GRAN TIERRA ENERGY, INC.
Form 10-Q
November 05, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED September 30, 2010

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM __________ TO __________

Commission file number 001-34018

GRAN TIERRA ENERGY INC.
(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	98-0479924 (I.R.S. employer identification number)
300, 625 11th Avenue S.W. Calgary, Alberta, Canada (Address of principal executive offices)	T2R 0E1 (Zip code)

(403) 265-3221
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. YES x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x	Accelerated Filer o
Non-Accelerated Filer o	(do not check if a smaller reporting company) Smaller Reporting

Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x

On November 2, 2010, the following numbers of shares of the registrant's capital stock were outstanding: 238,591,271 shares of the registrant's Common Stock, $0.001 par value; one share of Special A Voting Stock, $0.001 par value, representing 7,811,112 shares of Gran Tierra Goldstrike Inc., which are exchangeable on a 1-for-1 basis into the registrant's Common Stock; and one share of Special B Voting Stock, $0.001 par value, representing 10,657,065 shares of Gran Tierra Exchangeco Inc., which are exchangeable on a 1-for-1 basis into the registrant's Common Stock.

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

Gran Tierra Energy Inc.
Condensed Consolidated Statements of Operations and Retained Earnings (Accumulated Deficit) (Unaudited)
(Thousands of U.S. Dollars, Except Share and Per Share Amounts)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
REVENUE AND OTHER INCOME				
Oil and natural gas sales	$ 84,110	$ 75,171	$ 260,759	$ 166,606
Interest	459	183	1,034	824
	84,569	75,354	261,793	167,430
EXPENSES				
Operating	19,401	9,099	39,028	25,063
Depletion, depreciation, accretion, and impairment	35,254	35,246	107,238	95,466
General and administrative	10,977	7,076	27,848	19,226
Derivative financial instruments (gain) loss (Note 10)	-	(77)	(44)	207
Foreign exchange loss	16,320	18,867	33,740	32,353
	81,952	70,211	207,810	172,315
INCOME (LOSS) BEFORE INCOME TAXES	2,617	5,143	53,983	(4,885)
Income tax expense (Note 7)	(5,894)	(7,959)	(29,929)	(11,999)
NET (LOSS) INCOME AND COMPREHENSIVE (LOSS) INCOME	(3,277)	(2,816)	24,054	(16,884)
RETAINED EARNINGS (ACCUMULATED DEFICIT), BEGINNING OF PERIOD	48,256	(7,084)	20,925	6,984
RETAINED EARNINGS (ACCUMULATED DEFICIT), END OF PERIOD	$ 44,979	$ (9,900)	$ 44,979	$ (9,900)
NET (LOSS) INCOME PER SHARE — BASIC	$ (0.01)	$ (0.01)	$ 0.10	$ (0.07)
NET (LOSS) INCOME PER SHARE — DILUTED	$ (0.01)	$ (0.01)	$ 0.09	$ (0.07)
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC (Note 5)	254,951,642	242,232,717	252,487,462	240,585,878
WEIGHTED AVERAGE SHARES OUTSTANDING - DILUTED (Note 5)	254,951,642	242,232,717	260,294,503	240,585,878

(See notes to the condensed consolidated financial statements)

Gran Tierra Energy Inc.
Condensed Consolidated Balance Sheets (Unaudited)
(Thousands of U.S. Dollars, Except Share and Per Share Amounts)

	September 30, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 308,396	$ 270,786
Restricted cash	290	1,630
Accounts receivable	73,089	35,639
Inventory (Note 2)	5,479	4,879
Taxes receivable	2,310	1,751
Prepaids	1,810	1,820
Deferred tax assets (Note 7)	2,683	4,252
Total Current Assets	394,057	320,757
Oil and Gas Properties (using the full cost method of accounting)		
Proved	431,952	474,679
Unproved	270,479	234,889
Total Oil and Gas Properties	702,431	709,568
Other capital assets	5,135	3,175
Total Property, Plant and Equipment (Note 4)	707,566	712,743
Other Long Term Assets		
Restricted cash	846	162
Deferred tax assets (Note 7)	7,493	7,218
Other long term assets	319	347
Goodwill	102,581	102,581
Total Other Long Term Assets	111,239	110,308
Total Assets	$ 1,212,862	$ 1,143,808
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable (Note 8)	$ 37,682	$ 36,786
Accrued liabilities (Note 8)	47,560	40,229
Derivative financial instruments (Note 10)	-	44
Taxes payable	38,541	28,087
Asset retirement obligation (Note 6)	36	450
Total Current Liabilities	123,819	105,596

Long Term Liabilities		
Deferred tax liabilities (Note 7)	213,451	216,625
Deferred remittance tax	1,453	903
Asset retirement obligation (Note 6)	5,025	4,258
Total Long Term Liabilities	219,929	221,786
Commitments and Contingencies (Note 9)		
Shareholders' Equity		
Common shares (Note 5)	4,128	1,431
(238,161,748 and 219,459,361 common shares and 18,699,854 and 24,639,513 exchangeable shares, par value $0.001 per share, issued and outstanding as at September 30, 2010 and December 31, 2009 respectively)		
Additional paid in capital	817,505	766,963
Warrants	2,502	27,107
Retained earnings	44,979	20,925
Total Shareholders' Equity	869,114	816,426
Total Liabilities and Shareholders' Equity	$ 1,212,862	$ 1,143,808

(See notes to the condensed consolidated financial statements)

4

Gran Tierra Energy Inc.
Condensed Consolidated Statements of Cash Flows (Unaudited)
(Thousands of U.S. Dollars)

	Nine Months Ended September 30, 2010	2009
Operating Activities		
Net income (loss)	$ 24,054	$ (16,884)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depletion, depreciation, accretion, and impairment	107,238	95,466
Deferred taxes (Note 7)	(28,026)	(5,650)
Stock based compensation (Note 5)	5,424	3,483
Unrealized (gain) loss on financial instruments (Note 10)	(44)	294
Unrealized foreign exchange loss	27,136	32,982
Settlement of asset retirement obligations (Note 6)	(263)	(52)
Net changes in non-cash working capital		
Accounts receivable	(35,195)	(68,633)
Inventory	1	(286)
Prepaids	10	102
Accounts payable and accrued liabilities	(8,402)	6,501
Taxes receivable and payable	9,455	(12,296)
Net cash provided by operating activities	101,388	35,027
Investing Activities		
Restricted cash	656	(1,892)
Additions to property, plant and equipment	(88,954)	(65,595)
Proceeds from disposition of oil and gas property	1,600	4,800
Long term assets and liabilities	28	248
Net cash used in investing activities	(86,670)	(62,439)
Financing Activities		
Proceeds from issuance of common shares	22,892	2,257
Net cash provided by financing activities	22,892	2,257
Net increase (decrease) in cash and cash equivalents	37,610	(25,155)
Cash and cash equivalents, beginning of period	270,786	176,754
Cash and cash equivalents, end of period	$ 308,396	$ 151,599
Cash	$ 223,320	$ 66,980
Term deposits	85,076	84,619
Cash and cash equivalents, end of period	$ 308,396	$ 151,599
Supplemental cash flow disclosures:		

Cash paid for taxes	$	42,024	$	27,896
Non-cash investing activities:				
Non-cash working capital related to property, plant and equipment	$	30,747	$	8,233

(See notes to the condensed consolidated financial statements)

Gran Tierra Energy Inc.
Condensed Consolidated Statements of Shareholders' Equity (Unaudited)
(Thousands of U.S. Dollars)

	Nine Months Ended September 30, 2010	Year Ended December 31, 2009
Share Capital		
Balance, beginning of period	$ 1,431	$ 226
Issue of common shares	2,697	1,205
Balance, end of period	4,128	1,431
Additional Paid in Capital		
Balance, beginning of period	766,963	754,832
Issue of common shares	18,354	2,650
Exercise of warrants (Note 5)	24,605	2,777
Exercise of stock options (Note 5)	1,841	1,080
Stock based compensation expense (Note 5)	5,742	5,624
Balance, end of period	817,505	766,963
Warrants		
Balance, beginning of period	27,107	29,884
Exercise of warrants (Note 5)	(24,605)	(2,777)
Balance, end of period	2,502	27,107
Retained Earnings		
Balance, beginning of period	20,925	6,984
Net income	24,054	13,941
Balance, end of period	44,979	20,925
Total Shareholders' Equity	$ 869,114	$ 816,426

(See notes to the condensed consolidated financial statements)

Gran Tierra Energy Inc.

Notes to the Condensed Consolidated Financial Statements (Unaudited)

1. Description of Business

Gran Tierra Energy Inc., a Nevada corporation (the “Company” or “Gran Tierra”), is a publicly traded oil and gas company engaged in the acquisition, exploration, development and production of oil and natural gas properties. The Company’s principal business activities are in Colombia, Argentina, Peru and Brazil.

2. Significant Accounting Policies

These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”). The preparation of financial statements in accordance with GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the unaudited interim consolidated financial statements, and revenues and expenses during the reporting period. In the opinion of the Company’s management, all adjustments (all of which are normal and recurring) that have been made are necessary to fairly state the consolidated financial position of the Company as at September 30, 2010, the results of its operations for the three and nine month periods ended September 30, 2010 and 2009, and its cash flows for the nine month periods ended September 30, 2010 and 2009.

The note disclosure requirements of annual consolidated financial statements provide additional disclosures to that required for interim consolidated financial statements. Accordingly, these unaudited interim consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements as at and for the year ended December 31, 2009 included in the Company’s 2009 audited Annual Report on Form 10-K, filed with the Securities and Exchange Commission (“SEC”) on February 26, 2010. The Company’s significant accounting policies are described in Note 2 of the consolidated financial statements which are included in the Company’s 2009 Annual Report on Form 10-K and are the same policies followed in these unaudited interim consolidated financial statements, except as disclosed below. The Company has evaluated all subsequent events through to the date these unaudited interim consolidated financial statements were issued.

Inventory

Crude oil inventories at September 30, 2010 and December 31, 2009 are $4.2 million and $3.8 million, respectively. Supplies at September 30, 2010 and December 31, 2009 are $1.3 million and $1.1 million, respectively.

New Accounting Pronouncements

Variable Interest Entities

In June 2009, the Financial Accounting Standards Board (the “FASB”) issued revised accounting standards to improve financial reporting by enterprises involved with variable interest entities. The standards replace the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impact the entity’s economic performance and: (1) the obligation to absorb losses of the entity; or, (2) the right to receive benefits from the entity. This standard was effective for interim and annual reporting periods beginning after November 15, 2009. The implementation of this standard did not materially impact the Company’s consolidated financial position, operating results or cash flows.

Fair Value Measurements

In January 2010, the FASB issued Accounting Standards Update (“ASU”), “Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements”. This ASU amends existing disclosure requirements about fair value measurements by adding required disclosures about items transferred into and out of levels 1 and 2 in the fair value hierarchy; adding separate disclosures about purchases, sales, issuances, and settlements relative to level 3 measurements; and clarifying, among other things, the existing fair value disclosures about the level of disaggregation. This is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The implementation of this update on January 1, 2010 did not materially impact the Company’s disclosures.

Subsequent Events

In February 2010, the FASB issued ASU, "Subsequent Events (Topic 855)." The amendments remove the requirements for an SEC filer to disclose a date, in both issued and revised financial statements, through which subsequent events have been reviewed. This ASU was effective upon issuance. The implementation of this update did not materially impact the Company’s consolidated financial position, operating results or cash flows.

Stock Compensation
In April 2010, the FASB issued ASU, "Compensation–Stock Compensation (Topic 718)." The amendments clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The implementation of this update is not expected to materially impact the Company's consolidated financial position, operating results or cash flows.

Receivables
In July 2010, the FASB issued ASU, "Receivables (Topic 310)." The update is intended to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The implementation of this update is not expected to materially impact the Company's disclosures.

3. Segment and Geographic Reporting

The Company's reportable operating segments are Colombia and Argentina based on a geographic organization. The Company is primarily engaged in the exploration and production of oil and natural gas. Peru and Brazil are not reportable segments because the level of activity is not significant at this time and are included as part of the Corporate segment. The accounting policies of the reportable operating segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on profit or loss from oil and natural gas operations before income taxes.

The following tables present information on the Company's reportable geographic segments:

	Three Months Ended September 30, 2010			
(Thousands of U.S. Dollars except per unit of production amounts (1))	Colombia	Argentina	Corporate	Total
Revenues	$ 80,731	$ 3,379	$ -	$ 84,110
Interest income	301	-	158	459
Depletion, depreciation, and accretion ("DD&A")	33,916	1,208	130	35,254
Depletion, depreciation, and accretion - per unit of production	28.78	18.08	-	28.31
Segment income (loss) before income taxes	8,305	(405)	(5,283)	2,617
Segment capital expenditures	$ 22,084	$ 12,289	$ 13,313	$ 47,686

	Three Months Ended September 30, 2009			
(Thousands of U.S. Dollars except per unit of production amounts)	Colombia	Argentina	Corporate	Total
Revenues	$ 71,385	$ 3,786	$ -	$ 75,171
Interest income	31	34	118	183
Depletion, depreciation, and accretion	33,630	1,538	78	35,246
Depletion, depreciation, and accretion - per unit of production	30.37	18.38	-	29.59
Segment income (loss) before income taxes	7,955	390	(3,202)	5,143
Segment capital expenditures (2)	$ 17,024	$ 1,890	$ 210	$ 19,124

8

(Thousands of U.S. Dollars except per unit of production amounts)	Nine Months Ended September 30, 2010 Colombia	Argentina	Corporate	Total
Revenues	$ 250,767	$ 9,992	$ -	$ 260,759
Interest income	520	19	495	1,034
Depletion, depreciation, and accretion	99,243	3,999	296	103,538
Impairment of carrying value of oil and natural gas properties	-	3,700	-	3,700
Depletion, depreciation, and accretion - per unit of production	27.57	19.20	-	27.19
Impairment of carrying value of oil and natural gas properties - per unit of production	-	17.76	-	0.97
Segment income (loss) before income taxes	74,154	(6,158)	(14,013)	53,983
Segment capital expenditures	$ 68,531	$ 16,763	$ 16,752	$ 102,046

(Thousands of U.S. Dollars except per unit of production amounts)	Nine Months Ended September 30, 2009 Colombia	Argentina	Corporate	Total
Revenues	$ 156,257	$ 10,349	$ -	$ 166,606
Interest income	352	84	388	824
Depletion, depreciation, and accretion	90,565	4,671	230	95,466
Depletion, depreciation, and accretion - per unit of production	29.94	18.21	-	29.09
Segment income (loss) before income taxes	5,370	(577)	(9,678)	(4,885)
Segment capital expenditures (2)	$ 58,431	$ 3,162	$ 1,799	$ 63,392

(Thousands of U.S. Dollars)	As at September 30, 2010 Colombia	Argentina	Corporate	Total
Property, plant and equipment	$ 651,390	$ 33,341	$ 22,835	$ 707,566
Goodwill	102,581	-	-	102,581
Other assets	147,874	16,349	238,492	402,715
Total Assets	$ 901,845	$ 49,690	$ 261,327	$ 1,212,862

(Thousands of U.S. Dollars)	As at December 31, 2009 Colombia	Argentina	Corporate	Total
Property, plant and equipment	$ 681,854	$ 24,510	$ 6,379	$ 712,743
Goodwill	102,581	-	-	102,581
Other assets	123,380	12,574	192,530	328,484
Total Assets	$ 907,815	$ 37,084	$ 198,909	$ 1,143,808

(1) Unit of production is barrel of oil equivalent with gas volumes converted at the rate of six thousand cubic feet of gas per barrel of oil, based upon the approximate relative energy content of gas and oil, which rate is not necessarily indicative of the relationship of oil and gas prices.
(2) Net of net proceeds from the disposition of the Guachiria Blocks in Colombia (see Note 4).

The Company’s revenues are derived principally from uncollateralized sales to customers in the oil and natural gas industry. The concentration of credit risk in a single industry affects the Company’s overall exposure to credit risk because customers may be similarly affected by changes in economic and other conditions. In 2010, the Company has one significant customer for its Colombian crude oil, Ecopetrol S.A. (“Ecopetrol”), a Colombian government agency. Sales to Ecopetrol accounted for 96% and 95% of the Company’s revenues in the third quarter of 2010 and 2009, respectively. Sales to Ecopetrol accounted for 96% and 94% of the Company’s revenues for the nine month periods ended September 30, 2010 and 2009, respectively. In Argentina, the Company has one significant customer, Refineria del Norte S.A (“Refiner”). Sales to Refiner accounted for 4% and 5% of the Company’s revenues in the third quarter of 2010 and 2009, respectively. Sales to Refiner accounted for 4% and 6% of the Company’s revenues for the nine month periods ended September 30, 2010 and 2009, respectively.

4. Property, Plant and Equipment

	As at September 30, 2010			As at December 31, 2009		
(Thousands of U.S. Dollars)	Cost	Accumulated DD&A	Net book value	Cost	Accumulated DD&A	Net book value
Oil and natural gas properties						
Proved	$ 711,825	$ (279,873)	$ 431,952	$ 648,061	$ (173,382)	$ 474,679
Unproved	270,479	-	270,479	234,889	-	234,889
	982,304	(279,873)	702,431	882,950	(173,382)	709,568
Furniture and fixtures and leasehold improvements	4,940	(2,775)	2,165	3,843	(2,185)	1,658
Computer equipment	4,823	(2,192)	2,631	3,148	(1,907)	1,241
Automobiles	780	(441)	339	513	(237)	276
Total Property, Plant and Equipment	$ 992,847	$ (285,281)	$ 707,566	$ 890,454	$ (177,711)	$ 712,743

Depreciation, depletion, accretion and impairment for the nine months ended September 30, 2010 included a $3.7 million first quarter ceiling test impairment loss in the Company's Argentina cost center.

During the nine months ended September 30, 2010, the Company capitalized $2.9 million (year ended December 31, 2009 - $1.6 million) of general and administrative expenses related to the Colombian full cost center, including $0.2 million (year ended December 31, 2009 - $0.2 million) of stock based compensation expense, and $0.9 million (year ended December 31, 2009 - $0.6 million) of general and administrative expenses in the Argentina full cost center, including $0.1 million (year ended December 31, 2009 - $0.1 million) of stock based compensation.

The unproved oil and natural gas properties at September 30, 2010 consist of exploration lands held in Colombia, Argentina, Peru, and Brazil. As at September 30, 2010, the Company had $235.8 million (December 31, 2009 - $229.1 million) in unproved assets in Colombia, $14.3 million (December 31, 2009 - $0.4 million) of unproved assets in Argentina, $14.4 million (December 31, 2009 - $5.4 million) of unproved assets in Peru, and $6.0 million (December 31, 2009 - nil) of unproved assets in Brazil. These properties are being held for their exploration value and are not being depleted pending determination of the existence of proved reserves. Gran Tierra will continue to assess the unproved properties over the next several years as proved reserves are established and as exploration dictates whether or not future areas will be developed.

In April 2009, Gran Tierra closed the sale of the Company's interests in the Guachiria Norte, Guachiria, and Guachiria Sur blocks in Colombia. Principal terms included consideration of $7.0 million comprising an initial cash payment of $4.0 million at closing, followed by 15 monthly installments of $200,000 each which began on June 1, 2009 and extended through August 3, 2010. The Company recorded net proceeds of $6.3 million.

5. Share Capital

The Company's authorized share capital consists of 595,000,002 shares of capital stock, of which 570 million are designated as common stock, par value $0.001 per share, 25 million are designated as preferred stock, par value $0.001 per share, and two shares are designated as special voting stock, par value $0.001 per share. As at September 30, 2010, outstanding share capital consists of 238,161,748 common voting shares of the Company, 10,730,012 exchangeable shares of Gran Tierra Exchange Co., automatically exchangeable on November 14, 2013, and 7,969,842 exchangeable shares of Goldstrike Exchange Co., automatically exchangeable on November 10, 2012. The exchangeable shares of Gran Tierra Exchange Co, were issued upon acquisition of Solana Resources Limited ("Solana"). The exchangeable shares of Gran Tierra Goldstrike Inc. were issued upon the business combination between

Gran Tierra Energy Inc., an Alberta corporation, and Goldstrike, Inc., which is now the Company. Each exchangeable share is exchangeable into one common voting share of the Company. The holders of common stock are entitled to one vote for each share on all matters submitted to a stockholder vote and are entitled to share in all dividends that the Company's board of directors, in its discretion, declares from legally available funds. The holders of common stock have no pre-emptive rights, no conversion rights, and there are no redemption provisions applicable to the common stock. Holders of exchangeable shares have substantially the same rights as holders of common voting shares.

Warrants

At September 30, 2010, the Company had 410,750 warrants outstanding to purchase 205,375 common shares for $1.25 per share, expiring between October 1, 2010 and February 2, 2011, and 8,737,222 warrants outstanding to purchase 4,368,611 common shares for $1.05 per share, expiring between June 20, 2012 and June 30, 2012. For the nine months ended September 30, 2010, 10,438,473 common shares were issued upon the exercise of 13,731,008 warrants (nine months ended September 30, 2009, 3,224,216 common shares were issued upon the exercise of 8,919,706 warrants). Included in warrants exercised in the nine months ended September 30, 2010 were 7,145,938 warrants to purchase 7,145,938 common shares for $14.4 million, assumed in the acquisition of Solana in November 2008.

Stock Options

As at September 30, 2010, the Company has a 2007 Equity Incentive Plan, formed through the approval by shareholders of the amendment and restatement of the 2005 Equity Incentive Plan, under which the Company's board of directors is authorized to issue options or other rights to acquire shares of the Company's common stock. On November 14, 2008, the shareholders of Gran Tierra approved an amendment to the Company's 2007 Equity Incentive Plan, which increased the number of shares of common stock available for issuance thereunder from 9,000,000 shares to 18,000,000 shares. On June 16, 2010, another amendment to the Company's 2007 Equity Incentive plan was approved by shareholders, which increased the number of shares of common stock available for issuance thereunder from 18,000,000 shares to 23,306,100 shares.

The Company grants options to purchase common shares to certain directors, officers, employees and consultants. Each option permits the holder to purchase one common share at the stated exercise price. The options vest over three years and have a term of ten years, or three months after the grantee's end of service to the Company, whichever occurs first. At the time of grant, the exercise price equals the market price. For the nine months ended September 30, 2010, 2,324,256 common shares were issued upon the exercise of 2,324,256 stock options (nine months ended September 30, 2009 – 602,570). The following options are outstanding as of September 30, 2010:

	Number of Outstanding Options		Weighted Average Exercise Price $/Option
Balance, December 31, 2009	11,088,616	$	2.43
Granted in 2010	2,940,000		5.91
Exercised in 2010	(2,324,256)		(1.95)
Forfeited in 2010	(261,671)		(3.90)
Balance, September 30, 2010	11,442,689	$	3.38

The weighted average grant date fair value for options granted in 2010 was $3.33. The intrinsic value of options exercised for the nine months ended September 30, 2010 was $9.5 million (nine months ended September 30, 2009 - $22.6 million).

The table below summarizes stock options outstanding at September 30, 2010:

Range of Exercise Prices ($/option)	Number of Outstanding Options		Weighted Average Exercise Price $/Option	Weighted Average Expiry Years
0.50 to 1.30	1,389,170	$	1.10	5.8
1.31 to 2.00	243,335		1.72	7.1

2.01 to 3.50	5,983,517	2.45	8.0
3.51 to 5.50	501,667	4.50	9.0
5.51 to 7.75	3,325,000	5.97	9.4
Total	11,442,689	$ 3.38	8.2

The aggregate intrinsic value of options outstanding at September 30, 2010 is $56.1 million based on the Company's closing stock price of $7.72 for that date. At September 30, 2010, there was $7.7 million of unrecognized compensation cost related to unvested stock options which is expected to be recognized over the next three years.

For the nine months ended September 30, 2010, the stock based compensation expense was $5.7 million (nine months ended September 30, 2009 - $4.1 million) of which $4.6 million (nine months ended September 30, 2009 - $3.3 million) was recorded in general and administrative expense and $0.8 million was recorded in operating expense in the consolidated statement of operations (nine months ended September 30, 2009 – $0.2 million). For the nine months ended September 30, 2010, $0.3 million of stock based compensation was capitalized as part of exploration and development costs (nine months ended September 30, 2009 – $0.6 million).

The fair value of each stock option award is estimated on the date of grant using a Black-Scholes option pricing model based on assumptions noted in the following table. The Company uses historical data to estimate option exercises, expected term and employee departure behavior used in the Black-Scholes option pricing model. Expected volatilities used in the fair value estimate are based on historical volatility of the Company's stock. The risk-free rate for periods within the contractual term of the stock options is based on the U.S. Treasury yield curve in effect at the time of grant.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Dividend yield (per share)	$ nil	$ nil	$ nil	$ nil
Volatility	85%	97%	90%	97%
Risk-free interest rate	0.3%	0.5%	0.4%	0.5%
Expected term	3 years	3 years	3 years	3 years
Estimated forfeiture percentage (per year)	10%	10%	10%	10%

Weighted Average Shares Outstanding

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Weighted average number of common and exchangeable shares outstanding	254,951,642	242,232,717	252,487,462	240,585,878
Shares issuable pursuant to warrants	-	-	3,877,754	-
Shares issuable pursuant to stock options	-	-	3,929,287	-
Weighted average number of diluted common and exchangeable shares outstanding	254,951,642	242,232,717	260,294,503	240,585,878

Net Income (Loss) Per Share

For the three months ended September 30, 2010, options to purchase 11,442,689 common shares and 9,147,972 warrants to purchase 4,573,986 common shares were excluded from the diluted loss per share calculation as the instruments were anti-dilutive. For the nine months ended September 30, 2010, options to purchase 3,435,000 common shares were excluded from the diluted income per share calculation as the instruments were anti-dilutive. For the three and nine month periods ended September 30, 2009, options to purchase 11,397,074 common shares were excluded from the diluted loss per share calculation as the instruments were anti-dilutive. For the three and nine month periods ended September 30, 2009, 24,922,934 warrants to purchase 16,034,436 common shares were excluded from the diluted loss per share calculation as the instruments were anti-dilutive.

6. Asset Retirement Obligation

As at September 30, 2010 the Company's asset retirement obligation was comprised of a Colombian obligation in the amount of $4.2 million (December 31, 2009 - $3.5 million) and an Argentine obligation in the amount of $0.9 million

(December 31, 2009 - $1.2 million). As at September 30, 2010, the undiscounted asset retirement obligation was $12.6 million (December 31, 2009 - $7.7 million). Changes in the carrying amounts of the asset retirement obligations associated with the Company's oil and natural gas properties were as follows:

(Thousands of U.S. Dollars)	Nine Months Ended September 30, 2010	Year Ended December 31, 2009
Balance, beginning of period	$ 4,708	$ 4,251
Settlements	(263)	(52)
Disposal	-	(734)
Liability incurred	307	921
Foreign exchange	38	24
Accretion	271	298
Balance, end of period	$ 5,061	$ 4,708
Asset retirement obligation - current	$ 36	$ 450
Asset retirement obligation - long term	5,025	4,258
Balance, end of period	$ 5,061	$ 4,708

7. Income Taxes

The income tax expense (recovery) reported differ from the amount computed by applying the US statutory rate to income before income taxes for the following reasons:

(Thousands of U.S. Dollars)	Nine Months Ended September 30, 2010	2009 (1)
Income (loss) before income taxes	$ 53,983	$ (4,885)
	35%	35%
Income tax expense (recovery) expected	18,894	(1,710)
Permanent differences	4,721	1,561
Foreign currency translation adjustments	12,060	8,015
Impact of foreign taxes	(108)	(778)
Enhanced tax depreciation incentive	(6,842)	(1,003)
Stock based compensation	1,519	170
Increase in valuation allowance	4,536	9,974
Partnership and branch loss pick-up in the United States and Canada	(4,851)	(4,230)
Total income tax expense	$ 29,929	$ 11,999
Current income tax	57,955	17,649
Deferred tax recovery	(28,026)	(5,650)
Total income tax expense	$ 29,929	$ 11,999

(1) For the nine months ended September 30, 2010, the Company has used the United States statutory tax rate of 35% in the reconciliation of income taxes. Previously, the Company used the Canadian statutory rate in the reconciliation. This change was determined on the basis that Gran Tierra is a United States resident corporation and a reconciliation beginning with the United States statutory tax rate is more informative. The 2009 comparative income tax reconciliation has been recomputed using the United States statutory rate. This change in presentation has no impact on the income tax amounts reported in the consolidated statements of operations for the nine months ended September 30, 2009.

(Thousands of U.S. Dollars)	As at September 30, 2010	December 31, 2009
Deferred Tax Assets		
Tax benefit of loss carryforwards	$ 26,057	$ 22,318
Tax basis in excess of book value	1,963	1,691

Foreign tax credits and other accruals		14,140		15,508
Capital losses		1,781		1,481
Deferred tax assets before valuation allowance		43,941		40,998
Valuation allowance		(33,765)		(29,528)
	$	10,176	$	11,470
Deferred tax assets - current	$	2,683	$	4,252
Deferred tax assets - long-term		7,493		7,218
		10,176		11,470
Deferred Tax Liabilities				
Long-term - book value in excess of tax basis		(213,451)		(216,625)
Net Deferred Tax Liabilities	$	(203,275)	$	(205,155)

As at September 30, 2010, the Company has deferred tax assets relating to net operating loss carryforwards of $26.1 million (December 31, 2009 - $22.3 million) and capital losses of $1.8 million (December 31, 2009 - $1.5 million) before valuation allowances. Of these losses, $19.2 million (December 31, 2008 - $18.2 million) are losses generated by the foreign subsidiaries of the Company. Of the total losses, nil (December 31, 2009 - $0.1 million) will begin to expire by 2011 and $27.8 million of net operating losses (December 31, 2009 - $23.7 million) will begin to expire thereafter.

8. Accounts Payable and Accrued Liabilities

The balances in accounts payable and accrued liabilities and are comprised of the following:

	As at September 30, 2010			
(Thousands of U.S. Dollars)	Colombia	Argentina	Corporate	Total
Property, plant and equipment	$ 20,163	$ 8,531	$ 6,715	$ 35,409
Payroll	3,383	136	1,495	5,014
Audit, legal, and consultants	-	108	1,441	1,549
General and administrative	1,597	460	425	2,482
Operating	39,431	1,357	-	40,788
Total	$ 64,574	$ 10,592	$ 10,076	$ 85,242

	As at December 31, 2009			
(Thousands of U.S. Dollars)	Colombia	Argentina	Corporate	Total
Property, plant and equipment	$ 17,723	$ 844	$ 213	$ 18,780
Payroll	1,792	339	1,052	3,183
Audit, legal, and consultants	-	137	1,472	1,609
General and administrative	2,542	284	213	3,039
Operating	48,756	1,648	-	50,404
Total	$ 70,813	$ 3,252	$ 2,950	$ 77,015

9. Commitments and Contingencies

Leases

Gran Tierra holds three categories of operating leases: office, vehicle and housing. The Company pays monthly amounts of $196,000 for office leases, $9,000 for vehicle leases and $9,000 for certain employee accommodation leases in Colombia, Argentina, Peru, and Brazil. Future lease payments at September 30, 2010 are as follows:

	As at September 30, 2010 Payments Due in Period				
Contractual Obligations (Thousands of U.S. Dollars)	Total	Less than 1 Year	1 to 3 years	3 to 5 years	More than 5 years
Operating leases	$ 5,695	$ 2,302	$ 2,408	$ 985	$ -
Software and Telecommunication	1,600	1,188	412	-	-
Drilling, Completion, Facility Construction and Oil Transportation Services	65,580	59,182	6,398	-	-
Total	$ 72,875	$ 62,672	$ 9,218	$ 985	$ -

Guarantees

Corporate indemnities have been provided by the Company to directors and officers for various items including, but not limited to, all costs to settle suits or actions due to their association with the Company and its subsidiaries and/or affiliates, subject to certain restrictions. The Company has purchased directors’ and officers’ liability insurance to mitigate the cost of any potential future suits or actions. The maximum amount of any potential future payment cannot be reasonably estimated.

The Company may provide indemnifications in the normal course of business that are often standard contractual terms to counterparties in certain transactions such as purchase and sale agreements. The terms of these indemnifications will vary based upon the contract, the nature of which prevents the Company from making a reasonable estimate of the maximum potential amounts that may be required to be paid. Management believes the resolution of these matters would not have a material adverse impact on the Company’s liquidity, consolidated financial position or results of operations.

Contingencies

Ecopetrol and Gran Tierra Energy Colombia Ltd. “Gran Tierra Colombia”, the contracting parties of the Guayuyaco Association Contract, are engaged in a dispute regarding the interpretation of the procedure for allocation of oil produced and sold during the long term test of the Guayuyaco-1 and Guayuyaco-2 wells. There is a material difference in the interpretation of the procedure established in Clause 3.5 of Attachment-B of the Guayuyaco Association Contract. Ecopetrol interprets the contract to provide that the extended test production up to a value equal to 30% of the direct exploration costs of the wells is for Ecopetrol’s account only and serves as reimbursement of its 30% back-in to the Guayuyaco discovery. Gran Tierra Colombia’s contention is that this amount is merely the recovery of 30% of the direct exploration costs of the wells and not exclusively for benefit of Ecopetrol. There has been no agreement between the parties, and Ecopetrol has filed a lawsuit in the Contravention Administrative Court in the District of Cauca regarding this matter. Gran Tierra Colombia filed a response on April 29, 2008 in which it refuted all of Ecopetrol’s claims and requested a change of venue to the courts in Bogotá. At this time no amount has been accrued in the financial statements as the Company does not consider it probable that a loss will be incurred. Ecopetrol is claiming damages of approximately $5.8 million.

Gran Tierra has several lawsuits and claims pending for which the Company currently cannot determine the ultimate result. Gran Tierra records costs as they are incurred or become determinable. Gran Tierra believes the resolution of these matters would not have a material adverse effect on the Company’s consolidated financial position or results of operations.

10. Financial Instruments, Fair Value Measurements and Credit Risk

The Company’s financial instruments recognized in the balance sheet consist of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accrued liabilities, and derivative financial instruments. The estimated fair values of the financial instruments have been determined based on the Company’s assessment of available market information and appropriate valuation methodologies; however, these estimates may not necessarily be indicative of the amounts that could be realized or settled in a market transaction. As at September 30, 2010, the fair values of financial instruments approximate their book amounts due to the short term maturity of these instruments. Most of the Company’s accounts receivable relate to oil and natural gas sales and are exposed to typical industry credit risks. The Company manages this credit risk by entering into sales contracts with only credit worthy entities and reviewing its exposure to individual entities on a regular basis. The book value of the accounts receivable reflects management’s assessment of the associated credit risks.

Additionally, foreign exchange gains/losses result from the fluctuation of the U.S. dollar to the Colombian peso due to Gran Tierra's deferred tax liability, a monetary liability, which is denominated in the local currency of the Colombian foreign operations. As a result, a foreign exchange gain/loss must be calculated on conversion to the U.S. dollar functional currency. A strengthening in the Colombian peso against the U.S. dollar results in foreign exchange losses, estimated at $116,000 for each one peso decrease in the exchange rate of the Colombian peso to one U.S. dollar.

The Company’s revenues are derived principally from uncollateralized sales to customers in the oil and natural gas industry. The concentration of credit risk in a single industry affects the Company’s overall exposure to credit risk because customers may be similarly affected by changes in economic and other conditions. For the nine months ended September 30, 2010, the Company had one significant customer for its Colombian crude oil, Ecopetrol. In Argentina, the Company had one significant customer, Refiner.

The Company recognizes the fair value of its derivative instruments as assets or liabilities on the balance sheet. The Company currently does not have any financial derivatives. Previously, none of the Company's derivative instruments qualified as fair value hedges or cash flow hedges, and accordingly, changes in fair value of the derivative instruments were recognized as income or expense in the consolidated statement of operations and retained earnings with a corresponding adjustment to the fair value of derivative instruments recorded on the balance sheet.

11. Credit Facilities

Effective July 30, 2010, a subsidiary of Gran Tierra, Solana, established a credit facility with BNP Paribas for a three-year term which may be extended or amended by agreement between the parties. This reserve based facility has a maximum borrowing base up to $100 million and is supported by the present value of the petroleum reserves of the Company’s two subsidiaries with operating branches in Colombia – Gran Tierra Energy Colombia Ltd. and Solana Petroleum Exploration (Colombia) Ltd. The initial committed borrowing base is $20 million. Amounts drawn down under the facility bear interest at the USD LIBOR rate plus 3.5%. In addition, a stand-by fee of 1.50% per annum is charged on the unutilized balance of the committed borrowing base and is included in general and administrative expense. Under the terms of the facility, the Company is required to maintain and was in compliance with certain financial and operating covenants. As at September 30, 2010, the Company had not drawn down any amounts under this facility.

12. Related Party Transactions

On February 1, 2009, the Company entered into a sublease for office space with a company (“sublessee”), of which two of Gran Tierra’s directors at the time were shareholders and directors and one such director was an officer of the sublessee. The Gran Tierra director who was an officer of the sublessee resigned as Gran Tierra’s director in August 2010. The term of the sublease runs from February 1, 2009 to August 31, 2011 and the sublease payment is $7,900 per month plus approximately $4,600 for operating and other expenses. The terms of the sublease were consistent with market conditions in the Calgary, Alberta, Canada real estate market.

On August 3, 2010, Gran Tierra entered into a contract with a company, of which one of Gran Tierra’s directors is a shareholder and director, for the drilling program in Peru, commencing in the fourth quarter of 2010. The terms of the contract were consistent with market conditions.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Statement Regarding Forward-Looking Information

This report contains forward-looking statements within the meaning of Section 27A of the United States Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts included in this Quarterly Report on Form 10-Q, including without limitation, statements in this Management’s Discussion and Analysis of Financial Condition and Results of Operations regarding our projected financial position and results, estimated quantities and net present values of reserves, business strategy, plans and objectives of our management for future operations, covenant compliance and those statements preceded by, followed by or that otherwise include the words “believe”, “expects”, “anticipates”, “intends”, “estimates”, “projects”, “plans”, “objective”, “should”, or similar expressions or variations on such expressions are forward-looking statements. We can give no assurances that the assumptions upon which the forward-looking statements are based will prove to be correct nor can we assure adequate funding will be available to execute our planned future capital program. Because forward-looking statements are subject to risks and uncertainties, actual results may differ materially from those expressed or implied by the forward-looking statements. There are a number of risks, uncertainties and other important factors that could cause our actual results to differ materially from the forward-looking statements, including, but not limited to, those set out in Part II, Item 1A “Risk Factors” in this Quarterly Report on Form 10-Q. Except as otherwise required by the federal securities laws, we disclaim any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained in this Quarterly Report on Form 10-Q to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

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 Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission on February 26, 2010.

Overview

We are an independent international energy company incorporated in the United States and engaged in oil and natural gas acquisition, exploration, development and production. We are headquartered in Calgary, Alberta, Canada and operate in South America in Colombia, Argentina, Peru, and Brazil.

In September 2005, we acquired our initial oil and gas interests and properties, which were in Argentina. During 2006, we increased our oil and gas interests and property base through further acquisitions in Colombia, Argentina and Peru. We funded acquisitions of our properties in Colombia and Argentina through a series of private placements of our securities that occurred between September 2005 and June 2006.

Effective November 14, 2008, we completed the acquisition of Solana Resources Limited ("Solana"), an international resource company engaged in the acquisition, exploration, development and production of oil and natural gas in Colombia and incorporated in Alberta, Canada. At the date of acquisition, Solana held various working interests in nine blocks in Colombia including a 50% working interest in the Chaza Block, which includes the Costayaco field, and a 35% working interest in the Guayuyaco Block, which includes the Juanambu field.

Financial and Operational Highlights
(Dollar Amounts in Thousands of U.S. Dollars, Except Per Barrel and Per Share Amounts)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	% Change	2010	2009	% Change
Production - Barrels of Oil Equivalent per Day	13,536	12,945	5	13,949	12,021	16
Prices Realized - Per Barrel of Oil Equivalent	$ 67.54	$ 63.12	7	$ 68.48	$ 50.77	35
Revenue and Other Income	$ 84,569	$ 75,354	12	$ 261,793	$ 167,430	56
Net (Loss) Income	$ (3,277)	$ (2,816)	(16)	$ 24,054	$ (16,884)	242
Net (Loss) Income Per Share - Basic	$ (0.01)	$ (0.01)	-	$ 0.10	$ (0.07)	243
Net (Loss) Income Per Share - Diluted	$ (0.01)	$ (0.01)	-	$ 0.09	$ (0.07)	229
Funds Flow From Operations (1)	$ 37,185	$ 53,127	(30)	$ 135,782	$ 109,691	24
Capital Expenditures	$ 47,686	$ 19,124	149	$ 102,046	$ 63,392	61

(1) Funds flow from operations is a non-GAAP measure which does not have any standardized meaning prescribed under GAAP. Management uses this financial measure to analyze operating performance and the income (loss) generated by Gran Tierra's principal business activities prior to the consideration of how non-cash items affect that income (loss), and believes that this financial measure is also useful supplemental information for investors to analyze operating performance and Gran Tierra's financial results. Investors should be cautioned that this measure should not be construed as an alternative to net income (loss) or other measures of financial performance as determined in accordance with GAAP. Gran Tierra's method of calculating this measure may differ from other companies and therefore, it may not be comparable to similar measures used by other companies or appropriate for other purposes. Funds flow from operations, as presented, is net income (loss) adjusted for depletion, depreciation and accretion, deferred taxes, stock based compensation, unrealized loss (gain) on financial instruments and unrealized foreign exchange losses (gains).

Funds Flow From Operations - Non-GAAP Measure	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net (loss) income	$ (3,277)	$ (2,816)	$ 24,054	$ (16,884)
Adjustments to reconcile net (loss) income to funds flow from operations				
Depletion, depreciation, accretion, and impairment	35,254	35,246	107,238	95,466
Deferred taxes	(9,995)	(697)	(28,026)	(5,650)
Stock-based compensation	2,064	1,198	5,424	3,483
Unrealized (gain) loss on financial instruments	-	(77)	(44)	294
Unrealized foreign exchange loss	13,139	20,273	27,136	32,982
Funds Flows From Operations	$ 37,185	$ 53,127	$ 135,782	$ 109,691

	As at September 30, 2010	As at December 31, 2009	% Change
Cash & Cash Equivalents	$ 308,396	$ 270,786	14
Working Capital (including cash & cash equivalents)	$ 270,238	$ 215,161	26
Property, Plant & Equipment	$ 707,566	$ 712,743	(1)

Financial Highlights for the Three Months Ended September 30, 2010

- In the third quarter of 2010, oil and gas production (net after royalty and inventory adjustments) averaged 13,536 barrels of oil equivalent per day ("BOEPD") (comprised of 13,367 barrels of oil per day and 1,015 thousand cubic feet ("mcf") of natural gas per day), an increase of 5% over the same period in 2009, due mainly to production of crude oil from three new development wells in Colombia.

- Revenue and other income increased by 12% over the same period in 2009 due to increased production and higher oil prices.

- A net loss of $3.3 million or $0.01 per share basic and diluted, compared to a net loss of $2.8 million or a loss of $0.01 per basic and diluted share in the third quarter of 2009. Increased revenue, due to an 8% increase in realized oil prices, was more than offset by increased operating and general and administrative expenses ("G&A") in the current quarter compared to the same period in the prior year.

- Funds flow from operations of $37.2 million for the three months ended September 30, 2010 decreased 30% over the same quarter in the prior year primarily as a result of increased operating costs which more than offset increased production from three additional development wells drilled in Colombia and an 8% improvement in the oil price received for production.

- Oil and gas property expenditures for the third quarter of 2010 include expenditures for testing and completing the Moqueta – 1 exploration well, and the successful drilling of the Moqueta– 2 and – 3 delineation wells in the Chaza block in Colombia, facility construction in the Chaza block, seismic acquisition in Peru, preparation for sidetrack drilling operations for the VM.x–1001 gas well in Argentina, and our initial exploration and production transaction in Brazil.

- Our cash and cash equivalents of $308.4 million at September 30, 2010 increased from $270.8 million at December 31, 2009 as a result of cash provided by operating activities of $101.4 million, and the issuance of shares upon the exercise of warrants and stock options of $22.9 million, partially offset by year-to-date capital expenditures (adjusted for associated non-cash working capital) and other investing activities of $86.7 million.

- Working capital (including cash and cash equivalents) was $270.2 million at September 30, 2010, which is a $55.1 million increase from December 31, 2009, due mainly to the increase in our cash position as well as higher accounts receivable from year end. Accounts receivable at any period end other than year end include two months of oil sales in Colombia. Year end accounts receivable traditionally include less than one month of oil sales due to year end settlement of outstanding amounts.

- Property, plant and equipment as at September 30, 2010 was $707.6 million, a $5.2 million decrease from December 31, 2009, primarily as a result of depletion, depreciation and accretion (“DD&A”), partially offset by capital additions.

Financial Highlights for the Nine Months Ended September 30, 2010

- During the first three quarters of 2010, oil and gas production (net after royalty and inventory adjustments) averaged 13,949 BOEPD, an increase of 16% over the same period in 2009, due mainly to production of crude oil from five additional development wells in Colombia.

- Revenue and other income increased by 56% over the same period in 2009 due to increased production and higher oil prices.

- Net income of $24.1 million or $0.10 per share basic and $0.09 per share diluted, compares to a net loss of $16.9 million, or a net loss of $0.07 per share basic and diluted in 2009. Net income was positively impacted by a 35% increase in realized oil prices in the nine months compared to the same period in the prior year. Net income was also impacted by a $33.7 million foreign exchange loss (compared to a $32.4 million loss recorded for the same period in 2009), of which $27.1 million is an unrealized non-cash foreign exchange loss, primarily resulting from the translation of a deferred tax liability.

- Funds flow from operations for the nine months ended September 30, 2010 increased to $135.8 million, a 24% increase over the same period in the prior year, primarily as a result of increased production from five additional development wells drilled in Colombia and a 35% improvement in the oil price received for production.

- Oil and gas property expenditures for the nine months ended September 30, 2010 include expenditures for the successful drilling of the Juanambu – 2 well in the Guayuyaco block in Colombia, the successful drilling of the Moqueta – 1, – 2, – 3, and Costayaco – 11 wells in the Chaza block in Colombia, facility construction in the Chaza block, seismic acquisition in Peru, preparation for sidetrack drilling operations for the VM.x–1001 gas well in Argentina, and our initial exploration and production transaction in Brazil.

Operational Highlights for the Nine Months Ended September 30, 2010

- Expanded Exploration Portfolio in Peru

In September 2010, we acquired a 20% working interest, in 6.7 million gross acres, in three blocks (123, 124, and 129) in Peru. The agreement was entered into with Burlington Resources Peru Limited, Sucursal Peruana, a wholly owned subsidiary of ConocoPhillips Company. These three blocks are contiguous to blocks 122 and 128, in Peru, in which we hold a 100% working interest. For the purpose of enhancing the regional interpretation of the area, the terms of the transaction include sharing technical data derived from the seismic and drilling program on blocks 122 and 128.

- Initial Exploration and Production Transaction in Brazil

In August 2010, we announced our initial exploration and production transaction in Brazil. An agreement was signed with Alvorada Petroleo S.A. for a 70% working interest in four blocks (T-129, -142, -155, and -224) in the on-shore Reconcavo Basin in Brazil, where we would be operator. This transaction is subject to obtaining the customary regulatory approval from Brazil's Agencia Nacional de Petroleo Gas Natural e Biocombustiveis ("ANP").

- Oil Discovery at Moqueta in Colombia

In June 2010, we confirmed an oil discovery at the Moqueta-1 exploration well in the Chaza Block in Colombia. Initial testing without a pump flowed 349 barrels of oil per day "BOPD", in addition to successful gas testing in a shallower reservoir interval. Subsequent drilling and testing of the Moqueta-2 delineation well in August 2010 produced well flow rates, without pumps, of 850 BOPD. We anticipate the initiation of long term oil testing and early production in the first quarter of 2011.

- Environmental Impact Assessment ("EIA") Approval in Peru

The EIA approval for seismic and drilling operations was received for Block 128, in August 2010, and for Block 122, in September 2010; both blocks are in the Marañon Basin in Peru. We concluded 260 kilometers of 2D seismic on Block 128 in October 2010 and anticipate moving to Block 122 to begin seismic acquisition operations in the fourth quarter of 2010. We anticipate the drilling of up to four wells in Peru to commence in the fourth quarter of 2010 and continue into early 2011.

- Successful Production Testing of Costayaco - 11

In June 2010, we completed logging operations and initiated production testing of Costayaco – 11. Costayaco – 11 was drilled in the northern portion of the Costayaco field in Colombia, and was tied in and put on production in early July. The well is currently producing from the Caballos formation and is expected to be used as a water-injector in the future to provide pressure maintenance in the T-Sandstone reservoir.

- Successful Acreage Awards in Colombia

In June 2010, we were awarded three blocks (Putumayo 10, Cauca 6 and 10) in the 2010 Colombia Bid Round administered by Colombia's National Hydrocarbons Agency ("ANH"). Bid contracts are pending final approval by ANH. We believe Putumayo 10 will enable us to leverage existing knowledge of our Piedemonte Norte and Piedemonte Sur Blocks, and believe that Cauca 6 and 10 provide new frontier exploration opportunities for the company.

- Commenced Workover and Sidetrack Drilling Operations for the VM.x–1001 Gas Well in Argentina

At the end of June 2010 we began mobilization of the drilling rig for the VM.x–1001 gas well in the Valle Morado Block in Argentina. Workover and sidetrack drilling operations of this re-entry well, in the Noroeste Basin, commenced in August 2010.

- Successful Production Testing of Juanambu - 2

In February 2010, we completed logging operations of the Juanambu - 2 development well in the Juanambu field discovered in 2007 in the Guayuyaco Block in Colombia. Testing of the well was completed early in March 2010 and the well came on production later in the month.

- Dantayaco -1 Exploration Well

We completed drilling of the Dantayaco - 1 exploration well in the Chaza Block, in the Putumayo basin of Colombia, at the end of 2009. During testing, only formation water was recovered and the well was plugged and abandoned on January 3, 2010.

Consolidated Results of Operations

Consolidated Results of Operations (Thousands of U.S. Dollars)	Three Months Ended September 30, 2010	2009	% Change	Nine Months Ended September 30, 2010	2009	% Change
Oil and natural gas sales	$ 84,110	$ 75,171	12	$ 260,759	$ 166,606	57
Interest	459	183	151	1,034	824	25
	84,569	75,354	12	261,793	167,430	56

Operating expenses