PACIFIC RUBIALES ENERGY CORP.

MANAGEMENT DICUSSION AND ANALYSIS
May 8, 2014
Form 51 - 102 F1
For the three months ending March 31, 2014

This Management Discussion and Analysis ("**MD&A**") contains forward-looking information based on the current expectations, estimates, projections and assumptions of Pacific Rubiales Energy Corp ("**Pacific Rubiales**" or the "**Company**"). This information is subject to a number of risks and uncertainties, many of which are beyond the Company's control. Users of this information are cautioned that actual results may differ materially. For information on material risk factors and assumptions underlying our forward-looking information, see page 2.

This MD&A is management's assessment and analysis of the results and financial condition of the Company, and should be read in conjunction with the accompanying Interim Condensed Consolidated Financial Statements and related notes for the first quarter of 2014 and 2013. The preparation of financial information is reported in United States dollars and is in accordance with International Financial Reporting Standards ("**IFRS**") as issued by the International Accounting Standards Board ("**IASB**") unless otherwise noted. All comparative percentages are between the quarters ending March 31, 2014 and March 31, 2013 unless otherwise stated.

In order to provide shareholders with full disclosure relating to potential future capital expenditures, the Company has provided cost estimates for projects that in some cases are still in the early stages of development. These costs are preliminary estimates only. The actual amounts are expected to differ and these differences may be material. For further discussion of the significant capital expenditures, see "Capital Expenditures" on page 18.

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

This MD&A was prepared originally in the English language and subsequently translated into Spanish and Portuguese. In the case of differences or discrepancies between any of its translated versions, the English document shall prevail and be treated as the governing version.

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Legal Notice – Forward-Looking Information and Statements

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

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

For more information please see the Company´s Annual Information From which is available at www.sedar.com.

1. Company Overview and Strategy

Pacific Rubiales is a premier oil and gas exploration and production company publicly listed on the Toronto, Colombian and Brazilian stock exchanges. We are the largest independent oil and gas producer in Colombia, with a focus on identifying growth opportunities in Colombia, Peru, Brazil, Guatemala, and other countries in the region. The Company has a strong and growing reserve base, a proven track record of cash generation, and a robust portfolio of exploration assets that underline the prospects for future growth.

Business Strategy

Our near and medium-term business strategy is focused on:

- Continuous growth in addition to the replacement of the Rubiales field production by 2016
- Operational efficiency and cost reduction
- Accretive acquisitions: operational synergies, turn around of underperforming fields and growth potential
- Reserve and production diversification within and beyond the Colombian basins
- Delivering attractive returns to shareholders
- Long-term sustainable growth through innovation: enhanced oil recovery, exploration success and strategic projects such as our liquefied natural gas project

Operational Summary – First Quarter 2014

During the first quarter of 2014, we reached record levels in production at 148.8 Mboe/d with increases from a number of blocks, in particular the volumes contributed by blocks acquired with Petrominerales, which produced an average of 25 Mboe/d. Our sales volume reached a record of 151.8 Mboe/d, and did not include 492 Mbbl of crude that was part of a cargo being loaded on March 31, 2014. Our trading activities continued to deliver strong realized oil prices at an average of $98.44/bbl for the quarter, $2.90/bbl higher than the fourth quarter of 2013. The production at Rubiales was slightly down this quarter due to temporary restrictions on water disposal as a result of climate conditions, but production is returning to normal levels in the second quarter as the dry season is now over.

Our combined netback also had a strong increase during the quarter, to $63.80/boe from $59.43/boe in the fourth quarter of 2013 and $60.88/boe in the same period of 2013, in spite of additional transport costs associated with the unavailabilty of the Bicentenario pipeline since February, following security issues. The Company was able to transport its production through other transportation means, avoiding any disruption to our sales.

As a result of record sales and the strong netback, our adjusted EBITDA reached a record level of $708 million during the period. The funds flow and net earnings from operations for this quarter continued to be strong at $474 million and $331 million, respectively.

One of our most important short term objectives is the development of new heavy oil fields in Colombia. During the quarter we continued to advance our development plans in both the CPE-6 and Rio Ariari blocks, with six appraisal wells drilled in CPE-6 and one appraisal well drilled in Rio Ariari. In CPE-6, four wells under extended production tests averaged approximately 600 bbl/d total gross production at the end of the quarter.

In Peru, average net production for the offshore Block Z-1 increased 81% from 1,244 bbl/d in the fourth quarter of 2013 to 2,258 bbl/d during the current quarter.

On the exploration side, in Block 131 in Peru, the Los Angeles discovery well produced over 3,400 bbl/d later stabilized to an average rate of 1,159 bbl/d with a 0.6% water cut. Additionally, there were two new oil discoveries in the Guatiquia Block located in the Llanos basin, in Colombia.

In April 2014, the Company held high-level management meetings with Ecopetrol, S.A. ("**Ecopetrol**") to explore the application of STAR technology at the Rubiales field after 2016. Both companies agreed to jointly prepare and present a technical report to their senior management by the end of May 2014 for further evaluation.

Also, the quarter saw the commencement of operations of the Petroelectrica de los Llanos ("**PEL**") transmission line, bringing lower cost electricity to the Rubiales and Quifa fields, as well as to ODL. The new 230 kilovolts transmission line supplies up to 192 MW used in oil production and pipeline transportation activities, reducing our operating costs.

Financial Management

During the quarter we continued to focus our capital management strategy on maintaining a strong leverage ratio while delivering attractive returns to our shareholders. We completed the sale of our 5% equity interest in the Oleoducto Central S.A. (the "**Ocensa pipeline**") and associated transportation rights, which were part of the Petrominerales acquisition, for $385 million in cash, while retaining a ten-year right to use the pipeline by entering into a rights agreement. The proceeds from the sale of our Ocensa pipeline interest plus cash on hand, were used to repay the aggregate principal amount of $400 million outstanding on the U.S. Dollar revolving credit facility in April 2014. We have also signed an appraisal letter with the International Finance Corporation ("**IFC**"), a member of the World Bank, for the sale of a minority interest in our other mid-stream infrastructure assets (held by our wholly-owned subsidiary, Pacific Midstream Holding Corp.), to enhance the valuation on these assets and to also provide additional liquidity to the Company. During April 2014, we closed a new $1 billion syndicated revolving credit facility at a lower interest rate and cancelled the previous U.S. Dollar and Peso Facilities. The new facility provides us with additional financial flexibility, although we do not intend on drawing down on it in the short term.

During the first quarter of 2014, we paid a total of $52 million ($0.165 per share) in dividends. In addition, under the Company´s normal course issuer bid, we repurchased approximately 9.1 million common shares for a total outlay of $134 million. At an average purchase price of C$16.38 (US$14.8), the share repurchase program has returned tangible value to our shareholders.

2. Financial and Operating Highlights

Financial Summary

(in thousands of US$ except per share amounts or as noted)	**Q1 2014**	Q1 2013 [(1)]	Q4 2013 [(1)]
Oil and gas sales	**$ 1,283,453**	$ 1,258,762	$ 1,202,551
Adjusted EBITDA [(2)]	**708,158**	695,062	655,327
Adjusted EBITDA margin (Adjusted EBITDA/Revenues)	**55%**	55%	54%
Per share - basic ($) [(3)]	**2.23**	2.16	2.02
Funds flow from operations [(2)]	**473,609**	506,160	476,851
Funds flow from operations margin (Funds flow from operations/Revenues)	**37%**	40%	40%
Per share - basic ($) [(3)]	**1.49**	1.58	1.47
Net earnings from operations [(2)]	**330,789**	327,007	312,426
Per share - basic ($) [(3)]	**1.04**	1.02	0.96
Net earnings [(4)]	**119,240**	127,378	140,412
Per share - basic ($) [(3)]	**0.38**	0.40	0.43
Adjusted net earnings [(2)]	**120,566**	115,968	152,123
Per share - basic ($) [(3)]	**0.38**	0.36	0.47
Shares outstanding at the end of the period	**313,446,958**	322,428,270	322,503,758
Capital expenditures and farm-in´s	**481,409**	604,460	1,645,873
(COP$ / US$) exchange rate [(5)]	**1,965.32**	1,832.20	1,926.83

1. *Net Earnings for 2013 have been restated upon the first time adoption of IFRS 9 – Financial Instruments and the finalization of the purchase price allocation of C&C acquisition. Refer to Note 27 and Note 3 of the first quarter 2014 Interim Condensed Consolidated Financial Statements.*
2. *See "Additional Financial Measures" on page 38*
3. *The basic weighted average number of common shares outstanding for the first quarters of 2014 and 2013 was 317,835,678 and 321,344,499, respectively. The basic weighted average number of common shares outstanding for the fourth quarter of 2013 was 324,173,884.*
4. *Net earnings attributable to equity holders of the parent.*
5. *COP/USD exchange rate fluctuations can have a significant impact on the Company's accounting net earnings, due in the form of unrealized foreign currency translation on the Company´s financial assets and liabilities and deferred tax balances that are denominated in COP.*

Operating Summary

	Q1 2014	Q1 2013	Q4 2013
Average net production (boe/d)	**148,827**	127,889	134,313
Average sales volumes (boe/d)	**151,847**	143,650	143,864
Combined price ($/boe)	**93.38**	97.14	90.66
Production cost of barrels sold ($/boe)	**15.57**	12.22	13.98
Transportation (trucking and pipeline) ($/boe)	**13.88**	14.42	12.26
Diluent cost ($/boe)	**2.68**	8.58	2.14
Overlift/Underlift ($/boe)	**(3.84)**	0.18	(1.57)
Other costs ($/boe)	**1.29**	0.86	4.42
Combined netback ($/boe)	**63.80**	60.88	59.43
Crude oil netback ($/bbl)	**66.98**	63.34	62.31
Gas netback ($/boe)	**25.04**	32.52	25.36
WTI NYMEX ($/bbl)	**98.61**	94.36	97.61

Additional Financial Metrics

(in thousands of US$ except as noted)	Q1 2014	Q1 2013	Q4 2013
General and administrative expense	**$ 75,214**	$ 71,989	$ 112,808
Finance cost	**61,495**	47,577	43,298
Current income tax expense	**151,050**	161,320	89,293
Dividends paid	**51,933**	35,458	53,545
Shares repurchased	**134,176**	-	35,283

First Quarter 2014 Highlights

Record Level in Production, Sales and Adjusted EBITDA

- Increase in average daily net production by 11% to a record of 148,827 boe/d in the current quarter from 134,313 boe/d in the previous quarter; 16% increase when compared to 127,889 boe/d for the first quarter of 2013.
- Increase in revenue by 7% compared to the previous quarter, to $1.28 billion from $1.20 billion as a result of higher sales and a 3% rise in realized prices; revenue also increased 2% compared to the first quarter of 2013 on higher volume sold.
- Adjusted EBITDA of $708 million for the quarter, the highest ever recorded by the Company, and 8% and 2% higher than the fourth quarter and first quarter of 2013, respectively. Adjusted EBITDA for the quarter represented a margin of approximately 55% of revenue.
- Funds flow from operations decreased slightly to $474 million compared to $477 million in the fourth quarter 2013 and $506 million in the first quarter 2013, due to higher interest costs and other expenses.
- Earnings from operations increased to $331 million from $312 million in the fourth quarter of 2013; net earnings decreased from $140 million in the fourth quarter of 2013 to $119 million in the current quarter, mainly due to higher operating cost, depletion, depreciation and amortization, interest costs and income tax expense in Colombia.
- During the quarter the Company delivered to Ecopetrol 450 Mbbl of crude oil volumes that were outstanding from prior periods from the Quifa SW high-price clause ("**PAP**") arbitration decision. This cancels the outstanding debt and going forward, these volumes will be available for sale by the Company.

Increase in Combined Netbacks and Temporary Challenges on Operating Costs

- Combined operating netback increased to $63.80/boe in the first quarter of 2014 from $59.43/boe in the fourth quarter of 2013 and $60.88/boe in the same period of 2013. Oil netback averaged $66.98/bbl during the quarter, also higher than the $62.31/bbl for the fourth quarter of 2013 and $63.34/bbl in the same period of 2013.
- Total combined operating costs (including overlift and other costs) amounted to $29.58/boe, lower by $1.65/boe compared to the fourth quarter of 2013 and lower by $6.68/boe compared to the first quarter of 2013. These cost reductions underline the impact of cost optimization initatives the Company has been implementing.
- Our operating costs were impacted by a temporary reduction in production at the Rubiales field due to a restriction on the volume of water disposal at the field, resulting in an increase of $1.59/boe in per unit production cost during the quarter. This situation has normalized as dry season is now over and production volumes are returning to normal levels. Also, a temporary disruption on the Bicentenario pipeline resulted in an increase in transportation cost of approximately $1.62/boe as compared to the fourth quarter of 2013. The Company was able to maintain flow of production by diverting volumes to other pipelines through short-term agreements and by using tank trucks.
- Combined realized price for the quarter was $93.38/boe, higher than the previous quarter by $2.72/boe which offset the effect of the increase in production costs.
- During the quarter, the Company paid $29 million in take-or-pay fees to the Bicentenario pipeline during the period in which the capacity was not available. This cost was not included as part of our netback calculation as the pipeline was not operational and the cost is temporary in nature.

Exploration and Development Colombia and Peru

- In the CPE-6 block, a total of six appraisal wells were drilled, four of which are currently under production tests and averaging a combined oil production rate of 600 bbl/d.
- The first horizontal appraisal well was drilled in the Rio Ariari block and at the end of the quarter the well was being prepared for production test.
- Two new oil discoveries in the Guatiquia block in Colombia, where the wells are currently under production testing. Both wells, Ceibo-1X and Avispa-1X as a whole are currently producing in excess of 5,000 bbl/d of medium-light oil and openned a new window of for great potential for the rest of the prospects on the Guatiquía block.
- Average net production for the Block Z-1 in offshore Peru increased 81% from 1,244 bbl/d in the fourth quarter of 2013 to 2,258 bbl/d during the current quarter.

Projects Update

- In January 2014, the PEL power line commenced operation, bringing lower cost electricity to the Rubiales and Quifa fields, as well as to the ODL pipeline. The new 230 kilovolts transmission line supplies up to 192 MW used in oil production and pipeline transportation activities, reducing our operating costs.
- The Agrocascada irrigation project, which will reduce water disposal costs at the Rubiales and Quifa fields, is on track to be commissioned in the second half of 2014. As of March 2014, the construction of the reverse osmosis plants had reached 55% completion. Environmental permits to allow the use of treated water for agricultural purposes are in process.
- On April 22, 2014, the senior executives of the Company met with Ecopetrol to review current status of the pilot project employing the STAR technology in the Quifa block. As a result of the meeting, a joint technical report will be prepared and presented to the senior management of both companies in late May or early June 2014.

Financing

- Completed the sale of a 5% equity interest and the corresponding capacity rights in the Ocensa oil pipeline in Colombia for a total cash consideration of $385 million, of which $375 million have been received.
- In April, repaid the entire balance of $400 million outstanding on the U.S. dollar revolving credit facility using proceeds from the sale of the Ocensa pipeline plus cash on hand.
- Repurchased 9.1 million common shares under the share repurchase program for a total of $134 million at approximately C$16.38 per share.
- Signed an appraisal letter with the IFC to sell a minority interest in our infrastructure assets (ODL, Bicentenario, and PEL) which is expected to realize a tangible return on our investment.
- Paid cash dividends of $52 million or $0.165 per share.
- During April 2014, a new syndicated U.S. dollar revolving credit facility was closed, for up to $1 billion maturing in 2017 with a lower interest rate and improved covenant package than the previous revolving facility. The new facility provides additional financial flexibility, though we do not foresee the use of this line in the near term. The previously existing US Dollar and Peso revolvers were subsequently cancelled.

3. Financial Summary

A summary of the financial results for the three months ending March 31, 2014 and 2013 are as follows:

Results of First Quarter of 2014 Compared to First Quarter of 2013

Revenue for the first quarter of 2014 was a record of $1,283 million, 2% higher than the $1,259 million of the same period of 2013. During the first quarter of 2014, the total sales volume of crude oil and natural gas amounted to 13.7 MMboe compared to 12.9 MMboe during the first quarter of 2013, mainly as a result of the 16% increase in net production to 148,827 boe/d from 127,889 boe/d, comparing the first quarter of 2014 with the same period of 2013.

Net earnings for the first quarter of 2014 were $119 million, compared to $127 million reported in the same period of 2013, impacted by higher operating costs, depreciation, depletion and amortization, finance costs, foreign exchange and income tax. Net earnings from operations[(1)] for the first quarter of 2014 were $331 million, compared to $327 million in the same period of 2013. A reconciliation of the net earnings to the net earnings from operations follows:

(in thousands of US$)	Q1 2014	Q1 2013	Q4 2013
Net earnings	**$ 119,240**	$ 127,378	$ 140,412
Finance costs	**61,495**	47,577	43,298
Share of (gain) loss of equity-accounted investees	**(17,063)**	1,632	15,227
Foreign exchange (gain) loss	**1,775**	(14,971)	7,201
Loss (gain) on risk management	**(3,855)**	5,651	(9,801)
Other expenses (income)	**20,469**	(3,722)	(916)
Income tax expense	**149,458**	164,618	119,229
Loss attributable to non-controlling interest	**(730)**	(1,156)	(2,224)
Net earnings from operations [(1)]	**$ 330,789**	$ 327,007	$ 312,426

1. *See "Additional Financial Measures" on page 38.*

Adjusted EBITDA and Cash Flow from Operations

Adjusted EBITDA totaled $708 million for the first quarter of 2014, an increase of 2% compared to $695 million in the same period of 2013, and maintained a 55% margin on total revenues for the period. The strong adjusted EBITDA was achieved despite a 4% decrease in combined realized prices as compared to the first quarter of 2013. Funds flow from operations amounted to $474 million in the first quarter of 2014, a decrease when compared to $477 million in the fourth quarter and $506 million in the first quarter of 2013. Cash flow from operations was $385 million for the first quarter of 2014 compared to $474 million for the fourth quarter of 2013 and $622 million in the first quarter of 2013, primarily due to the movement in net working capital.

Additional details on financial results for first quarter of 2014 are provided in Section 8 - Discussion of 2014 First Quarter Financial Results on page 23.

4. Operating Results

Average volume produced and sold

During the first quarter of 2014, net production after royalties and internal consumption in Colombia and Peru totaled a record 148,827 boe/d (324,938 boe/d total field production), an increase of 11% as compared to the fourth quarter of 2013 and 16% when compared with the first quarter of 2013.

Volume of oil and gas produced and sold, including diluents, but excluding trading volumes, was 141,261 boe/d during the first quarter of 2014, lower by 7,566 boe/d as compared to the total production of the period, due to the following events:

- During the quarter the Company delivered to Ecopetrol the final 450 Mbbl (4,996 bbl/d) of prior period crude oil volumes that were outstanding from the Quifa SW high-price clause ("PAP") arbitration decision. Previous PAP volumes have been fully settled and going forward, these volumes will be available for sale by the Company.
- As of March 31, 2014, a total volume of 492 Mbbl (5,463 bbl/d) of crude oil that were part of a cargo were not loaded and therefore could not be accounted as part of the revenues for this period. This volume remained in inventory for the quarter.
- Included in the volume sold was 3,211 bbl/d of diluents purchased.

Total oil for trading volumes during the first quarter totaled 10,586 bbl/d. Combined with the volume produced and sold, the Company recorded total volumes of sales of 151,847 boe/d, higher by 6% when compared to the 143,650 boe/d for the first quarter of 2013 and 143,864 boe/d for the fourth quarter of 2013.

A reconciliation of the oil and gas volumes produced and sold during the current quarter is provided below:

Production to total sales reconciliation	**Three Months Ending March 31**		**Three Months Ending December 31**
	2014	**2013**	**2013**
Average total field production (boe/d)	324,938	307,138	315,955
Net production			
Colombia oil (bbl/d)	135,694	115,318	122,190
Colombia gas (boe/d)	10,709	11,110	10,879
Peru oil (bbl/d)	2,424	1,461	1,244
Total net production (boe/d)	**148,827**	**127,889**	**134,313**
Diluent volumes (bbl/d)	3,211	9,607	2,261
PAP (bbl/d) (1)	(4,996)	-	(6,363)
Overlift and Inventory movements (boe/d) (2)	(5,781)	2,259	10,254
	141,261	**139,755**	**140,465**
Oil for trading (bbl/d)	10,586	3,895	3,399
Volume sold (boe/d)	**151,847**	**143,650**	**143,864**

1. *Corresponds to the inventory delivered to Ecopetrol during the first quarter of 2014 and 2013.*
2. *Includes part of the cargo that was not fully loaded as at March 31, 2014, equivalent to (5,463 bbl/d).*

Operating Netback – Q1 2014 Compared to Q4 2013

	Three Months Ending March 31			Three Months Ending December 31		
	2014			2013		
	Crude Oil	Natural Gas	Combined	Crude Oil	Natural Gas	Combined
Average daily volume sold (boe/day)[(1)]	**130,526**	**10,735**	**141,261**	**129,547**	**10,918**	**140,465**
Operating netback ($/boe)						
Crude oil and natural gas sales price	98.44	31.80	93.38	95.54	32.69	90.66
Production cost of barrels sold [(2)]	16.51	4.18	15.57	14.80	4.24	13.98
Transportation (trucking and pipeline) [(3)]	15.02	0.01	13.88	13.29	-	12.26
Diluent cost	2.90	-	2.68	2.32	-	2.14
Total operating cost	**34.43**	**4.19**	**32.13**	**30.41**	**4.24**	**28.38**
Overlift/Underlift [(4)]	(4.21)	0.64	(3.84)	(1.71)	0.07	(1.57)
Other costs [(5)]	1.24	1.93	1.29	4.53	3.02	4.42
Total operating cost including overlift/underlift and other costs	**31.46**	**6.76**	**29.58**	**33.23**	**7.33**	**31.23**
Operating netback crude oil and gas ($/boe)	**66.98**	**25.04**	**63.80**	**62.31**	**25.36**	**59.43**

1. *Combined operating netback data based on weighted average of daily volume sold which includes diluents necessary for the blending of the Rubiales crude oil, and excludes oil for trading volumes.*
2. *Cost of production mainly includes lifting cost and other direct production costs such as fuel consumption, outsourced energy, fluid transport (oil and water), and personnel expenses and workovers, among others. Increases in oil production costs are driven by higher fluid (mainly water) production, which affects fuel consumption, outsourced energy and fluid transport costs, as compared to the prior periods of 2013.*
3. *Includes the transport costs of crude oil and gas through pipelines and tank trucks incurred by the Company when taking the products to the delivery points for customers.*
4. *Corresponds to the net effect of the overlift position of $49 million income during the first quarter of 2014 ($2.3 million cost for the first quarter of 2013).*
5. *Other costs mainly correspond to inventory fluctuation, storage cost and the net effect of the currency hedges of operating expenses incurred in Colombian pesos during the period, as well as royalties paid in cash on gas and oil production and external road maintenance at the fields.*

During the first quarter of 2014, the combined crude oil and gas operating netback was $63.80/boe, higher by $4.37/boe as compared to the fourth quarter of 2013 ($59.43/boe).

Combined realized price for the quarter was $93.38/boe, an increase of $2.72/boe over the fourth quarter of 2013 ($90.66/boe) due to an increase in international oil prices.

Total combined operating costs (including overlift and other costs) amounted to $29.58/boe, a reduction of $1.65/boe compared to the fourth quarter of 2013. During the first quarter, we experienced certain operational challenges, outside of the Company's control, that had an impact on our costs (production, transport and diluent costs):

- Production from the Rubiales field was temporarily reduced by an average of 3,800 bbl/d net (6%) during the quarter, due to a restriction on the volume of water disposal at the field. The volume of treated water that may be released into the rivers near the Rubiales field is a function of the river water level, which was lower as a result of an unseasonable drought in the area. This resulted in an increase of $1.59/boe in per unit production cost during the quarter as compared to the fourth quarter of 2013. The dry season is now over and production volumes are returning to normal levels.
- Since February 2014, operations in Bicentenario pipeline have been temporarily suspended following security related disruptions. As a result, we were not able to access our 47 Mbbl/d of transport capacity on the pipeline. The Company was able to maintain flow of production by diverting volumes to other pipelines through short-term agreements and by using tank trucks, resulting in an increase in transportation cost of approximately $1.62/boe as compared to the fourth quarter of 2013.

The above increases were offset by decreases in the overlift/underlift movement and other costs. The net effect of all of the above is a total operating cost reduction of $1.65/boe as compared to the fourth quarter of 2013.

During the period of pipeline disruption, the Company still incurred take-or-pay fees, which amounted to $29 million. Bicentenario is currently working on restoring the pipeline to operation. This cost was not included in the netback calculation, given the fact that no crude was transported through the pipeline during this period and the payment is temporary in nature.

Operating Netback – Q1 2014 Compared to Q1 2013

	Three Months Ending March 31					
	2014			2013		
	Crude Oil	Natural Gas	Combined	Crude Oil	Natural Gas	Combined
Average daily volume sold (boe/day)[1]	**130,526**	**10,735**	**141,261**	**128,641**	**11,114**	**139,755**
Operating netback ($/boe)						
Crude oil and natural gas sales price	98.44	31.80	93.38	102.06	40.26	97.14
Production cost of barrels sold [2]	16.51	4.18	15.57	12.89	4.49	12.22
Transportation (trucking and pipeline) [3]	15.02	0.01	13.88	15.66	0.05	14.42
Diluent cost	2.90	-	2.68	9.32	-	8.58
Total operating cost	**34.43**	**4.19**	**32.13**	**37.87**	**4.54**	**35.22**
Overlift/Underlift [4]	(4.21)	0.64	(3.84)	0.17	0.29	0.18
Other costs [5]	1.24	1.93	1.29	0.68	2.91	0.86
Total operating cost including overlift/underlift and other costs	**31.46**	**6.76**	**29.58**	**38.72**	**7.74**	**36.26**
Operating netback crude oil and gas ($/boe)	**66.98**	**25.04**	**63.80**	**63.34**	**32.52**	**60.88**

Notes: Refer to the operating netback table on page 9

During the first quarter of 2014 the combined crude oil and gas operating netback was $63.80/boe, higher by $2.92/boe as compared to the first quarter of 2013 ($60.88/boe).

Combined realized price for the quarter was $93.38/boe, lower than the first quarter 2013 by $3.76/boe due to a decrease in international oil prices.

Total combined operating costs (including overlift and other costs) amounted to $29.58/boe, a reduction of $6.68/boe compared to the first quarter of 2013. The decrease was primarily due to a significant reduction in diluent cost, as the Company used more of its own produced light oil as diluent instead of purchased natural gasoline.

Operating Netback - Crude Oil Trading

In addition to selling the crude it produces, the Company also purchases crude oil from third parties for trading purposes. The crude trading business is opportunistic in nature and the volume traded may change from period to period depending on market conditions and timing/availability of transportation capacity.

The netback on crude trading activities during the first quarter of 2014 was lower than the same period of 2013, due to an increase in the cost of purchases relative to sales price, as indicated below:

	Three Months Ending		
Crude oil trading	March 31		December 31
	2014	2013	2013
Average daily volume sold (bbl/d)	**10,586**	**3,895**	**3,399**
Operating netback ($/bbl)			
Crude oil traded sales price	101.06	105.24	99.11
Cost of purchases of crude oil traded	99.87	101.55	98.35
Operating netback crude oil trading ($/bbl)	**1.19**	**3.69**	**0.76**

Oil and Gas Production

During the first quarter of 2014, net production after royalties and internal consumption totaled 148,827 boe/d, representing an increase of 16% from the average net production of 127,889 boe/d reported for the first quarter of 2013, and a 11% increase from the average net production of 134,313 for the fourth quarter of 2013.

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

The following table sets out the average daily net production after royalties for the Company's producing regions:

	Average Production (in boe/d) Net share after royalties		
	Three Months Ending		
	Q1 2014	**Q1 2013**	**Q4 2013**
Colombia/Regions			
Central (1)	134,703	115,360	122,079
North (2)	10,665	11,068	10,811
South (3)	1,035	-	179
Total Production - Colombia	146,403	126,428	133,069
Peru/Region			
Offshore / Onshore Basin	2,424	1,461	1,244
Total Production - Peru	2,424	1,461	1,244
Total Production Colombia and Peru	148,827	127,889	134,313

1. *Includes Upper and Middle Magdalena Valley, Cordillera and Eastern Llanos basins.*
2. *Includes Lower Magdalena Valley, Cesar Rancheria and Catatumbo basins.*
3. *Includes Caguan-Putumayo basin.*

Oil and Gas Production in Colombia

During the first quarter of 2014, average net production after royalties in Colombia rose to 146,403 boe/d (319,775 boe/d total field production) from 126,428 boe/d (304,156 boe/d total field production) in the same period of 2013, representing an increase of 16%, mainly due to:

- Net production after royalties contributed by the Petrominerales acquisition totaled 25,468 bbl/d (total field production of 29,770 boe/d), representing 17% of the total net production after royalties.
- Drilling of 51 development wells at the Rubiales field, 18 development wells at the Quifa SW field, 5 wells at the Cajúa field and 21 wells in other producing fields. Additionally, there was an increase in the capacity of the production facilities at Rubiales and Quifa fields.
- Licence modification for Quifa SW and Cajua fields allowing for an increase in volume of water disposal capacity, which will increase production levels starting in the second quarter of 2014.
- Net production at Rubiales and Quifa fields decreased 9% due to restrictions in the water treatment disposal caused by a drought in the field area. Production is expected to normalize in the second quarter as the dry season is now over and production is returning to normal levels. La Creciente natural gas field also decreased by 3% as compared with the same period of 2013 due to constrain in the gas pipeline transport capacity. These reductions were compensated by the production contribution from the Petrominerales acquisition.

Oil and Gas Production in Peru

Net production after royalties for the first quarter of 2014 from Block Z-1 and Block 131 increased to 2,424 bbl/d (total gross field production of 5,163 bbl/d), from 1,461 bbl/d (total gross field production of 2,982 bbl/d) in the same period of 2013, representing an increase of 66% of net production after royalties, due to two new wells that began production in Corvina and Albacora, on February and March, respectively.

The following table highlights the average daily production from all of the Company's producing fields located in Colombia and Peru for the three months ending March 31, 2014 and 2013:

First Quarter of 2014 - 2013 Production by Field

	Average Q1 Production (in boe/d)					
	Total field production		Gross share before royalties (1)		Net share after royalties	
Producing Fields - Colombia	**Q1 2014**	**Q1 2013**	**Q1 2014**	**Q1 2013**	**Q1 2014**	**Q1 2013**
Rubiales / Piriri	192,305	210,159	80,845	88,121	64,676	70,495
Quifa SW (2)	53,290	54,076	31,696	32,244	22,327	25,435
Cubiro	10,669	7,064	6,468	4,443	5,990	4,104
Cravoviejo	10,231	9,328	10,171	9,293	9,357	8,549
Casanare este	7,113	-	7,113	-	6,528	-
Guatiquia	5,946	-	5,946	-	5,548	-
Casimena	5,908	-	5,892	-	5,486	-
Cajua	4,362	3,591	2,617	2,155	2,460	2,026
Corcel	4,000	-	3,906	-	3,700	-
CPI Neiva	3,701	-	2,146	-	1,975	-
Cachicamo	2,444	2,429	2,444	2,429	2,248	2,235
Arrendajo	1,868	1,404	1,261	948	1,191	872
Abanico	1,178	1,385	315	377	301	360
Sabanero (3)	1,163	1,086	1,135	532	1,067	500
Dindal / Rio Seco	838	1,353	224	763	188	621
New production at exploration areas (4)	554	-	366	-	345	-
Other producing fields (5) (6)	1,836	923	1,429	177	1,316	163
Total Production Central - Colombia	**307,406**	**292,798**	**163,974**	**141,482**	**134,703**	**115,360**
La Creciente (7)	10,713	11,041	10,508	10,805	10,508	10,805
Other producing fields (5) (6)	221	317	157	268	157	263
Total Production North - Colombia	**10,934**	**11,358**	**10,665**	**11,073**	**10,665**	**11,068**
Other producing fields (5) (6)	1,435	-	1,125	-	1,035	-
Total Production South - Colombia	**1,435**	**-**	**1,125**	**-**	**1,035**	**-**
Total Production - Colombia	**319,775**	**304,156**	**175,764**	**152,555**	**146,403**	**126,428**
Producing Fields - Peru (See note below)						
Block Z-1 - off-shore	4,609	2,982	2,258	1,461	2,258	1,461
Block 131 - on-shore	554	-	166	-	166	-
Total Production - Peru	**5,163**	**2,982**	**2,424**	**1,461**	**2,424**	**1,461**
Total Production Colombia and Peru	**324,938**	**307,138**	**178,188**	**154,016**	**148,827**	**127,889**

1. *Share before royalties is net of internal consumption at the field and before PAP at the Quifa SW field.*
2. *The Company's share before royalties in the Quifa SW field is 60% and decreases in accordance to a high-price clause that assigns additional production to Ecopetrol.*
3. *On December 26, 2013, the ANH approved the transaction by which the Company acquired 100% of the Sabanero Block.*
4. *Includes CPE-6 and Rio Ariari blocks.*
5. *'Other producing fields' corresponds to producing assets located in Cerrito, Moriche, Las Quinchas, Guama, Guasimo, Buganviles, Carbonera, Carbonera La Silla, Prospecto S, CPI Orito, Corcel Northeast, Mapache, Yamu and Llanos 19 Blocks (Yamu is not an operated block). Subject to Ecopetrol´s or ANH´s approval (as and if applicable), the Company is in the process of divesting its participation in the Moriche, Las Quinchas, Guasimo, Chipalo, Cerrito, Yamu and Carbonera blocks.*
6. *During the second quarter of 2013, the ANH requested the Company to pay in cash royalties related to crude oil for the Lisa, Yaguazo, Apamate, Cotorra and Cerro Gordo fields.*
7. *Royalties on production from La Creciente field are payable in cash and are accounted as part of the production cost. During the second quarter of 2013, the ANH requested the Company to pay in cash royalties related to the condensate from La Creciente field. The Company has completed 98% of the project to increase the process capacity to 100 MMcf/d at La Creciente Station.*

Royalties and High-Price Participation

The current royalty rates for volumes of hydrocarbons produced from the Company's Colombian assets range from 5% to 20%. Royalties on production represent the entitlement of the respective states to a portion of the Company's share of production and are recorded using rates in effect under the terms of existing contracts and laws applicable at the time of hydrocarbon discovery. In Colombia, royalties for oil may be payable in kind while royalties for gas are payable in cash. During the second quarter of 2013, the Agencia Nacional de Hidrocarburos (National Hydrocarbon Agency or "**ANH**" of Colombia) requested the Company to pay in cash the royalties related to the condensate of La Creciente field and the crude oil of minor fields operated by the Company. In Peru, royalty calculations for oil resulted in a 5.3% levy on total gross revenues, which the government allows companies to pay either in kind or cash. However, the current practice is to pay the royalties in cash.

Additional Production Share in the Quifa SW Field

The Company's share of production after royalties in the Quifa SW field is 60%. However, this participation may change monthly as a function of the PAP formula stipulated in the Quifa Association Contract. Starting in April 2013, the Company initiated the delivery of the additional PAP production from the Quifa SW field to Ecopetrol. In addition, during the second half of 2013, the Company agreed to deliver to Ecopetrol approximately 6,500 bbl/d to settle the accumulated PAP prior to the final arbitration decision (previously recorded as a financial provision in the Company's financial statements starting at year-end 2012). During the first quarter of 2014, the Company fully delivered the remaining balance of prior period-accumulated PAP volumes.

Carrizales Field (Cravoviejo Block)

On April 27, 2013, the exploitation area of the Carrizales field reached five million barrels of accumulated production of oil, activating the ANH rights on additional PAP pursuant to the E&P Cravoviejo contract. According to the contract terms, this additional participation share from Carrizales field is payable either in cash or in kind, and has been accounted for as part of the operating cost for this field.

PAP Disagreement with the ANH

Through various business acquisitions, the Company secured certain exploration contracts where there existed outstanding disagreements with the ANH relating to the interpretation of the PAP clause. These contracts require PAP to be paid to the ANH once an exploitation area within a contracted area has cumulatively produced five million or more barrels of oil. The disagreement is around whether the exploitation areas under these contracts should be determined individually or combined with other exploitation areas within the same contracted area, for the purpose of determining the five million barrel threshold. The ANH has interpreted that the high-price participation should be calculated on a combined basis.

The Company disagrees with the ANH's interpretation, and asserts that in accordance with the exploration contracts, the five million barrel threshold should be applied on each of the exploitation areas within a contracted area. One of these contracts relates to the Corcel block, which was acquired as part of the Petrominerales acquisition. An arbitration process was initiated by Petrominerales in the prior year, but is currently suspended by mutual agreement of the parties. The amount under arbitration was approximately $183 million plus related interest of $70 million as of December 31, 2013. The Company also disagrees with the interest rate that the ANH has used in calculating the interest cost. The Company asserts that since the PAP is denominated in U.S. dollars, the contract requires the interest rate to be three-month LIBOR plus 4%, whereas the ANH has applied the highest legally authorized interest rate on Colombian Peso liabilities, which was over 20%. An amount under discussion with the ANH for another contract is approximately $64 million plus interest.

The Company and the ANH are currently in discussion to further understand the differences in interpretation of these exploration contracts, and expect to resolve these differences within one year. The Company believes that it has a strong position with respect to the PAP discussion based on legal interpretation of the contracts and technical data available. However, in accordance with IFRS 3 on accounting for business acquisitions, the Company is required to and has recorded a liability for such contingencies as of the date of acquisition, even though the Company believes the disagreement will be resolved in favour of the Company. The Company does not disclose the amount recognized on the grounds that this would be prejudicial to the outcome of the dispute resolution.

Update on Environmental Permits

Colombia

During the first quarter of 2014, the Company obtained the following environmental permits by the Environmental Authority in Colombia ("**ANLA**"):

- Environmental licence for the Mapache II block, which allows the Company to start exploration activities in the block.
- Amendment of the environmental licence for Cachicamo block, allowing the Company to increase its exploitation activities in the block.
- Amendment in the environmental licence for the Quifa block to increase water disposal up to 1.5 MMbwpd, which will help the Company to increase its production at this block.

During this quarter the Company presented before ANLA the documents needed to obtain the environmental licence for the LNG export project, including the underwater pipeline and the offshore facilities.

Commercial Activity

During the first quarter of 2014, oil and gas sales volumes totaled 151,847 boe/d (143,650 boe/d in the first quarter of 2013), representing an increase of 6% year-over-year, mainly driven by the increase in oil production and oil for trading volumes.

The following table highlights the average daily crude oil and gas produced and the trading volume sold as well as the respective realized and international prices:

	Average Volume of Sales (in boe/d)		
	Three Months Ending		
Colombia and Peru	**Q1 2014**	**Q1 2013**	**Q4 2013**
Oil	130,526	128,641	129,547
Gas	10,735	11,114	10,918
Trading	10,586	3,895	3,399
Total barrels sold (in boe/d)	151,847	143,650	143,864
Prices			
Oil realized price $/bbl	98.44	102.06	95.54
Gas realized price $/boe	31.80	40.26	32.69
Trading realized price $/bbl	101.06	105.24	99.11
Combined realized price oil and gas $/boe (excluding trading)	93.38	97.14	90.66
WTI NYMEX ($/bbl)	98.61	94.36	97.61
BRENT ICE ($/bbl)	107.87	112.64	109.35
Regulated Gas Price ($/MMBTU) (1)	3.97	5.94	5.65
Henry Hub average Natural Gas Price ($/MMbtu)	4.73	3.48	3.85

1. *The domestic natural gas sales price is referenced to* Market Reference Price (“***MRP***”) *for gas produced in La Guajira field. The MRP is modified every six months based on the previous half-year variation of the US Gulf Coast Residual Fuel No. 6 1.0% sulphur, Platts.*

Combined oil and gas realized price for the first quarter of 2014 was $93.38/boe, lower by $3.76/boe as compared to that of the first quarter of 2013 ($97.14/boe). In the first quarter of 2014, Colombian crude prices experienced a premium reduction versus WTI, mainly due to the $9.02/bbl decrease in the ICE Brent - WTI NYMEX differential ($9.26/bbl in the first quarter of 2014 versus $18.28/bbl in the first quarter of 2013).

- As indicated in the table above, the Company’s combined realized oil and gas price in the first quarter of 2014 was $93.38/bbl; lower by $5.23/bbl than the average market price of WTI NYMEX during the same period.
- In the first quarter of 2014, natural gas sales averaged 61.67 MMcf/d, representing a 2.4% decrease from 63.2 MMcf/d for the same period in 2013. Most of the sales were from La Creciente field and averaged $5.44/MMbtu (equivalent to $5.41/Mcf), signifying a premium of 37% over the Guajira fields’ weighted price of $3.97/MMbtu and 15% over the Henry Hub natural gas price in the United States.

Export Sales Volume

During the first quarter of 2014, the Company sold a total of 13.67 MMboe of crude oil and natural gas, of which 12.52 MMbbl of crude oil (92%) were exported. A breakdown of the crude oil export sales by destination and type of crude is as follows:

	Three Months Ending March 31			
Export by destination (MMbbl)	**2014**	**%**	**2013**	**%**
Asia	6.62	53%	3.10	26%
USA	4.12	33%	6.26	53%
Europe	1.54	12%	1.28	11%
LATAM / Caribbean	0.24	2%	1.13	10%
Total Export	**12.52**	**100%**	**11.77**	**100%**

	Three Months Ending March 31			
Export crude oil reference	**2014**	**%**	**2013**	**%**
Castilla Blend	7.93	63%	7.00	59%
Vasconia Blend	4.58	37%	2.85	24%
Rubiales	0.01	0%	1.70	15%
Bunkers	-	0%	0.22	2%
Total Export	**12.52**	**100%**	**11.77**	**100%**

Transport of Hydrocarbons

During the first quarter of 2014, the Company transported 172,892 bbl/d through different pipelines and by truck, as follows:

	Three Months Ending March 31	
Means of transport (bbl/d)	**2014**	**2013**
ODL-OCENSA pipeline system	92,659	71,305
OCENSA pipeline system (Monterrey and Cusiana facilities)	14,804	-
ODC pipeline	525	23,308
ODL and Bicentenario system	9,802	-
OTA Pipeline	1,008	-
Trucks	54,094	48,700
Total Transport of Hydrocarbons	**172,892**	**143,313**

In the first quarter of 2014, the Guaduas facility handled 23,845 bbl/d of crude oil volumes including 11,421 bbl/d of third-party volumes, generating operating profit of $0.84 million.

Exploration Activities

During the first quarter of 2014, a total of 16 wells were drilled in Colombia, consisting of eight exploration and eight appraisal wells, resulting in two new discoveries in the Guatiquia Block.

	Three Months Ending March 31	
	2014	**2013**
Successful exploratory wells	2	4
Successful appraisal wells [1]	7	1
Dry wells	7	3
Total (see breakdown in the table below)	**16**	**8**
Success rate	**56%**	**63%**

1. *Includes horizontal appraisal wells.*

Details of Exploratory and Appraisal Wells Drilled During the First Quarter of 2014

No. of wells	Country	Block	Area / Field / Prospect	Well Name	Type	Total Depth MD (feet)	Net Pay (feet) [1]
1	Colombia	CPE-6	Hamaca	CPE6H-3	Appraisal	3,305	25.50
2	Colombia	CPE-6	Hamaca	CPE6H-5	Appraisal	3,545	25.50
3	Colombia	CPE-6	Hamaca	CPE6-H6	Appraisal	3,501	1.50
4	Colombia	CPE-6	Hamaca	CPE6-8H	Appraisal	5,380	830
5	Colombia	CPE-6	Hamaca	CPE6H-12H	Appraisal	5,041	860
6	Colombia	CPE-6	Hamaca	HAMACA 8	Appraisal	3,372	19.50
7	Colombia	Rio Ariari	Mochelo	Mochelo-4Hz ST	Appraisal	6,600	1,100
8	Colombia	Arrendajo	Buho	BUHO 1ST	Exploratory	7,035	-
9	Colombia	Arrendajo	Mirla Oeste	ARR-MO-1X	Exploratory	7,864	-
10	Colombia	Casimena	Cafetillo	Cafetillo-1	Exploration	8,580	2
11	Colombia	Casimena	Taqua	Taqua -1ST	Exploration	8,565	-
12	Colombia	Canaguaro	Canaguay	Canaguay -2 ST2	Appraisal	14,700	32
13	Colombia	Guatiquia	Ceibo	Ceibo-1	Exploration	12,450	68
14	Colombia	Guatiquia	Avispa	Avispa-1	Exploration	12,262	65
15	Colombia	La Creciente	La Creciente "H"	LCH-1X ST	Exploration	11,030	-
16	Colombia	Muisca	Balsa	Balsa - 1X	Exploration	7,530	-

1. *"Net Pay" represents the total estimated net pay encountered in the horizontal or vertical drilled sections.*

Colombia

In the CPE-6 block, the Company continued with the appraisal campaign in the Hamaca discovery. A total of six appraisal wells (four vertical and two horizontal), were drilled during the period. Four wells were under extended production tests averaging a total aggregate oil production volume of 600 bbl/d as of March 31, 2014. The CPE6-8H well encountered net pay, however the well's completion had operational problems, so a workover is being carried out prior to further production testing. The CPE6H-6 well encountered 1.5 feet of net pay, so the well was suspended pending additional information from the 3D seismic, which will be used to deviate the well.

In the Rio Ariari Block, the Mochelo-4Hz ST appraisal well was drilled to a vertical depth of 6,600 feet and with a 1,197 foot horizontal leg. The well encountered 1,100 feet of net pay within the horizontal section. Currently, the well is being prepared for short term testing. The Company has five drill rigs active or mobilized in Rio Ariari.

In the Quifa block, the acquisition of 721 km^2 of 3D seismic survey continued in the northwestern portion of the block. At the end of the first quarter, progress of 80% has been reported and the project is expecting to be completed by May 2014.

In the CPO-14 block, the Company completed the acquisition and processing of 238 km of 2D seismic as part of the exploration commitments for the first phase of the contract. Seismic interpretation is in progress to define the exploration opportunities for potential stratigraphic and exploration wells to be drilled in the block.

In the Arrendajo block, two exploration wells were drilled, Buho 1ST and ARR-MO-1X, reaching a TD of 7,035 and 7,864 feet respectively in the Ubaque Formation. Both wells were plugged and abandoned after no petrophysical evidence of prospectivity was encountered.

In the Casimena block, the Company drilled two exploration wells, Cafetillo-1 and Taqua-1 ST. Cafetillo-1 was located on trend but down structure from the Mantis discovery. A non-economic pay section, insufficient to warrant testing, was encountered and so the well was plugged and abandoned. The Taqua-1ST well was drilled with the Mirador Formation as a primary objective. The petrophysical evaluation did not show presence of hydrocarbons, and the well was plugged and abandoned.

In the Canaguaro block, the Canaguary-2 ST2 appraisal well reached a total depth of 14,700 feet MD. The well encountered 32 feet of net pay in the Mirador formation based upon petrophysical interpretation. The well is being cased for testing in the Lower Mirador Formation.

In the Guatiquia block, the Company drilled the Ceibo-1 and the Avispa-1 exploration wells. The Ceibo-1 well reached a total depth of 12,450 feet and encountered 68 feet of net pay comprised of 48 feet of net pay in the Cretaceous Guadalupe Formation and 20 feet of net pay in the Lower Mirador Formation. The well was completed in the Lower Mirador Unit and is producing an average daily rate around 3,500 bbl/d with a 1.3 % BSW. The Avispa-1 well reached a total depth of 12,262 feet MD and targeted a separate structure midway between the recent Ceibo-1 discovery and the Candelilla fields. Petrophysical evaluation indicates the presence of 65 feet of net pay comprised of 51 feet of net pay in the Guadalupe formation and 15 feet of net pay in the Lower Sand 1 Mirador Formation. This well is currently being tested with an average production of 1,550 bbl/d in the Guadalupe Formation. The two discoveries, Ceibo and Avispa, locate in the same trend of Yatay and Candelilla producing fields and increase the exploration potential of the zone.

In the Guama block, the Company initiated civil works and logistical preparations for the extended tests of Pedernalito-1X, Cotorra-1X, Manamo-1X and Capure-1X exploration wells. The extended tests are planned to begin in late July.

In the La Creciente block, the LCH-1X ST exploration well was drilled as side-track to well LCH-1X, targeting the western flank of prospect "H". The well reached a TD of 11,030 feet MD and subsequent well tests were unsuccessful so the well was plugged and abandoned.

In the COR-24 block, the Company started the acquisition of a 305 km 2D seismic survey. The survey is expected to be finished in the second quarter.

In the Muisca block, the operator Maurel & Prom Colombia B.V. spudded the Balsa-1X exploration well in early December. The well reached TD at 7,530 feet. The well was completed and tested; the well was suspended waiting for further analysis. In the Tacacho and Terecay blocks, the bidding process for the acquisition of 956 kilometers of 2D seismic was completed, and the survey is expected to begin during the second half of 2014.

Peru

In Block 131, the Los Angeles discovery well produced over 3,400 bbl/d with a 48/64" choke and then was stabilized at an average daily rate of 1,159 bbl/d with 0.6% watercut, a choke size between 16/64" to 48/64" and tubing head pressure between 150 psi and 514 psi. After 40 days of production, the well has produced a total of 47,536 bbl.

In Block 116 in the Santiago Basin of northern Peru, the Company started drilling the Fortuna-1X exploration well. The well is targeting potential limestone and sandstone reservoirs in the Cretaceous with a planned TD of 12,659 feet. At the end of first quarter, the well had reached 973 feet MD.

In Block Z-1, located in the offshore Tumbes Basin of northern Peru, the Company continued with the corresponding environmental permit process in the central and southern areas.

Guatemala

In the Guatemala blocks (N-10-96 and O-10-96), the block operator Compañía Petrolera del Atlántico S.A. ("**CPA**"), continued operations in the Balam-1X exploration well with the Cretaceous Cobán Formation as the main exploration objective. The well showed presence of hydrocarbons in four intervals, so the well was tested within a total of 542 feet intervals. The first interval (330 feet) resulted in slight indications of light to very light oil. Currently, operations for testing the second interval (48 feet) are under way.

Belize

In Belize, the Company started a 650 km 2D seismic survey. Additionally, surface geology studies were completed and sample analysis and surface geochemistry were initiated. The processing of the 2,500 km of aeromagnetic and aerogravity data was completed and interpretation is scheduled to begin during the first days of April.

Brazil

In the Karoon blocks, offshore Santos Basin, the operator Karoon Petróleo & Gás Ltda., the block operator, expects to commence drilling during the second half of 2014, subject to rig availability. Two confirmed wells are planned, including an up-dip appraisal of the 2013 Kangaroo-1 discovery and an exploration well on the undrilled Kangaroo West prospect.

Guyana

In the Corentyne block, reinterpretation work on 3,500 km² of 3D seismic data is in progress. Based on this interpretation, a well recommendation will be made with an anticipated spud date of not later than May 2015.

In the Berbice Block, additional exploration activities are already being performed at a regional basin level, including gravimetry/magnetic interpretation and modeling; hyperspectral studies and well geochemical and geochronological studies.

Papua New Guinea

In Block PRL-39, the operator spudded the Raptor-1 exploration well on March 28. The TD of the well is expected at 14,765 feet during June 2014.

5. Capital Expenditures

Capital expenditures during the first quarter of 2014 totaled $481 million, lower by $123 million as compared to $604 million in the first quarter of 2013, mainly due to acquisitions during the same period of 2013. A total of $115 million was invested in the expansion and construction of production infrastructure, primarily in Quifa SW, Block Z-1, Cajua and in the Rubiales fields; $134 million went into exploration activities including drilling, seismic and other geophysical activities in Colombia, Peru, Brazil, Guatemala, Belize, Guyana and Papua; $22 million was included in early facilities and others; $174 million in development drilling; and $23 million was invested in other projects including the STAR project at Quifa SW.

	Three Months Ending March 31		Three Months Ending December 31
(in thousands of US$)	**2014**	**2013**	**2013**
Production facilities [(1)]	$ 115,018	$ 147,029	$ 202,677
Exploration activities [(2)]	134,428	78,363	145,123
Early facilities and others	21,962	-	26,367
Development drilling [(1)]	173,852	153,691	183,688
Other projects (STAR, Gas export, PEL)	23,649	26,289	67,543
Farm-in Agreement and others [(3)]	12,500	199,088	1,020,475
Total capital expenditures	**$ 481,409**	**$ 604,460**	**$ 1,645,873**

1. *Includes investment in Maurel & Prom Colombia B.V., in which the Company holds a 49.999% participation.*
2. *Exploration activities for the first quarter of 2014 include drilling, seismic and other geophysical expenditures in Colombia, Peru, Brazil, Guatemala, Belize and Guyana.*
3. *For the first quarter of 2014 includes the capital expenditures of $12 million to acquire a 50% participating interest in the Tinigua block onshore in Colombia. For the first quarter of 2013 includes the capital expenditures of $115 million related to the 35% participating interest in the offshore contract located in the Santos Basin in Brazil currently operated by Karoon. Also, includes the investment of $7 million on Portofino Block in Colombia, and investment of $77 million on PPL37 Block in Papua New Guinea.*

6. Farm-in Transactions and Acquisitions

The following is a summary of the farm-in transactions and acquisitions completed during the first quarter of 2014.

Acquisition of a Participating Interest in Colombia

On February 27, 2014, the Company reached an agreement with Petronova Colombia Inc. ("**Petronova**") to acquire a 50% participating interest in the Tinigua block onshore in Colombia. The investment will be comprised of an up-front down payment of $12.5 million cash for past exploration costs, a $19 million carry of obligations related to the next two exploration wells, and an additional carry obligation with respect to the third and fourth exploratory wells of up to $14 million. This additional carry obligation will be recovered from proceeds of production. Petronova will remain as the operator of the block for the exploration phase, while the Company has the option to become the operator during the production phase. The transaction is subject to regulatory approval.

Papua New Guinea - New Licence

On March 6, 2014, the Minister of Petroleum & Energy of Papua New Guinea granted to SPI (220) Limited, Interoil Partners Limited and the Company, Petroleum Prospecting Licence 475 as a result of a top file application, which had been presented by the companies in light of the expiration of the Petroleum Prospecting Licence 237. On March 28, 2014, SPI (220) Limited, operator of the PPL-475, began drilling the Raptor-1 new field wildcat as part of the oil and gas exploration campaign in the licence.

Petroleum Prospecting Licence 39 was granted after the Minister of Petroleum and Energy approved on December 20, 2013 the Company's application for Petroleum Retention Licence 39, which includes the Triceratops discovery in which the Company holds a 10% net participating interest.

7. Project Status

Following is an update on the current status and working-interest share of costs incurred as of March 31, 2014, for the Company's major projects:

		As of March 31, 2014		
Project	**Project financed by**	**Total cost to complete the project**	**Cost incurred to date**	**Expected future costs to incur**
STAR project in the Quifa field	Internally generated funds	$ 131,600	$ 115,780	$ 15,820
Bicentenario pipeline	Equity and debt combination	804,661	661,371	143,290
PEL-Power transmission line project	Equity and debt combination	220,000	171,000	49,000
Small-scale LNG project	Equity and debt combination	180,000	26,000	154,000
Water treatment for agricultural development	Equity and debt combination	170,000	70,000	100,000
Puerto Bahia project	Equity and debt combination	239,071	80,385	158,686
OLECAR	Equity and debt combination	155,771	39,151	116,620
CX15 - Platform Pacific Stratus Peru	Equity and debt combination	96,000	96,000	-
		$ 1,997,103	**$ 1,259,687**	**$ 737,416**

STAR Project in the Quifa SW Field

In March 2011, the Company and its partner Ecopetrol agreed to carry out a pilot project using the proprietary STAR enhanced oil-recovery technology, covering an area of approximately 20 acres in the Quifa SW field as a preliminary step to expanding the technology to a commercial level. The pilot project followed two years of extensive laboratory testing and simulation. The STAR technology is aimed at significantly increasing recovery in the Company's heavy oil fields in Colombia, which under primary flow, only results in a 14% to 16% recovery of the Original Oil in Place ("**OOIP**"), leaving the remaining oil behind in the ground.

The pilot facility, including the wells and compression equipment were constructed in 2012. Air injection and thermal ignition were initiated in February 2013 and sustained throughout the year, demonstrating synchronized control of the thermal front and the producing wells.

During the third quarter of 2013, the Company received reports from three independent engineering firms on the progress of the pilot project and their estimate of the OOIP for the project area. These estimates, combined with the cumulative oil production from the pilot project, confirm at least a doubling of the expected primary recovery factor has been achieved to date since commencement of air injection in February 2013.

Also in the third quarter of 2013, the Colombian patent authority, the SIC, granted the Company two patents for its STAR technology. These patent awards provide the Company with intellectual property rights to the STAR technology in Colombia for an exclusive 20-year period from the filing date of April 1, 2011 until April 1, 2031.

Based on the pilot results and as a first stage of a commercial project, the Company together with Ecopetrol is evaluating a semi-commercial rollout of the STAR technology in Quifa SW by converting to STAR a number of contiguous wells, in two neighboring clusters of the pilot test area, which are currently producing on primary flow.

On April 22, 2014, the senior executives of the Company met with Ecopetrol to review the current status of the pilot project employing the STAR Technology in the Quifa Block. As a result of the meeting, a joint technical report will be prepared and presented to the senior management of both companies in late May or early June 2014.

Bicentenario Pipeline

The Company has a 43.03% equity interest in the Bicentenario Pipeline. Bicentenario is a special-purpose entity formed by Ecopetrol, who has a 55.97% interest in the company with the remaining 1% interest owned by other oil producers operating in Colombia. Bicentenario is responsible for the financing, design, construction and operation of the Bicentenario Pipeline, Colombia's newest oil pipeline transportation system, which runs from Araguaney in the Casanare Department of central Colombia to the Coveñas Export Terminal in the Caribbean. Phase 1, which comprises a 230-km, 42-inch pipeline from Araguaney to Banadía, reached mechanical completion in December 2013 and line fill ended on October 3, 2013.

As of March 2014, overall construction progress for Phase 1 was substantially complete and the two tanks with a total capacity of 600 Mbbl from Coveñas terminal are operating. As of the date of this report, approximately 3.4 MMbbl has been pumped through the system, and full completion of Phase 1 is expected by June 2014.

PEL – Power Transmission Line Project

Petroelectrica is a wholly owned subsidiary of the Company and is responsible for constructing and operating a new power transmission line of 230 kilovolts that connects the Rubiales field with Colombia's electrical grid. The new transmission line originates at the Chivor Substation and stretches 260 km to the Rubiales field. The project includes two substations (Jagüey and Corocora) to supply power to the booster stations of the ODL Pipeline, as well as substations for the Rubiales and Quifa fields. The new power line supplies up to 192 MVA power to be used in oil production and pipeline transportation activities. The PEL transmission line reduces the operating costs for the Rubiales and Quifa fields by lowering electricity costs for oil production and transportation. This is the largest private power transmission asset in Colombia and very strategic for the development of blocks currently under exploration by the Company in the Llanos basin, such as CPE-6 and CPO-14. As at December 2013, the power transmission line and the Rubiales substation achieved mechanical completion and ANLA granted an environmental permits for substations Jagüey and Corocora.

The power line commenced operation on January 20, 2014, and as of March 31, 2014, the line has transmitted 148,000 MW-hr to ODL, Rubiales and Quifa fields. Estimated savings in operating costs will exceed $100 million for 2014 for Rubiales, Quifa and ODL. As of the date of this report, the Quifa substation construction was 64% completed and permits to expand the line capacity from 192MW to 262MW have been submitted. This expansion will help the Company to meet current demand of the Rubiales and Quifa fields and the future developments in the Llanos basin with significant cost savings. The conceptual engineering for the power transmission line to CPE-6 is currently in progress and environmental scouting and land surveys are ongoing.

Caribbean FLNG (World's First Floating LNG Project)

The Company is actively looking for alternate ways to monetize its existing natural gas reserves in the La Creciente and Guama fields as well as exploit its other extensive gas exploration resources in nearby fields. The Company has initiated a small-scale liquefied natural gas project ("**LNG**") that is being developed jointly with Exmar NV ("**Exmar**"), an experienced LNG/LPG transportation company based in Belgium. The project is targeting LNG supply FOB from Colombia.

The project comprises an 88-km, 18-inch gas pipeline from La Creciente Gas Field to the Colombian Atlantic Coast and a Floating, Liquefaction and Storage Unit ("**FLSU**"). The FLSU will be connected to a Floating Storage Unit ("**FSU**") in order to allow FOB exports to standard carriers (130,000 to 150,000 CBM). Caribbean FLNG (the project name) will be the first floating liquefaction plant worldwide. The project was nominated for an innovation prize at the last LNG World Summit.

In March 2012, the Company signed a tolling agreement with Exmar. Under the terms of this agreement, the first natural gas liquefaction is targeted for mid-2015. Environmental permits for the onshore portion of the gas pipeline are in place. Construction of the FLSU is underway in Wison´s shipyard in China and construction is 80% completed.

In November 2013, the Company and Gazprom announced the execution of a Heads of Agreement for the negotiation of a five-year Sale and Purchase Agreement for approximately 0.5 million tons per year of liquefied natural gas FOB Colombia (Caribbean Sea) beginning in the second quarter of 2015. The offtake agreement with Gazprom will allow the Company to reach LNG worldwide markets. The Company will have a competitive advantage in the gas markets in Japan and South Korea, once the expansion of the Panama Canal is complete.

As of March 2014, basic and detailed engineering for the gas pipeline and the offshore jetty has been completed. Port concession terms for the LNG terminal have been released, and environmental permits for the gas pipeline have been filed with the corresponding authorities. As of the date of this report, the bidding process to select the EPC contractor is in progress.

Water Treatment for Agricultural Development

In order to handle the increasing volume of water produced in the Rubiales and Quifa fields, the Company has initiated a project to treat produced formation water from these fields and use it for irrigation purposes in a neighboring palm oil project for biodiesel manufacturing. The first phase of this project includes the construction of two water treatment plants using Reverse Osmosis ("RO") technology, each with a capacity of 500,000 bbl/d. This project will bring significant savings in terms of energy and capital expenditures compared to current disposal by injection. In addition, the palm oil project will create sustainable jobs and social development for the area.

As of March 2014, the construction of the RO plants had reached 55% completion. The main plantation now has 1,300 hectares of palm trees and an additional 1,300 hectares will be planted during the rainy season in 2014. Environmental permits to allow the use of treated water for agricultural purposes have been initiated.

This project represents an innovative approach for water disposal in Colombia. It brings benefits to oil producers in terms of lower operating costs and extending the economic life of the oil fields, and also is an excellent example of "Shared Value" with communities, bringing sustainable development from a social point of view to areas in need of development. The concept will be replicated by the Company in future developments in oil fields with high water production rates.

Pacific Infrastructure: Puerto Bahía Terminal and Olecar Pipeline

As of March 31, 2014, the Company had a 41.6% interest in Pacific Infrastructure Venture Inc. ("**Pacific Infrastructure**"), a private company that is currently developing Puerto Bahía, an oil export terminal located in Cartagena Bay in Colombia. Puerto Bahía will be developed in three phases: (i) 1.7 MMbbl of oil and petroleum product storage capacity, a berthing position for vessels of up to 80K DWT, a truck loading and unloading station with a capacity of up to 30 Mbbl/d and a fixed bridge; (ii) additional storage capacity of up to 3 MMbbl, an additional berthing position for vessels of up to 150K DWT and barge handling facilities with a capacity of up to 45 Mbbl/d; and (iii) a liquids terminal with capacity of up to 4 MMbbl, a multi-purpose terminal handling bulk materials, containers and a berthing platform with a length of 300 meters to handle dry materials.

During 2012, the environmental permits, the port concession and the free-trade zone permits were granted. Designs and engineering were completed during the first half of 2013. As of March 31, 2014, construction of Phase 1 reached 66% progress.

Recognizing the strategic importance of Puerto Bahía Terminal, Pacific Infrastructure signed an O&M agreement with Oiltanking International. Oiltanking is recognized globally as a world-class operator of large-scale liquids terminals. During the first quarter of 2013 Pacific Infrastructure signed a credit agreement with Itau Bank for $370 million, which was closed on February 25, 2014.

In addition to Puerto Bahía, Pacific Infrastructure is also developing the Olecar pipeline, which will connect Puerto Bahía to the oil pipeline hub at the port of Coveñas, ensuring the uninterrupted supply of crude oil for export. The Olecar project includes: (i) a pumping station at Coveñas with a capacity of 300 Mbbl/d; (ii) a 130-km, 30-inch diameter pipeline; and (iii) bidirectional connections between the Cartagena Refinery, the second largest refinery in Colombia, and Puerto Bahía.

As of the date of this report, environmental permits for the Olecar pipeline have been granted by ANLA and right-of-way negotiations are in progress. Engineering for the Coveñas and Reficar are under way. Long-lead items' purchase orders have been placed, including valves and main pumps, and the pipe has been received on site. CONCOCAR Consortium has been selected as the EPC Company for the construction of the pipeline. The Olecar project is currently 18% complete.

8. Discussion of 2014 First Quarter Financial Results

Revenues

Revenues for the first quarter of 2014 were $1,283 million, higher by 2% as compared to the first quarter of 2013 mainly driven by higher sales volume. For additional details related to oil and gas sales, please refer to section 4 – "Operating Results - Commercial Activities".

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Net crude oil and gas sales	$ 1,187,171	$ 1,221,870
Trading revenue	96,282	36,892
Total Revenue	**$ 1,283,453**	**$ 1,258,762**
$ per boe oil and gas	93.38	97.14
$ per bbl trading	101.06	105.24
$ Total average revenue per boe	**93.91**	**97.36**

	Three Months Ending March 31			
	2014	2013	Difference	% Change
Total of boe sold (Mboe)	13,666	12,929	737	6%
Avg. combined price - oil & gas and trading ($/boe)	93.91	97.36	(3.45)	-4%
Total Revenue	**1,283,453**	**1,258,762**	**24,691**	**2%**

Following is an analysis of the revenue drivers for the first quarter of 2014 in comparison to the same period of 2013:

Drivers for the revenue increase:		
Due to volume	$ 71,826	291%
Due to price	(47,135)	-191%
	$ 24,691	

Operating Costs

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Oil and gas operating costs	$ 408,434	$ 442,995
Overlift/Underlift and other costs	(32,413)	13,115
Trading operating	95,150	35,601
Total Cost before Bicentenario disrupted capacity	**$ 471,171**	**$ 491,711**
Fees paid on suspended pipeline capacity	28,910	$ -
Total Cost	**$ 500,081**	**$ 491,711**
$ per boe crude oil and gas operating cost	32.13	35.22
$ per boe (Under)/Overlift and other costs	(2.55)	1.04
$ Total average cost per boe including overlift/underlift and other costs	**$ 29.58**	**$ 36.26**
$ per bbl Trading operating costs	99.87	101.55
$ Total average cost per boe before Bicentenario disrupted capacity	**$ 34.48**	**$ 38.03**
$ per bbl take or pay fees on disrupted transport capacity	2.27	-

Total operating cost for the first quarter of 2014 was $500 million including $29 million in take-or-pay fees paid to Bicentenario pipeline when the capacity was not available due to security issues. Operating costs was higher as compared to $492 million for the same period of 2013, as a result of an increase in oil and gas produced, an increase in the volume of oil for trading and challenges out of the control of the Company. Total average cost for the first quarter of 2014 was $34.48/boe, lower by 9% as compared to $38.03/boe for the same period of 2013. The decrease was primarily due to a significant reduction in diluent cost, as the Company used more of our own produced light oil as diluent instead of purchased natural gasoline.

For additional details related to operating costs, please refer to section 4 – "Operating Results"

Depletion, Depreciation and Amortization

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Depletion, depreciation and amortization	$ 375,642	$ 332,523
$/per boe sales	27.49	25.72

Depletion, depreciation and amortization ("**DD&A**") costs for the first quarter of 2014 were $375.6 million compared to $332.5 million in the same period of 2013. The increase of 13% over 2013 was primarily due to: (i) increase in production and higher capitalized costs that are subject to depreciation; (ii) higher depreciable cost base of oil and gas properties from the acquisition of Petrominerales; and (iii) higher depreciable cost base of the Rubiales field, which is depreciated over the remaining life of the contract expiring in 2016. DD&A per boe for the first quarter of 2014 was $27.59/boe, 7% higher than the $25.72/boe for the same period of 2013. As a result of the additions of proved and probable reserves during 2013, starting with the fourth quarter of 2013 the majority of the Company's assets (with the exception of the Rubiales field) are being depleted over a larger 2P reserves pool.

General and Administrative Costs

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
General and administrative costs	$ 75,214	$ 71,989
$/per boe sales	5.50	5.57

General and administrative costs increased to $75.2 million in the first quarter of 2014 from $71.9 million in the same period of 2013, mainly due to expanded operations and production, following several acquisitions in 2013.

Finance Costs

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Finance costs	$ 61,495	$ 47,577

Finance costs include interest on the Company's bank loans, convertible debentures, senior notes, revolving credit facilities, working capital loans, finance leases and fees on letters of credit, net of interest income received. For the first quarter of 2014, interest expenses totaled $61.5 million compared to $47.6 million for the same period of 2013. The increase in finance costs is primarily due to the $1.3 billion senior notes due 2019 that were issued for the Petrominerales acquisition and the $300 million notes due 2021 issued in November of 2013. Also, the $1 billion senior notes due 2023 that were issued at the end of the first quarter 2013 only started incurring interest expenses in the second quarter of 2013.

Foreign Exchange

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Foreign exchange (loss) gain	$ (1,775)	$ 14,971

The U.S. dollar is the Company's functional currency. Foreign exchange gains or losses primarily result from the movement of the Colombian peso ("**COP**") against the U.S. dollar. A significant portion of the Company's operating and capital expenditures, as well as assets and liabilities, are denominated in COP. During the first quarter of 2014, the COP depreciated against the U.S. dollar by 2.00% as compared to a depreciation by 3.62% during the same period of 2013. Foreign exchange loss for the first quarter of 2014 was $1.8 million compared to an income of $15.0 million for the same period of 2013. The foreign exchange loss for the first quarter of 2014 was mainly due to unrealized loss from the translation of COP-denominated balances into the U.S. dollar.

Income Tax Expense

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Current income tax	$ 151,050	$ 161,320
Deferred income tax	(1,592)	3,298
Total income tax expense	**$ 149,458**	**$ 164,618**

The Canadian statutory combined income tax rate was 26.50% for the first quarter of 2014 and 2013. The Peruvian income tax rate for Block Z-1 was 22% for the first quarter of 2014 and 2013.

The Colombian statutory tax rate for the first quarter of 2014 was 25%. The Colombian Congress approved a new tax law in December 2012, which came into effect on January 1, 2013, whereby the general income tax rate was reduced from 33% to 25%. In addition, the law introduced a fairness tax ("**CREE**") at the rate of 9% to substitute for the elimination of certain payroll taxes primarily related to low-income salaries, which effectively increased the income tax rate to 34%.

The effective tax rate (income tax expenses as a percentage of net earnings before income tax) was 56% for the first quarter of 2014 compared to 57% for the same period of 2013. The Company's effective tax rate differs from the statutory rate due to the following:

- Expenses that are not deductible for tax purposes (such as share-based compensation, foreign exchange gains or losses, and other non-deductible expenditures in both Canada and Colombia);
- Corporate expenses that result in tax loss carry forwards, but for which no deferred tax assets and recovery have been recognized. When the Company has a reasonable expectation to utilize those losses in the future, a deferred tax asset and a corresponding deferred tax recovery may be recognized which would reduce the income tax expense; and
- Foreign exchange effect on the deferred tax, which is determined on COP-denominated assets and liabilities. The Company's assets are primarily located in Colombia. As a result, the tax base of these assets is denominated in COP, and the related deferred tax balances are subject to fluctuations in the U.S.-COP exchange rate. The depreciation of the COP against the U.S. dollar by 2.00% during the first quarter of 2014 resulted in an estimated unrealized deferred income tax expense of $31.9 million. In comparison, the Company recorded a $28.4 million unrealized income tax recovery during the same period of 2013 as a result of the depreciation of the COP against the U.S. dollar by 3.62%.

Financial Position

Debts and Credit Instruments

The Company was compliant with all of its debt covenants during the first quarter of 2014. The following debts were outstanding as at March 31, 2014.

2011 Senior Notes due 2021

The 2011 Senior Notes, due December 12, 2021, are direct and unsecured with an interest rate of 7.25% payable semi-annually (the "**2011 Senior Notes**"). The 2011 Senior Notes are listed on the Official List of the Luxembourg Stock Exchange and trade on the Euro MTF. On November 28, 2013, the Company closed a reopening of the 2011 Senior Notes for $300 million. As at March 31, 2014, the aggregate principal amount of 2011 Senior Notes outstanding was $1,012 million.

2013 Senior Notes due 2023

The 2013 Senior Notes, due March 28, 2023, are direct and unsecured with an interest rate of 5.125% payable semi-annually. The 2013 Senior Notes are listed on the Official List of the Luxembourg Stock Exchange. As at March 31, 2014, the aggregate principal amount of the 2013 Senior Notes outstanding was $1 billion.

2013 Senior Notes due 2019

The 2013 Senior Notes, due July 26, 2019, are direct and unsecured with an interest rate of 5.375% payable semi-annually. The 2013 Senior Notes are listed on the Official List of the Luxembourg Stock Exchange. As at March 31, 2014, the aggregate principal amount of the 2013 Senior Notes outstanding was $1.3 billion.

Revolving Credit Facilities

On September 13, 2012, the Company entered into two Revolving Credit and Guaranty Agreements: (i) a $400 million Revolving Credit and Guaranty Agreement (the "**U.S. Dollar Facility**") with a syndicate of international lenders and Bank of America, N.A. as the administrative agent; and (ii) Meta Petroleum Corp. Colombia Branch and Pacific Stratus Energy Corp. Colombia Branch entered into a Colombian Peso equivalent of a $282 million Revolving Credit Agreement as borrowers (the "**Colombian Peso Facility**") with a syndicate of Colombian lenders and Sociedad Fiduciaria Bogotá, S.A. as the administrative agent.

The revolving credit facilities have an interest rate determined in accordance with the ratings assigned to the Company's senior debt securities by Standard & Poor's Ratings Group, Moody's and Fitch Inc. Based on the Company's credit rating as of December 2013, the interest rate was LIBOR + 2.75% under the U.S. Dollar facility and DTF+2.25% under the Colombian Peso Facility. In addition, the Company is required to pay commitment fees of 0.95% on the unutilized portion under the U.S. Dollar Facility and 0.40% under the Colombian Peso Facility.

As at March 31, 2014, the Company had drawn down the $400 million U.S. Dollar Facility. The $276.3 million equivalent remained available under the Colombian Peso Facility. There was no drawdown of the Peso facility during the year. The U.S. Dollar Facility was repaid in full in April 2014. Both the U.S. Dollar Facility and the Colombian Peso Facility were subsequently cancelled.

New Revolver Credit Facility

On April 25, 2014, the Company entered into a new Revolving Credit and Guaranty Agreement of $1 billion (the "**2014 U.S. Dollar Facility**") with a syndicate of international and Colombian lenders and Bank of America, N.A. as the administrative agent. The U.S Dollar Facility has an interest rate determined in accordance with the ratings assigned to the Company's senior debt securities by Standard & Poor's, Moody's and Fitch Inc. Based on the Company's credit rating as of April 2014; the interest rate was LIBOR + 2.25%. In addition, the Company is required to pay commitment fees of 0.95% on the unutilized portion under the U.S. Dollar Facility and is fully committed to its maturity in 2017.

Bank of America Credit Facility

On May 2, 2013, the Company entered into a $109 million Credit and Guaranty Agreement with Bank of America, N.A. as lender. Proceeds from this facility were used in part to repay the entire $100 million outstanding on the Itau Credit Facility. This loan has a maturity of 44 months from the date of the loan and an interest rate of LIBOR + 1.5%.

HSBC Long term facility

On April 8, 2014, the Company entered into a $250 million Credit and Guaranty Agreement with HSBC as lender. Proceeds from this facility were used for the share buyback program and general corporate purposes. This loan has a maturity of 36 months from the date of the loan and an interest rate of LIBOR + 2.75%.

Bladex Long term facility

On April 4, 2013, the Company entered into a $75 million Credit Agreement with Banco Latinoamericano de Comercio Exterior, S.A (Bladex) as lender. Proceeds from this facility were used for general corporate purposes. This loan has a maturity of 48 months from the date of the loan and an interest rate of LIBOR + 2.7%.

Working Capital Loans

From time to time, the Company maintains working capital facilities with several banks. As of March 31, 2014, our current facilities are with Citibank, N.A., Bank of America, N.A., JPMorgan Chase Bank, N.A. Itau BBA, Bank of Tokyo and Mercantil Commerce Bank, N.A. The terms of these loans are generally less than a year. As at March 31, 2014, we had $255 million in borrowings outstanding under these Working Capital Facilities and the interest rates have a range between LIBOR + 0.95% and LIBOR + 1.25%.

Letters of Credit

As at March 31, 2014, the Company had issued letters of credit and guarantees for exploration and operational commitments for a total of $408.3 million.

Outstanding Share Data

Common Shares

As of March 31, 2014, 313,446,958 common shares were issued and outstanding.

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

During the quarter, the Company repurchased from the open market approximately 9 million common shares under the previously announced share repurchase program. The total amount paid for the repurchases during the quarter was $134.2 million.

Stock Options and Warrants

As at March 31, 2014, there were no warrants outstanding. 25,912,692 stock options were outstanding, of which all were exercisable.

Liquidity and Capital Resources

Liquidity

Funds flow provided by operating activities for the first quarter of 2014 totaled $474 million ($506 million in the same period of 2013). The decrease in funds flow for first quarter of 2014 was the result of an increase in production and higher combined crude oil and gas netback. The Company has been generating cash flows from operations from the sale of crude oil and natural gas and continues to plan for increased future production; additionally the Company sold its 5% equity in the Ocensa oil pipeline in Colombia for a total cash consideration of $385 million.

As at March 31, 2014, the Company had negative working capital of $431.2 million, mainly comprised of $306.4 million of cash and cash equivalents, $1,053.8 million of account receivables, $67.2 million of inventory, $173.4 million of income tax receivable, $1.7 million of prepaid expenses, $1,602.1 million of accounts payable and accrued liabilities, $158.8 million of income tax payable, $255.3 million of the current portion of long-term debt and $17.5 million of finance lease obligations.

As at March 31, 2014, the Company had drawn down its $400 million U.S. Dollar Facility, and has approximately $300 million available in its Colombian Peso Facility. The U.S. Dollar Facility was fully repaid in April 2014.

On April 25, 2014, the Company entered into the 2014 U.S. Dollar Facility, which matures in 2017 and undrawn as of the date of the report.

The Company believes it has adequate resources to fund its capital plan for 2014 with its cash flows from operations and current debt facilities. With respect to the Company's broader integration strategy, the Company will pay for the expansion plan with its own cash flow. However, if additional resources are required, there are possible sources of funds available to the Company to finance additional capital expenditures and operations including the revolving credit facility, existing working capital incurring new debt, and the issuance of additional common shares if necessary.

As of March 2014, the Company has entered into working capital facilities with several banks, which includes Bank of America, N.A., Citibank, N.A., Itau BBA, Mercantil Commerce Bank, N.A., JP Morgan, N.A., and Bank of Tokyo, N.A. as lenders. Proceeds from these facilities will be used for working capital. These loans have a maximum maturity of seven months from the inception date with an interest rate that will be negotiated when the Company needs the funds. As at March 31, 2014, the Company has drawn down $255 million with a weighted average interest rate of 1.32%.

9. Commitments and Contingencies

Tax Review in Colombia

The Company currently has a number of tax filings under review by the Colombian tax authority ("**DIAN**").

The DIAN has reassessed value-added tax ("**IVA**") for 2009 on the basis that the volume of oil produced and used for internal consumption at certain fields in Colombia should have been subjected to IVA. The amount reassessed, including interest and penalties, is estimated to be $10 million. The Company disagrees with the DIAN's reassessment and as of September 30, 2013, an official appeal had been initiated. Several other taxation periods through to 2011 in respect of IVA on field oil consumption are currently under review by the DIAN. For the periods that are under review, if the DIAN's views were to prevail, the Company estimates that the IVA, including interest and penalties, could range between $12 million and $41 million. The Company continues to utilize oil produced for internal consumption, which is an accepted practice for the oil industry in Colombia.

The DIAN is also reviewing certain income tax deductions in respect to the special tax benefit for qualifying petroleum assets, as well as other exploration expenditures. To date, the DIAN has reassessed $12 million of tax owing, including estimated interest and penalties, with respect to the denied deductions.

As of March 31, 2014, the Company believes that the disagreements with the DIAN related to IVA and denied income tax deductions will be resolved in favour of the Company. As a result, no provision has been made in the financial statements.

High Price Royalty in Colombia

The Company is currently in discussion with the ANH with respect to the interpretation of the high-price participation clause in certain exploration contracts. Refer to "PAP Disagreement with the ANH" on page 13 for details relating to this contingency.

Commitments

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

Disclosure concerning the Company's significant commitments can be found in Note 21 of the Interim Condensed Consolidated Financial Statements. The Company has no off-balance sheet arrangements.

10. Risk Management Contracts

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

Disclosure concerning the Company's risk management contracts can be found in Note 24 of the Interim Condensed Consolidated Financial Statements.

11. Selected Quarterly Information

	2014	2013				2012		
(in thousands of US$)	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Financials:								
Net sales	$1,283,453	$1,202,551	$1,109,973	$1,055,573	$1,258,762	$1,046,689	$ 870,369	$ 1,035,854
Net earnings (loss) attributable to equity holders of the parent for the period (1)	119,240	140,412	84,013	74,279	127,378	(18,282)	73,351	219,394
Earnings (loss) per share								
- basic	0.38	0.43	0.26	0.23	0.40	(0.08)	0.23	0.76
- diluted	0.37	0.43	0.26	0.23	0.39	(0.08)	0.23	0.74

(1) Net Earnings for 2013 and 2012, have been restated upon the first time adoption of IFRS 9 – Financial Instruments and the finalization of the purchase price allocation of the C&C acquisition. Refer to Note 27 and Note 3 of the first quarter 2014 Interim Condensed Consolidated Financial Statements.

12. Related-Party Transactions

According to IFRS, parties are considered to be related if one party has the ability to “control” (financially or by share capital) the other party or have significant influence (management) on the other party in making financial, commercial and operational decisions. The board of directors of the Company has created the New Business Opportunities Committee (the “**NBOC**”) to review and approve related-party transactions. The NBOC is comprised of the following independent directors: Miguel Rodriguez (Chair), Dennis Mills, Victor Rivera and Hernan Martinez. The NBOC is apprised of related-party transactions prior to implementation, engages independent legal counsel as needed, and meets *in camera* to deliberate. The NBOC also reviews the business rationale for each transaction and ensures that the transaction is in compliance with applicable securities laws and the Company’s debt covenants.

The Company’s internal audit and legal compliance departments also monitor related-party transactions. The audit and legal compliance teams work together to compose a list of potential related parties. This list is cross-checked against the Company’s list of suppliers and other creditors.

The related-party transactions during the current quarter corresponded to the normal course of operations and were measured at fair value, which is the amount of consideration established and agreed to by the related parties and which, in the opinion of management and the NBOC, are considered similar to those negotiable with third parties.

The following sets out the details of the Company’s related-party transactions:

a) During the months ended March 31, 2014, the Company paid $2.6 million (March 31, 2013: $12.8 million) to Transportadora Del Meta S.A.S. (“**Transmeta**”) in crude oil transportation costs. In addition the Company has accounts receivable of $1.4 million (December 31, 2013: $1.5 million) from Transmeta and accounts payable of $1.5 million (December 31, 2013: $1.7 million) to Transmeta as at March 31, 2014. Transmeta is controlled by German Efromovich, a director of the Company.

b) As at March 31, 2014, the Company had trade accounts receivable of $2.9 million (December 31, 2013: $0.2 million) from Proelectrica, in which the Company has a 24.9% indirect interest and which is 31.49% owned by Blue Pacific Assets Corp. (“**Blue Pacific**”). The Company’s and Blue Pacific’s indirect interests are held through Pacific Power. Revenue from Proelectrica in the normal course of the Company’s business was $2.5 million for the three months ended March 31, 2014 (March 2013 - $11.2 million).

   In October 2012, the Company and Ecopetrol signed two Build, Own, Manage, and Transfer (“**BOMT**”) agreements with Consorcio Genser Power-Proelectrica and its subsidiaries (“**Genser-Proelectrica**”) to acquire certain power generation assets for the Rubiales field. Genser-Proelectrica is a joint venture between Proelectrica and Genser Power Inc. which is 51% owned by Pacific Power. Total commitment under the BOMT agreements is $229.7 million over ten years. In April 2013 the Company and Ecopetrol entered into another agreement with Genser-Proelectrica to acquire additional assets for a total commitment of $57 million over ten years. At the end of the Rubiales Association Contract in 2016, the Company’s obligations along with the power generation assets will be transferred to Ecopetrol. As at March 31, 2014 those assets were under construction and the Company paid cash advances of $9.3 million (March 2013: $0.5 million). The Company has accounts payable of $0.1 million (December 2013: $0.4 million) due to Genser-Proelectrica.

   Three directors and officers, and an executive officer of the Company (Serafino Iacono, Miguel de la Campa, José Francisco Arata and Laureano von Siegmund) control, or provide investment advice to the holders of, 78% of the shares of Blue Pacific.

c) In June 2007, the Company entered into a 5-year lease agreement with Blue Pacific for administrative office space in one of its Bogota, Colombia locations. Monthly rent expense of $0.087 million was payable to Blue Pacific under this agreement. During 2011, the lease was amended to include additional space in Bogota for a 10-year term with a monthly rent of $0.5 million, and assignment of the lessor to an entity controlled by Blue Pacific. Effective January 1, 2014, Blue Pacific ceased to be a party to the lease agreements upon assigning the rights under these agreements to a third party that is not related to the Company.

d) The Company has entered into aircraft transportation agreements with Petroleum Aviation Services S.A.S. ("**PAS**"), a company controlled by German Efromovich, a director of the Company. During the three months ended March 31 2014, the Company paid $2.2 million (March 31, 2013: $4.1 million) in fees as set out under the transportation agreements. As at March 31, 2014, the Company had accounts payable of $2.8 million to PAS (December 31, 2013: $2.5 million).

e) During the three months ended March 31, 2014, the Company paid $28.6 million to ODL (March 31, 2013: $32.4 million) for crude oil transport services under the pipeline take or pay agreement, and has accounts payable of $14.9 million to ODL as at March 31, 2014 (December 31, 2013: $7.4 million). The Company received $0.1 million from ODL during the months ended March 31, 2014 (March 31, 2013: $0.3 million) with respect to certain administrative services and rental equipment and machinery. The Company's accounts receivable from ODL as at March 31, 2014 were $0.6 million (December 31, 2013: $0.1 million).

f) During the three months ended March 31, 2014, the Company paid $50 million to Bicentenario (2013: Nil) for crude oil transport services under the pipeline take-or-pay agreement. As at March 31, 2014 the balance of loans outstanding to Bicentenario under the agreement in note 16 of the interim condensed consolidated financial statements (other assets) is $42 million (December 31, 2013: $42 million). Interest income of $0.65 million was recognized during the three months ended March 31, 2014 (March 31, 2013: $0.5 million). The Company has received $0.5 million during the three months ended March 31, 2014 (March 31, 2013: $0.4 million) with respect to certain administrative services and rental equipment and machinery. The Company has accounts receivable from Bicentenario as at March 31, 2014 of $42 million (December 31, 2013: $42 million) and advanced $100.8 million to (December 31, 2013: $90 million) to Bicentenario as a prepayment of transport tariff, which is amortized against the barrels transported.

g) During the three months ended March 31, 2014, the Company paid $0.1 million (March 31, 2013: $0.3 million) to Helicopteros Nacionales de Colombia S.A.S. ("Helicol") with respect to air transportation services. Helicol is controlled by German Efromovich, a director of the Company.

h) The Company has established a charitable foundation in Colombia, with the objective of advancing social and community development projects in the country. During the three months ended March 31, 2014, the Company contributed $7.0 million to these foundations (March 31, 2013: $10.8 million).

i) As at March 31, 2014, the Company has a loan receivable from PII in the amount of $38 million. The loan is guaranteed by PII's port project and bears interest at 7% per annum.

New standards, interpretations and amendments adopted by the Company

The accounting policies used in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Company's annual consolidated financial statements for the year ended December 31, 2013, as described below, except for the adoption of new standards and interpretations effective as of January 1, 2014.

<u>IFRIC 21 Levies</u>

IFRIC 21 is effective for annual periods beginning on or after January 1, 2014 and is applied retrospectively. It is applicable for all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 Income Taxes) and fines or other penalties for breaches of legislation.

The interpretation clarifies that an entity recognizes a liability for a levy no earlier than when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, no liability is recognized before the specified minimum threshold is reached. The interpretation requires these same principles to be applied in the interim condensed financial statements. The adoption of IFRIC 21 did not have any material impact on the Company´s interim condensed consolidated financial statements.

<u>Financial Instruments- IFRS 9</u>

As of January 1, 2014, the Company early adopted IFRS 9 - Financial Instruments ("IFRS 9"). IFRS 9 replaces International Accounting Standard 39 – Financial Instruments: Recognition and Measurement ("IAS 39") and addresses the accounting for financial instruments, including hedge accounting. Upon adoption of IFRS 9, certain comparative figures were restated and the impact of such restatement on the financial position of the Company and results of operations are summarized below, and also disclosed in note 27 of the interim condensed consolidated financial statements.

Balance Sheet Line Item Impact	As at December 31, 2013	Effect of IFRS 9 Adoption	After Adoption As at December 31, 2013	As at January 1, 2013	Effect of IFRS 9 Adoption	After Adoption As at January 1, 2013
Equity						
Time value for hedging instruments reserve	-	(3,092)	(3,092)	-	(7,415)	(7,415)
Retained earnings	$ 1,389,192	$ 3,092	$ 1,392,284	$ 1,154,547	$ 7,415	$ 1,161,962

Comprehensive Income Line Item Impact	Year ended December 31, 2013	Effect of IFRS 9 Adoption	After Adoption As at December 31, 2013	Three months ended March 31, 2013	Effect of IFRS 9 Adoption	After Adoption As at March 31, 2013
Statements of Income						
Foreign exchange (loss) gain	$ 6,325	$ (4,323)	$ 2,002	$ 17,835	$ (2,864)	$ 14,971
Statements of other comprehensive income						
Unrealized gain (loss) on the time value of cash flow hedges	-	(4,323)	(4,323)	-	(2,864)	(2,864)
EPS -Basic			1.32			0.40
EPS -Diluted			1.31			0.39

The transition to IFRS 9 resulted in changes to some of the Company's previous accounting policies as applied and disclosed in the interim condensed consolidated financial statements for the year ended December 31, 2013. The revised accounting policies affected by the early adoption of IFRS 9 have been included below.

<u>Financial Instruments</u>

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial instruments classified as amortized costs are included with the carrying value of such instruments. Transaction costs directly attributable to the acquisition of financial instruments classified as fair value through profit or loss are recognized immediately in earnings

Financial Assets

All recognized financial assets are subsequently measured in their entirety at either amortized cost or fair value, depending on this classification.

Financial assets that meet the following conditions are subsequently measured at amortized cost less impairment loss:

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
- The asset was not acquired principally for the purpose of selling in the near term or management for short-term profit taking (held for trading).

All other financial assets except equity investments as described below are subsequently measured at fair value (classified as fair value through profit and loss ("**FVTPL**"). The gains or losses arising on re-measurement are recognized in earnings and included in the other' line item (see note 24 in the interim condensed consolidated financial statements).

On the day of acquisition of an equity instrument, the Company can make an irrevocable election (on an instrument-by-instrument basis) to designate investments in equity instruments as at fair value through other comprehensive income ("**FVTOC**I"). Designation FVTOCI is not permitted if the equity investment is held for trading. Investments in equity instruments at FVTOCI are initially measured at fair value plus transaction costs. Subsequently, they are measured at fair value with gains and losses arising from changes in fair value recognized in other comprehensive income and accumulated in the fair value instrument. The cumulative gain or loss will not be reclassified to profit or loss on disposal of the investments. The Company has designated all investments in equity instruments as FVTOCI on initial application of IFRS 9 (see note 24 in the interim condensed consolidated financial statements).

Financial Liabilities

Financial liabilities are classified as at FVTPL when the financial liability is either held for trading or it is designated as at FVTPL.

Financial liabilities at FVTPL are stated at fair value. Any gains or losses arising on re-measurement of held-for-trading financial liabilities are recognized in earnings. Such gains or losses recognized in profit or loss incorporate any interest paid on the financial liabilities.

Financial liabilities that are not held-for-trading and are not designated as at FVTPL are measured at amortized cost at the end of subsequent accounting periods. The carrying amounts of financial liabilities that are subsequently measured at amortized cost are determined based on the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the expected life of the financial liability.

Derivative Financial Instruments

The Company enters into a variety of derivative financial instruments to manage its exposure to foreign exchange rate risks and commodity price risks, including collars and forwards.

Derivatives are initially recognized at fair value at the date the derivative contracts are entered into and are subsequently re-measured to their fair value at the end of each reporting period. The resulting gain or loss is immediately recognized in earnings unless the derivative is designated and effective as a hedging instrument (further explained below under "Hedge Accounting"), in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

Embedded derivatives

Derivatives embedded in non-derivative host contracts that are not financial assets within the scope of IFRS 9 (e.g. financial liabilities) are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at FVTPL. Fair value is determined in the manner described in note 24 of the interim condensed consolidated financial statements.

Hedge Accounting

The Company designates certain hedging instruments, in respect of foreign currency risk and commodity price risk, as cash flow hedges,

At the inception of the hedge relationship, the Company documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Company documents whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows of the hedged item attributable to the hedged risk.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income and accumulated under the heading of cash flow hedge reserve. The gain or loss relating to the ineffective portion is recognized immediately in profit or loss, and is included in the foreign exchange gain or loss line item of the interim statements of income for foreign currency hedging instruments and the risk management gain or loss line item for commodity hedging instruments.

Amounts previously recognized in other comprehensive income and accumulated in equity are reclassified to earnings in the periods when the hedged item is recognized in earnings, within the same line of the interim consolidated statements of income as the recognized hedged item. However, when the hedged forecast transaction results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously recognized in other comprehensive income and accumulated in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

If upon the designation of an option instruments as hedging instruments, the intrinsic and time value components are separated, with only the intrinsic component designated as the hedging instrument, the aligned time value component will be deferred in OCI as a cost of hedging.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or when it no longer meets the criteria for hedge accounting. Any gain or loss recognized in other comprehensive income and accumulated in equity at that time remains in equity and is recognized when the forecast transaction is ultimately recognized in profit or loss. When a forecast transaction is no longer expected to occur, the gain or loss accumulated in equity is recognized immediately in profit or loss.

The Company has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

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

In accordance with National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings ("**NI 52-109**") of the Canadian Securities Administrators ("**CSA**"), the Company issues quarterly a "Certification of Interim Filings". This 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**").

During this quarter, 110 controls over 25 corporate processes were evaluated. From this evaluation, the Company concluded that there were no material weaknesses or significant deficiencies in the design and effectiveness of the controls evaluated.

During this quarter, Internal Audit continued reviews focused on identifying, evaluating, and addressing critical and material risks for the organization. Following are some of the most significant risks identified, as well as the actions initiated by management to mitigate them:

- Regulatory compliance: Actions include the Corruption of Foreign Public Officials Act ("**CFPOA**"), an anti-money laundering training program, and the updating of all regulatory obligations the Company has in different countries.
- Price and exchange rate volatility: Actions are focused on hedging processes and strategies in order to improve the automated environment.
- Fraud: Risk assessment is related to asset misappropriation, corruption and financial fraud. The Company has launched e-learning programs for employee fraud awareness training to help maintain fraud resistance.
- Data security and privacy protection: Actions are focused on access to the network and application security in accordance with standards.
- Health, safety, and environmental risks: The Company is operating with a zero-tolerance HSE program.

15. Outlook

The Company will continue to implement its growth strategy through the second half of 2014 by expanding its resource and reserve base and developing its production and transport capacity. The outlook for the remainder of 2014 includes:

- The Company is on track to grow average daily production by 15% – 25% from 2013, to approximately 148 to 162 Mboe/d.
- The exploration campaign is on schedule; for the remainder of the year we will continue with exploration drilling, seismic data acquisition and investment in early facilities, expected to total around $550 million.
- For the CPE-6 Block, our appraisal campaign will continue with the drilling of two exploration wells and seven appraisal wells as well, as production tests during the remainder of the year.
- An estimated $750 to $800 million for the remainder of 2014 to be invested in drilling 350 development wells (excluding workovers). The focus will be on the development of the Rio Ariari block, infill drilling in the Quifa SW and Rubiales fields, and light oil development in the Cubiro Block in Colombia. In addition, we will continue development drilling in Block Z-1 in Peru following the increase in production reported in the current quarter.
- The construction of facilities and infrastructure is on track, and we expect to incur around $425 to $475 million for the remainder of the year. The investments will be directed primarily to the Rubiales, Quifa, SW, Cajua, Sabanero, and CPE-6 fields, as well as other light oil fields in Colombia.

16. Additional Financial Measures

This report contains the following financial terms that are not considered in IFRS: Funds Flow from Operations, Adjusted Net Earnings, Adjusted EBITDA and Net Earnings from Operations. These non-IFRS measures do not have any standardized meaning and therefore are unlikely to be compared to similar measures presented by other companies. These non-IFRS financial measures are included because management uses this information to analyze operating performance, leverage and liquidity. Therefore, these measures should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

a) Funds Flow from Operations

The following table shows the reconciliation of funds flow from operations to cash flow from operating activities for the three months ending March 31, 2014:

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Cash flow from operating activities	$ 384,687	$ 622,533
Changes in non-cash working capital	(88,922)	116,373
Funds flow from operations	**$ 473,609**	**$ 506,160**

b) Adjusted Net Earnings

	Three Months Ending March 31	
(in thousands of US$)	2014	2013
Adjusted net earning	**$ 120,566**	**$ 115,968**
Non-operating items		
Other expenses	(20,469)	3,722
(Loss) gain from foreign exchange	(1,775)	14,971
Gain (loss) on risk management	3,855	(5,651)
Gain (loss) from equity investments	17,063	(1,632)
Total non-operating items	**(1,326)**	**11,410**
Net earnings attributable to equity holders of the parent, as reported	**$ 119,240**	**$ 127,378**

"Adjusted Net Earnings" is a non-IFRS financial measure that represents Net Earnings adjusted for certain items of a non-operational nature, including non-cash items. This is one of the indicators against which the Company evaluates its performance. The reconciliation chart lists the effects of certain non-operational items that are included in the Company's financial results and may not be comparable to similar measures presented by other companies.

c) Adjusted EBITDA

The Company uses the financial measure "Adjusted EBITDA" in this MD&A, whereas in the past we have used the term EBITDA. Our calculation of this measure has not changed from previous quarters, but the terminology has changed due to guidance provided by the Ontario Securities Commission. Adjusted EBITDA is an indicator that the Company uses to assess its financial returns from normal operations, adjusting for non-cash and one-time items.

A reconciliation of Net Earnings to Adjusted EBITDA follows:

(in thousands of US$)	Three Months Ending March 31 2014	2013
Net earnings [(1)]	**$ 119,240**	**$ 127,378**
Adjustments to net earnings		
Income taxes expense	149,458	164,618
Foreign exchange loss (gain)	1,775	(14,971)
Finance cost	61,495	24,881
Loss (gain) on risk management contracts	(3,855)	5,651
(Loss) gain from equity investment	(17,063)	1,632
Other expenses (income)	20,469	(3,722)
Share-based compensation	1,727	35,532
Loss attributable to non-controlling interest	(730)	(1,156)
Depletion, depreciation and amortization	375,642	332,523
Adjusted EBITDA	**$ 708,158**	**$ 672,366**

1. *Net earnings attributable to equity holders of the parent.*

d) Net Earnings from Operations

Additional details on Net Earnings from Operation for the first quarter of 2014 are provided in Section 3 - Financial Summary on page 7.

17. Sustainability Policies

Pacific Rubiales is comprised of people who are committed to building a sustainable company that triggers the growth of its surroundings. We are convinced that through our shared value model, we have an opportunity to contribute to sustainable solutions to the social and environmental challenges of the countries where we operate .

As one of the fastest growing companies in the world, we have an enormous responsibility to develop hand in hand with the interests of our stakeholders. According to Platts, we rank at 152 among energy companies with the greatest impact in the world, and among seven exploration and production companies in the western hemisphere, we rank 10.

One of the key determinants of our exponential growth is cultivating the best talent. Our commitment to having the best talent has been recognized by various organizations. In 2013, our Corporate University was awarded with the Excellence and Innovation in Learning Prize in the “Branding” and “Learning Technologies” categories, in which world-class companies such as Microsoft, HP, NASA, Boeing, etc., competed. This prize is given out by the Corporate University Exchange ("CorpU"), which includes corporate universities and the training centers of major corporations worldwide.

Beyond promoting academic growth and opportunities, our Company guarantees the physical safety of the employees and contractors involved in its operations. One of the most significant accomplishments of our Company was the recognition of having the highest occupational health and industrial safety out of all the companies in the world assessed by the Dow Jones Sustainability Index (“**DJSI**”). Given this outstanding performance in this and other criteria, we were included in the DJSI yearbook with the top 15% leading companies in the oil and gas industry.

Operating with excellence also means upholding the best environmental practices. Our commitment to our surroundings transcends traditional practices associated with the mitigation and compensation of our activities. We recently obtained the ISO 50001 energy efficiency certification in our water injection processes meaning fewer emissions associated with the use of electricity. We are the first company in the industry amongst those operating in Latin America to receive this recognition.

We are currently working with different projects that seek to create business opportunities that increase profitability while addressing needs and challenges in its local areas of operation as well as host countries. During the beginning of 2014, we continued our water treatment project, the purpose of which is to transform the water generated in the hydrocarbon extraction process into a water resource that meets quality conditions for its reuse in crop irrigation for biofuel or biomass purposes for the generation of energy.

We also believe that we can create business opportunities by promoting knowledge transfer processes and installing capacities amongst local communities so they can participate in sustainable developmental processes. At Pacific Rubiales we promote a technical cooperation program with the Meta Region National Learning Service (SENA) to integrate professional training, business development, labor training and certification of labor competencies in our operating zones in the region. Thanks to this alliance, 950 beneficiaries were able to join different economic activities in the region. Aside from our commitment to increase competitiveness among our area of influence, we also promoted initiatives for education, institutional strengthening and various solidary investments.

In line with our commitment to spark local commerce we undertook purchases and contracts with suppliers from the regions of influence, which represents a growth of 218% versus the local/regional contract figure at the close of 2012. Likewise, the proportion of purchases and contracts with suppliers nationally registered in Colombia was 93%. This drive for local and regional purchases and contracts is mainly due to growing business activity in the regions of influence and the production cycle of the fields. Our effort has focused on exploiting these opportunities and integrating them into our value chain.

Finally, we are one of the first companies to sign the Global Compact’s Business for Peace Initiative, which is mainly focused on practices that contribute to the economic advancement of former combatants. This leads to the complementary responsibility of firmly committing ourselves to developing the business in equitable and peaceful surroundings, particularly in facing the aftermath of the conflict in Colombia.

On May 1, 2014 we published 2013 Annual and Sustainability Report, the first year that all four operational, financial, social and environmental performances will be disclosed in one document to our stakeholders.

18. Risks and Uncertainties

The business, operations and earnings of the Company could be impacted by the occurrence of risks of all kinds including financial, operational, technological and political that might affect this industry. Our Enterprise Risk Management program identifies, assesses and provides action plans and controls to mitigate the occurrence of the risks described below, which can potentially affect businesses and hence the profitability and value of the shares of the Company.

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

- Fluctuating oil and gas prices;
- Global financial conditions;
- Exploration and development;
- Operating hazards and risks;
- Security risks;
- Reserves estimates;
- Transportation costs;
- Cash flows and additional funding requirements;
- Disruptions in production;
- Political risks;
- Environmental factors;
- Title matters;
- Payment of dividends;
- Dependence on management;
- Ability to attract and retain qualified personnel;
- Changes in legislation;
- Litigation;
- Repatriation of earnings;
- Enforcement of civil liabilities;
- Competition;
- Environmental licences & required permits;
- Partner relationships;
- Oil & gas transportation;
- Availability of diluents;
- Water disposal;
- Labour relations;
- HSE works;
- Community relations;
- Fraud;
- Foreign exchange rate fluctuation;
- Business continuity;
- Regulatory compliance; and
- Shareholder relations.

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

Finding Costs

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

Boe Conversion

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

All of the Company's natural gas reserves are contained in the La Creciente, Guama and other blocks in Colombia as well as in the Piedra Redonda field in Block Z-1, Peru. For all natural gas reserves in Colombia, boe's have been expressed using the Colombian conversion standard of 5.7 Mcf: 1 bbl required by the Colombian Ministry of Mines and Energy. For all natural gas reserves in Peru, boe's have been expressed using the Canadian conversion standard of 6.0 Mcf: 1 bbl. If a conversion standard of 6.0 Mcf: 1 bbl was used for all of the Company's natural gas reserves, this would result in a reduction in the Company's net 1P and 2P reserves of approximately 4.2 and 4.7 MMboe respectively.

Prospective Resources

Readers should give attention to the estimates of individual classes of resources and appreciate the differing probabilities of recovery associated with each class. Estimates of remaining (un-risked) recoverable resources include prospective resources that have not been adjusted for risk based on the chance of discovery or the chance of development and contingent resources that have not been adjusted for risk based on the chance of development. It is not an estimate of volumes that may be recovered. Actual recovery is likely to be less and may be substantially less or zero.

Prospective Resources are those quantities of petroleum estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Prospective Resources have both an associated chance of discovery and a chance of development. Prospective Resources are further subdivided in accordance with the level of certainty associated with recoverable estimates, assuming their discovery and development, and may be sub-classified based on project maturity. There is no certainty that any portion of the resources will be discovered. If discovered, there is no certainty that any discovery will be technically or economically viable in order to produce any portion of the resources.

Translations

This MD&A was prepared originally in the English language and subsequently translated into Spanish and Portuguese. In the case of any differences between the English version and its translated versions, the English document shall prevail and be treated as the governing version.

20. Abbreviations

The following abbreviations are frequently used in our MD&A.

1P	Proved reserves (also known as P90)
2P	Proved reserves + Probable reserves.
3P	Proved reserves + Probable reserves + Possible reserves
bbl	Barrels
bbl/d	Barrels per day
Bcf	Billion cubic feet
boe	Barrels of oil equivalent
boe/d	Barrels of oil equivalent per day
Btu	British thermal units
Bwpd	Barrels of water per day
CBM	Cubic Billion Meter
ESP	Electro-Submersible Pump
GDP	Gross Domestic Product
ha	Hectare
km	Kilometers
KWh	Kilowatt Hour
Mbbl	Thousand barrels
Mboe	Thousand barrels of oil equivalent
MMcf/d	Million cubic feet per day
MD	Measured depth
MMbbl	Million barrels
Mmboe	Million barrels of oil equivalent
MMBtu	Million British thermal units
MMcf	Million cubic feet
MMcf/d	Million cubic feet per day
Mmscf/d	Million standard cubic feet per day
MW	Megawatts
NGL	Natural gas liquids
OOIP	Original oil in place
Tcf	Trillion cubic feet
TD	Total depth
TVDSS	True vertical depth below sea level
USGC	US Gulf Coast
WTI	West Texas Intermediate index