

PetroFalcon Corporation

Interim Consolidated Financial Statements
(Unaudited)

March 31, 2005 and 2004

(expressed in U.S. dollars)

PetroFalcon Corporation
Interim Consolidated Balance Sheets
(Unaudited)

(expressed in U.S. dollars)

	March 31, 2005 \$	December 31, 2004 \$
Assets		
Current assets		
Cash	15,910,258	20,445,802
Restricted cash	3,600,000	3,600,000
Accounts receivable	4,778,057	4,310,634
Income taxes recoverable	92,420	61,092
	<u>24,380,735</u>	<u>28,417,528</u>
Property and equipment	<u>28,741,096</u>	<u>16,413,226</u>
	<u>53,121,831</u>	<u>44,830,754</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	9,847,080	1,963,706
Income tax payable	123,074	58,314
Bank loans	2,005,814	2,825,521
	<u>11,975,968</u>	<u>4,847,541</u>
Provision for asset retirement obligation	<u>354,674</u>	<u>347,720</u>
	<u>12,330,642</u>	<u>5,195,261</u>
Shareholders' Equity		
Capital stock (note 4)	36,611,768	36,513,195
Contributed surplus	1,751,655	1,316,359
Retained earnings	2,427,766	1,805,939
	<u>40,791,189</u>	<u>39,635,493</u>
	<u>53,121,831</u>	<u>44,830,754</u>

PetroFalcon Corporation

Interim Consolidated Statements of Operations and Retained Earnings (Deficit) (Unaudited)

(expressed in U.S. dollars)

	Three months ended March 31,	
	2005	2004
	\$	\$
Revenue	2,545,038	1,372,579
Expenses		
Operating and maintenance	623,935	424,192
General and administrative	877,494	390,687
Amortization, depletion and accretion	409,560	257,867
Stock-based compensation	444,000	132,000
	<u>2,354,989</u>	<u>1,204,746</u>
Income before financing income (expenses) and income taxes	<u>190,049</u>	<u>167,833</u>
Financing income (expenses)		
Interest expense on bank loans	(98,478)	(94,796)
Interest income on bank deposits	98,537	31,687
Gain on financing transaction (note 3)	675,739	676,041
Gain on foreign exchange	57,049	629,812
	<u>732,847</u>	<u>1,242,744</u>
Income before income taxes	922,896	1,410,577
Income taxes	(301,069)	-
Net income	621,827	1,410,577
Retained earnings (deficit) – Beginning of period	1,805,939	(307,111)
Retained earnings – End of period	<u>2,427,766</u>	<u>1,103,466</u>
Weighted average number of common shares outstanding	<u>75,256,515</u>	<u>54,786,862</u>
Basic earnings per share	0.01	0.03
Diluted earnings per share	0.01	0.03

PetroFalcon Corporation

Interim Consolidated Statements of Cash Flows (Unaudited)

(expressed in U.S. dollars)

	Three months ended March 31,	
	2005	2004
	\$	\$
Cash provided by (used in)		
Operating activities		
Net income for the period	621,827	1,410,577
Items not affecting cash		
Amortization, depletion and accretion	409,560	257,867
Stock-based compensation	444,000	132,000
	<u>1,475,387</u>	<u>1,800,444</u>
Net change in non-cash working capital items		
Accounts receivable	(467,423)	520,524
Accounts payable and accrued liabilities	302,360	(215,521)
Income taxes recoverable	33,431	15,042
	<u>1,343,755</u>	<u>2,120,489</u>
Financing activities		
Proceeds from private placement	-	15,859,165
Repayment of bank loans	(819,707)	(2,027,195)
Proceeds received on exercise of share options and warrants	89,870	7,277,717
	<u>(729,837)</u>	<u>21,109,687</u>
Investing activities		
Acquisition of property and equipment	(12,730,476)	(553,665)
Movement in non-cash working capital from investing activities	7,581,014	103,243
	<u>(5,149,462)</u>	<u>(450,422)</u>
Net (decrease) increase in cash during the period	<u>(4,535,544)</u>	<u>22,779,754</u>
Cash – Beginning of period	<u>20,445,802</u>	<u>4,505,657</u>
Cash – End of period	<u>15,910,258</u>	<u>27,285,411</u>
Supplementary information		
Interest paid	108,626	137,637
Income taxes paid	230,071	10,499

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2005 and 2004

(expressed in U.S. dollars)

1 Description of business and reorganization

The principal business of the Company is conducted through its indirect wholly owned subsidiary, Vinccler Oil and Gas C.A. ("Vinccler Venezuela") which provides oil and gas operating services in Venezuela. All of the revenues of Vinccler Venezuela are generated through an Operating Service Agreement with Petroleos de Venezuela, S.A. ("PDVSA"), the state oil company of Venezuela.

2 Significant accounting policies

The interim consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. These interim consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles using the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2004.

3 Gain on financing transactions

During the three months ended March 31, 2005, the Company's subsidiary, Vinccler Venezuela, realized a foreign exchange gain of \$675,739 as a result of the acquisition and disposal of US dollar denominated Venezuelan government bonds (2004 – \$676,041).

4 Capital stock

Authorized

Unlimited number of common shares

Unlimited number of preferred shares issuable in series

Issued

	Number of Shares	Amount \$
As at December 31, 2004	75,178,228	36,513,195
Exercise of share options	156,573	89,870
Transfer from contributed surplus		8,703
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As at March 31, 2005	75,334,801	36,611,768

Common stock

The common shares of the Company are all of the same class, are voting and entitle shareholders to receive dividends. In the event of a liquidation, dissolution or winding up, the common stockholders are entitled to receive equal distributions of net assets or any dividends which may be declared.

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Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2005 and 2004

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Stock option plan

A summary of the status of the Company's stock option plan and changes during the periods is presented below:

	2005		2004	
	Share Options	Weighted- average exercise price CDN\$	Share options	Weighted- average exercise price CDN\$
Outstanding – Beginning of period	7,420,000	1.67	4,365,000	0.93
Exercised	(156,573)	0.71	(50,000)	0.50
Outstanding – End of period	7,263,427	1.70	4,315,000	0.94
Options exercisable – End of period	2,048,420	0.90	640,000	0.57

A summary of stock options outstanding at March 31, 2005 is set out below:

Exercise price	Outstanding stock options		Exercisable stock options
	Number	Weighted average remaining contractual life	Number
\$0.50	350,000	3.45 years	350,000
\$0.72	100,000	2.15 years	100,000
\$1.00	3,551,687	8.45 years	1,598,354
\$1.30	26,740	8.75 years	73
\$2.20	350,000	9.25 years	-
\$2.35	1,885,000	9.45 years	-
\$3.28	1,000,000	9.65 years	-
	<u>7,263,427</u>		<u>2,048,427</u>

5 Related party transactions and balances

Pacific Oil and Gas, LLC and Venezolana de Inversiones y Construcciones Clerico, C.A. are controlled by officers of the Company. During the three months ended March 31, 2005, the Company was invoiced \$210,000 by Pacific Oil and Gas, LLC (formerly Pacific Petroleum LLC) (2004 – \$165,000). During the period, the Company incurred an estimated \$800,000 for construction services in progress provided by Venezolana de Inversiones y Construcciones Clerico, C.A.

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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.

6 Financial instruments

The Company is exposed to fluctuations in commodity prices, interest rates and Canada/U.S. dollars and Venezuelan Bolivar/U.S. dollars exchange rates. The Company, when appropriate, utilizes financial instruments to manage its exposure to these risks. As of March 31, 2005 the Company has not used any financial instrument.

7 Economic dependence

Payments to the Company from PDVSA under the Operating Service Agreement are the primary source of revenues. Any material failure of PDVSA to fulfill its obligations under the Operating Service Agreement would have a material adverse effect on the Company's business, financial condition and results of operations.

8 Subsequent events

Subsequent to the quarter end, Vinccler Venezuela received notice from the Ministry of Energy and Petroleum in Venezuela ("MEP") and PDVSA that existing relationships governed by operating services agreements are to be restructured into joint ventures. It is the understanding of the Company that (i) Vinccler Venezuela will be required to transfer the East Falcon Unit to a mixed company in exchange for a 49% interest; and (ii) PDVSA will obtain the remaining 51% interest in exchange for contributing other oil and gas interests and assets. The Company has been advised that PDVSA intends to conclude these negotiations within the next six months.

In addition, the Company has been advised that the Servicio Nacional Integral de Administracion Aduanera y Tributaria ("SENIAT"), the Venezuelan income tax authority, has stated that the income tax rates for activities conducted under the various operating service agreements in Venezuela, including Vinccler Venezuela's operating service agreement, will increase from 34% to 50%. The SENIAT has also announced that it will audit companies that have operating service agreements, however, the Company does not know the timing or impact of such audit.

As a result of these various governmental amendments, the operating results of the Company may be adversely impacted, however, at this time the economic impact and actual timing of the implementation of these are unknown to the Company.

