



Building Value in Venezuela

MANAGEMENT DISCUSSION & ANALYSIS

YEAR ENDED DECEMBER 31, 2006

March 30, 2007

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 audited consolidated financial statements for the years ended December 31, 2006, and December 31, 2005. 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 where 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 (“USD”). Transactions and balances using Venezuelan Bolivars (“Bs”) are converted into US dollars using the temporal method at the official exchange rate (currently 2,150 Bs/USD).

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 (“mcf”) 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; being a minority partner in an Empresa Mixta; being dependent on dividends from an Empresa Mixta; the imposition of higher 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 2007 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 company (“Empresa Mixta”), PetroCumarebo, S.A. (“PetroCumarebo”). Subject to an assignment agreement, a joint operating agreement and approval by the Venezuelan Ministry of Energy and Petroleum (“MEP”), Vinccler Venezuela is also acquiring a 30% interest in the offshore natural gas license for the Cardon III Block (“Cardon III”) in the Gulf of Venezuela.

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-owned oil and gas 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 Operating Service Agreement for the West Falcon Block (“West Falcon OSA”). PetroFalcon’s revenues for the nine months ended December 31, 2006, were derived from Vinccler Venezuela’s proportional share of PetroCumarebo’s revenues.

Empresa Mixta Creation

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 Corporación Venezolana del Petróleo (“CVP”), an affiliate of PDVSA, to create an Empresa Mixta, later incorporated as PetroCumarebo, which would hold all the operating rights to the East Falcon Block and West Falcon Block.

PetroCumarebo Conversion Contract

On September 29, 2006, Vinccler Venezuela and CVP executed the Empresa Mixta Conversion Agreement (“Conversion Contract”), which identified 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 has the exclusive right to explore for, develop and produce oil and natural gas in its area of operations (838,000 acres) for a term of 20 years;
- PetroCumarebo can only sell its oil and natural gas production to PDVSA;
- PetroCumarebo pays a royalty of 33.3% on oil and natural gas production;
- PetroCumarebo has an applicable income tax rate of 50%;

- PetroCumarebo pays 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;
- When there are sufficient net and available profits, and subject to the prior approval of the shareholders, Vinccler Venezuela may receive annual dividends in US dollars, or quarterly loans against those projected dividends, derived from its 40% participation; and
- Vinccler Venezuela, as a 40% shareholder, will be responsible for 40% of PetroCumarebo’s capital expenditures and operating expenses, if no other means of financing is available.

PetroCumarebo Joint Control

The Conversion Contract provides specific legal protections for Vinccler Venezuela as 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.

PetroCumarebo Transitional Period

Vinccler Venezuela agreed with PDVSA to continue operating its oil and gas assets (the “East Falcon Block and West Falcon Block”) during a transitional period between April 1, 2006, and December 31, 2006, (“Transitional Period”) under the following general terms:

- PDVSA paid royalties on behalf of PetroCumarebo for oil and natural gas delivered from the East Falcon Block and West Falcon Block;
- Vinccler Venezuela was reimbursed by PDVSA for 100% of capital expenditures and operating expenses incurred by Vinccler Venezuela on behalf of PetroCumarebo related to the East Falcon Block and West Falcon Block; and
- Vinccler Venezuela delivered oil and natural gas production from the East Falcon Block and West Falcon Block on behalf of PetroCumarebo to PDVSA, which will be invoiced later by PetroCumarebo.

On October 24, 2006, PetroCumarebo, S.A. was legally incorporated as the joint venture entity described in the Conversion Contract. On November 24, 2006, PetroCumarebo received the

presidential transfer decree to operate the East Falcon Block and West Falcon Block, the ceremonial last step in the conversion from the East Falcon OSA and West Falcon OSA to PetroCumarebo. On December 28, 2006, as required by the Conversion Contract, Vinccler Venezuela contributed its 40% share of PetroCumarebo's first month of working capital, a total of approximately \$2.1 million (\$200,000 USD and 4.1 billion Bs). As a result of the conversion to PetroCumarebo, Management has included Vinccler Venezuela's proportional share of PetroCumarebo's revenues and earnings in PetroFalcon's consolidated financial statements as of December 31, 2006.

PetroCumarebo Dividends

Under Venezuelan law, dividends can only be declared to the extent a company has net and available profits as stated in a company's approved financial statements. Therefore, if there are sufficient net and available profits, subject to the prior approval of the shareholders, PetroFalcon, through Vinccler Venezuela, may receive annual dividends in US dollars, or quarterly loans against those projected dividends. If PetroCumarebo's board of directors does not propose dividends, or PetroCumarebo's shareholders do not approve dividends, or PetroCumarebo does not have net and available profits to declare dividends, Vinccler Venezuela cannot expect to receive payment from PetroCumarebo. Dividends from PetroCumarebo must be proposed by four out of the five board members (80%), and Vinccler Venezuela only has two out of the five board seats (40%). Dividends proposed by the board are approved by a qualified majority (75%) of the shareholders, and Vinccler Venezuela only accounts for 40% of the shareholders. Given PetroCumarebo's large non-cash charges for depreciation and the resulting losses reported in its financial statements, PetroCumarebo may not be able to legally declare dividends for the foreseeable future.

PetroCumarebo Funding

As of March 30, 2007, Vinccler Venezuela has been reimbursed by PDVSA for the operating and capital expenditures advanced by Vinccler Venezuela on behalf of PetroCumarebo during the Transitional Period in the second, third and fourth quarters of 2006. PetroCumarebo is now operating as an independent entity with its own working capital, and funds are no longer advanced by Vinccler Venezuela for subsequent reimbursement by PDVSA. PetroCumarebo is now operating on contributed working capital and will finance its future operations through cash flow from operations, cash calls to shareholders (Vinccler Venezuela and CVP) and/or through debt using its own balance sheet.

Due to the Empresa Mixta Transitional Period, PetroCumarebo was not able to officially invoice PDVSA for oil production delivered in the second, third and fourth quarters of 2006 until March 29, 2007. PetroCumarebo has now invoiced PDVSA for oil production (net of royalties), and PDVSA has officially received the invoice, totaling approximately \$12.3 million. PetroCumarebo expects payment from PDVSA within 45 days in accordance with the terms of the Conversion Contract. PetroCumarebo has not yet officially invoiced PDVSA for natural gas production delivered in the second, third and fourth quarters of 2006 (an amount expected to be approximately \$1.7 million net of royalties), because it has not yet received confirmation from MEP for the natural gas volumes delivered during this period. However, PetroCumarebo expects to finalize the natural gas invoice in the second quarter of 2007.

PDVSA has paid royalties on the oil and natural gas production on behalf of PetroCumarebo, and PDVSA has reimbursed Vinccler Venezuela for 100% of the operating and capital expenditures for the Transitional Period. Given the sequence of events and the recent submission of the initial invoice to PDVSA, PetroCumarebo does not have a history of payment from PDVSA under the Conversion Contract. Until the parties have established a pattern of invoicing and receiving payment, it is possible that amounts invoiced may not be paid by PDVSA in a timely manner in accordance with the terms of the Conversion Contract.

PetroCumarebo/OSA Terms Comparison

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 term of the former OSA contracts, as well as a near-market oil price (approximately 100% of WTI for the East Falcon Block and 85% of WTI for the West Falcon Block) 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 significantly under the OSAs after the recovery of capital and interest.

Cardon III Terms

On January 24, 2007, Vinccler Venezuela and Chevron Corporation (“Chevron”) signed a Heads of Terms agreement whereby Vinccler Venezuela will acquire a 30% working interest from Chevron in the offshore natural gas license for the Cardon III Block in the Gulf of Venezuela. The Cardon III Block covers an area of over 200,000 acres and is located in relatively shallow waters 38 kilometers northwest of the Paraguana Refinery Complex. Under the terms of the agreement effective January 1, 2007, Chevron remains operator and majority partner with a 70% interest. PDVSA retains the right to acquire up to 35% of the project after declaration of commerciality. The transaction is subject to MEP approval, as well as the signature of an assignment agreement and a joint operating agreement between Chevron and Vinccler Venezuela, which is expected in the second quarter of 2007. The following table outlines the terms of the natural gas license:

	Cardon III
PetroFalcon Equity Stake*	30%
Contract Expiration	2035
Gas Price (\$/mcf)**	To Be Negotiated
Royalty	20%
Income Tax Rate	34%

*Subject to MEP approval. Chevron holds the remaining 70% of the license. If PDVSA decides to acquire 35% after declaration of commerciality, PetroFalcon, through Vinccler Venezuela, would still own approximately 20% of the license pro rata.

**Cardon III is still in the exploration phase, and, if successful, first commercial production of natural gas is not expected by Chevron until 2011.

PRODUCTION AND REVENUE

Please see “Current Status of Operations of PetroFalcon”.

Effective April 1, 2006, Vincler Venezuela’s East Falcon OSA and West Falcon OSA were converted into a 40% ownership of PetroCumarebo, a joint venture with CVP.

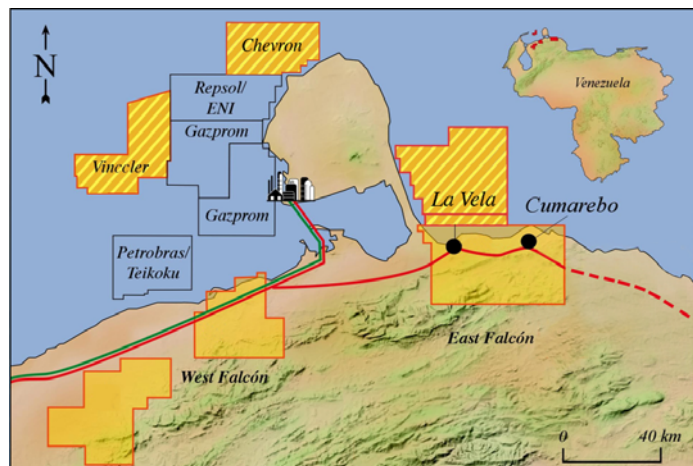
For the three months ended December 31, 2006, PetroCumarebo’s average gross production from both the East Falcon Block and West Falcon Block was 2,232 boe/d. PetroFalcon’s 40% share before royalties was 893 boe/d.

It is expected that oil and natural gas production will continue increasing in 2007 from the La Vela and Cumarebo fields through development drilling, the completion of the new production facilities at La Vela and Cumarebo and from an aggressive work-over campaign in both the East Falcon Block and West Falcon Block.

EAST FALCON BLOCK

For the three months ended December 31, 2006, PetroCumarebo’s average gross production from the East Falcon Block was 1,881 boe/d. PetroFalcon’s 40% share before royalties was 752 boe/d. For the comparable period ended December 31, 2005, PetroFalcon’s average production was 1,046 bbls/d of oil.

At December 31, 2006, the East Falcon Block had 11 producing oil wells, 4 shut-in oil wells, no producing natural gas wells and 4 shut-in natural gas wells.



PetroCumarebo delivers natural gas into PDVSA’s Interconnection Centro Occidente (“ICO”) natural gas pipeline, which then transports the natural gas to the nearby Paraguana Refinery Complex. On December 6th, 2006, PDVSA’s ICO pipeline experienced a joint rupture, and PDVSA closed the pipeline section leading to PetroCumarebo’s production in the Cumarebo Field. As a result, most of PetroCumarebo’s natural gas production is temporarily shut-in, but its wells and facilities are unaffected. Initial reports from PDVSA suggested the ICO pipeline repair would require two months. As of March 30, 2007, Management has not received official notice from PDVSA regarding a revised timeframe. However, the ICO pipeline repair has not been completed.

As a result of the ICO pipeline rupture, PetroCumarebo has approximately 8 mmcf/d of natural gas and 150 bbls/d of oil (40% net to PetroFalcon being 3.2 mmcf/d and 60 bbls/d) shut-in at the Cumarebo Field in the East Falcon Block. Almost 65% of PetroCumarebo’s total oil and natural gas production is therefore shut-in as of March 30, 2007.

WEST FALCON BLOCK

Effective March 21, 2006, Vinccler Venezuela completed the acquisition of West Falcon, a subsidiary of Samson International LLC, which owned a separate Operating Service Agreement for the West Falcon Block. The West Falcon OSA was converted pursuant to the Conversion Contract, and the oil and gas rights are now owned by PetroCumarebo.

For the three months ended December 31, 2006, PetroCumarebo's average gross production from the West Falcon Block was 351 boe/d. PetroFalcon's 40% share before royalties was 140 boe/d.

At December 31, 2006, the West Falcon Block had 11 producing oil wells, 5 shut-in oil wells, 4 producing natural gas wells and no shut-in natural gas wells.

PRODUCTION/SALES AND REVENUES

	PetroCumarebo (Gross)	PetroFalcon (Net)	
	Three months ended Dec 31, 2006	Three months ended Dec 31, 2006	Three months ended Dec 31, 2005
Daily production/sales*			
Oil - bbls/d	866	347	921
Natural gas - mcf/d	8,194	3,278	756
Total – boe/d	2,232	893	1,046
Product pricing (\$)*			
Oil - per bbl	58.44	58.44	37.35
Natural gas – per mcf	1.50	1.50	1.33
Revenue per boe	28.19	28.19	33.81
Total Revenues (\$000s)	5,788	2,315	3,256

*Production before royalties. PetroFalcon, through Vinccler Venezuela, owns 40% of PetroCumarebo. PetroCumarebo's oil price is based on the formulas 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.

PetroCumarebo's gross revenues from the East Falcon Block and West Falcon Block for the three months ended December 31, 2006 were \$5.8 million. PetroFalcon's 40% share before royalties was \$2.3 million, compared to PetroFalcon's \$3.3 million in revenues from the East Falcon OSA for the three months ended December 31, 2005. The average price received by PetroCumarebo for the three months ended December 31, 2006, was \$58.44 per barrel of oil and \$1.50 per mcf of natural gas. The combined average price received for the three months ended December 31, 2006, was \$28.19 per boe. For the three months ended December 31, 2005, the average price received by PetroFalcon was \$37.35 per barrel 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. Most of the gas produced during the comparable time period ended December 31, 2005, was used only for operations, including fuel and gas lift.

PetroFalcon's decrease in revenue during the three months ended December 31, 2006, occurred due to lower levels of production on a boe basis; 81,630 boe net to PetroFalcon before royalties for the three months ended December 31, 2006, as compared to 96,288 boe for the three months ended December 31, 2005. The decrease in production was due to PDVSA's ICO pipeline closure on December 6, 2006, which shut-in approximately 8 mmcf/d of natural gas and 150 bbls/d of oil, or approximately 1,500 boe per day of PetroCumarebo's production (40% net to PetroFalcon being 600 boe per day) from the Cumarebo Field in the East Falcon Block.

PetroFalcon's revenues before royalties from the East Falcon Block and West Falcon Block for the year ended December 31, 2006, were \$11.1 million, which includes three months under the East Falcon OSA and nine months with a 40% interest in the Empresa Mixta, PetroCumarebo. This compares to \$11.3 million in revenues from the East Falcon OSA for the year ended December 31, 2005. The average price received by PetroFalcon for the year ended December 31, 2006, was \$59.34 per barrel of oil and \$1.48 per mcf of natural gas. The combined average price received for the year ended December 31, 2006, was \$35.72 per boe. For the year ended December 31, 2005, the average price received by PetroFalcon was \$35.46 per barrel 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. Most of the gas produced during the comparable time period ended December 31, 2005, was used only for operations, including fuel and gas lift.

PetroFalcon's decrease in revenue during the year ended December 31, 2006, occurred due to the transition to the Empresa Mixta and the resulting lower levels of production on a net boe basis; 323,316 boe net to PetroFalcon before royalties for the year ended December 31, 2006, as compared to 328,367 boe for the year ended December 31, 2005. Note that lower revenue-earning 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 ICO natural gas pipeline at the Cumarebo Field in early August.

Oil and natural gas production is delivered to PDVSA, and it is expected that PetroCumarebo will receive payment before the end of the second quarter of 2007 for the oil and natural gas production delivered during the Transitional Period ended December 31, 2006, as outlined in the Conversion Contract. The price per barrel of crude oil delivered is derived from detailed formulas outlined in the Conversion Contract. The formulas are specific to quality and gravity of crude oil delivered, and they are based on different weightings of several global benchmark oil prices. Using historical oil price data, Management estimates these formulas 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 the East Falcon Block and the West Falcon Block 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). Potential dividends from PetroCumarebo to Vinccler Venezuela will be 100% in US Dollars and are at the

discretion of the shareholders of PetroCumarebo, depending on net and available profits (Please see “PetroCumarebo Dividends” under “Current Status of Operations of PetroFalcon”).

ROYALTIES

The Company’s share of royalties during the three months ended December 31, 2006, was \$765,107 (40% of PetroCumarebo’s royalties). The Company’s share of royalties during the year ended December 31, 2006, was \$2,667,400. 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 periods ended December 31, 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 December 31, 2006, this amount equalled \$950,417 for Vinccler Venezuela (40% of PetroCumarebo). In the year ended December 31, 2006, this amount equalled \$1,299,409 for Vinccler Venezuela.

OPERATING EXPENSES

(\$000s except boe amount)	Three months ended December 31, 2006	Three months ended December 31, 2005
Operating Expenses (including maintenance and transportation)	1,371	985
Average expense (\$ per boe)	16.79	10.23

(\$000s except boe amount)	Year ended December 31, 2006	Year ended December 31, 2005
Operating Expenses (including maintenance and transportation)	4,346	3,097
Average expense (\$ per boe)*	13.44	9.43

*Note that the “per boe” number for the year ended December 31, 2006, includes three months under the East Falcon OSA (for a net total of 323,316 boe).

Please see “Current Status of Operations of PetroFalcon”.

PetroFalcon’s operating expenses during the three months ended December 31, 2006, were \$1,370,760 (40% of PetroCumarebo plus other operating expenses outside of PetroCumarebo). Operating expenses for the three months ended December 31, 2005, were \$984,731. For the year ended December 31, 2006, PetroFalcon’s operating expenses were \$4,346,236 (as 40% of PetroCumarebo plus three months under the East Falcon OSA), compared to \$3.1 million in the same period ended December 31, 2005. Operating expenses during the previous periods 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 December 31, 2006	Three months ended December 31, 2005
Expenses	1,116	1,191
Average expense (\$ per boe)	13.68	12.37

(\$000s except boe amount)	Year ended December 31, 2006	Year ended December 31, 2005
Expenses	2,951	3,730
Average expense (\$ per boe)*	9.13	11.36

*Note that the "per boe" number for the year ended December 31, 2006, includes three months under the East Falcon OSA (for a net total of 323,316 boe).

Please see "Current Status of Operations of PetroFalcon".

PetroFalcon's general and administrative expenses were \$1,116,404 during the three months ended December 31, 2006, as compared to \$1.2 million during the three months ended December 31, 2005. During the year ended December 31, 2006, PetroFalcon's general and administrative expenses were \$2,951,380, compared to \$3.7 million 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 December 31, 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 year 2005 and the first half of fiscal year 2006, resulting in zero penalty payments for Vinccler Venezuela. Management does not expect to receive any penalties for VAT payments made during the second half of fiscal year 2006.

PetroFalcon does not capitalize general and administrative expenses.

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

(\$000s except boe amount)	Three months ended December 31, 2006	Three months ended December 31, 2005
Amortization, Depletion and Accretion	90	563
Depletion Rate (\$ per boe)	1.10	5.85

(\$000s except boe amount)	Year ended December 31, 2006	Year ended December 31, 2005
Amortization, Depletion and Accretion	1,697	1,719
Depletion Rate (\$ per boe)*	5.25	5.24

*Note that the “per boe” number for the year ended December 31, 2006, includes three months under the East Falcon OSA (for a net total of 323,316 boe).

Please see “Current Status of Operations of PetroFalcon”.

For the three months ended December 31, 2006, PetroFalcon’s AD&A was \$89,929, which compares to AD&A of \$563,255 for the three months ended December 31, 2005. AD&A for the year ended December 31, 2006, was \$1,696,762, compared to \$1.7 million for the same period ended December 31, 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 December 31, 2006, PetroFalcon had \$11.9 million in cash and short-term deposits compared to \$9.3 million at December 31, 2005. During the three months ended December 31, 2006, the Company recorded interest income in the amount of \$124,145 as compared to \$47,550 during the three months ended December 31, 2005. Interest income was \$328,020 during the year ended December 31, 2006, compared to \$260,324 in the year ended December 31, 2005.

PetroFalcon incurred interest expense of \$468,077 during the three months ended December 31, 2006, as compared to \$844,590 during the three months ended December 31, 2005. Interest expense was \$2,186,973 during the year ended December 31, 2006, compared to \$1.4 million in the year ended December 31, 2005. The increase in interest expense during the year ended December 31, 2006, is detailed below:

- (i) Additional interest payable to the International Finance Corporation (“IFC”) of \$16,339 during the three months ended December 31, 2006, based on 3% of Vinccler Venezuela’s estimated consolidated earnings before interest, depreciation, amortization and exploration costs;

- (ii) Interest of \$156,940 during the three months ended December 31, 2006, or \$510,586 during the year ended December 31, 2006, under the IFC long-term borrowing facility;
- (iii) Increased interest of \$806,655 during the three months ended December 31, 2006, paid to local banks due to higher average short-term debt of \$11.6 million as of December 31, 2006, versus \$7.1 million as of December 31, 2005. Total interest paid to local banks during the year ended December 31, 2006, was \$1.5 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 December 31, 2006, the Company recorded \$919,916 in stock-based compensation expense as compared to \$572,000 during the three months ended December 31, 2005. The Company recorded \$2,809,668 in stock-based compensation expense for the year ended December 31, 2006, compared to \$2 million for the same period ended December 31, 2005. Higher stock-based compensation was due to a greater number of stock options being issued.

INCOME TAXES

(\$000s)	Three months ended December 31, 2006	Three months ended December 31, 2005
Consolidated Current Income Tax Expense	(143)	1,081
Future Income Tax	55	(513)

(\$000s)	Year ended December 31, 2006	Year ended December 31, 2005
Consolidated Current Income Tax Expense	1,016	1,515
Future Income Tax	343	(313)

During the three months ended December 31, 2006, PetroFalcon recorded a current income tax adjustment of \$142,785 (40% of PetroCumarebo), compared to \$1.1 million during the three months ended December 31, 2005. The year-over-year decrease corresponds to current income tax expense of \$1.1 million recognized in December 2005 by Vinccler Venezuela due to additional tax assessments received from the SENIAT with respect to the income tax returns for the years ended December 31, 2001, to 2004, 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 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%).

During the year ended December 31, 2006, PetroFalcon recorded a current income tax expense of \$1,015,632 which mainly corresponds to: \$473,243 recorded by PetroFalcon for Canadian tax expense and \$542,389 recorded by Vinccler Venezuela with respect to the final settlement of the tax assessments received in April 2006 for the years ended December 31, 2001, to 2004.

During the third quarter of 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.

During the three months ended December 31, 2006, the Company realized future income tax assets of \$55,401 corresponding to carry-forward losses of Vinccler Oil and Gas Corporation, compared to \$513,000 of net future income tax assets recorded during the three months December 31, 2005, related to carry-forward losses of PetroFalcon and Vinccler Oil and Gas Corporation.

During the year ended December 31, 2006, the Company realized a future income tax asset of \$851,528 related to Vinccler Oil and Gas Corporation and PetroFalcon's carry-forward losses and reduced Vinccler Venezuela's future income tax asset of \$262,003. In addition, Vinccler Venezuela reversed a future income tax liability of \$769,833 related to a timing difference in the financial and fiscal treatment of fixed assets transferred to PetroCumarebo.

ANALYSIS OF 2006 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. The PetroCumarebo 2006 Budget represents the gross budget of the Empresa Mixta, of which Vinccler Venezuela was responsible for 40%. The “Incurred As of December 31, 2006 (Gross)”, amount represents the total amount spent by Vinccler Venezuela under the East Falcon OSA in the three months ended March 31, 2006, and by Vinccler Venezuela on behalf of PetroCumarebo under the Transitional Period terms for the nine months ended December 31, 2006. The “Incurred As of December 31, 2006 (Net)”, amount represents the total amount spent by Vinccler Venezuela under the East Falcon OSA in the three months ended March 31, 2006, and 40% of the amount spent by Vinccler Venezuela on behalf of PetroCumarebo under the Transitional Period terms for the nine months ended December 31, 2006.

(\$000s)	PetroCumarebo 2006 Budget*	PetroFalcon 40% Share	Incurred As of Dec 31, '06 (Gross)	Incurred As of Dec 31, '06 (Net)
Drilling and Workovers				
- La Vela	20,261	8,104	3,350	1,324
- Cumarebo	5,332	2,133	47	19
- West Falcon	2,533	1,013	-	-
- Total Drilling and Workovers	28,126	11,250	3,397	1,343
Processing Facilities and Infrastructure				
- La Vela	4,948	1,979	3,788	1,433
- Cumarebo	4,310	1,724	6,298	2,230
- West Falcon	3,300	1,320	-	-
- Total Central Processing Facilities	12,558	5,023	10,086	3,663
Total Capital Budget	40,684	16,273	13,483	5,006

*Due to the delay in the incorporation of the Empresa Mixta, PetroCumarebo was not able to spend its complete 2006 capital budget.

PROCESSING FACILITIES AND INFRASTRUCTURE

During the three months ended December 31, 2006, Vinccler Venezuela (on behalf of PetroCumarebo) continued the construction of the second phase of facilities at the La Vela and

Cumarebo fields. These gas and oil treatment facilities allow PetroCumarebo to produce up to 20 mmcf/d of natural gas and 1,700 bbls/d of oil at the La Vela Field and 30 mmcf/d of natural gas and 5,000 bbls/d of oil at the Cumarebo Field. The tie-in to PDVSA's ICO pipeline was completed in December 2005 at the La Vela Field and in August 2006 at the Cumarebo Field, resulting in initial additional hydrocarbons production from the Cumarebo Field of 10 mmcf/d of natural gas and 285 bbls/d of oil. Production from the Cumarebo Field was subsequently disrupted by PDVSA's ICO pipeline closure in December 2006 (Please see "Production and Revenue").

DRILLING AND WORKOVERS

During the three months ended December 31, 2006, PetroCumarebo commenced a development drilling program in the East Falcon Block. PetroCumarebo permitted and built locations for 8 wells at the La Vela Field offsetting the LV-10 well to develop the shallow oil and natural gas discovery by Vinccler Venezuela in 2005. Vinccler Venezuela (on behalf of PetroCumarebo) also had previously permitted and built locations for two development wells and an appraisal well at the Cumarebo Field.

On November 30, 2006, PetroCumarebo commenced drilling operations at the La Vela Field in the East Falcon Block with the LV-11 well on Platform-A with the Pride 421 900 HP rig. The well was expected to test numerous prospective reservoirs, including the recently discovered Socorro reservoir successfully completed in the LV-10 well in July 2005. The LV-11 well was the first of eight development wells scheduled for the La Vela Field in 2006-2007.

The LV-11 well was drilled to a total planned depth of 3,120 feet on December 22, 2006, and, according to mud logs, encountered thick sections of potential oil and gas reservoirs in the same stratigraphic column as in the LV-10 discovery well. The LV-11 well confirmed Vinccler Venezuela's structural interpretation and the continued presence of oil and gas reservoirs. However, excessive loss of mud and unexpected pressure at the wellhead forced PetroCumarebo to abandon the well without logging and to re-drill the well as LV-12.

The LV-12 well was successfully drilled to a total planned depth of 3,167 feet on January 13, 2007, and, according to wireline logs, encountered 136 feet of net hydrocarbon sands in the Caujarao and Socorro formations. After construction of the flowline and connection to the trunkline, the well was perforated from 2,460 to 2,584 feet in the middle Miocene Socorro formation and tested at a rate of 5 mmcf/d with a flowing tubing pressure of 1,000 psig on a half-inch choke. There is an additional 102 feet of potential shallow oil and gas reservoirs that remains to be tested in the upper Socorro formation and in the still shallower Caujarao formation. Potential commercial production from LV-12 is not affected by PDVSA's recent ICO pipeline closure, as the pipeline rupture occurred east of the La Vela Field and only affects PetroCumarebo's production from the Cumarebo Field.

The LV-13 well, planned as a deviated J-shape well from Platform A, was abandoned after a blowout of shallow gas occurred at 696 feet on January 25, 2007. Vinccler Venezuela expects to recover its 40% cost (approximately \$800,000) for the LV-13 well from its well control insurance policy after a \$100,000 net deductible. After abandoning the LV-13 well, PetroCumarebo moved the rig to the La Vela Platform-B and began drilling the second 4-well cluster, starting with LV-14. Changes in casing design and drilling procedures and upgrades of

equipment on the drilling rig were made prior to the spudding of LV-14 in order to reduce operational difficulties caused by the presence of shallow gas.

The LV-14 well was successfully drilled to a depth of 3,168 feet on March 12, 2007, and was found to be 67 feet high to the LV-12 well at the top of the Socorro formation. According to wireline logs, the well encountered 98 feet of hydrocarbon bearing sands in the Caujarao and Socorro formations, including 27 feet in the middle Socorro reservoir already found in LV-12, thereby confirming the potential of the Socorro section in the area. The rest of the pay zones were found in Upper Socorro and Caujarao formations, which have not been tested yet in the area and represent added potential for oil and gas development in the La Vela Field. The well has been completed mechanically and will be tested shortly.

On March 16, 2007, PetroCumarebo spudded LV-15, the second development well scheduled in the La Vela Platform-B cluster.

At the West Falcon Block, PetroCumarebo recently began a workover and maintenance campaign by contracting a 400 HP workover rig. Operations started with down-hole pump replacements in the TIG-29 and TIG-25 wells, adding 100 bbls/d, and new zone perforation in the MON-18 well, adding 40 bbls/d.

CAPITAL BUDGET FOR 2007

Please see “Current Status of Operations of PetroFalcon”.

The following tables outline PetroCumarebo’s capital budget for the year ended December 31, 2007, as well as Vinccler Venezuela’s commitment to Chevron on its new partnership in the Cardon III Block in the Gulf of Venezuela. The PetroCumarebo 2007 Budget represents the gross budget of the Empresa Mixta, of which Vinccler Venezuela will be responsible for 40%. Separately, the Cardon III Block’s budget represents the gross budget of the natural gas license for the Cardon III Block to date, as well as the planned expenditures for 2007, of which Vinccler Venezuela will be responsible for 30%. **Additional financing will be needed to meet these budget requirements in 2007, but funding may not be available on terms and conditions acceptable to the Company or PetroCumarebo. If funds are not available, Vinccler Venezuela risks defaulting on commitments to PetroCumarebo and Cardon III, which could result in interest charges or a dilution of Vinccler Venezuela’s equity interests.**

PetroCumarebo:

(\$000s)	PetroCumarebo 2007 Budget	PetroFalcon 40% Share
Drilling and Workovers		
- La Vela	14,700	5,880
- Cumarebo	5,700	2,280
- West Falcon	-	-
- Total Drilling and Workovers	20,400	8,160
Processing Facilities and Infrastructure		
- La Vela	4,400	1,760
- Cumarebo	2,800	1,120
- West Falcon	-	-
- Total Central Processing Facilities	7,200	2,880
Total Capital Budget	27,600	11,040

The 2007 budget of PetroCumarebo for the development of the East Falcon Block and West Falcon Block was established by the board of PetroCumarebo to exploit PetroCumarebo's inventory of development wells and locations. First, 8 wells will be drilled in the La Vela Field in order to develop the shallow oil and gas reserves discovered with the LV-10 well in 2005. Afterwards, PetroCumarebo will drill 3 wells in the Cumarebo Field on existing locations, including two development wells and one delineation well, which may extend the limits of a proven gas/condensate reservoir in the northeast portion of the Cumarebo Field. At the end of 2007, two exploratory wells in the La Cruz and San Patricio areas of the East Falcon Block are being contemplated in order to target potential oil and gas reserves. These wells would likely be drilled under a revised 2007 or 2008 capital budget.

De-bottlenecking of the La Vela and Cumarebo processing facilities is also included in the PetroCumarebo 2007 budget in order to increase the dew point processing plants capacities to 20 mmcf/d of natural gas in La Vela and 30 mmcf/d of natural gas in Cumarebo. The 2007 budget also includes the commencement of engineering work on the La Vela processing facilities.

The current gross production of PetroCumarebo is approximately 875 bbls/d of oil, with 150 bbls/d of oil and 8 mmcf/d of natural gas shut-in due to PDVSA's ICO pipeline closure. Depending on available financing and the results of PetroCumarebo's drilling and workover program, PetroCumarebo's 2007 budget of \$27.6 million is estimated to significantly increase

production for the East Falcon Block and the West Falcon Block to approximately 2,500 bbls/d of oil and 20 mmcf/d of gas (40% net to Vinccler Venezuela being 1,000 bbls/d of oil and 8 mmcf/d of natural gas).

Cardon III Block:

(\$000s)	Cardon III Budget	PetroFalcon 30% Share
Chevron Bid Bonus (2005)	5,600	1,680
Related Costs before January 1, 2007*	1,800	540
530 km ² of 3-D Seismic (2007)**	5,000	1,500
Total Cost to Drilling Decision***	12,400	3,720

*Vinccler Venezuela signed a Heads of Terms agreement on January 24, 2007, for the acquisition of 30% of the natural gas license for the Cardon III Block from Chevron, effective January 1, 2007.

**A 3-D seismic vessel began work on the Cardon III Block on February 18, 2007.

***The drilling decision for an exploration well is expected in the fall of 2007.

Vinccler Venezuela's acquisition of 30% of the offshore natural gas license for the Cardon III Block from Chevron is subject to the negotiation and execution of an assignment agreement and a joint operating agreement between Chevron and Vinccler Venezuela within 6 months of the effective date of January 1, 2007, as well as the receipt of approval from MEP within 12 months of the effective date. The total cost from bid bonus to a drilling decision on the Cardon III Block is estimated to be \$3.7 million net to PetroFalcon. On March 9, 2007, Vinccler Venezuela paid Chevron \$2.2 million of this amount, which included Vinccler Venezuela's 30% of the 2005 bid bonus and all related costs before the effective date. Under the agreement, all funds paid by Vinccler Venezuela to Chevron will be returned if MEP approval is denied. Following the evaluation of the 3-D seismic data later this year, Chevron and Vinccler Venezuela will decide whether to proceed with an exploration well in 2008, at an additional estimated cost of \$3 million net to PetroFalcon. If successful, first commercial production of natural gas from Cardon III is expected in 2011.

CASH FLOW FROM OPERATIONS*

(\$000s except per share data)	Three months ended December 31, 2006	Three months ended December 31, 2005
Cash flow from operations*	(510)	(505)
Per basic share	(0.01)	(0.01)
Net (loss) income	(2,502)	(1,128)
Per basic share	(0.03)	(0.01)
Working capital	4,252	10,288

* This is a non-GAAP measure of profitability

(\$000s except per share data)	Year ended December 31, 2006	Year ended December 31, 2005
Cash flow from operations*	(778)	4,412
Per basic share	(0.01)	0.06
Net (loss) income	(6,696)	1,010
Per basic share	(0.08)	0.01

* This is a non-GAAP measure of profitability

Please see “Current Status of Operations of PetroFalcon”.

OPERATING NETBACK

(\$ per boe)	Three months ended December 31, 2006	Three months ended December 31, 2005
Sales price	28.19	33.81
Operating expenses	(16.79)	(10.23)
Operating netback*	11.40	23.59

* This is a non-GAAP measure of profitability

(\$ per boe)	Year ended December 31, 2006	Year ended December 31, 2005
Sales price	35.72	34.49
Operating expenses	(13.44)	(9.43)
Operating netback*	22.28	25.06

* This is a non-GAAP measure of profitability

Note that the “per boe” number for the year ended December 31, 2006, includes three months under the East Falcon OSA (for a net total of 323,316 boe).

LIQUIDITY AND CAPITAL RESOURCES

As of March 30, 2007, PetroFalcon had 86,331,336 issued and outstanding common shares and 96,837,830 common shares on a fully diluted basis.

As of December 31, 2006, PetroFalcon had 86,331,336 issued and outstanding common shares and 96,837,830 common shares on a fully diluted basis. 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 December 31, 2006, PetroFalcon had \$11.9 million in cash and short-term deposits and working capital of \$4.3 million. As of December 31, 2006, PetroFalcon’s total short-term debt was \$11.6 million and total long-term debt was zero. At September 30, 2006, PetroFalcon had \$11.1 million in cash and short-term deposits and working capital of \$6.5 million. At September 30, 2006, PetroFalcon had total current debt of \$11.8 million and total long-term debt of \$4 million.

At December 31, 2006, PetroFalcon had \$13.3 million in accounts receivable (compared to \$14.5 million at September 30, 2006). As of December 31, 2006, the Company had \$10.0 million in accounts payable compared to \$9.3 million at September 30, 2006. The large accounts payable is due to the fact that the Company has been reimbursed for 100% of the operating and capital expenditures made on behalf of PetroCumarebo during the second, third and fourth quarters of 2006. As a result, Vinccler Venezuela, through PetroCumarebo, now owes 40% of these costs to PDVSA, plus 40% of PetroCumarebo’s royalties for the second, third and fourth quarters of 2006.

During 2005, the Company reached an agreement with the IFC, pursuant to which the IFC would 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 were due in 2011. Interest was 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 was also entitled to receive 3% of Vinccler Venezuela’s cash flow as Additional Interest as long as it did not exceed 10% per annum of the principal amount of the “C” loan on an aggregate accumulated basis.

On June 26, 2005, 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 2,078,273 shares at an average price of CDN\$2.37 per share based on the market-weighted average share price over the previous 20 trading days to the notice date.

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.

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.

On December 8, 2006, the IFC provided notice of its intention to convert the remaining \$4 million of its outstanding loan into common shares of PetroFalcon. The IFC received 4,160,578 shares at an average price of CDN\$1.11 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 the entire \$12 million disbursed in 2005 into common shares of PetroFalcon, which means PetroFalcon has zero long-term debt, and the IFC is a significant shareholder of the Company.

PetroFalcon’s contractual obligations are summarized in the table below (see also Note 17 “Commitments” in PetroFalcon’s consolidated financial statements for the year ending December 31, 2006):

(\$000)	Payments Due by Period				
	Under 1 yr	1-3 yrs	4-5 yrs	Over 5 yrs	Total
Debt*	11,913	0	0	0	11,913
Purchase/Service Agreements**	540	1,080	0	0	1,620
Leases***	50	0	0	0	50
Total Obligation	12,503	1,080	0	0	13,583

*Short-term debt on 90 days revolving basis at 12% annual interest, payable in Bolivars.

**Includes technical service agreement to Pacific Oil and Gas, LLC, payable in US dollars.

***Office lease on 12-month basis, payable in Bolivars.

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 additional debt or equity securities financing. The Company cannot be certain that capital will be available when needed.

Please see Note 1 “Going Concern” in PetroFalcon’s consolidated financial statements for the year ending December 31, 2006.

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)	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue	2,545	2,469	3,055	3,256	3,129	NA	5,707	2,315
Net income (loss)	622	428	1,087	(1,128)	(1,181)	(1,700)	(1,313)	(2,502)
Earnings (loss) per share basic and diluted	0.01	0.01	0.01	(0.01)	(0.02)	(0.02)	(0.02)	(0.03)

Note: Q2 2006 revenue is shown as “NA”, because, under the Transitional Period terms, PetroFalcon did not recognize revenue from PetroCumarebo during the three months ended June 30, 2006. This revenue was subsequently recognized in Q3 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 December 31, 2006, the Company paid Pacific Oil and Gas, LLC, controlled by PetroFalcon’s Vice Chairman, Clarence Cottman and PetroFalcon’s President, William Gumma, \$210,000 for professional services, compared to \$210,000 for the three months ended December 31, 2005. For the year ended December 31, 2006, PetroFalcon paid to Pacific Oil and Gas, LLC, \$840,000, compared to \$840,000 for the year ended December 31, 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. These payments are recovered from Vinccler Venezuela through a technical service operating agreement.

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 December 31, 2006, PetroFalcon did not receive services from Venezolana de Inversiones y Construcciones Clerico, C.A (compared to \$395,000 during the three months ended December 31, 2005). During the year ended December 31, 2006, the Company was invoiced \$11,669 for construction services (\$1.8 million for the year ended December 31, 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 December 31, 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, third and fourth quarters of 2006, the Company delivered oil and natural gas to PDVSA on behalf of PetroCumarebo. The Conversion Contract provides different formulas to price deliveries of crude oil and natural gas. Due to the various procedures involved in incorporating a new company (PetroCumarebo) with a pre-incorporation effective date (April 1, 2006), PetroCumarebo was not able to invoice PDVSA for oil production delivered between April 1 and December 31, 2006, until March 29, 2007. In addition, as of March 30, 2007, PetroCumarebo has still not been able to invoice PDVSA for natural gas production delivered between April 1 and December 31, 2007. PetroCumarebo expects to invoice PDVSA for natural gas production as soon as it receives confirmation from the MEP of the natural gas volumes delivered to PDVSA for this period. Due to the joint control established by the terms of the Conversion Contract, the Company's share of PetroCumarebo's revenues and accounts receivable have been recorded for the period April 1 to December 31, 2006. As of March 30, 2007, no cash has been received by PetroCumarebo from PDVSA related to this revenue, but PetroCumarebo expects to receive payment from PDVSA within 45 days of invoicing. PDVSA has paid royalties on the oil and natural gas production on behalf of PetroCumarebo, and PDVSA has reimbursed Vinccler Venezuela for 100% of the operating and capital expenditures for the Transitional Period. Given the sequence of events and the recent submission of the initial invoice to PDVSA, PetroCumarebo does not have a history of payment from PDVSA under the Conversion Contract. Until the parties have established a pattern of invoicing and receiving payment, it is possible that amounts invoiced may not be paid by PDVSA in accordance with the terms of the Conversion Contract.

PetroFalcon reported a net loss of \$7.3 million for the year ended December 31, 2006, and the Company had a working capital surplus of \$4.3 million at December 31, 2006. The Company's ability to continue as a going concern is dependent upon the Company's ability to raise capital; the success of any drilling and exploration program; and the ability to access funds from PetroCumarebo. There can be no assurance that the Company will be successful with any of

these initiatives. PetroFalcon's financial statements for the year ended December 31, 2006, do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

Management is reviewing the new accounting standards for 2007 and any potential impacts on PetroFalcon's financial statements. As of March 30, 2007, there is no indication of a potential impairment for PetroFalcon.

CONCLUSION REGARDING EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES AND DESIGN OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

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 and assessed the design of its internal control over financial reporting for the period ended December 31, 2006, pursuant to the requirements of Multilateral Instrument 52-109. 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, but contained certain weaknesses, as at the end of the period ended December 31, 2006.

Management has concluded that as of December 31, 2006, the following weaknesses existed in the design of internal controls over financial reporting. These weaknesses should also be considered as weaknesses in the Company's disclosure controls and procedures.

Management of PetroFalcon has been advised that, due to the early stage of the Empresa Mixta, PetroCuamrebo lacks formal documentation of policies and procedures for all of its business processes. This includes organizational structure, definitions of roles and responsibilities, required reports and personnel for financial processes. For the first nine months from its inception effective April 1, 2006, PetroCumarebo adopted some policies from Vinccler Venezuela and some from PDVSA. Lack of documented procedures may adversely affect the control of these activities and therefore may compromise the objectives of the Company. The Board of Directors of PetroCumarebo intends to prepare internal control documentation during 2007, including developing a detailed organizational structure, defining roles and responsibilities, identifying critical transactions and reports to be generated and training personnel responsible for these processes.

In addition, the Company does not have adequate segregation of duties within the finance function due to the small size of its staff. As a result, there is no independent review of more complex areas of accounting and certain accounting estimates. This could result in errors, with the potential for material misstatements not being identified.

Furthermore, the Company lacks expertise in Canadian GAAP reporting, which has resulted in material adjustments being identified by the external auditor to accurately account for certain items in the consolidated financial statements reflected under Canadian GAAP.

Also, the Company uses commercial software for its bookkeeping, but due to the complexity of some transactions, the Company uses Excel spreadsheets to make calculations of certain costs, which are easily subject to errors.

Even though there are certain weaknesses that the Company intends to address during 2007, Management has concluded and the Board of Directors has agreed that, taking into account the best interests of the Company and its shareholders, the Company does not have sufficient size and scale to warrant the hiring of additional staff to correct the weaknesses in the segregation of duties and Canadian GAAP expertise at this time.

PetroFalcon's Management and Board of Directors policy is transparency and completeness in its disclosures. Therefore, the existence of internal control over financial reporting and disclosure and procedures control weaknesses in a business with a small number of employees and limited resources, such as PetroFalcon, need not necessarily be interpreted as evidence of a lack of integrity, of unsound business practices or of unacceptable risks to its shareholders and other related parties.

During the three months ended December 31, 2006, there were no changes to internal controls over financial reporting that have materially affected, or are reasonably like to materially affect, the Company's internal controls over financial reporting.

SUBSEQUENT EVENTS

None.

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**.