

## CANADIAN OVERSEAS PETROLEUM LIMITED

### MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2012

The following is the Management's Discussion and Analysis ("MD&A") of the operating and financial results of Canadian Overseas Petroleum Limited, and its wholly owned subsidiaries COPL Technical Services Limited, Canadian Overseas Petroleum (UK) Limited ("COPL UK"), Canadian Overseas Petroleum (Bermuda Holdings) Limited ("COPL Bermuda Holdings") and Canadian Overseas Petroleum (Bermuda) Limited ("COPL B") (collectively "COPL" or the "Company") as at and for the three and six month periods ended June 30, 2012. The information is provided as of August 9, 2012. The results for the three and six month periods ended June 30, 2012 have been compared to the same periods in 2011. This discussion and analysis should be read in conjunction with the Company's audited consolidated financial statements as at and for the years ended December 31, 2011 and 2010, together with the accompanying notes and the Annual Information Form ("AIF") dated March 29, 2012. These documents and additional information about COPL are available on the Company's website at [www.canoverseas.com](http://www.canoverseas.com) and on SEDAR at [www.sedar.com](http://www.sedar.com).

All amounts are presented in Canadian dollars unless otherwise noted.

#### BUSINESS OF THE COMPANY

Canadian Overseas Petroleum Limited is a publicly traded oil and gas company listed on the TSX Venture Exchange (TSX-V) under the symbol "XOP".

COPL is an international oil and gas exploration and development company currently active offshore in the UK North Sea and West Africa. Senior management and strategic corporate functions are performed by COPL's head office in Calgary, and geological, geophysical, engineering, accounting and administrative functions are performed by COPL Technical Services Limited. Drilling oversight and some geological and UK accounting functions are provided by COPL (UK). COPL B was incorporated in May 2011 in anticipation of operations offshore Liberia.

#### FORWARD-LOOKING INFORMATION

This MD&A contains forward-looking statements relating to future events or future performance. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expects", "projects", "plans", "anticipates", "potential", "intend", "believe" and similar expressions. These statements represent management's expectations or beliefs concerning, among other things, future operating results and various components thereof or the economic performance of Canadian Overseas Petroleum Limited. The projections, estimates and beliefs contained in such forward-looking statements necessarily involve known and unknown risks and uncertainties, including the business risks, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or results expressed or implied by such forward-looking statements. Operating conditions and weather can have a significant effect on the timing of events. Accordingly, readers are cautioned that events or circumstances could cause results to differ materially from those predicted.

Forward-looking statements included or incorporated by reference in this document include statements with respect to:

- the Company's strategy to establish and grow an oil and gas business in the UK North Sea, West Africa and elsewhere (the "Business of the Company", "Overview", "Outlook", "Liquidity and Capital Resources" sections);
- the Company's ability to raise capital and obtain the financing necessary to develop profitable oil operations (the "Overview", "Outlook" and "Liquidity and Capital Resources" sections);
- the Company's assumptions in respect of the calculation of stock-based compensation and valuation of warrants;
- the Company's ability to manage its financial and operational risks (the "Overview", "Loss on UK contracts", "Financial Instruments" and "Liquidity and Capital Resources" sections).

**FORWARD-LOOKING INFORMATION (CONTINUED)**

The Company's MD&A and AIF for the year ended December 31, 2011 describe major risks, material assumptions and other factors related to forward-looking statements that could influence actual results and are incorporated herein by reference. These risks, assumptions and other factors have been provided for readers to gain a more complete perspective on COPL's future operations. However, readers should be cautioned that the list of factors is not exhaustive and that this information may not be appropriate for other purposes. Forward-looking statements included or incorporated by reference in this MD&A are valid only as at the date of this MD&A, and the Company does not intend to update or revise these forward-looking statements except as required by applicable securities laws. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

**OVERVIEW \***

***Terminated Projects with BG - UK***

There is still approximately GBP 10.1 million in the escrow account with BG International Limited ("BG") as at June 30, 2012 and the date of filing this MD&A. The amount is in dispute as both the Company and BG are claiming rights to this amount and as such, the funds will not be released by the escrow agent to either party without both parties' consent or a court order.

On April 4, 2012, BG filed a claim with the High Court of Justice against the escrow agent and COPL UK in which BG is seeking an order directing the escrow agent to release the escrow funds to BG. The Company opposed the claim and the escrow agent defended the claim on the basis that it was not obliged to act on the BG claim of the escrow funds.

The Company believes that given all payments and obligations for drilling and testing the Esperanza well have been made by COPL, it retains all its rights in Block 22/15. On April 18, 2012, the Company notified BG that COPL UK was executing its rights under the SPA to complete the purchase of the Block 22/15 interest. BG replied by asserting that, as a result of the termination of the SPA, that COPL UK has no rights regarding either Block 22/15 or Block 23/21. The Company is currently assessing its legal status regarding the acquisition of the 50% interest in Block 22/15.

***Terminated farm-in with SSE***

Due to the termination of the projects with BG, the exploration wells in Block 23/21 Rest of Block Shallow ("RoB") will not be drilled. Accordingly, a respective termination agreement of the earn-in agreement has been signed with SSE E&P UK Limited ("SSE") on June 19, 2012. GBP 5.0 million (approximately \$8.0 million) of funds in escrow with SSE was returned to the Company and the remaining GBP 0.2 million (approximately \$0.3 million) is expected to be returned at the end of the year, net of any further termination costs (currently estimated at GBP 40 thousand).

***Liberia prospect***

In April 2012, the National Oil Company of Liberia ("NOCAL") advised that it accepts that the proposed joint venture between ExxonMobil Exploration and Production Liberia Limited ("ExxonMobil") and COPL satisfies in principle the technical and financial competence requirements of the transfer provisions for the Production Sharing Contract ("PSC") governing Block LB-13 subject to agreeing on proposed amendments to the PSC, and the requirement that ExxonMobil acquires its interest immediately following Peppercoast Petroleum plc ("Peppercoast") assignment to COPL B.

Negotiations in respect of amendments to the PSC are currently in progress and, subject to the approval of the Government of Liberia, the proposed transactions are expected to close in second half of 2012.

*\* This section contains forward-looking information. Please see the "Forward-looking Information" section (at the beginning of this document) for a discussion of risks and uncertainties relating to such information.*

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**FINANCIAL SUMMARY**

In the first half of 2012 the Company continued its activities in the UK North Sea and negotiations in respect of proposed transactions for offshore block LB-13 in Liberia. The total additions to its UK exploration and evaluation assets amounted to \$49,000 and \$122,000 for the three and six month periods ended June 30, 2012, respectively, and related to the Fulla project. The costs related to drilling and testing the Esperanza well plus certain costs in respect of Block 23/21 RoB totalling \$32.6 million were recorded against the provision for loss on UK contracts which was set up at the end of 2011 as the respective agreements with BG and SSE were terminated. Costs related to the Bluebell prospect of approximately \$0.2 million and \$8.4 million for the three and six month periods ended June 30, 2012, respectively, were recorded as exploration expenses as the Bluebell well drilled in March 2012 was not successful.

General and administrative costs amounted to \$2.1 million and \$3.7 million for the three and six month periods ended June 30, 2012 (net of \$0.2 million and \$0.6 million of costs allocated to exploration projects, respectively) compared to \$2.2 million and \$4.4 million for the three and six month periods ended June 30, 2011 (with \$0.6 million of costs allocated to exploration projects for both the three and six month periods ended June 30, 2011). There was no stock-based compensation expense during the first half of 2012 compared to \$4.8 million recognized for stock options granted in the first quarter of 2011. Pre-license costs of \$0.9 million and \$1.3 million for the three and six month periods ended June 30, 2012 related to the Liberia project compared to \$0.7 million for the same periods in 2011. The Company recognized interest income of \$13,000 and \$32,000 for the three and six month periods ended June 30, 2012, compared to \$0.1 million and \$0.5 million for the three and six month periods ended June 30, 2011, respectively. Foreign exchange gains of \$77,000 and \$38,000 were recorded for the three and six month periods ended June 30, 2012, compared to \$0.6 million and \$0.2 million for the same periods in 2011. As a result, the Company's loss amounted to \$3.1 million and \$13.3 million for the three and six months ended June 30, 2012, compared losses of of \$2.2 million and \$9.1 million for the same periods in 2011.

As at June 30, 2012, the Company's cash and cash equivalents amounted to \$26.9 million (December 31, 2011 - \$71.9 million) and included \$17.8 million (December 31, 2011 - \$67.7 million) of cash held in escrow accounts with farm-in partners, restricted for use on specific exploration projects in accordance with escrow agreements. As at June 30, 2012, \$16.2 million of these escrow funds were in dispute with BG (as discussed in the "Overview" section).

Cash used in operating activities amounted to \$45.9 million for the six month period ended June 30, 2012, compared to \$5.1 million for the same period in 2011, mainly as a result of payments for the provision for the loss on UK contracts (discussed further in the "Loss on UK Contracts" section) and exploration expenses related to the Bluebell well.

**OUTLOOK \***

The Company's current strategy is to establish and grow its oil and gas business by farming into and/or acquiring interests in unappraised and/or undeveloped assets.

The Company's short-term operations will focus on:

- completing the transactions in respect of Block LB-13 offshore Liberia;
- working toward resolving the dispute with BG (over funds in escrow and interest in the Esperanza discovery);
- continuing to explore options for additional property deals in the UK North Sea, including participating in 27<sup>th</sup> Licensing Round; and
- evaluating opportunities in West Africa and elsewhere.

Currently, the Company does not have material cash inflows and/or adequate financing to develop profitable operations. The Company is pursuing exploration projects that, if successful, will require substantial additional financing before they are able to generate positive cash flows. Accordingly, the Company's continued successful operation is dependent on its ability to obtain additional financing. No assurance can be provided that the Company will raise the required levels of financing.

*\* This section contains forward-looking information. Please see the "Forward-looking Information" section (at the beginning of this document) for a discussion of risks and uncertainties relating to such information.*

**FINANCIAL AND OPERATING HIGHLIGHTS****INCOME AND CASH FLOWS FROM OPERATING ACTIVITIES**

The following table summarizes the Company's financial results for the three and six month periods ended June 30, 2012 and 2011:

(\$ 000's) except per share	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Services to third parties	\$ 63	\$ -	\$ 110	\$ -
Administrative expenses	(2,144)	(2,216)	(3,682)	(4,350)
Stock-based compensation	-	-	-	(4,718)
Exploration expenses	(221)	-	(8,444)	-
Pre-license costs	(889)	(716)	(1,346)	(716)
Net Interest income	7	118	22	498
Foreign exchange gain	77	594	38	170
Loss	(3,131)	(2,224)	(13,339)	(9,123)
Per share loss	\$ (0.01)	\$ (0.01)	\$ (0.05)	\$ (0.04)
Cash used in operating activities	\$ (11,460)	\$ (3,300)	\$ (45,855)	\$ (5,052)
Outstanding common shares at				
June 30	<b>284,016,939</b>	284,016,939	<b>284,016,939</b>	284,016,939
Weighted average - basic	<b>284,016,939</b>	284,016,939	<b>284,016,939</b>	230,585,183

Exploration expenses in the amount of \$0.2 million and \$8.4 million for the three and six month periods ended June 30, 2012 relate to the Bluebell project in the UK.

Pre-licence costs of \$0.9 million and \$1.3 million for the three and six month periods ended June 30, 2012 (\$0.7 million for the same periods in 2011), relate to the Liberia project for which anticipated transactions have not been completed yet.

Administrative expenses amounted to \$2.1 million and \$3.7 million for the three and six month periods ended June 30, 2012 compared to \$2.2 million and \$4.4 million for the same periods in 2011. Administrative expenses are presented net of costs allocated to exploration projects of \$0.2 million and \$0.6 million for the three and six month periods ended June 30, 2012, compared to \$0.6 million in allocations for both the three and six month periods ended June 30, 2011.

**COMPARATIVE FINANCIAL POSITION ITEMS**

The following table summarizes the Company's financial position as at June 30, 2012, March 31, 2012 and December 31, 2011:

(\$ 000's) except per share	June 30, 2012	March 31, 2012	December 31, 2011
Cash and cash equivalents	\$ 26,935	\$ 37,516	\$ 71,924
Current assets	27,245	37,824	72,533
Exploration and evaluation assets	20,716	20,667	20,594
Deposit for seismic data	15,287	14,987	15,255
Provision for loss on UK contracts	64	183	32,641
Current liabilities	2,948	10,317	35,048
Share capital	100,768	100,768	100,768
Shareholders' equity	\$ 60,553	\$ 63,425	\$ 73,604

The decrease in cash of \$45.0 million during the six months ended June 30, 2012 relates mainly to the decrease in the provision for the loss on UK contracts of approximately \$32.6 million (discussed further in the "Loss on UK Contracts" section), approximately \$6.8 million in exploration expenses related to the Bluebell well and the remaining on pre-license and other operating and administrative costs.

As at June 30, 2012, \$17.8 million (December 31, 2011 - \$67.7 million) was held in banks in escrow accounts restricted by escrow agreements signed with UK partners for use on specific exploration projects, including \$16.2 million of escrow funds which are currently in dispute (discussed further in the "Overview" section).

**ADDITIONAL DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE**

The Company is a TSX Venture issuer that has not had significant revenue from operations in either of its last two financial years. In accordance with National Instrument 51-102, additional disclosure on material costs is presented below.

(\$ 000's)	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Administrative:				
Payroll, external directors' fees and related costs	\$ 878	\$ 747	\$ 1,698	\$ 1,440
Consulting services	237	406	459	643
Professional services	749	831	1,218	1,368
Travel expenses	128	522	262	709
Office expenses	252	228	509	477
Stock exchange and transfer agent fees	3	43	50	98
Other general and administrative	53	-	102	176
Costs allocated to exploration projects	(156)	(561)	(616)	(561)
Total administrative	\$ 2,144	\$ 2,216	\$ 3,682	\$ 4,350
Capitalized exploration and evaluation costs – UK North Sea	\$ 49	\$ 6,612	\$ 122	\$ 7,304

**LOSS ON UK CONTRACTS \***

The movement in the provision for loss on UK contracts during the period ended June 30, 2012 can be summarized as follows:

(\$ 000's)	<b>Six months ended June 30, 2012</b>
<b>Balance, beginning of period</b>	<b>\$ 32,641</b>
Addition to the termination provision	11
Consideration and costs settled during period:	
Payments to BG	(32,106)
Payments to SSE	(21)
The Company's costs in respect of Esperanza and Block 23/21 RoB	(461)
<b>Provision for loss on UK contracts, end of period</b>	<b>\$ 64</b>

As at the date of release of these MD&A, approximately GBP 10.1 million remain in the escrow account with BG. The amount is in dispute as both the Company and BG are claiming rights to this amount and as such, it will not be released by the escrow agent to either party without both parties' consent or a court order.

On April 4, 2012, BG filed a claim with the High Court of Justice against the escrow agent and COPL UK, in which BG is seeking an order directing the escrow agent to release the escrow funds to BG. The Company opposed the claim and the escrow agent defended the claim on the basis that it was not obliged to act on the BG claim of the escrow funds.

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**FINANCIAL INSTRUMENTS\***

The Company's financial instruments consist of cash, short-term deposits, cash held in escrow, credit card and other deposits, loans, accounts receivable, as well as accounts payable and accrued liabilities. It is management's opinion that the Company is not currently exposed to significant interest and/or credit risks arising from these financial instruments and that the fair value of these financial instruments approximates their carrying value.

As the Company's current exploration activities are carried out in the UK, significant amounts are transacted in or referenced to currencies other than the Canadian dollar, including the British Pound and U.S. dollar. As a result, fluctuations in the exchange rates between the Canadian dollar, British Pound and U.S. dollar can have a significant effect on the Company's financial position and its reported results. To mitigate a portion of its exposure and to the extent it is feasible, the Company keeps its funds in currencies applicable to its known short-term commitments. No assurance can be given that such management of risk exposure will offset and/or eliminate the foreign exchange fluctuations.

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**LIQUIDITY AND CAPITAL RESOURCES \***

As of June 30, 2012, the Company had working capital of approximately \$24.3 million, shareholders' equity of \$60.6 million and cash of \$26.9 million, including \$17.8 million of cash in escrow and restricted for particular UK projects (including \$16.2 million of escrow funds in dispute).

Currently, the Company does not have material cash inflows and/or adequate financing to develop profitable operations. The Company is pursuing exploration projects that, if successful, will require substantial additional financing before they are able to generate positive cash flows. Accordingly, the Company's continued successful operations are dependent on its ability to obtain additional financing. No assurance can be provided that the Company will raise the required levels of financing.

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**SELECTED QUARTERLY INFORMATION**

Eight Most Recent Quarters:

(\$ 000's)	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011
<b>Revenue</b>	76	66	159	125
<b>Loss</b>	(3,131)	(10,208)	(42,097)	(2,208)
<b>Loss per share - basic &amp; diluted</b>	(0.01)	(0.04)	(0.15)	(0.01)

(\$ 000's)	June 30, 2011	March 31, 2011	December 31, 2010	September 30, 2010
<b>Revenue</b>	118	380	6	8
<b>Loss</b>	(2,224)	(6,899)	(4,492)	(1,148)
<b>Loss per share - basic &amp; diluted</b>	(0.01)	(0.04)	(0.07)	(0.05)

**ACCOUNTING PRONOUNCEMENTS****FUTURE ACCOUNTING CHANGES**

Changes to future accounting policies, standards and interpretations, as described in Note 3 of the audited consolidated financial statements as at and for the years ended December 31, 2011 and 2010, have not materially changed since December 31, 2011.

**CRITICAL ACCOUNTING ESTIMATES**

Management is required to make judgements, assumptions and estimates in applying the Company's accounting policies and practices, which may have a significant impact on the financial results reported by the Company. The amounts recorded in respect of stock options and share purchase warrants granted are based on the Company's estimation of their fair value, calculated using assumptions regarding the life of the option and warrant, interest rates and volatility. By their nature, these estimates and assumptions are subject to uncertainty, and the actual fair value of option and warrant may differ at any time.

**DIRECTORS**

Arthur S. Millholland, P.Geol. - President and Chief Executive Officer  
Harald Ludwig - Director  
Massimo Carello - Director  
Christopher McLean - Director  
Rick Schmitt - Director

**OFFICERS**

Arthur S. Millholland, P.Geol. - President and Chief Executive Officer  
Aleksandra Owad, CGA, FCCA (UK) – Chief Financial Officer  
Rod Christensen, P.Geol. – Vice President, Exploration and Exploitation  
  
Faralee A. Chanin, LL.B., M.B.A. – Corporate Secretary