

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with the Financial Statements'as set out in Part I, Item 1 of this Quarterly Report on Form 10-Q as well as the Financial Statements and Supplementary Data'and Management's Discussion and Analysis of Financial Condition and Results of Operations'included in Part II, Items 8 and 7, respectively, of our 2017 Annual Report on Form 10-K, filed with the SEC on February 27, 2018. Please see the cautionary language at the beginning of this Quarterly Report on Form 10-Q regarding the identification of and risks relating to forward-looking statements, as well as Part I, Item 1A "Risk Factors" in our 2017 Annual Report on Form 10-K.

Financial and Operational Highlights

Key Highlights for the second quarter of 2018⁽¹⁾

- Achieved a new company milestone: record Colombia working interest production before royalties of 35,400 BOEPD, 18% higher compared with 30,098 BOEPD in the second quarter of 2017. Production increased largely because of production from development activities in the Acordionero Field.
- The quarter's Colombia production was also up 57% from second quarter 2015 when the strategy to refocus Gran Tierra on Colombia began, an annual growth rate of 16%
- Since acquiring the Acordionero field in the Middle Magdalena Valley ("MMV") in August 2016, we have increased production 274% to a record high average rate during the quarter of 17,710 bopd (14,076 bopd NAR). From the acquisition date of August 23, 2016, until June 30, 2018, the MMV assets have generated \$327 million in oil and natural gas sales
- Production NAR was 28,198 BOEPD, 12% higher than the second quarter of 2017.
- Continued significant exposure to oil price strength with oil representing 100% of our production
- Oil and natural gas sales volumes were 27,902 BOEPD, 11% higher than the second quarter of 2017. The quarter's increase in oil and gas sales volumes was driven by the production increase (5,302 bopd) , partially offset by higher royalties (2,383 bopd) due to higher oil prices and a change in inventories (149 bopd).
- Net income was \$20.3 million compared with net loss of \$6.8 million in the second quarter of 2017. Net loss in the comparative period included the loss on sale of Brazil business unit.
- Funds flow from operations⁽²⁾ increased by 86% to \$94.5 million compared with the second quarter of 2017, while the Brent price increased only 47% from the second quarter of 2017.
- Active quarter with capital expenditures of \$84.4 million. Funds flow from operations exceeded capital expenditures by \$10.2 million.
- Oil and gas sales per BOE were \$64.37, 60% higher than the second quarter of 2017.
- Operating netback⁽²⁾ per BOE was \$47.99, 85% higher compared with the second quarter of 2017.
- Operating expenses per BOE were \$13.81, 21% higher compared with the second quarter of 2017 as a result of payments triggered by renegotiating our field operating agreements, power generation costs, equipment rental and accelerated maintenance costs, mainly in the Acordionero field, in the quarter.
- Quality and transportation discount was \$10.53 per BOE compared with \$10.74 per BOE in the second quarter of 2017; this \$0.21 per BOE reduction resulted from optimization of transportation routes and narrowing of differentials
- Transportation expenses per BOE were \$2.57, 7% lower compared with the second quarter of 2017. The decrease was due to the increased use of alternative transportation routes, which had lower costs per BOE.
- General and administrative ("G&A") expenses before stock-based compensation per BOE decreased by 18% to \$2.60 per BOE compared with the second quarter of 2017.
- Exited the quarter with \$125.8 million of cash and cash equivalents.

⁽¹⁾ Except for net income, funds flow from operations and G&A expenses, all numbers and comparisons above are based on Colombia only, excluding Brazil which was sold in 2017.

⁽²⁾ Funds flow from operations and operating netback are non-GAAP measures which do not have any standardized meaning prescribed under GAAP. Refer to the non-GAAP measures disclosure below for a definition and reconciliation of these measures.

(Thousands of U.S. Dollars, unless otherwise indicated)	Three Months Ended June 30,			Three Months Ended March 31	Six Months Ended June 30,		
	2018	2017	% Change	2018	2018	2017	% Change
Average Daily Volumes (BOEPD)							
Consolidated							
Working Interest Production Before Royalties	35,400	31,437	13	35,075	35,239	30,663	15
Royalties	(7,202)	(5,014)	44	(6,886)	(7,045)	(5,051)	39
Production NAR	28,198	26,423	7	28,189	28,194	25,612	10
Increase in Inventory	(296)	(140)	111	(986)	(639)	(61)	948
Sales ⁽¹⁾	27,902	26,283	6	27,203	27,555	25,551	8
Colombia							
Working Interest Production Before Royalties	35,400	30,098	18	35,075	35,239	29,294	20
Royalties	(7,202)	(4,819)	49	(6,886)	(7,045)	(4,843)	45
Production NAR	28,198	25,279	12	28,189	28,194	24,451	15
Increase in Inventory	(296)	(147)	101	(986)	(639)	(70)	813
Sales ⁽¹⁾	27,902	25,132	11	27,203	27,555	24,381	13
Net Income (Loss)	\$ 20,300	\$ (6,807)	398	\$ 17,861	\$ 38,161	\$ 5,964	540
Operating Netback							
Oil and Natural Gas Sales	\$ 163,446	\$ 96,128	70	\$ 138,228	\$ 301,674	\$ 190,787	58
Operating Expenses	(35,059)	(27,208)	29	(26,265)	(61,324)	(51,145)	20
Transportation Expenses	(6,522)	(6,492)	—	(6,997)	(13,519)	(13,434)	1
Operating Netback ⁽²⁾	\$ 121,865	\$ 62,428	95	\$ 104,966	\$ 226,831	\$ 126,208	80
G&A Expenses Before Stock-Based Compensation	\$ 6,604	\$ 7,610	(13)	\$ 7,982	\$ 14,586	\$ 15,173	(4)
G&A Stock-Based Compensation	6,609	1,903	247	3,178	9,787	3,052	221
General and Administrative ("G&A") Expenses, Including Stock-Based Compensation	\$ 13,213	\$ 9,513	39	\$ 11,160	\$ 24,373	\$ 18,225	34
EBITDA ⁽²⁾	\$ 102,278	\$ 41,634	146	\$ 88,588	\$ 190,866	\$ 103,172	85
Funds Flow From Operations ⁽²⁾	\$ 94,549	\$ 50,920	86	\$ 74,748	\$ 169,297	\$ 95,946	76
Capital Expenditures	\$ 84,394	\$ 57,865	46	\$ 72,694	\$ 157,088	\$ 104,025	51

(Thousands of U.S. Dollars)	As at		
	June 30, 2018	December 31, 2017	% Change
Cash and Cash Equivalents	\$ 125,807	\$ 12,326	921
Revolving Credit Facility	\$ —	\$ 148,000	(100)
Senior Notes	\$ 300,000	\$ —	—
Convertible Notes	\$ 115,000	\$ 115,000	—

⁽¹⁾ Sales volumes represent production NAR adjusted for inventory changes.

⁽²⁾ **Non-GAAP measures**

Operating netback, EBITDA and funds flow from operations are non-GAAP measures which do not have any standardized meaning prescribed under GAAP. Management views these measures as financial performance measures. Investors are cautioned that these measures should not be construed as alternatives to net income or loss or other measures of financial performance as determined in accordance with GAAP. Our method of calculating these measures may differ from other companies and, accordingly, may not be comparable to similar measures used by other companies. Each non-GAAP financial measure is presented along with the corresponding GAAP measure so as not to imply that more emphasis should be placed on the non-GAAP measure.

Operating netback, as presented, is defined as oil and natural gas sales less operating and transportation expenses. Management believes that operating netback is a useful supplemental measure for management and investors to analyze financial performance and provides an indication of the results generated by our principal business activities prior to the consideration of other income and expenses. A reconciliation from oil and natural gas sales to operating netback is provided in the table above.

EBITDA, as presented, is defined as net income or loss adjusted for depletion, depreciation and accretion ("DD&A") expenses, interest expense and income tax expense. Management uses this supplemental measure to analyze performance and income or loss generated by our principal business activities prior to the consideration of how non-cash items affect that income or loss, and believes that this financial measure is useful supplemental information for investors to analyze our performance and our financial results. A reconciliation from net loss to EBITDA is as follows:

(Thousands of U.S. Dollars)	Three Months Ended June 30,		Three Months Ended March 31,	Six Months Ended June 30,	
	2018	2017	2018	2018	2017
Net income (loss)	\$ 20,300	\$ (6,807)	\$ 17,861	\$ 38,161	\$ 5,964
Adjustments to reconcile net income (loss) to EBITDA					
DD&A expenses	46,607	31,813	39,461	86,068	58,689
Interest expense	7,375	3,331	5,495	12,870	6,426
Income tax expense	27,996	13,297	25,771	53,767	32,093
EBITDA (non-GAAP)	102,278	41,634	88,588	190,866	103,172

Funds flow from operations, as presented, is defined as net income or loss adjusted for DD&A expenses, deferred tax expense, stock-based compensation expense, amortization of debt issuance costs, cash settlement of RSUs, unrealized foreign exchange gains and losses, financial instruments gains or losses, cash settlement of financial instruments and loss on sale. Management uses this financial measure to analyze performance and income or loss generated by our principal business activities prior to the consideration of how non-cash items affect that income or loss, and believes that this financial measure is also useful supplemental information for investors to analyze performance and our financial results. A reconciliation from net income or loss to funds flow from operations is as follows:

(Thousands of U.S. Dollars)	Three Months Ended June 30,		Three Months Ended March 31,	Six Months Ended June 30,	
	2018	2017	2018	2018	2017
Net income (loss)	\$ 20,300	\$ (6,807)	\$ 17,861	\$ 38,161	\$ 5,964
Adjustments to reconcile net income (loss) to funds flow from operations					
DD&A expenses	46,607	31,813	39,461	86,068	58,689
Deferred tax expense	23,169	11,525	13,482	36,651	22,904
Stock-based compensation expense	6,893	1,980	3,309	10,202	3,183
Amortization of debt issuance costs	843	620	670	1,513	1,225
Cash settlement of RSUs	(240)	(183)	(120)	(360)	(501)
Unrealized foreign exchange loss (gain)	1,583	3,895	(1,044)	539	1,076
Financial instruments loss (gain)	4,768	(1,447)	6,946	11,714	(6,886)
Cash settlement of financial instruments	(9,666)	448	(5,817)	(15,483)	1,216
Loss on sale	292	9,076	—	292	9,076
Funds flow from operations (non-GAAP)	\$ 94,549	\$ 50,920	\$ 74,748	\$ 169,297	\$ 95,946

Additional Operational Results

(Thousands of U.S. Dollars)	Three Months Ended June 30,			Three Months Ended March 31,	Six Months Ended June 30,		
	2018	2017	% Change	2018	2018	2017	% Change
Oil and natural gas sales	\$ 163,446	\$ 96,128	70	\$ 138,228	\$ 301,674	\$ 190,787	58
Operating expenses	35,059	27,208	29	26,265	61,324	51,145	20
Transportation expenses	6,522	6,492	—	6,997	13,519	13,434	1
Operating netback ⁽¹⁾	121,865	62,428	95	104,966	226,831	126,208	80
DD&A expenses	46,607	31,813	47	39,461	86,068	58,689	47
G&A expenses before stock-based compensation	6,604	7,610	(13)	7,982	14,586	15,173	(4)
G&A stock-based compensation expense	6,609	1,903	247	3,178	9,787	3,052	221
Equity tax	—	—	—	—	—	1,224	(100)
Foreign exchange loss (gain)	1,924	3,897	(51)	(942)	982	2,050	(52)
Financial instruments loss (gain)	4,768	(1,447)	430	6,946	11,714	(6,886)	270
Interest expense	7,375	3,331	121	5,495	12,870	6,426	100
	73,887	47,107	57	62,120	136,007	79,728	71
Loss on sale	(292)	(9,076)	(97)	—	(292)	(9,076)	(97)
Interest income	610	245	149	786	1,396	653	114
Income before income taxes	48,296	6,490	644	43,632	91,928	38,057	142
Current income tax expense	4,827	1,772	172	12,289	17,116	9,189	86
Deferred income tax expense	23,169	11,525	101	13,482	36,651	22,904	60
	27,996	13,297	111	25,771	53,767	32,093	68
Net income (loss)	\$ 20,300	\$ (6,807)	398	\$ 17,861	\$ 38,161	\$ 5,964	540

Sales Volumes (NAR)

Total sales volumes, BOEPD	27,902	26,283	6	27,203	27,555	25,551	8
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Average Prices

Oil and NGL's per bbl	\$ 64.50	\$ 40.44	59	\$ 56.63	\$ 60.64	\$ 41.65	46
Natural gas per Mcf	\$ 2.26	\$ 2.52	(10)	\$ 2.91	\$ 2.67	\$ 1.91	40

Brent Price per bbl	\$ 74.90	\$ 50.92	47	\$ 67.18	\$ 71.04	\$ 52.79	35
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Consolidated Results of Operations per BOE Sales Volumes NAR

Oil and natural gas sales	\$ 64.37	\$ 40.19	60	\$ 56.46	\$ 60.49	\$ 41.25	47
Operating expenses	13.81	11.38	21	10.73	12.30	11.06	11
Transportation expenses	2.57	2.71	(5)	2.86	2.71	2.90	(7)
Operating netback ⁽¹⁾	47.99	26.10	84	42.87	45.48	27.29	67
DD&A expenses	18.36	13.30	38	16.12	17.26	12.69	36
G&A expenses before stock-based compensation	2.60	3.18	(18)	3.26	2.92	3.28	(11)
G&A stock-based compensation expense	2.60	0.80	225	1.30	1.96	0.66	197
Equity tax	—	—	—	—	—	0.26	(100)
Foreign exchange loss (gain)	0.76	1.63	(53)	(0.38)	0.20	0.44	(55)
Financial instruments loss (gain)	1.88	(0.60)	413	2.84	2.35	(1.49)	258
Interest expense	2.90	1.39	109	2.24	2.58	1.39	86
	29.10	19.70	48	25.38	27.27	17.23	58
Loss on sale	(0.12)	(3.79)	(97)	—	(0.06)	(1.96)	(97)
Interest income	0.24	0.10	140	0.32	0.28	0.14	100
Income before income taxes	19.01	2.71	601	17.81	18.43	8.24	124
Current income tax expense	1.90	0.74	157	5.02	3.43	1.99	72
Deferred income tax expense	9.12	4.82	89	5.51	7.35	4.95	48
	11.02	5.56	98	10.53	10.78	6.94	55
Net income (loss)	\$ 7.99	\$ (2.85)	380	\$ 7.28	\$ 7.65	\$ 1.30	488

⁽¹⁾ Operating netback is a non-GAAP measure which does not have any standardized meaning prescribed under GAAP. Refer to "Financial and Operational Highlights—non-GAAP measures" for a definition and reconciliation of this measure.

Oil and Gas Production and Sales Volumes, BOEPD

	Three Months Ended June 30, 2018		Three Months Ended June 30, 2017		
	Total		Colombia	Brazil	Total
Average Daily Volumes (BOEPD)					
Working Interest Production Before Royalties	35,400		30,098	1,339	31,437
Royalties	(7,202)		(4,819)	(195)	(5,014)
Production NAR	28,198		25,279	1,144	26,423
(Increase) Decrease in Inventory	(296)		(147)	7	(140)
Sales	27,902		25,132	1,151	26,283
Royalties, % of Working Interest Production Before Royalties	20	%	16%	15%	16%
	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017		
	Total		Colombia	Brazil	Total
Average Daily Volumes (BOEPD)					
Working Interest Production Before Royalties	35,239		29,294	1,369	30,663
Royalties	(7,045)		(4,843)	(208)	(5,051)
Production NAR	28,194		24,451	1,161	25,612
(Increase) Decrease in Inventory	(639)		(70)	9	(61)
Sales	27,555		24,381	1,170	25,551
Royalties, % of Working Interest Production Before Royalties	20	%	17%	15%	16%

Oil and gas production NAR for the three and six months ended June 30, 2018 increased by 7% to 28,198 and by 10% to 28,194 BOEPD compared with 26,423 and 25,612 BOEPD, respectively, in the corresponding periods of 2017.

Colombian oil and gas production NAR for the three and six months ended June 30, 2018 increased by 12% and 15%, respectively, compared with the corresponding periods of 2017. The increase in production was a result of successful drilling and a workover campaign in the Acordionero and Costayaco Fields and the Vonu-1 exploration well. Working interest production before royalties from the Acordionero Field averaged 17,710 bopd before royalties (14,076 bopd NAR) during the three months ended June 30, 2018 compared with 8,362 bopd in the corresponding period of 2017, a 112% increase. Acordionero Field production increased 959 bopd before royalties from the three months ended March 31, 2018. During the second quarter of 2018, four wells were brought on production. Production was negatively impacted by two Electronic Submersible Pumps ("ESPs") failures in Acordionero and one ESP failure in Costayaco.

Royalties as a percentage of production for the three and six months ended June 30, 2018 increased compared with the corresponding periods of 2017 commensurate with the increase in oil prices due to price sensitive royalties payable in Colombia, higher API in the Acordionero Field and this field reaching the threshold for the High Price Royalties.

Operating Netbacks

(Thousands of U.S. Dollars)	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017		
	Total	Colombia	Brazil	Total
Oil and Natural Gas Sales	\$ 163,446	\$ 91,905	\$ 4,223	\$ 96,128
Transportation Expenses	(6,522)	(6,319)	(173)	(6,492)
	156,924	85,586	4,050	89,636
Operating Expenses	(35,059)	(26,192)	(1,016)	(27,208)
Operating Netback ⁽¹⁾	\$ 121,865	\$ 59,394	\$ 3,034	\$ 62,428

U.S. Dollars Per BOE Sales Volumes NAR

Brent	\$ 74.90	\$ 50.92	\$ 50.92	\$ 50.92
Vasconia, Quality and Transportation Discounts	(10.53)	(10.74)	(10.62)	(10.73)
Average Realized Price	64.37	40.18	40.30	40.19
Transportation Expenses	(2.57)	(2.76)	(1.65)	(2.71)
Average Realized Price Net of Transportation Expenses	61.80	37.42	38.65	37.48
Operating Expenses	(13.81)	(11.45)	(9.69)	(11.38)
Operating Netback ⁽¹⁾	\$ 47.99	\$ 25.97	\$ 28.96	\$ 26.10

(Thousands of U.S. Dollars)	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017		
	Total	Colombia	Brazil	Total
Oil and Natural Gas Sales	\$ 301,674	\$ 182,369	\$ 8,418	\$ 190,787
Transportation Expenses	(13,519)	(13,084)	(350)	(13,434)
	288,155	169,285	8,068	177,353
Operating Expenses	(61,324)	(49,348)	(1,797)	(51,145)
Operating Netback ⁽¹⁾	\$ 226,831	\$ 119,937	\$ 6,271	\$ 126,208

U.S. Dollars Per BOE Sales Volumes NAR

Brent	\$ 71.04	\$ 52.79	\$ 52.79	\$ 52.79
Vasconia, Quality and Transportation Discounts	(10.55)	(11.46)	(13.03)	(11.54)
Average Realized Price	60.49	41.33	39.76	41.25
Transportation Expenses	(2.71)	(2.96)	(1.65)	(2.90)
Average Realized Price Net of Transportation Expenses	57.78	38.37	38.11	38.35
Operating Expenses	(12.30)	(11.18)	(8.49)	(11.06)
Operating Netback ⁽¹⁾	\$ 45.48	\$ 27.19	\$ 29.62	\$ 27.29

⁽¹⁾ Operating netback is a non-GAAP measure which does not have any standardized meaning prescribed under GAAP. Refer to "Financial and Operational Highlights—non-GAAP measures" for a definition and reconciliation of this measure.

Oil and gas sales for the three and six months ended June 30, 2018 increased by 70% to \$163.4 million and 58% to \$301.7 million, respectively, compared with the corresponding periods of 2017. Compared with the prior quarter, oil and gas sales increased by 18%. The increases were due to increased sales volumes and realized oil prices. The following table shows the effect of changes in realized prices and sales volumes on our oil and gas sales for the three and six months ended June 30, 2018 compared with the prior quarter and the corresponding periods in 2017:

	Second Quarter 2018 Compared with First Quarter 2018	Second Quarter 2018 Compared with Second Quarter 2017	Six Months Ended, June 30, 2018 Compared with Six Months Ended June 30, 2017
Oil and natural gas sales for the comparative period	\$ 138,228	\$ 96,128	\$ 190,787
Realized sales price increase effect	20,096	61,401	95,920
Sales volume increase effect	5,122	5,917	14,967
Oil and natural gas sales for period ended June 30, 2018	\$ 163,446	\$ 163,446	\$ 301,674

Average realized prices for the three and six months ended June 30, 2018 increased by 60% and 47%, respectively, compared with the corresponding periods of 2017. Compared with the prior quarter, average realized prices increased by 14%. The increases were commensurate with increases in benchmark oil prices and lower quality and transportation discounts. Average Brent oil prices for the three and six months ended June 30, 2018 increased by 47% and 35%, respectively, compared with the corresponding periods of 2017 and increased by 11% compared with the prior quarter.

We have options to sell our oil through multiple pipelines and trucking routes. Each transportation route has varying effects on realized sales prices and transportation expenses. We focus on maximizing operating netback. The following table shows the percentage of oil volumes we sold in Colombia using each transportation method for the three and six months ended June 30, 2018 and 2017 and the prior quarter:

	Three Months Ended June 30,		Three Months Ended March 31	Six Months Ended June 30,	
	2018	2017	2018	2018	2017
Volume transported through pipeline	9%	20%	9%	9%	22%
Volume sold at wellhead	41%	52%	52%	42%	52%
Volume not sold at wellhead, trucking	50%	28%	39%	49%	26%
	100%	100%	100%	100%	100%

Volumes transported not sold at the wellhead receive higher realized prices, but incur higher transportation expenses. Volumes sold at the wellhead have the opposite effect of lower realized prices, offset by lower transportation expenses.

Total Company transportation expenses for the three and six months ended June 30, 2018 of \$6.5 million and \$13.5 million, respectively, were comparable with the corresponding periods of 2017. On a per BOE basis, transportation expenses for the three and six months ended June 30, 2018 decreased by 5% to \$2.57, and by 7% to \$2.71, from \$2.71 and \$2.90, respectively, compared with the corresponding periods of 2017. The decrease was primarily due to the use of alternative transportation routes, which had lower costs per BOE.

Colombian transportation expenses for the three and six months ended June 30, 2018 on a per BOE basis decreased by 7% and 8% to \$2.57 and \$2.71 per BOE, from \$2.76 and \$2.96, respectively in the corresponding periods of 2017. The decrease in Colombian transportation expenses per BOE was due to renegotiation of certain sales contracts, which had lower transportation costs compared to contracts used in 2017.

Transportation expenses for the three months ended June 30, 2018 decreased 7% compared with \$7.0 million in the prior quarter. On a per BOE basis, transportation expenses decreased by 10% to \$2.57 from \$2.86 in the prior quarter. The decrease was primarily due to the use of alternative transportation routes, which had lower costs per BOE.

In addition to lower transportation expenses, we also achieved decreases in quality and transportation discounts. The following table shows the variance in our average realized prices net of transportation expenses in Colombia for the three and six months ended June 30, 2018 compared with the prior quarter and the corresponding periods in 2017:

U.S. Dollars Per BOE Sales Volumes NAR	Second Quarter 2018 Compared with First Quarter 2018	Second Quarter 2018 Compared with Second Quarter 2017	Six Months Ended, June 30, 2018 Compared with Six Months Ended June 30, 2017
Average realized price net of transportation expenses for the comparative period	\$ 53.60	\$ 37.42	\$ 38.37
Increase in benchmark prices	7.72	23.98	18.25
Decrease in quality and transportation discounts	0.19	0.21	0.91
Decrease in transportation expenses	0.29	0.19	0.25
Average realized price net of transportation expenses for the period ended June 30, 2018	\$ 61.80	\$ 61.80	\$ 57.78

Total Company operating expenses for the three and six months ended June 30, 2018 increased by 29% to \$35.1 million, and by 20% to \$61.3 million, respectively, compared with total Company operating expenses in the corresponding periods of 2017.

Colombian operating expenses for the three and six months ended June 30, 2018 on a per BOE basis increased by \$2.36 and \$1.12, respectively, compared with the corresponding periods of 2017. Workover expenses increased by \$0.11 and decreased by \$0.27, respectively, over the same periods. Excluding workover expenses, Colombia operating expenses increased by \$2.25 and \$1.39, respectively, primarily as a result of payments triggered by renegotiating our field operating agreements, power generation costs, equipment rental and accelerated maintenance costs mainly in the Acordionero field during the second quarter of 2018.

Operating expenses for the three months ended June 30, 2018 increased by 33% compared with the prior quarter. On a per BOE basis, operating expenses increased by \$3.08. Workover expenses increased by \$1.45. Excluding workover expenses, operating expenses increased by \$1.63 compared with the prior quarter as a result of higher operating activities during the second quarter of 2018 mentioned in the paragraph above.

DD&A Expenses

	Three Months Ended June 30, 2018		Three Months Ended June 30, 2017	
	DD&A expenses, thousands of U.S. Dollars	DD&A expenses, U.S. Dollars Per BOE	DD&A expenses, thousands of U.S. Dollars	DD&A expenses, U.S. Dollars Per BOE
	Colombia	\$ 46,065	\$ 18.14	\$ 30,130
Brazil	—	—	1,050	10.02
Peru	—	—	412	—
Corporate	542	—	221	—
	\$ 46,607	\$ 18.36	\$ 31,813	\$ 13.30

	Six Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	DD&A expenses, thousands of U.S. Dollars	DD&A expenses, U.S. Dollars Per BOE	DD&A expenses, thousands of U.S. Dollars	DD&A expenses, U.S. Dollars Per BOE
	Colombia	\$ 84,564	\$ 16.96	\$ 55,065
Brazil	—	—	2,263	10.69
Peru	—	—	921	—
Corporate	1,504	—	440	—
	\$ 86,068	\$ 17.26	\$ 58,689	\$ 12.69

DD&A expenses for the three and six months ended June 30, 2018 increased to \$46.6 million (\$18.36 per BOE) and \$86.1 million (\$17.26 per BOE), respectively, from \$31.8 million (\$13.30 per BOE) and \$58.7 million (\$12.69 per BOE), respectively, in the corresponding periods in 2017. On a per BOE basis, the increase was due to higher costs in the depletable base, partially offset by increased proved reserves. On a per BOE basis, DD&A expenses increased by 14% from \$16.12 per BOE in the prior quarter primarily due to higher costs in the depletable base.

G&A Expenses

(Thousands of U.S. Dollars)	Three Months Ended June 30,			Three Months Ended March 31	Six Months Ended June 30,		
	2018	2017	% Change	2018	2018	2017	% Change
G&A Expenses Before Stock-Based Compensation	\$ 6,604	\$ 7,610	(13)	\$ 7,982	\$ 14,586	\$ 15,173	(4)
G&A Stock-Based Compensation	6,609	1,903	247	3,178	9,787	3,052	221
G&A Expenses, Including Stock-Based Compensation	\$ 13,213	\$ 9,513	39	\$ 11,160	\$ 24,373	\$ 18,225	34

U.S. Dollars Per BOE Sales Volumes NAR							
G&A Expenses Before Stock-Based Compensation	\$ 2.60	\$ 3.18	(18)	\$ 3.26	\$ 2.92	\$ 3.28	(11)
G&A Stock-Based Compensation	2.60	0.80	225	1.30	1.96	0.66	197
G&A Expenses, Including Stock-Based Compensation	\$ 5.20	\$ 3.98	31	\$ 4.56	\$ 4.88	\$ 3.94	24

For the three and six months ended June 30, 2018, G&A expenses before stock-based compensation decreased by 13% and 4%, respectively, from the corresponding periods of 2017. The decrease was primarily the result of higher overhead recoveries, partially offset by increase in Colombia and Corporate G&A expenses commensurate with our growth. On a per BOE basis, G&A expenses before stock-based compensation decreased 18% and 11%, respectively, from the corresponding periods of 2017.

After stock-based compensation, G&A expenses for the three and six months ended June 30, 2018 increased by 39% to \$13.2 million and by 34% to \$24.4 million, respectively, compared with the corresponding periods in 2017 mainly due to higher G&A Stock-Based Compensation resulting from a higher share price at June 30, 2018. G&A expenses for the three months ended June 30, 2018 increased by 18% compared with the prior quarter for the same reason.

Foreign Exchange Losses

For the three and six months ended June 30, 2018 we had foreign exchange losses of \$1.9 million and \$1.0 million, respectively, compared with \$3.9 million and \$2.1 million, respectively, in the corresponding periods of 2017. Deferred taxes are considered a monetary liability and require translation from local currency to U.S. dollar functional currency at each balance sheet date. This translation was the main source of the foreign exchange gains and losses. Due to the long-term nature of deferred tax liabilities, the related foreign exchange losses are not expected to be realized in the near-term.

The following table presents the change in the U.S. dollar against the Colombian peso for the three and six months ended June 30, 2018, and 2017:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Change in the U.S. dollar against the Colombian peso	strengthened by 5%	strengthened by 6%	weakened by 2%	strengthened by 1%

Financial Instrument Gains and Losses

The following table presents the nature of our financial instruments gains and losses for the three and six months ended June 30, 2018, and 2017:

(Thousands of U.S. Dollars)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Commodity price derivative loss (gain)	\$ 14,461	\$ (1,545)	\$ 19,455	\$ (6,247)
Foreign currency derivatives loss (gain)	1,945	98	(2,024)	(639)
Investment gain	(11,638)	—	(5,717)	—
	\$ 4,768	\$ (1,447)	\$ 11,714	\$ (6,886)

Income Tax Expense and Recovery

(Thousands of U.S. Dollars)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Income before income tax	\$ 48,296	\$ 6,490	\$ 91,928	\$ 38,057
Current income tax expense	\$ 4,827	\$ 1,772	\$ 17,116	\$ 9,189
Deferred income tax expense	23,169	11,525	36,651	22,904
Total income tax expense	\$ 27,996	\$ 13,297	\$ 53,767	\$ 32,093
Effective tax rate			58%	84%

Current income tax expense was higher in the three and six months ended June 30, 2018 compared with the corresponding periods of 2017 as a result of higher taxable income in Colombia. The deferred income tax expense for the three and six months ended June 30, 2018 of \$23.2 million and \$36.7 million, respectively, was primarily due to excess tax depreciation as compared with accounting depreciation in Colombia.

Current income tax expense decreased to \$4.8 million compared with \$12.3 million in the prior quarter primarily as a result of accelerated tax write-off related to current period drilling activities.

For the six months ended June 30, 2018, the difference between the effective tax rate of 58% and the 21% U.S. statutory rate was primarily due to an increase to the impact of foreign taxes, valuation allowance, stock-based compensation, foreign currency translation and non-deductible third party royalty in Colombia.

For the six months ended June 30, 2017, the difference between the effective tax rate of 84% and the 35% U.S. statutory rate was primarily due to an increase in the impact of foreign taxes, other permanent differences, valuation allowance largely attributable to losses incurred in the United States and Colombia, as well as the impact of a non-deductible third-party royalty in Colombia, stock-based compensation and other local taxes.

Net Income and Funds Flow from Operations (a Non-GAAP Measure)

(Thousands of U.S. Dollars)	Second Quarter 2018 Compared with First Quarter 2018	% change	Second Quarter 2018 Compared with Second Quarter 2017	% change	Six Months Ended, June 30, 2018 Compared with Six Months Ended June 30,	% change
Net income (loss) for the comparative period	\$ 17,861		\$ (6,807)		\$ 5,964	
Increase (decrease) due to:						
Prices	20,096		61,401		95,920	
Sales volumes	5,122		5,917		14,967	
Expenses:						
Operating	(8,794)		(7,851)		(10,179)	
Transportation	475		(30)		(85)	
Cash G&A and RSU settlements, excluding stock-based compensation expense	1,411		1,156		1,012	
Interest, net of amortization of debt issuance costs	(1,707)		(3,821)		(6,156)	
Realized foreign exchange	(240)		(338)		531	
Settlement of financial instruments	(3,849)		(10,114)		(16,699)	
Current taxes	7,462		(3,055)		(7,927)	
Equity tax	—		—		1,224	
Other	(175)		364		743	
Net change in funds flow from operations ⁽¹⁾ from comparative period	19,801		43,629		73,351	
Expenses:						
Depletion, depreciation and accretion	(7,146)		(14,794)		(27,379)	
Deferred tax	(9,687)		(11,644)		(13,747)	
Amortization of debt issuance costs	(173)		(223)		(288)	
Stock-based compensation, net of RSU settlement	(3,464)		(4,856)		(7,160)	
Financial instruments gain or loss, net of financial instruments settlements	6,027		3,899		(1,901)	
Unrealized foreign exchange	(2,627)		2,312		537	
Loss on sale	(292)		8,784		8,784	
Net change in net income or loss	2,439		27,107		32,197	
Net income for the current period	\$ 20,300	14%	\$ 20,300	398%	\$ 38,161	540%

⁽¹⁾Funds flow from operations is a non-GAAP measure which does not have any standardized meaning prescribed under GAAP. Refer to "Financial and Operational Highlights—non-GAAP measures" for a definition and reconciliation of this measure.

2018 Capital Program

Colombia remains our focus and represents 100% of the 2018 capital program. We have expanded the 2018 development capital program by an additional \$15 to \$30 million for;

- Ayombero appraisal drilling of 3 wells based on the success of the Ayombero-1 well;
- Costayaco development drilling in legacy reservoirs and 1 additional water injection well; and
- 2 Acordionero development wells accelerated from 2019 into fourth quarter 2018.

We expect the following ranges for our revised 2018 capital budget:

	Number of Wells (Gross)	Number of Wells (Net)	2018 Capital Budget (\$ million)
Colombia			
Development	22-24	21-22	\$130-135
Exploration	8-11	7-10	80-90
Facilities	—	—	75-80
Seismic and Studies	—	—	20
	<u>30-35</u>	<u>28-32</u>	<u>\$305-325</u>

Based on the midpoint of the guidance, the capital budget is forecasted to be approximately 68% directed to development and 32% to exploration. Between 35% and 40% of the revised 2018 development capital program is expected to be directed to facilities, with approximately 75% of this investment expected to be dedicated to the acceleration of the ongoing facilities expansion at the Acordionero Field. We expect our revised 2018 capital program to be fully funded by cash flows from operations.

Capital expenditures during the three months ended June 30, 2018, were \$84.4 million:

(Thousands of U.S. Dollars)

Colombia:		
Exploration	\$	18,301
Development:		
Facilities		16,957
Drilling and Completions		41,696
Other		6,803
		<u>83,757</u>
Corporate		637
	\$	<u>84,394</u>

During the three months ended June 30, 2018, we drilled the following wells in Colombia:

	Number of wells (Gross)	Number of wells (Net)
Development	5	5.0
Exploration	1	0.5
Total Colombia	<u>6</u>	<u>5.5</u>

Five development wells were spud, consisting of two in the Midas Block (Acordionero-23-i and 24), two in the Chaza Block (Costayaco-33 and 35-i), and one in the Putumayo-7 Block (Cumplidor-2). Three of these wells are currently on production (Costayaco-33, 35-i and Cumplidor-2). Additionally, of the wells that were in-progress at March 31, 2018, three development wells (Acordionero-20, 22 and Costayaco-32) are currently producing. We also drilled the Tonga-1 exploration well in the Sinu-3 Block, which was plugged and abandoned as the well did not encounter commercial hydrocarbon quantities. This was a commitment exploration well.

We also continued facilities work at the Acordionero Field on the Midas Block and the Moqueta and Costayaco Fields on the Chaza Block.

During the three months ended June 30, 2018, we acquired additional working interests in Alea1848-A and 1947-C for total cash consideration of \$3.1 million, which increased our position in these blocks to 100% and expanded our exploration

opportunities in the Putumayo Basin. These acquisitions are subject to approval by the Agencia Nacional de Hidrocarburos (National Hydrocarbons Agency).

Liquidity and Capital Resources

(Thousands of U.S. Dollars)	As at		
	June 30, 2018	% Change	December 31, 2017
Cash and Cash Equivalents	\$ 125,807	921	\$ 12,326
Current Restricted Cash and Cash Equivalents	\$ 2,836	(76)	\$ 11,787
Revolving Credit Facility	\$ —	(100)	\$ 148,000
Senior Notes	\$ 300,000	—	\$ —
Convertible Notes	\$ 115,000	—	\$ 115,000

We believe that our capital resources, including cash on hand, cash generated from operations and available capacity on our credit facility, will provide us with sufficient liquidity to meet our strategic objectives and planned capital program for 2018, given current oil price trends and production levels. In accordance with our investment policy, available cash balances are held in our primary cash management banks or may be invested in U.S. or Canadian government-backed federal, provincial or state securities or other money market instruments with high credit ratings and short-term liquidity. We believe that our current financial position provides us the flexibility to respond to both internal growth opportunities and those available through acquisitions.

At June 30, 2018, we had a revolving credit facility with a syndicate of lenders with a borrowing base of \$300 million and we had zero drawn on this credit facility. Availability under the revolving credit facility is determined by the reserves-based borrowing base determined by the lenders. The next re-determination of the borrowing base is due to occur no later than November 2018.

At June 30, 2018, we had \$115 million aggregate principal amount of 5.00% Convertible Senior Notes due 2021 (the "Convertible Notes") and \$300 million aggregate principal amount of 6.25% Senior Notes due 2025 (the "Senior Notes") outstanding. The Convertible Notes bear interest at a rate of 5.00% per year, payable semi-annually in arrears on April 1 and October 1 of each year. The Convertible Notes will mature on April 1, 2021, unless earlier redeemed, repurchased or converted. The Convertible Notes are convertible to Common Stock at a conversion price of approximately \$3.21 per share of Common Stock at the option of the holder at any time prior to the close of business on the business day immediately preceding the maturity date. The Senior Notes bear interest at a rate of 6.25% per year, payable semi-annually in arrears on February 15 and August 15 of each year, beginning on August 15, 2018. The Senior Notes will mature on February 15, 2025, unless earlier redeemed or repurchased.

Under the terms of our credit facility and Senior Notes, we are required to maintain compliance with certain financial and operating covenants which include: limitations on our ratio of debt to net income plus interest, taxes, depreciation, depletion, amortization, exploration expenses and all non-cash charges minus all non-cash income ("EBITDAX") to a maximum of 4.0 to 1.0 (under the credit facility) and 3.5 to 1.0 (under the Senior Notes); the maintenance of a ratio of EBITDAX to interest expense of at least 2.5 to 1.0 (definitions of debt, EBITDAX and other relevant terms are per the credit agreement or the indenture governing the Senior Notes and may differ between these agreements). As at June 30, 2018, we were in compliance with all financial and operating covenants in these agreements. Under the terms of the credit facility and Senior Notes, we are also limited in our ability to make distributions to our shareholders.

Cash and Cash Equivalents Held Outside of Canada and the United States

At June 30, 2018, 100% of our cash and cash equivalents were held by subsidiaries and partnerships outside of Canada and the United States. This cash was generally not available to fund domestic or head office operations unless funds were repatriated. At this time, we do not intend to repatriate further funds other than to pay head office charges, but if we did, we might have to accrue and pay withholding taxes in certain jurisdictions on the distribution of accumulated earnings. Undistributed earnings of foreign subsidiaries are considered to be permanently reinvested and a determination of the amount of unrecognized deferred tax liability on these undistributed earnings is not practicable.

In Colombia, we participate in a special exchange regime, and we receive revenue in U.S. dollars offshore. We may also pay invoices denominated in U.S. dollars for our Colombian business from these U.S. dollars received offshore.

Derivative Positions

At June 30, 2018, we had outstanding commodity price derivative positions as follows:

Period and type of instrument	Volume, bopd	Reference	Sold Swap (\$/bbl, Weighted Average)	Purchased Call (\$/bbl, Weighted Average)
Swaps: July 1, to December 31, 2018	5,000	ICE Brent \$	55.90	n/a
Participating Swaps: July 1, to December 31, 2018	5,000	ICE Brent \$	52.50 \$	56.11

At June 30, 2018, current liabilities on our balance sheet included \$27.2 million in relation to the above outstanding commodity price derivative positions.

At June 30, 2018, we had the following outstanding foreign currency derivative positions:

Period and type of instrument	Amount Hedged (Millions COP)	U.S. Dollar Equivalent of Amount Hedged (Thousands of U.S. \$)⁽¹⁾	Reference	Purchased Call (COP)	Sold Put (COP, Weighted Average)
Collars: July 1, 2018 to December 31, 2018	87,000	29,685	COP	3,000	3,107

⁽¹⁾ At June 30, 2018 foreign exchange rate.

At June 30, 2018, current assets on our balance sheet included \$0.9 million in relation to the above outstanding foreign currency derivative positions. We do not have any outstanding commodity price derivative positions relating to 2019.

Cash Flows

The following table presents our primary sources and uses of cash and cash equivalents for the periods presented:

	Six Months Ended June 30,	
	2018	2017
Sources of cash and cash equivalents:		
Net income	\$ 38,161	\$ 5,964
Adjustments to reconcile net income to EBITDA ⁽¹⁾ and funds flow from operations ⁽¹⁾		
DD&A expenses	86,068	58,689
Interest expense	12,870	6,426
Income tax expense	53,767	32,093
EBITDA	190,866	103,172
Current income tax expense	(17,116)	(9,189)
Stock-based compensation expense	10,202	3,183
Contractual interest and other financing expenses	(11,357)	(5,201)
Cash settlement of RSUs	(360)	(501)
Unrealized foreign exchange loss	539	1,076
Financial instruments loss (gain)	11,714	(6,886)
Cash settlement of financial instruments	(15,483)	1,216
Loss on sale	292	9,076
Funds flow from operations	169,297	95,946
Proceeds from bank debt, net of issuance costs	4,988	98,304
Proceeds from issuance of Senior Notes, net of issuance costs	288,087	—
Proceeds from issuance of shares	845	—
Cash deposit received for letter of credit arrangements upon sale of Brazil business unit	—	4,700
Deposit received for sale of Brazil business unit	—	34,481
	463,217	233,431
Uses of cash and cash equivalents:		
Additions to property, plant and equipment	(157,088)	(104,025)
Additions to property, plant and equipment - property acquisitions	(3,100)	(30,410)
Repayment of bank debt	(153,000)	(33,000)
Repurchase of shares of Common Stock	(1,208)	(10,000)
Net changes in assets and liabilities from operating activities	(37,994)	(28,112)
Changes in non-cash investing working capital	(6,142)	(627)
Settlement of asset retirement obligations	(369)	(298)
Foreign exchange loss on cash, cash equivalents and restricted cash and cash equivalents	(69)	(1,175)
	(358,970)	(207,647)
Net increase in cash and cash equivalents and restricted cash and cash equivalents	\$ 104,247	\$ 25,784

(1) EBITDA and funds flow from operations are a non-GAAP measures which do not have any standardized meaning prescribed under GAAP. Refer to "Financial and Operational Highlights - non-GAAP measures" for a definition and reconciliation of this measure.

One of the primary sources of variability in our cash flows from operating activities is the fluctuation in oil prices, the impact of which we partially mitigate by entering into commodity derivatives. Sales volume changes and costs related to operations

and debt service also impact cash flow. Our cash flows from operating activities are also impacted by foreign currency exchange rate changes, the impact of which we partially mitigate by entering into foreign currency derivatives.

Off-Balance Sheet Arrangements

As at June 30, 2018, we had no off-balance sheet arrangements.

Contractual Obligations

During February 2018, we issued \$300 million aggregate principal amount of the Senior Notes. Refer to Note 5 in the Notes to the Condensed Consolidated Financial Statements (Unaudited) in Part I, Item 1 of this Form 10-Q, incorporated herein by reference, for further information. During the six months ended June 30, 2018, we fully repaid the balance of \$153 million outstanding under our revolving credit facility, which remained undrawn at June 30, 2018.

Except as noted above, as at June 30, 2018, there were no other material changes to our contractual obligations outside of the ordinary course of business from those as at December 31, 2017.

Critical Accounting Policies and Estimates

Our critical accounting policies and estimates are disclosed in Item 7 of our 2017 Annual Report on Form 10-K, filed with the SEC on February 27, 2018, and have not changed materially since the filing of that document, other than as follows:

Revenue Recognition

We adopted ASC 606 *Revenue from Contracts with Customers* with a date of initial application of January 1, 2018 in accordance with the modified retrospective approach. Except for providing enhanced disclosures on our revenue transactions, the application of ASC 606 did not have an impact on our consolidated financial position, results of operations or cash flows.

We evaluate our arrangements with third parties and partners to determine if we act as a principal or an agent. In making this evaluation, management considers if we obtain control of the product delivered, which is indicated by us having the primary responsibility for the delivery of the product, having ability to establish prices or having inventory risk. If we act in the capacity of an agent rather than as a principal in transaction, then the revenue is recognized on a net-basis, only reflecting the fee realized by us from the transaction. When determining if we acted as a principal or as an agent in transactions, we determine if we obtain control of the product. As part of this assessment, management considered detailed criteria for revenue recognition set out in ASC 606.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

Commodity price risk

Our principal market risk relates to oil prices. Oil prices are volatile and unpredictable and influenced by concerns over world supply and demand imbalance and many other market factors outside of our control. Most of our revenues are from oil sales at prices which reflect the blended prices received upon shipment by the purchaser at defined sales points or are defined by contract relative to ICE Brent and adjusted for quality each month.

We have entered into commodity price derivative contracts to manage the variability in cash flows associated with the forecasted sale of our oil production, reduce commodity price risk and provide a base level of cash flow in order to assure we can execute at least a portion of our capital spending.

Foreign currency risk