



Building Value in Venezuela

MANAGEMENT DISCUSSION & ANALYSIS

THIRD QUARTER 2006

November 14, 2006

The following management discussion and analysis (“MD&A”), as provided by the management of PetroFalcon Corporation (“PetroFalcon” or the “Company”), should be read in conjunction with the Company's interim financial statements for the three and nine months ended September 30, 2006, and 2005, together with the 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 Company'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 the Venezuelan Bolivar (“Bs.”) are converted 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 the Empresa Mixta; 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 Company; 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 there from. 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.

CURRENT STATUS OF OPERATIONS OF PETROFALCON

PetroFalcon Corporation is engaged in the exploration, development, production and management of oil and natural gas properties through its indirect wholly-owned subsidiary, Vinccler Oil and Gas, C.A. (“Vinccler Venezuela”), which owns 40% of the joint venture (“Empresa Mixta”), PetroCumarebo, S.A. (“PetroCumarebo”). PetroFalcon’s revenues for the first three months ended March 31, 2006, were derived from the East Falcon Block under the Operating Service Agreement (“East Falcon OSA”) with Petróleos de Venezuela, S.A. (“PDVSA”), the state oil company of Venezuela. Effective March 21, 2006, Vinccler Venezuela completed the acquisition of West Falcon Hydrocarbons, S.R.L (“West Falcon”), a subsidiary of Samson International LLC, which owned a separate OSA for the West Falcon Block (“West Falcon OSA”).

On March 31, 2006, Vinccler Venezuela reached an initial agreement with the Venezuelan government with respect to its oil and natural gas rights in Venezuela. Vinccler Venezuela signed a Memorandum of Understanding (“MOU”) with PDVSA and its affiliated entity, Corporación Venezolana del Petróleo (“CVP”), to create the Empresa Mixta (later named PetroCumarebo), which would hold all operating rights to the East Falcon Block and West Falcon Block. The formation of the Empresa Mixta transfers Vinccler Venezuela’s interests in the East Falcon Block and West Falcon Block, covering more than 800,000 acres in northwestern Venezuela, into a single development entity, and it gives the Empresa Mixta the exclusive right to produce and sell oil and natural gas from the designated area of operations.

On September 29, 2006, Vinccler Venezuela and PDVSA/CVP executed the Empresa Mixta Conversion Agreement (“Conversion Contract”), which created PetroCumarebo and confirmed the ownership structure as 40% held by Vinccler Venezuela and 60% held by CVP. In accordance with the MOU, the Conversion Contract also established the following general terms for the Empresa Mixta:

- The effective date of PetroCumarebo is April 1, 2006;
- PetroCumarebo pays a royalty of 33.3% on oil and natural gas production;
- PetroCumarebo has an applicable income tax rate of 50%;
- PetroCumarebo will pay a “special advantage” tax, which requires that if in any year the aggregate amount of royalties, taxes and certain other contributions is less than 50% of the gross value of the hydrocarbons produced, PetroCumarebo must pay the Venezuelan government the difference;
- PetroCumarebo has the exclusive right to explore, develop and produce oil and natural gas in its area of operations (838,000 acres) for a term of 20 years;
- Vinccler Venezuela expects to receive dividends from PetroCumarebo in US dollars on a quarterly basis derived from its 40% participation; and

- Vinccler Venezuela will be responsible for 40% of PetroCumarebo's approved capital expenditure budget (currently \$40.7 million for 2006) and 40% of the operating expenses.

The Conversion Contract provides specific legal protections for the minority partner:

- Vinccler Venezuela has the right to nominate the Technical and Operations Manager;
- Certain matters require the approval of the ownership of at least 75% of the shares of PetroCumarebo;
- Each shareholder has the right to nominate a percentage of management personnel equal to its share ownership; and
- Budgets and work programs must be consistent with the business plan appended to the Conversion Contract as approved by Vinccler Venezuela and CVP.

Vinccler Venezuela has agreed with PDVSA to continue operating its oil and gas assets (the "East Falcon Block and West Falcon Block") during a transitional period starting April 1, 2006, until shortly after the incorporation of PetroCumarebo ("Transitional Period") under the following general terms:

- PDVSA is paying royalties on behalf of PetroCumarebo for oil and natural gas delivered from the East Falcon Block and West Falcon Block;
- Vinccler Venezuela is being reimbursed 100% by PDVSA for capital expenditures and operating expenses incurred on behalf of PetroCumarebo related to the East Falcon Block and West Falcon Block; and
- Vinccler Venezuela is delivering oil and natural gas production from the East Falcon Block and West Falcon Block on behalf of PetroCumarebo to PDVSA, which is expected to be invoiced by PetroCumarebo shortly after incorporation.

On October 24, 2006, PetroCumarebo was legally incorporated as the joint venture entity described in the Conversion Contract. As a result, Management has included Vinccler Venezuela's proportional share of PetroCumarebo's revenues and earnings in PetroFalcon's consolidated financial statements as of September 30, 2006. **Note that PetroFalcon's financial statements for the third quarter of 2006 include Vinccler Venezuela's share of PetroCumarebo during six months of pre-incorporation operations (April 1 to September 30, 2006). Therefore, PetroFalcon's results for the three months ended September 30, 2006, are not comparable to previous three-month periods.**

As of November 14, 2006, Vinccler Venezuela has been reimbursed by PDVSA for the operating and capital expenditures made on behalf of PetroCumarebo in the second and third quarters of 2006. **While PDVSA has paid the royalties, operating and capital expenditures during the second and third quarters of 2006, it is possible that PetroCumarebo's revenue and accounts receivable for this period under the terms of the Conversion Contract may not be paid by PDVSA.**

The following table is a comparison of the current Conversion Contract terms and the former terms of the East Falcon OSA and West Falcon OSA (collectively “the OSAs”). Although PetroFalcon, through Vinccler Venezuela, is now only a 40% owner of PetroCumarebo, PetroFalcon is benefiting from a significant extension on the life of the former OSA contracts, as well as a near-market oil price (approximately 100% of WTI for East Falcon and 85% of WTI for West Falcon) for the duration of PetroCumarebo’s contract.

	PetroCumarebo*	West Falcon OSA	East Falcon OSA
PetroFalcon Equity Stake	40%	100%	100%
Contract Expiration	2026	2015	2015
Oil Price (% of WTI)	85-100% (est.)	65%**	61-67%**
Gas Price (\$/mcf)	\$1.50	7% of oil price	\$1.33
Royalty	33.3%	0%	0%
Income Tax Rate	50%	50%	50%

*PetroCumarebo’s Conversion Contract also includes a “special advantage” tax, which requires that if in any year the aggregate amount of royalties, taxes and certain other contributions is less than 50% of the gross value of the hydrocarbons produced, PetroCumarebo must pay the Venezuelan government the difference.

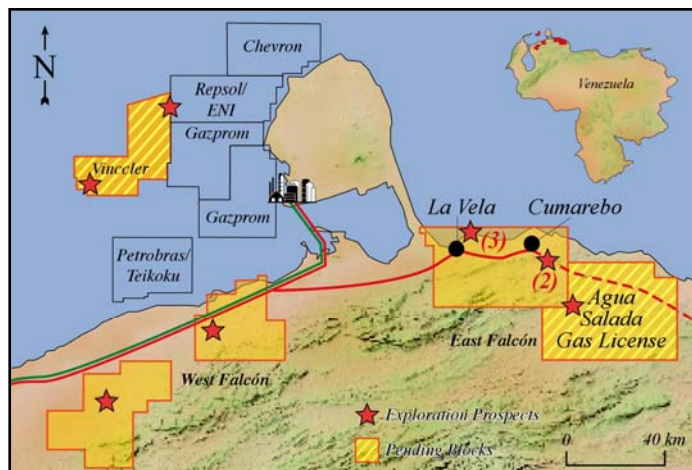
**Note that the oil price received would have decreased dramatically under the OSAs after the recovery of capital and interest.

PRODUCTION AND REVENUE

Please see “Current Status of Operations of PetroFalcon”.

For the three months ended September 30, 2006, PetroCumarebo’s average gross production from both the East Falcon Block and the West Falcon Block was 2,194 boe/d. PetroFalcon’s 40% share before royalties was 878 boe/d.

It is expected that oil and natural gas production will continue increasing during the remainder of 2006 and 2007 from the La Vela and Cumarebo fields through development drilling, the completion of the new production facility at Cumarebo and future development in the West Falcon Block.



EAST FALCON BLOCK

For the three months ended September 30, 2006, PetroCumarebo’s average gross production from the East Falcon Block was 1,823 boe/d. PetroFalcon’s 40% share before royalties was 729 boe/d. For the comparable period ended September 30, 2005, PetroFalcon’s average production was 826 bbls/d of oil.

At September 30, 2006, the East Falcon Block had 12 producing oil wells, 3 shut-in oil wells, 2 producing natural gas wells and 2 shut-in natural gas wells.

WEST FALCON BLOCK

Effective March 21, 2006, Vinccler Venezuela completed the acquisition of West Falcon, which owned a separate OSA for the West Falcon Block. The West Falcon OSA was converted pursuant to the Conversion Contract, and it is now owned by PetroCumarebo.

For the three months ended September 30, 2006, PetroCumarebo's average gross production from the West Falcon Block was 371 boe/d. PetroFalcon's 40% share before royalties was 148 boe/d.

At September 30, 2006, the West Falcon Block had 14 producing oil wells, 9 shut-in oil wells, 4 producing natural gas wells and no shut-in gas wells.

REVENUES

	PetroCumarebo (Gross)		PetroFalcon (Net)		PetroFalcon (Reported)	
	Q2'06	Q3'06	Q2'06	Q3'06	Three months ended Sept 30, 2006	Three months ended Sept 30, 2005
Daily production/sales*						
Oil - bbls/d	1,025	1,073	410	429	NA	826
Natural gas - mcf/d	2,760	6,727	1,104	2,691	NA	-
Total - boe/d	1,485	2,194	594	878	NA	826
Product pricing (\$)*						
Oil - per bbl	67.29	67.76	67.29	67.76	NA	40.20
Natural gas - per mcf	1.50	1.50	1.50	1.50	NA	-
Revenue per boe	49.23	37.74	49.23	37.74	NA	40.20
Total Revenues (\$000s)	6,651	7,618	2,660	3,047	5,707	3,055

*Production before royalties. PetroFalcon, through Vinccler Venezuela, has a 40% ownership stake in PetroCumarebo. PetroCumarebo's oil price is based on the formula in the Conversion Contract where, on average, East Falcon oil receives 100% of WTI and West Falcon oil receives 85% of WTI. Under the East Falcon OSA in the comparable period, PetroFalcon, through Vinccler Venezuela, received 61-67% of WTI for its oil production.

PetroFalcon reported revenue before royalties of \$5.7 million for the three months ended September 30, 2006. This revenue is derived from PetroFalcon's 40% share of PetroCumarebo's revenues between April 1, 2006, and September 30, 2006. PetroFalcon's reported revenue is therefore the sum of 40% of PetroCumarebo's revenues in the second and third quarters of 2006, as detailed in the table above. Since PetroFalcon's reported revenue for the three months ended September 30, 2006, is actually from six months of operations, it is not comparable to previous three-month periods.

PetroCumarebo's actual gross revenues from the East Falcon Block and West Falcon Block for the three months ended September 30, 2006 were \$7.6 million. PetroFalcon's 40% share before

royalties was \$3.1 million, compared to PetroFalcon's \$3.1 million in revenues for the three months ended September 30, 2005. The average price received by PetroCumarebo for the three months ended September 30, 2006, was \$67.76 per barrel of oil and \$1.50 per mcf of natural gas. The combined average price received for the three months ended September 30, 2006, was \$37.74 per boe. For the three months ended September 30, 2005, the average price received by PetroFalcon was \$40.20 per barrel of oil. The gas produced during the comparable time period ended September 30, 2005, was used only for operations, including fuel and gas lift.

PetroFalcon's increase in revenue during the three months ended September 30, 2006, occurred due to higher levels of production on a boe basis; 80,745 boe net to Vinccler Venezuela before royalties for the three months ended September 30, 2006, as compared to 75,996 boe for the three months ended September 30, 2005, as well as higher average oil prices, \$67.76 per barrel of oil for the three months ended September 30, 2006, as compared to \$40.20 per barrel of oil for the three months ended September 30, 2005. Note that natural gas production more than doubled between the second and the third quarters of 2006 due to the expansion and tie-in to PDVSA's Interconnection Centro Occidente ("ICO") natural gas pipeline at the Cumarebo Field in early August.

PetroFalcon's revenues before royalties from the East Falcon Block and West Falcon Block for the nine months ended September 30, 2006 were \$8.8 million, compared to \$8.1 million in revenues for the nine months ended September 30, 2005. The average price received by PetroFalcon for the nine months ended September 30, 2006, was \$48.91 per barrel of oil and \$1.44 per mcf of natural gas. The combined average price received for the nine months ended September 30, 2006, was \$30.98 per boe. For the nine months ended September 30, 2005, the average price received by PetroFalcon was \$34.77 per barrel of oil. The gas produced during the comparable time period ended September 30, 2005, was used only for operations, including fuel and gas lift.

PetroFalcon's increase in revenue during the nine months ended September 30, 2006, occurred due to higher levels of production on a boe basis; 241,184 boe net to Vinccler Venezuela before royalties for the nine months ended September 30, 2006, as compared to 232,079 boe for the nine months ended September 30, 2005, as well as higher average oil prices, \$48.91 per barrel of oil for the nine months ended September 30, 2006, as compared to \$34.77 per barrel of oil for the nine months ended September 30, 2005.

Oil and natural gas production is delivered to PDVSA, and it is expected that PetroCumarebo will receive payment before the end of 2006 for the production delivered during the six pre-incorporation months ended September 30, 2006, as outlined in the Conversion Contract. The price per barrel of crude oil delivered is derived from a detailed formula outlined in the Conversion Contract. The formula is specific to quality and gravity of crude oil delivered, and it is based on different weightings of several global benchmark oil prices. Using historical oil price data, Management estimates this formula to equate on average to a price that will be approximately 100% of WTI for East Falcon oil and 85% of WTI for West Falcon oil. Both East and West Falcon produce light sweet crude that sells at a premium to most of the oil produced in Venezuela.

Payment from PDVSA under the OSAs was 75% in US Dollars and 25% in Bolivars. Payment from PDVSA to PetroCumarebo will be 100% in US Dollars for crude oil and 100% in Bolivars

for natural gas. The price received for natural gas is pegged to a US Dollar amount of \$1.50 per mcf (at the official fixed exchange rate, with an adjustment for inflation over time). Dividends from PetroCumarebo to Vinccler Venezuela will be 100% in US Dollars.

ROYALTIES

The Company's share of royalties during the three months ended September 30, 2006, was \$1,902,293 (40% of PetroCumarebo's royalties for the six months of revenue being reported). Royalties are calculated as 33.3% of gross revenues. The Company's production was not subject to royalties for the oil and gas production delivered under the East Falcon OSA during the comparable period ended September 30, 2005.

Under the terms of the Conversion Contract, PetroCumarebo is subject to a "special advantage" tax, which requires that if in any year the aggregate amount of royalties, taxes and certain other contributions is less than 50% of the gross value of the hydrocarbons produced, PetroCumarebo must pay the Venezuelan government the difference. In the three months ended September 31, 2006, this amount equalled \$348,992 for Vinccler Venezuela (40% of PetroCumarebo).

OPERATING EXPENSES

(\$000s except boe amount)	Three months ended September 30, 2006	Three months ended September 30, 2005
Operating Expenses (including maintenance and transportation)	1,835	805
Average expense (\$ per boe)*	13.61	10.59

(\$000s except boe amount)	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Operating Expenses (including maintenance and transportation)	2,975	2,112
Average expense (\$ per boe)*	12.34	9.10

*Note that the "per boe" number for the three months ended September 30, 2006, is calculated based on PetroFalcon's net production from PetroCumarebo's first six months of operations (for a net total of 134,786 boe). The "per boe" number for the nine months ended September 30, 2006, includes three months under the East Falcon OSA (for a net total of 241,184 boe).

Please see "Current Status of Operations of PetroFalcon".

PetroFalcon's operating expenses during the three months ended September 30, 2006, were \$1,834,530 (40% of PetroCumarebo plus other operating expenses outside of PetroCumarebo). Operating expenses for the three months ended September 30, 2005, were \$804,754. For the nine months ended September 30, 2006, PetroFalcon's operating expenses were \$2,975,477 (as

40% of PetroCumarebo plus three months under the East Falcon OSA), compared to \$2,111,880 in the same period ended September 30, 2005. Operating expenses during the previous period were incurred in accordance with the Company's East Falcon OSA and are not be comparable to this period's recorded expenses.

GENERAL AND ADMINISTRATIVE ("G&A") EXPENSES

(\$000s except boe amount)	Three months ended September 30, 2006	Three months ended September 30, 2005
Expenses	470	703
Average expense (\$ per boe)*	3.49	9.25

(\$000s except boe amount)	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Expenses	1,835	2,538
Average expense (\$ per boe)*	7.61	10.94

*Note that the "per boe" number for the three months ended September 30, 2006, is calculated based on PetroFalcon's net production from PetroCumarebo's first six months of operations (for a net total of 134,786 boe). The "per boe" number for the nine months ended September 30, 2006, includes three months under the East Falcon OSA (for a net total of 241,184 boe).

Please see "Current Status of Operations of PetroFalcon".

PetroFalcon's general and administrative expenses were \$470,405 (40% of PetroCumarebo's G&A, plus 100% of PetroFalcon's corporate G&A) during the three months ended September 30, 2006, as compared to \$703,063 during the three months ended September 30, 2005. During the nine months ended September 30, 2006, PetroFalcon's general and administrative expenses were \$1,834,976 (40% of PetroCumarebo's G&A, plus other corporate G&A and one quarter under the East Falcon OSA), compared to \$2,538,468 for the same period in 2005. General and administrative expenses during the previous periods were incurred in accordance with the Company's East Falcon OSA and are not comparable to this period's recorded expenses.

During the three months ended September 30, 2006, the National Integrated Customs and Tax Administration Service ("SENIAT"), the Venezuelan tax authorities, reviewed the Value Added Tax (VAT) payments for services received during the fiscal years 2003 and 2004, resulting in a penalty for Vinccler Venezuela of approximately \$140,000. Management does not expect to receive any penalties for VAT payments during the fiscal years 2005 or 2006.

PetroFalcon does not capitalize general and administrative expenses.

AMORTIZATION, DEPLETION AND ACCRETION (“AD&A”)

(\$000s except boe amount)	Three months ended September 30, 2006	Three months ended September 30, 2005
Amortization, Depletion and Accretion	1,011	362
Depletion Rate (\$ per boe)*	7.50	4.77

(\$000s except boe amount)	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Amortization, Depletion and Accretion	1,607	1,157
Depletion Rate (\$ per boe)*	6.66	4.98

*Note that the “per boe” number for the three months ended September 30, 2006, is calculated based on PetroFalcon’s net production from PetroCumarebo’s first six months of operations (for a net total of 134,786 boe). The “per boe” number for the nine months ended September 30, 2006, includes three months under the East Falcon OSA (for a net total of 241,184 boe).

Please see “Current Status of Operations of PetroFalcon”.

For the three months ended September 30, 2006, PetroFalcon’s AD&A was \$1,011,447 (40% of PetroCumarebo) as compared to \$362,349 for the three months ended September 30, 2005. AD&A for the nine months ended September 30, 2006, was \$1,606,833 (40% of PetroCumarebo plus three months under the East Falcon OSA), compared to \$1,156,606 for the same period ended September 30, 2005. AD&A during the previous periods was incurred in accordance with the Company’s East Falcon OSA and is not comparable to this period’s AD&A.

INTEREST INCOME AND EXPENSE

At September 30, 2006, PetroFalcon had \$11.1 million in cash and short-term deposits compared to \$14.1 million at September 30, 2005. During the three months ended September 30, 2006, the Company recorded interest income in the amount of \$94,148 as compared to \$57,910 during the three months ended September 30, 2005. Interest income was \$203,875 during the nine months ended September 30, 2006, compared to \$212,774 in the nine months ended September 30, 2005.

PetroFalcon incurred interest expense of \$430,846 during the three months ended September 30, 2006, as compared to \$286,887 during the three months ended September 30, 2005. Interest expense was \$1,718,896 during the nine months ended September 30, 2006, compared to \$547,978 in the nine months ended September 30, 2005. The increase in interest expense in the three and nine months ended September 30, 2006, is detailed below:

- (i) Accrual of additional interest payable to the International Finance Corporation (“IFC”) of \$16,339 during the three months ended September 30, 2006, based

on 3% of Vinccler Venezuela's estimated earnings before interest, depreciation, amortization and exploration costs;

- (ii) Interest of \$86,480 during the three months ended September 30, 2006, or \$301,292 during the nine months ended September 30, 2006, under the IFC long-term borrowing facility;
- (iii) Increased interest of \$327,988 (\$131,441 paid and \$196,547 accrued) during the three months ended September 30, 2006, paid to local banks due to higher average short-term debt of \$11.8 million as of September 30, 2006, versus \$3.9 million as of September 30, 2005. Total interest paid to local banks during the nine months ended September 30, 2006, was \$1.0 million; and
- (iv) An additional \$236,977 of interest paid by Vinccler Venezuela for the Venezuelan Tax Assessment during the first quarter 2006.

STOCK-BASED COMPENSATION

During the three months ended September 30, 2006, the Company recorded \$612,603 in stock-based compensation expense as compared to \$526,000 during the three months ended September 30, 2005. The Company recorded \$1,889,752 in stock-based compensation expense for the nine months ended September 30, 2006, compared to \$1,423,000 for the same period ended September 30, 2005. Higher stock-based compensation during the three months ended September 30, 2006, was due to a greater number of stock options outstanding during the three months ended September 30, 2006; 10,256,494 options were outstanding at September 30, 2006, as compared to 8,706,194 options outstanding at September 30, 2005.

INCOME TAXES

(\$000s)	Three months ended September 30, 2006	Three months ended September 30, 2005
Consolidated Current Income Tax Expense	(616)	(200)

(\$000s)	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Consolidated Current Income Tax Expense	(1,158)	(634)

During the three months ended September 30, 2006, PetroFalcon recorded a current income tax expense of \$616,028 (40% of PetroCumarebo), compared to \$200,000 during the three months ended September 30, 2005. During the nine months ended September 30, 2006, PetroFalcon recorded a current income tax expense of \$1,158,417, compared to \$634,148 during the nine months ended September 30, 2005.

During the three months ended September 30, 2006, the SENIAT performed a review of Vinccler Venezuela's income tax expense for the fiscal year ended December 31, 2005. The review concluded that no amounts were payable to the SENIAT.

ANALYSIS OF CAPITAL EXPENDITURES

Please see "Current Status of Operations of PetroFalcon".

The following table outlines PetroCumarebo's capital budget for the year ended December 31, 2006, and expenditures for the nine months ended September 30, 2006. The PetroCumarebo 2006 Budget represents the gross budget of the Empresa Mixta, of which Vinccler Venezuela is responsible for 40%. The Incurred As of September 30, 2006, amount represents the total amount spent by Vinccler Venezuela in the three months ended March 31, 2006, and by Vinccler Venezuela on behalf of PetroCumarebo for the six months ended September 30, 2006. Vinccler Venezuela has advanced capital on behalf of PetroCumarebo with subsequent reimbursements from PDVSA expected to continue in the fourth quarter of 2006 under the Transitional Period terms. Additional financing will be needed to meet the following budget requirements in 2007, but funding may not be available on terms and conditions acceptable to the Company.

(\$000s)	PetroCumarebo 2006 Budget*	PetroFalcon 40% Share	Incurred As of Sept 30,'06 (Gross)
Drilling and Workovers			
- La Vela	20,261	8,104	139
- Cumarebo	5,332	2,133	30
- West Falcon	2,533	1,013	-
- Total Drilling and Workovers	28,126	11,250	169
Processing Facilities and Infrastructure			
- La Vela	4,948	1,979	1,756
- Cumarebo	4,310	1,724	1,983
- West Falcon	3,300	1,320	-
- Total Central Processing Facilities	12,558	5,023	3,739
Total Capital Budget	40,684	16,274	3,908

*Due to the delay in the incorporation of the joint venture, PetroCumarebo will not be able to spend its complete 2006 capital budget. Management expects the PetroCumarebo 2006 capital budget to be pushed into 2007.

Despite the transitional uncertainty, Vinccler Venezuela (on behalf of PetroCumarebo) has continued with a comprehensive development and exploitation program designed to increase natural gas and oil reserves, production, earnings, cash flow and net asset value.

PROCESSING FACILITIES AND INFRASTRUCTURE

During the three months ended September 30, 2006, Vinccler Venezuela (on behalf of PetroCumarebo) continued the construction of the second phase of facilities at the La Vela Field. These facilities will include compression and dew point processing equipment allowing PetroCumarebo to produce natural gas from various proven reservoirs for up to 20 MMcf/d of natural gas and 1,700 bbls/d of oil. At the Cumarebo Field, Vinccler Venezuela (on behalf of PetroCumarebo) continued expansion and upgrades of existing facilities designed to process 30 MMcf/d of natural gas and 5,000 bbls/d of oil. The expansion and tie-in to PDVSA's ICO pipeline at the Cumarebo Field was completed in early August, resulting in initial additional hydrocarbons production from the Cumarebo field of 10 MMcf/d of natural gas and 285 bbls/d of associated oil. At the West Falcon Block, PetroCumarebo plans to begin development of the previously discovered Los Moroches field.

DRILLING AND WORKOVERS

Before the end of 2006, PetroCumarebo intends to mobilize a drilling rig in the East Falcon Block to commence a development and exploratory drilling program. PetroCumarebo is currently permitting and building locations for 11 wells at the La Vela Field to develop the shallow oil and natural gas discovery in 2005 offsetting the LV-10 well. Vinccler Venezuela (on behalf of PetroCumarebo) has already permitted and built locations for a development well and an appraisal well at the Cumarebo Field. In West Falcon, PetroCumarebo is also planning a long-term test of an apparent oil and gas discovery at Los Moroches drilled in 1995 by the previous operator.

Continued re-processing and mapping of the 85-kilometer 2-D seismic program acquired by Vinccler Venezuela in 2005 has delineated several new structural prospects in the area around Cumarebo. These prospects, along with PetroCumarebo's existing prospect portfolio, will be prioritized, permitted and slated for drilling in late 2006 and throughout 2007.

Due to the delay in the incorporation of the joint venture, PetroCumarebo will not be able to spend its complete 2006 capital budget. Management expects the PetroCumarebo 2006 capital budget to be pushed into 2007. The completion of PetroCumarebo's rolling 12-month capital budget of US\$40.7 million is estimated to significantly increase production for the East Falcon Block and West Falcon Block above the present gross level of approximately 3,200 boe/d (40% net to Vinccler Venezuela).

CASH FLOW FROM OPERATIONS*

(\$000s except per share data)	Three months ended September 30, 2006	Three months ended September 30, 2005
Cash flow from operations	774	2,175
Per basic share	0.01	0.03
Net (loss) income	(1,313)	1,087
Per basic share	(0.02)	0.01
Working capital	6,489	14,524

* This is a non-GAAP measure of profitability

(\$000s except per share data)	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Cash flow from operations	(268)	4,917
Per basic share	(0.00)	0.06
Net (loss) income	(4,194)	2,137
Per basic share	(0.05)	0.03

* This is a non-GAAP measure of profitability

Please see “Current Status of Operations of PetroFalcon”.

OPERATING NETBACK *

(\$ per boe)	Three months ended September 30, 2006	Three months ended September 30, 2005
Sales price	37.74	40.20
Operating expenses	(13.61)	(10.59)
Operating netback*	24.13	29.61

* This is a non-GAAP measure of profitability

(\$ per boe)	Nine months ended September 30, 2006	Nine months ended September 30, 2005
Sales price	30.98	34.77
Operating expenses	(12.34)	(9.10)
Operating netback*	18.64	25.67

* This is a non-GAAP measure of profitability

*Note that the “per boe” number for the three months ended September 30, 2006, is calculated based on PetroFalcon’s net production from PetroCumarebo’s first six months of operations (for a net total of 134,786 boe). The “per boe” number for the nine months ended September 30, 2006, includes three months under the East Falcon OSA (for a net total of 241,184 boe).

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2006, PetroFalcon had 82,170,758 issued and outstanding common shares and 92,527,252 common shares on a fully diluted basis. As of June 30, 2006, PetroFalcon had 82,150,758 issued and outstanding common shares and 92,542,252 common shares on a fully diluted basis.

As of September 30, 2006, PetroFalcon had \$11.1 million in cash and short-term deposits and working capital of \$6.5 million. As of September 30, 2006, PetroFalcon’s total short-term debt was \$11.8 million and total long-term debt was \$4 million. At June 30, 2006, PetroFalcon had \$11.0 million in cash and short-term deposits and working capital of \$8.7 million. At June 30, 2006, PetroFalcon had total current debt of \$10.1 million and total long-term debt of \$4 million.

At September 30, 2006, PetroFalcon had \$14.5 million in accounts receivable (compared to \$7.3 million at June 30, 2006). Vinccler Venezuela will continue to pay 100% of the operating expenses and capital investments for the East Falcon Block and West Falcon Block, with subsequent reimbursements expected from PDVSA. As of September 30, 2006, the Company had \$9.3 million in accounts payable compared to \$2.4 million at June 30, 2006. The large increase in accounts payable is because the Company has been reimbursed for 100% of the operating and capital expenditures made on behalf of PetroCumarebo during the second and third quarters of 2006. As a result, Vinccler Venezuela, through PetroCumarebo, now owes 40% of

these costs back to PDVSA, plus 40% of PetroCumarebo's royalties for the second and third quarters of 2006.

During 2005, the Company reached an agreement with the IFC, pursuant to which the IFC will provide up to \$36 million in two loans ("A" and "C") to Vinccler Venezuela for the development of the Company's 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 is payable semi-annually on May 15 and November 15 at the London Inter Bank Offered Rate ("Libor") plus 1% for the "C" Loan from September 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 as Additional Interest as long as it does not exceed 10% per annum of the principal amount of the "C" loan on an aggregate accumulated basis.

On April 5, 2006, the IFC provided notice pursuant to the terms of the "C" Loan Agreement of its intention to convert \$4 million of its outstanding loan into common shares of PetroFalcon Corporation. The IFC received 2,639,651 shares at an average price of CDN \$1.77 per share based on the market-weighted average share price over the previous 20 trading days to the notice date. The IFC has now converted \$8 million of the original \$12 million disbursed in 2005 into common shares of PetroFalcon Corporation. With this conversion, the remaining outstanding principal due to IFC is \$4 million.

On October 12, 2006, Vinccler Venezuela gave 30-day notice to the IFC in order to cancel the "A" Loan option, effective November 11, 2006.

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 lines of credit and PetroCumarebo dividends. However, in the event that additional funds are required, the Company may determine that it is best to raise capital by way of debt or equity securities financing. The Company cannot be certain that capital will be available when needed.

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			2006		
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Revenue	2,864	2,545	2,469	3,055	3,256	3,129	NA	5,707
Net income (loss)	964	622	428	1,087	(1,128)	(1,181)	(1,700)	(1,313)
Earnings (loss) per share basic and diluted	0.01	0.01	0.01	0.01	(0.01)	(0.02)	(0.02)	(0.02)

Under the Transitional Period terms, PetroFalcon did not recognize revenue from the Empresa Mixta in the three months ended June 30, 2006.

RELATED PARTY TRANSACTIONS

Pacific Oil and Gas, LLC and Venezolana de Inversiones y Construcciones Clerico, C.A. are controlled by officers of PetroFalcon. For the three months ended September 30, 2006, the Company paid Pacific Oil and Gas, LLC, controlled by PetroFalcon's Chief Financial Officer, Clarence Cottman and PetroFalcon's President, William Gumma, \$210,000 for professional services, compared to \$210,000 for the three months ended September 30, 2005. For the nine months ended September 30, 2006, PetroFalcon paid to Pacific Oil and Gas, LLC, \$630,000, compared to \$630,000 for the nine months ended September 30, 2005. These payments for professional services include the salaries of Mr. Clerico, Mr. Cottman and Mr. Gumma, as well as the operating expenses for PetroFalcon's technical office in Carpinteria, California.

PetroFalcon also receives construction services provided by Venezolana de Inversiones y Construcciones Clerico, C.A., an independent operating construction company controlled by the Company's Chairman of the Board and Chief Executive Officer, Juan Francisco Clerico. During the three months ended September 30, 2006, PetroFalcon did not receive services from Venezolana de Inversiones y Construcciones Clerico, C.A. (compared to \$261,858 during the three months ended September 30, 2005). During the nine months ended September 30, 2006, the Company was invoiced \$11,669 for construction services (\$1.18 million for the nine months ended September 30, 2005). On August 25, 2006, Venezolana de Inversiones y Construcciones Clerico, C.A. paid on behalf of Vinccler Venezuela the amount of \$350,000 to purchase the data package for the Delta Caribe offshore natural gas bid process in Venezuela. This amount has not been repaid as of September 30, 2006.

These related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

CRITICAL ACCOUNTING ESTIMATES

The Company 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 Company.

PROVED OIL AND NATURAL GAS RESERVES AND FULL COST ACCOUNTING

The Company 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 Company 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 Company 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 a decrease in estimated reserves could result in a write-down of property and equipment based on the ceiling test.

ASSET RETIREMENT OBLIGATION

The Company recognizes its proportional share of 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 PetroCumarebo's agreements. The fair value calculation takes into account estimated timing of abandonment, inflation and the 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 Company 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 Company 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 Company'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.

EMPRESA MIXTA

PetroCumarebo's Conversion Contract indicates that both parties agree to contractually share the continuing power to determine its strategic operating, investing and financing policies. When accounting for Vinccler Venezuela's interests in PetroCumarebo, it is essential that the Company reflects the substance and underlying economic reality of its interest. Management believes that, based on the terms established in the Conversion Contract, there is joint control of PetroCumarebo, and PetroFalcon therefore reports its interest in the assets, liabilities, revenue and expenses of PetroCumarebo using the proportional consolidation method.

During the second and third quarters of 2006, Vinccler Venezuela delivered oil and natural gas to PDVSA on behalf of PetroCumarebo. The Conversion Contract provides formulae to price deliveries of crude oil and natural gas. In accordance with the terms of the Conversion Contract, PetroFalcon's share of PetroCumarebo's revenues and accounts receivable, being \$5,707,450, have been recorded for the period April 1, 2006, to September 30, 2006. As of November 14, 2006, no cash has been received by PetroCumarebo from PDVSA related to this revenue. While PDVSA has paid the royalties, operating and capital expenditures for this period, it is possible that the amounts receivable under the terms of the Conversion Contract may not be paid by PDVSA.

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 September 30, 2006. Based on the evaluation conducted, the Chief Executive Officer and 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 period ended September 30, 2006, 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 quarter ended September 30, 2006.

SUBSEQUENT EVENTS

On October 24, 2006, the Empresa Mixta, PetoCumarebo, S.A., was legally incorporated with 40% held by Vinccler Venezuela and 60% held by CVP.

Effective October 30, 2006, PetroFalcon's indirect wholly-owned subsidiary, West Falcon Hydrocarbons, S.R.L, was merged into Vinccler Venezuela, and West Falcon Hydrocarbons, S.R.L ceased to exist.

On November 1, 2006, PetroFalcon received a final settlement payment from previous shareholders for CDN \$450,000 relating to funds advanced to previous senior management for a residence and property purchased in the Czech Republic and repaid in accordance with a settlement agreement.

ADDITIONAL INFORMATION

Additional information regarding the Company, 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.