the high price participation payment is only required once each exploitation area has cumulatively produced more than five million barrels of oil.

The dispute is currently in a conflict resolution process as provided for in the Corcel Contract. Petrominerales believes that the resolution of this dispute will be in favour of the Company, and accordingly, no additional royalty provision has been made in these financial statements.

Corporate Information

Directors

Jerald L. Oaks ⁽¹⁾

Denver, Colorado, U.S.A.

Alastair Macdonald ⁽²⁾

Pembroke, Bermuda

Kenneth R. McKinnon ^{(1) (2)}

Calgary, Alberta, Canada

Ernesto Sarpi ⁽³⁾

Naples, Italy

Enrique Umaña-Valenzuela ⁽¹⁾

Bogotá D.C., Colombia

John D. Wright ⁽³⁾

Calgary, Alberta, Canada

Chairman & Strategic Advisor

Geir Ytreland ^{(2) (3)}

Droebak, Norway

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Reserves Committee

Officers

Ruben Cano

Vice President Services and Logistics

Jeff Chant

Vice President Organizational Performance

Andrea Hatzinikolas

Assistant Corporate Secretary
and General Counsel

Allen E. Knight

Vice President New Ventures

Erik Lyngberg

Senior Vice President Exploration

Alastair MacDonald

Corporate Secretary

Tannya E. Morales

Vice President, Finance

Corey Ruttan

President and
Chief Executive Officer

Lorne Saina

Vice President, Operations

John (Jack) F. Scott

Chief Operating Officer

Kelly Sledz

Chief Financial Officer

Head Office

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Computershare Trust

Company of Canada

Calgary, Alberta, Canada

Legal Counsel

McCarthy Tétrault LLP

Calgary, Alberta, Canada

Bankers

Standard Bank

New York, New York, U.S.A.

Auditors

Deloitte & Touche LLP

Calgary, Alberta, Canada &

Bogotá D.C., Colombia

Reserve Engineers

DeGoyler and MacNaughton

Dallas, Texas, U.S.A.

Exchange Listing

Toronto Stock Exchange

SYMBOL: **PMG**

Securities Filings

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Information requests and other
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Forward Looking Information

Certain statements contained in this Financial Report constitute forward-looking statements.

In particular, this Financial Report may contain forward-looking statements pertaining to the following: the performance characteristics of the Company's oil properties; oil production levels; the size of the oil reserves; projections of market prices and costs; supply and demand for oil; expectations regarding the ability to continually add to reserves through acquisitions and development; treatment under governmental regulatory regimes and tax laws; and capital expenditure programs.

In addition, statements relating to 'reserves' or 'resources' are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future.

With respect to forward looking statements contained in this Financial Report, the Company has made assumptions regarding: oil production levels; commodity prices; general economic and financial market conditions; availability of labour and drilling equipment; timing and amount of capital expenditures; government regulation in the areas of taxation, royalty rates and environmental protection; and expectations and assumptions concerning the obtaining of necessary regulatory approvals.

The actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors set forth in the Financial Report and other risk factors including but not limited to: volatility in market prices for oil; fluctuation in foreign currency exchange rates; financial resources of the Company, liabilities inherent in oil operations; uncertainties associated with estimating oil reserves; competition for, among other things, capital, acquisitions of reserves and undeveloped lands; geological, technical, drilling and processing problems; changes in legislation, risks associated with the Company's international operations, changes in environmental or tax laws; and the other factors discussed under the heading 'Risk Factors' in the Company's annual information form.

Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward-looking statements contained in this Annual Report are expressly qualified by this cautionary statement. Further, any forward-looking statement is made only as of a certain date, and the Company undertakes no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as may be required by applicable securities laws. New factors emerge from time to time, and it is not possible for management of the Company to predict all of these factors and to assess in advance the impact of each such factor on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

Annual General Meeting

The Annual General Meeting will be held on May 12, 2011 at 10:00 (Bogotá time) in the Millennium Room at the Hotel Radisson, Calle 113 No. 7 – 65, Bogotá, Colombia. All shareholders are cordially invited and encouraged to attend. The meeting will also be webcast. The webcast details will be available on our website in advance of the meeting.

FSC Logo goes here



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