

MANAGEMENT'S DISCUSSION & ANALYSIS

YEAR ENDED DECEMBER 31, 2005

March 28, 2006

The following management discussion and analysis ("MD&A") is provided by the management of PetroFalcon Corporation ("PetroFalcon" or the "Corporation"), and should be read in conjunction with the Corporation's audited consolidated financial statements for the years ended December 31, 2005 and December 31, 2004. These financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). Estimates and forward-looking information are based on assumptions of future events and actual results may vary from these estimates.

This MD&A contains the terms "cash flow from operations" and "operating netback", which should not be considered alternatives to, or more meaningful than cash flow from operating activities and net income as determined in accordance with Canadian GAAP as an indicator of the Corporation's performance. PetroFalcon's determination of "cash flow from operations" is defined as cash from operating activities before changes from non-cash working capital items and "operating netback" is defined as revenue less operating, maintenance and transportation expenses and may not be comparable to that reported by other companies. PetroFalcon also presents cash flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. All dollar amounts are expressed in US Dollars. Transactions and balances using Venezuelan Bolivar ("Bs.") are translated into U.S. dollars using the temporal method at the official exchange rate (currently Bs. 2,150/US\$).

For the purposes of calculating unit costs, unit netbacks and combined production and revenue, natural gas has been converted to a barrel of oil equivalent ("boe") using a conversion rate of six thousand cubic feet equal to one barrel (6:1).

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Except for statements of historical fact, all statements in this MD&A, including, without limitation: statements with respect to royalty payments; oil and natural gas production; general and administrative expenses; future income tax; future drilling; planned growth and development; contractual obligations; new projects; forecasted production; future plans; objectives and results constitute forward-looking information within the meaning of applicable Canadian securities legislation which involve risks, uncertainties and assumptions including,

without limitation, risks associated with operating exclusively in a foreign jurisdiction; changes to operating services agreements in Venezuela; the imposition of royalties and income taxes; the impact of general economic conditions in Venezuela and world-wide; industry conditions including the adoption of environmental, tax and other laws and changes in how they are interpreted and enforced; the existence of operating risks in finding, developing and producing oil and natural gas; volatility of oil and natural gas prices; oil and natural gas product supply and demand; processing facility access; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; stock market volatility; commodity prices; interest rates; opportunities available to or pursued by the Corporation; and other factors, many of which are beyond our control. All such forward-looking information is based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. The foregoing factors are not exhaustive and are further discussed in the Annual Information Form of PetroFalcon available on SEDAR at www.sedar.com. Actual results, performance or achievements could differ materially from those expressed in, or implied by, such forward-looking information and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking information will transpire or occur, or if any of them do so, what benefits will be derived therefrom. Investors should not place undue reliance on forward-looking information. Statements relating to “reserves” or “resources” are also deemed to be forward-looking information as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. Except as required by law, PetroFalcon Corporation and its subsidiaries expressly disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise. In the event subsequent events prove past statements about current trends to be materially different, we may choose to issue a news release explaining the reasons for the difference and update the guidance on the anticipated impact on revenue, earnings and other key events.

The information contained in this MD&A is expressly qualified by this cautionary statement.

RESULTS OF OPERATIONS

For the three months ended December 31, 2005, average production was 1,046 boe/d. On December 19, 2005, the Corporation commenced delivering natural gas to Petroleos de Venezuela, S.A. (“PDVSA”)’s Interconnection Centro Occidente Pipeline (the “ICO Pipeline”) at an exit rate of 4 mmcfg/d. For the three months ended December 31, 2004, average production was 1,058 boe/d.

For the year ended December 31, 2005, average production was 900 boe/d. For the year ended December 31, 2004, average production was 852 boe/d.

During the three months ended December 31, 2005, PetroFalcon had 16 producing oil wells, 1 producing natural gas well, 2 shut-in natural gas wells and 2 shut-in oil wells. During the year ended December 31, 2005 the Corporation drilled 2 new wells at the La Vela field and discovered a shallow oil and natural gas field in the southern part of the La Vela structure.

The Corporation expects an increase in oil and natural gas production during 2006 from the La Vela and Cumarebo fields through development drilling, expansion of the facilities at La Vela and the new natural gas facility construction at Cumarebo.

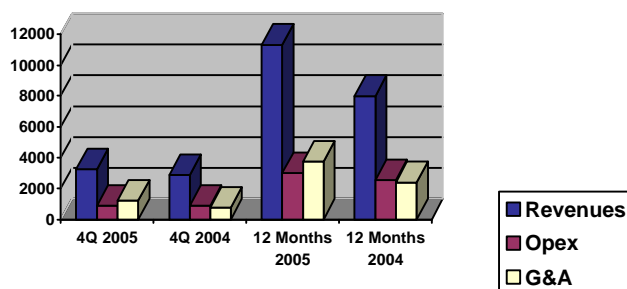
REVENUES

PetroFalcon recorded revenue in the amount of \$3.3 million for the three months ended December 31, 2005, as compared to \$2.9 million for the three months ended December 31, 2004. The average price received for the three months ended December 31, 2005 was \$37.35 per bbl of oil and \$1.33 per mcf of natural gas. The combined average price received for the three months ended December 31, 2005 was \$33.81 per boe. For the three months ended December 31, 2004, the average price was \$29.43 per bbl of oil.

During the year ended December 31, 2005, PetroFalcon recorded revenue in the amount of \$11.3 million, compared to \$8 million for the year ended December 31, 2004. The average price received for the year ended December 31, 2005 was \$35.46 per bbl of oil and \$1.33 per mcf of natural gas. The combined average price received for the year ended December 31, 2005 was \$34.49 per boe. For the year ended December 31, 2004, the average price was \$26.07 per bbl of oil.

The increase in revenue during the year ended December 31, 2005, occurred due to higher levels of production, 328,367 boe for the year ended December 31, 2005, as compared to 306,720 boe for the year ended December 31, 2004, as well as higher average prices, \$34.49 per boe for the year ended December 31, 2005, as compared to \$26.07 per boe for the year ended December 31, 2004.

The Corporation had no derivative contracts and consequently benefited from strong oil prices during the year ended December 31, 2005. Oil and natural gas production is delivered to PDVSA, and the Corporation's wholly owned subsidiary, Vinccler Oil and Gas, C.A. ("Vinccler Venezuela") receives payment in accordance with the terms of an operating service agreement and a related gas addendum entered into between Vinccler Venezuela and affiliates of PDVSA (together the "OSA"). On August 4, 2005, Vinccler Venezuela signed a transitory agreement (the "Transitory Agreement") with a wholly-owned subsidiary of PDVSA pursuant to which Vinccler Venezuela agreed to convert the rights currently granted pursuant to the terms of the OSA to an Empresa Mixta. An Empresa Mixta is the style of joint venture arrangement required to replace existing operating services agreements as required by recently enacted changes to Venezuelan hydrocarbon laws. The terms and conditions of the Empresa Mixta are subject to negotiations which are currently ongoing. In addition to the Transitory Agreement, Vinccler and PDVSA entered in a confidentiality agreement to facilitate the exchange of information during the negotiation period.



The terms and conditions, including the equity ownership, of the Empresa Mixta to be entered between Vinccler Venezuela and PDVSA is the subject of negotiations which are presently ongoing. While the ultimate

contractual arrangement that will result from negotiations remain, at present, uncertain, PDVSA has advised Vinccler Venezuela that PDVSA will own a majority, controlling interest in the Empresa Mixta, Vinccler Venezuela will hold a minority interest, the Empresa Mixta will be subject to a royalty on production of oil and natural gas at a rate of 30% and will be taxed at a rate of 50%. Vinccler Venezuela will be required to pay its proportionate share of the applicable royalties and taxes charged to the Empresa Mixta. The term of the Empresa Mixta is expected to be 20 years.

While Vinccler Venezuela is engaged in good faith negotiations with PDVSA, there are no assurances that the migration of the rights granted pursuant to the OSA will be transferred to the Empresa Mixta on acceptable terms.

Presently, payment from PDVSA under the OSA is made 75% in US Dollars and 25% in Bolivars. Payment terms under the Empresa Mixta have not yet been negotiated.

ROYALTIES

The Corporation's oil and natural gas production is not subject to any royalties. When the rights granted pursuant to the OSA are migrated to an Empresa Mixta, management anticipates that its share of oil and natural gas production will become subject to royalty payments of thirty percent (30%).

OPERATING EXPENSES

(\$000s except boe amount)	Three months ended December 31, 2005	Three months ended December 31, 2004
Operating Expenses (including maintenance and transportation)	985	875
Average expense (\$ per boe)	10.23	8.98

(\$000s except boe amount)	Year ended December 31, 2005	Year ended December 31, 2004
Operating Expenses (including maintenance and transportation)	3,097	2,547
Average expense (\$ per boe)	9.43	8.30

For the three months ended December 31, 2005, operating expenses were \$984,731 as compared to \$875,048 during the three months ended December 31, 2004. For the year ended December 31, 2005, operating expenses increased to \$3.1 million compared to \$2.5 million during the year ended December 31, 2004 due to increased volumes of oil production at Cumarebo and La Vela Fields and the commencement of natural gas production at La Vela Field. PetroFalcon expects to continue increasing oil and natural gas production in 2006. Higher oil and natural gas production

is expected to decrease per boe operating expenses during 2006 as costs are spread over greater boe production.

GENERAL AND ADMINISTRATIVE EXPENSES

(\$000s except boe amount)	Three months ended December 31, 2005	Three months ended December 31, 2004
Expenses	1,191	764
Average expense (\$ per boe)	12.37	7.84

(\$000s except boe amount)	Year ended December 31, 2005	Year ended December 31, 2004
Expenses	3,730	2,395
Average expense (\$ per boe)	11.36	7.80

General and administrative expenses were \$1.2 million during the three months ended December 31, 2005, as compared to \$763,617 during the three months ended December 31, 2004. During the year ended December 31, 2005, general and administrative expenses were \$3.7 million as compared to \$2.4 million during the year ended December 31, 2004. During the three months ended December 31, 2005, the Corporation recorded the penalty portion of the Venezuelan Tax Assessment for the years 2001 to 2004, inclusive, which amounted to \$253,418 and has been recorded as a general and administrative expense. In addition to the Venezuelan Tax Assessment, the overall increase in general and administrative expenses during the three months and year ended December 31, 2005, is related to an increase in employees, higher salaries and increased consultants costs, all of which are required to implement the Corporation's growth strategy. General and administrative expenses per boe are expected to decline as production increases during 2006. PetroFalcon does not capitalize general and administrative expenses.

AMORTIZATION, DEPLETION AND ACCRETION ("AD&A")

(\$000s except boe amount)	Three months ended December 31, 2005	Three months ended December 31, 2004
Amortization, Depletion and Accretion	563	408
Depletion Rate (\$ per boe)	5.85	4.19

(\$000s except boe amount)	Year ended December 31, 2005	Year ended December 31, 2004
Amortization, Depletion and Accretion	1,719	1,285
Depletion Rate (\$ per boe)	5.24	4.19

For the three months ended December 31, 2005 AD&A was \$563,255 as compared to \$408,331 for three months ended December 31, 2004. For the year ended December 31, 2005 AD&A was \$1.7 million as compared to \$1.3 million during the year ended December 31, 2004. The AD&A expense during the year ended December 31, 2005 was higher compared to the year ended December 31, 2004 due to an increase in project capital expenditures. AD&A per boe is expected to remain relatively constant during 2006.

INTEREST INCOME AND EXPENSE

At December 31, 2005, PetroFalcon had \$9.3 million in cash and short-term deposits compared to \$24.1 million (\$3.6 million of which was restricted) at December 31, 2004. During the three months ended December 31, 2005, the Corporation recorded interest income in the amount of \$47,550 as compared to \$86,060 during the three months ended December 31, 2004. Interest income was lower during the year ended December 31, 2005; \$260,324 as compared to \$292,580 in the year ended December 31, 2004. Interest income is lower compared to the prior year and fourth quarter of 2004 due to lower average balances.

PetroFalcon incurred interest expense of \$844,590 during the three months ended December 31, 2005 as compared to \$127,954 during the three months ended December 31, 2004. During the year ended December 31, 2005, the Corporation incurred interest expense of \$1.4 million as compared to \$401,194 during the year ended December 31, 2004. The increase in interest expense in the three months ended December 31, 2005 is due to mandatory interest on the Venezuelan Tax Assessment for the years 2001 to 2004, inclusive, of \$532,883. The general increase in interest over the year ended December 31, 2005, is due to higher average debt with local banks and interest incurred pursuant to an International Finance Corporation (“IFC”) borrowing facility.

PetroFalcon recorded a loss due to exchange rate fluctuations of \$613 during the three months ended December 31, 2005 and a gain of \$116,731 during the year ended December 31, 2005 on the exchange of Bolivars to US dollars. The Corporation recorded a gain on bond sales of \$293,935 during the three months ended December 31, 2005 and \$2,443,876 during the year ended December 31, 2005.

The Corporation reached an agreement with the IFC pursuant to which the IFC will provide up to \$36 million in loans to Vinccler Venezuela for the development of oil and gas properties. During the second quarter of 2005, the IFC disbursed \$12 million from the “C” Loan. Principal repayments on the “C” Loan are due in 2011. Interest will be payable semi-annually on May 15 and November 15 and will accrue at the London Inter Bank Offered Rate (“Libor”) plus 1% for the “C” Loan from June 27, 2005, the date of the full disbursement of the “C” loan. IFC is also entitled to receive three percent of Vinccler Venezuela's cash flow so long it does not exceed 10% per annum of the principal amount of the “C” loan on an aggregate accumulated basis. At December 31, 2005, the outstanding principal due to IFC was \$8 million as a result of IFC's conversion of \$4 million of debt into 2,078,273 common shares of PetroFalcon based on a price of CDN\$2.37, which was determined by the average closing price of the last 20 trading days to the date of the “C” Loan Agreement. During the year ended December 31, 2005, the effective interest rate on the “C” loan was 5.44%. IFC has the option, from January 1, 2006, until December 27, 2008, to convert all or portion of the remaining \$8 million “C” loan into common shares of PetroFalcon at the market price of PetroFalcon's common shares at the time of conversion. The facility contains a number of covenants that Vinccler Venezuela must fulfill

including the satisfaction of minimum financial tests, compliance with IFC and World Bank environmental and social policies and compliance with restrictions on the use and application of the proceeds.

STOCK-BASED COMPENSATION

During the three months ended December 31, 2005, the Corporation recorded \$572,000 in stock based compensation expense as compared to \$357,000 during the three months ended December 31, 2004. For the year ended December 31, 2005, stock based compensation was \$2 million as compared to \$1 million during the year ended December 31, 2004. Higher stock based compensation during the three months and year ended December 31, 2005 was due to a greater number of stock options outstanding during 2005; 8,896,194 options outstanding in 2005 as compared to 7,420,000 options outstanding in 2004.

INCOME TAXES

During the three months ended December 31, 2005, the Corporation recorded a current income tax expense of \$1.1 million as compared to \$265,475 during three months ended December 31, 2004. During the year ended December 31, 2005, the Corporation recorded a current income tax expense of \$1.5 million as compared to \$265,475 during the year ended December 31, 2004, and a future income tax benefit of \$312,542 during 2005. No future income tax was recognized during 2004.

Current income tax expense was recognized in Vinccler Venezuela due to additional tax assessments received from the National Integrated Customs and Tax Administration Service of Venezuela (“SENIAT”) with respect to the income tax returns for the years ended December 31, 2001 to 2004, inclusive, for a total of \$3,288,000 (Bs. 7,071,000,000) payable in nominal Bolivars. The revised tax assessment was mainly due to the SENIAT’s reinterpretation of Vinccler Venezuela’s business purpose. The SENIAT stresses that under its income tax laws, Vinccler Venezuela is an oil and natural gas producing company instead of an operating service company. Thus, the income tax expense for the audited years had to be recalculated at the rate of 50% (rather than the previous rate of 34%). Vinccler Venezuela filed amended tax returns on December 22, 2005, and partially accepted SENIAT’s objections, which represents the current income tax expense of \$1,515,078 (Bs. 3,257,000,000) and includes additional income tax of \$1,365,000 (Bs. 2,936,000,000). On January 26, 2006, Vinccler Venezuela filed a discharge claim with SENIAT and SENIAT is expected to issue an acceptance resolution within one year from the filing date of the discharge claim. There are technical arguments to support the inadmissibility of objections by the SENIAT tax authorities in the tax assessments and the Corporation has not, therefore, set aside any provision to cover additional liabilities, however, there are no assurances that the SENIAT will accept the technical arguments made.

A future income tax expense of \$770,000 was recognized in Vinccler Venezuela based on a timing difference in the financial and fiscal treatment of fixed assets. In addition, Vinccler Venezuela recorded a future income tax benefit of \$150,000 related to carry forward tax losses for the years ended December 31, 2005 to 2008, inclusive. Future income tax benefits were also recognized in the two Canadian entities Vinccler Oil and Gas Corporation and PetroFalcon. These benefits arose due to an exchange loss of \$2.4 million from the fluctuation of each company’s currency for Canadian tax filing purposes.

(\$000s)	Three months ended December 31, 2005	Three months ended December 31, 2004
Consolidated Income Tax Expense	1,081	265
Future Income Tax	(513)	-

(\$000s)	Year ended December 31, 2005	Year ended December 31, 2004
Consolidated Income Tax Expense	1,515	265
Future Income Tax	(313)	-

ANALYSIS OF 2005 CAPITAL EXPENDITURES

The following table outlines the Capital Budget and expenditures for the year ended December 31, 2005.

(\$000s)	2005 (as revised on the second quarter)	Actual
Drilling and Workovers		
- La Vela	13,000	13,970
- Cumarebo	3,600	1,520
- Prospects	1,800	555
- Total Drilling	18,400	16,045
Central Processing Facilities		
- La Vela	8,500	11,253
- Cumarebo	2,000	1,177
- Total Central Processing Facilities	10,500	12,430
- Seismic Acquisition	2,200	2,661
Total Capital Budget	31,100	31,136

DRILLING

During the year ended December 31, 2005, the Corporation completed two new wells in the La Vela Field, the LV-9 and LV-10, and put on production the LV-7X.

The LV-10 well was drilled and pipe was set to a total depth of 9,990 feet. Based on electric logs, the well encountered approximately 240 feet of potentially productive reservoir in the deep portion of the well. This potential pay is in addition to the approximately 150 feet of potential reservoir encountered in the shallow Caujarao and Socorro formations. The Corporation completed production testing from the LV-10 well and discovered a shallow oil and natural gas field in the southern part of the La Vela structure. The LV-9 well was put on production during the year ended December 31, 2005. The LV-7X well was put on production in December 2005 with natural gas being sold into the ICO pipeline.

The Corporation is building drilling pads, permitting drilling locations and currently negotiating with contractors for the mobilization of a rig to resume development drilling at the Cumarebo and La Vela fields during the second quarter of 2006.

CENTRAL PROCESSING FACILITIES

At the La Vela Field, construction of an early production facility, capable of processing 1,500 bbls/d of oil and 10 mmcf of natural gas per day, was completed in December 2005. The new processing facility is adjacent to the LV-6X well and located at the southern end of the La Vela Field. The Corporation is expanding and upgrading the facility with compression and dew point control to be completed in the second quarter of 2006. The Corporation plans to upgrade the existing facilities at the Cumarebo Field to process up to 20 mmcf/d of natural gas. The upgrade is expected to be completed and operational during the second quarter 2006. The Cumarebo Field facilities are capable of processing up to 10,000 bbls/d of oil.

SEISMIC ACQUISITION

Seismic data acquisition at Cumarebo and La Vela fields and adjacent prospects was completed in the first quarter of 2005. The seismic data processing was completed during the second quarter of 2005. The Corporation is reprocessing the seismic data and continues to refine the structural interpretation. The new seismic data is expected to further define the Corporation's prospects and delineate drilling locations at the two existing fields.

CAPITAL BUDGET FOR 2006

(\$000s)	2006
Drilling	
- La Vela	12,500
- Cumarebo	5,500
- Total Drilling	18,000
Central Processing Facilities	
- La Vela	3,100
- Cumarebo	4,200
- Total Central Processing Facilities	7,300
Total Capital Budget for 2006	25,300

PetroFalcon has initiated a comprehensive development and exploitation program designed to increase natural gas and oil reserves, production, earnings, cash flow and net asset value. The Corporation's 2006 program consists of:

- The commencement of construction of the second phase of facilities at the La Vela Field. These facilities will include compression and dew point processing equipment allowing the Corporation to produce natural gas from various proven reservoirs for up to 20 MMcf/d of gas and 1,500 bbls/d of oil. At the Cumarebo Field, the Corporation will also begin expansion and upgrades of existing facilities designed to process 15 MMcf/d of gas. This expansion and tie-in to the ICO pipeline is expected to be completed by July 2006.
- Upon finalization of the Empresa Mixta, the Corporation plans to mobilize a drilling rig into the Service Area and commence a development and exploratory drilling program. Permits for four development wells have been issued for the La Vela Field to test the shallow oil and natural gas discovery made in 2005 offsetting the LV-10 well. Permits for three wells have been issued at the Cumarebo Field, targeting proven natural gas reservoirs as well as probable and possible upside reserves. The total capital drilling budget is currently \$18 million which has been approved by PDVSA. Upon commencement of operations pursuant to the terms of the Empresa Mixta, PDVSA is expected to bear its proportionate share of capital and operating expenses.
- Continued re-processing and mapping of the 85 kilometre 2-d seismic program acquired by Vinccler Venezuela in 2005 has delineated several new structural prospects in the area around Cumarebo. These, along with the Corporation's existing prospect portfolio and the additional opportunities which have resulted as a consequence of the West Falcon Samson Hydrocarbons, S.R.L. ("WFSH") acquisition on March 21, 2006, will be prioritized, permitted and slated for drilling in late 2006 and early 2007.

CASH FLOW FROM OPERATIONS

(\$000s except per share data)	Three months ended December 31, 2005	Three months ended December 31, 2004
Cash flow from operations	(505)	1,729
Per basic share	(0.01)	0.02
Net income	(1,128)	965
Per basic share	(0.01)	0.01

(\$000s except per share data)	Year ended December 31, 2005	Year ended December 31, 2004
Cash flow from operations	4,412	4,376
Per basic share	0.06	0.06

(\$000s except per share data)	Year ended December 31, 2005	Year ended December 31, 2004
Net income	1,010	2,113
Per basic share	0.01	0.03
Working capital	10,288	23,570



PetroFalcon

OPERATING NETBACK*

(\$ per boe)	Three months ended December 31, 2005	Three months ended December 31, 2004
Sales price	33.81	29.43
Operating expenses	(10.23)	(8.98)
Operating netback*	23.59	20.45

(\$ per boe)	Year ended December 31, 2005	Year ended December 31, 2004
Sales price	34.49	26.07
Operating expenses	(9.43)	(8.30)
Operating netback*	25.06	17.77

* This is a non-GAAP measure of profitability

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2005, PetroFalcon had 77,631,407 issued and outstanding common shares and 86,627,601 common shares on a fully diluted basis. As at the end of the third quarter of 2005, PetroFalcon had 77,526,407 issued and outstanding common shares and 86,332,601 common shares on a fully diluted basis.

As of December 31, 2005, PetroFalcon had \$9.3 million in cash and short term deposits and a working capital surplus of \$10.3 million. As at December 31, 2005, PetroFalcon's total current debt was \$10 million and total long term debt was \$8 million. At September 30, 2005, PetroFalcon had \$15.10 million in cash and short term deposits, including \$1 million in restricted cash and a working capital surplus of \$14.5 million. At September 30, 2005, PetroFalcon had total current debt of \$3.9 million and a total long term debt of \$8 million.

As of December 31, 2005, PetroFalcon had \$14.4 million in accounts receivable of which \$3 million represents a value added taxes ("IVA") credit incurred as a result of the Corporation's investments during the period and \$7.39 million of which represents the return of the Corporation's original bid for the Castilletes Noreste II Block in the Rafael Urdaneta Phase B lease sale in the Gulf of Venezuela (the "Castilletes Block") which was returned in February 14, 2005. As at December 31, 2005, the Corporation had \$4.8 million in accounts payable of which \$0.8 million represents the accrued portion of capital expenditures not yet billed.

During the second quarter of 2005, the Corporation reached an agreement with the IFC, the private sector arm of the World Bank, pursuant to which the IFC will provide up to \$36 million in loans to Vinccler Venezuela for the development of the Corporation's oil and natural gas properties. During the second quarter of 2005, the IFC disbursed \$12 million from the "C" Loan. The disbursement of the remaining \$24 million (the "A" Loan) is subject to the completion of

certain technical tests. At December 31, 2005, the outstanding principal due to IFC was \$8 million after the conversion of \$4 million of loans into shares of PetroFalcon.

The planned growth and development activities for the next twelve months will require additional funds. Management of PetroFalcon anticipates that these funds will be obtained from cash flow from operations, lines of credit and the IFC loan facility. However, in the event that additional funds are required, the Corporation may determine that it is best to raise capital by way of debt or equity securities financing.

The Corporation conducts business in Venezuela and certain corporate and structural matters are subject to Venezuelan legislation and negotiations with governmental authorities, including the creation of an Empresa Mixta. There can be no certainty regarding the structure of the arrangements or outcome of the Empresa Mixta until negotiations have been finalized, documents have been drafted and the appropriate and necessary governmental approvals have been obtained.

SUMMARY OF QUARTERLY RESULTS

The following table sets forth selected consolidated financial information of PetroFalcon for the last eight quarters:

(\$000s, except per share amounts)	2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue	1,373	1,677	2,082	2,864	2,545	2,469	3,055	3,256
Net income (loss)	1,411	(455)	193	964	622	428	1,087	(1,128)
Earnings (loss) per share basic and diluted	0.03	(0.01)	0.00	0.01	0.01	0.01	0.01	(0.01)

Increased revenue occurred due to higher production levels: 328,367 boe in the year ended December 31, 2005 as compared to 306,720 boe in the year ended December 31, 2004, and higher average prices of \$34.49 per boe in the year ended December 31, 2005 as compared to \$26.07 per boe in the year ended December 31, 2004.

During the fourth quarter 2005, the Corporation recorded a loss of \$1.6 million due to the payment of the tax assessment to SENIAT.

CASH FLOW

PetroFalcon's contractual obligations, including payments due for the next five years are as follows:

	Payments Due by Period (\$000s)				
	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years	Total
Contractual Obligations					
Debt	10,081	0	0	8,000	18,081
Purchase Obligations for Capital Expenditures	800	0	0	0	800
Total Contractual Obligations	10,881	0	0	8,000	18,881

RELATED PARTY TRANSACTIONS

For the three months ended December 31, 2005 the Corporation paid \$210,000 (\$180,000 during the three months ended December 31, 2004) to Pacific Oil and Gas, LLC (“Pacific”), a Corporation controlled by PetroFalcon’s Chief Financial Officer, Clarence Cottman and the Corporation’s President, William Gumma, for professional services provided to PetroFalcon. For the year ended December 31, 2005 the Corporation paid \$840,000 (\$680,000 during the year ended December 31, 2004) to Pacific.

For the three months ended December 31, 2005, the Corporation incurred expenses of \$395,000 to Venezolana de Inversiones y Construcciones Clerico, C.A., an independent operating construction Corporation controlled by the Corporation’s Chairman of the Board and Chief Executive Officer, Juan Francisco Clerico. Vinccler Venezuela was invoiced \$1.84 million during the year ended December 31, 2005. The charges were for construction work at the La Vela central processing facility, as well as drilling locations and road repair.

On November, 26, 2005, Vinccler Venezuela received a short term loan for the amount of \$3,000,000 from its Chief Executive Officer. The purpose of the facility was to finance the bid for the Castilletes Block. On February 15, 2006, the short term loan received by Vinccler Venezuela from its Chief Executive Officer was fully re-paid.

BUSINESS CONDITIONS AND RISKS

As a result of all of the Corporation’s oil and natural gas properties being located in Venezuela, the Corporation is subject to political, economic and other uncertainties, including, but not limited to, changes, sometimes frequent, in legislation, energy policies or the personnel administering them, nationalization, expropriation of property without fair compensation, cancellation or modification of contract rights, foreign exchange restrictions, currency fluctuations, export quotas, royalty and tax increases and other risks arising out of foreign governmental sovereignty over the areas in which the Corporation’s operations are conducted, as well as risks of loss due to civil strife, acts of war, guerrilla activities and insurrections. The Corporation’s international operations may also be adversely affected by laws and policies of Canada affecting foreign trade, taxation and investment. In the event of a dispute arising in connection with its foreign operations, the Corporation may be subject to the exclusive jurisdiction of foreign courts or may not be successful in subjecting foreign persons to the jurisdiction of courts in Canada or enforcing Canadian judgments in foreign jurisdictions. In addition, the Corporation’s existing operating subsidiary is formed pursuant to, and its operations are governed by, a number of complex legal and contractual relationships. The effectiveness of and enforcement of such contracts and relationships with parties in these jurisdictions cannot be assured. Consequently, the Corporation’s foreign exploration, development and production activities could be substantially affected by factors beyond the Corporation’s control, any of which could have a material adverse effect on the Corporation.

The oil industry is central to and dominates the Venezuelan economy. The rate of economic growth, the level of tax revenues and the supply of foreign exchange in Venezuela are materially affected by oil prices and conditions in the international oil markets generally. A future downturn in international oil prices may have a material adverse effect on the Venezuelan economy which in turn is likely to have a material adverse effect on the Corporation.

The business of exploration, development and acquisition of oil and natural gas reserves involves a number of uncertainties and, as a result, PetroFalcon is exposed to a number of risks inherent in the oil and natural gas industry. Operationally, the Corporation faces technical risks that are associated with finding, developing and producing these oil and natural gas reserves. Additional risks include economic changes, legal and regulatory changes, changes to tax rates, environmental and safety concerns, as well as environmental and safety legislation, and access to processing facilities. In addition there are financial risks that are not within PetroFalcon's control, including fluctuations in commodity prices and interest rates.

PetroFalcon mitigates all these risks through the competence of the management team, adequate insurance coverage, and safety and environmental programs that meet or exceed regulations.

CONCLUSION REGARDING EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer and Chief Financial Officer of PetroFalcon have carried out an evaluation of the effectiveness of PetroFalcon's disclosure controls and procedures for the period ended December 31, 2005. Based on the evaluation conducted, the Chief Executive Officer and the Chief Financial Officer have concluded that the design and operation of PetroFalcon's disclosure controls and procedures were effective as at the end of the fiscal year ended December 31, 2005 to provide reasonable assurance that material information relating to PetroFalcon and its consolidated subsidiaries would be made known to the Chief Executive Officer and Chief Financial Officer by others within those entities in order to complete an analysis and review of the financial position and results of operations of PetroFalcon for the year ended December 31, 2005.

CRITICAL ACCOUNTING ESTIMATES

The Corporation makes assumptions in applying the following critical accounting estimates that are uncertain at the time the accounting estimate is made and may have a significant effect on the financial statements of the Corporation.

PROVED OIL AND NATURAL GAS RESERVES AND FULL COST ACCOUNTING

The Corporation follows the Canadian full cost method of accounting whereby all costs related to the exploration and development of oil and natural gas reserves are initially capitalized and are depleted and depreciated using the unit-of-production method based upon proved oil and natural gas reserves as determined by independent engineers. In applying the full cost method, the Corporation performs a cost recovery ceiling test that places a limit on the carrying value of property and equipment. The carrying value is considered recoverable when the fair value, calculated as the sum of the undiscounted value of future net revenues from proved reserves, the lower of cost and market of unproved properties and the cost of major development properties, exceeds the carrying value.

The amounts recorded for depletion and depreciation of exploration and development costs and the ceiling test are based on estimates of proved reserves, producing rates, future oil and natural gas prices and future costs, which are all subject to measurement uncertainties and various

interpretations. The Corporation expects that its estimates of reserves will be revised, upwards or downwards over time, based on future changes to those variables.

Reserve estimates can have a material impact on the depletion and depreciation expense and the carrying value of property and equipment. Revisions to reserves estimates could increase or decrease depletion and depreciation expense charged to net income and decrease in estimated reserves could result in a write-down of property and equipment based on the ceiling test.

ASSET RETIREMENT OBLIGATION

The Corporation recognizes the fair value of an asset retirement obligation with a corresponding amount capitalized to property and equipment. The liability increases and accretion expense is recognized each period due to the passage of time. The capitalized portion is depleted based on the unit-of-production method.

The asset retirement obligation is based on factors including current regulations, abandonment costs, technologies, industry standards and obligations in the Corporation's agreements. The fair value calculation takes into account estimated timing of abandonment, inflation and credit-adjusted risk free interest rate. Changes in any of the factors and revision to any of the estimates used in calculating the obligation may result in a material impact to the carrying value of property and equipment, asset retirement obligation and depletion expense charged to net income. The Corporation expects that its estimates of its asset retirement obligations will be revised, upwards or downwards over time, based on future changes to the factors and estimates involved.

STOCK-BASED COMPENSATION

The Corporation uses the fair value method of accounting for its stock-based compensation expense associated with its stock option plan. Compensation expense is based on the fair value of stock options at the grant date using the Black-Scholes option pricing model. The Black-Scholes model requires estimates for the expected volatility of the Corporation's stocks, a risk-free interest rate, expected dividends on the stock and expected life of the option. Changes in these estimates may result in the actual compensation expense being materially different than the compensation expense recognized; however, this expense is not subsequently adjusted for changes in these factors.

SUBSEQUENT EVENTS

On January 12, 2006 Vinccler Venezuela opened a line of credit with Banco Mercantil for Bs. 2 billion (\$1 million).

On November 15, 2005, Vinccler Venezuela was declared the winning bidder for the Castilletes Block. Due to circumstances beyond Vinccler Venezuela's control, exploration and exploitation activities may not be commenced in the Castilletes Block. On February 1, 2005, Vinccler Venezuela signed an agreement with the Ministry of Energy and Petroleum of the Bolivarian Republic of Venezuela ("MENPET") defining Vinccler Venezuela future rights and obligations regarding the Castilletes Block. The agreement states that, in consideration of Vinccler Venezuela waiving all claims for damages that may flow from the postponement of the start of exploration and exploitation activities in the Castilletes Block, MENPET agreed to initiate all

procedures with the Venezuelan national treasury to return the \$7,388,000 bid paid for the Castilletes Block and granted Vinccler Venezuela the exclusive right to exercise the option of commencing exploration and exploitation activities when circumstances permit by re-posting the bid amount. On February 14, 2006 Vinccler Venezuela was returned the full amount of the bid from MENPET.

Vinccler Venezuela completed the acquisition of WFSH, which is permitted pursuant to the terms of an operating service agreement entered into on November 17, 1994 with a predecessor of PDVSA, to produce oil and natural gas on the West Falcon Block which is immediately adjacent to the East Falcon Block and covers approximately 2 million acres. The acquisition was effective October 1, 2005 and the purchase price was \$2 million in cash and the issuance of 1.75 million common shares of PetroFalcon. Current production is approximately 450 boe/d. Vinccler Venezuela anticipates that the West Falcon operating service agreement will become a part of the Empresa Mixta which is presently being negotiated with PDVSA.

ADDITIONAL INFORMATION

Additional information regarding the Corporation, including its annual information form, reserves information and annual report may be found on SEDAR at www.sedar.com or by visiting www.petrofalcon.com.



PetroFalcon