

PetroFalcon Corporation

Interim Consolidated Financial Statements
(Unaudited)
March 31, 2007, and 2006
(expressed in U.S. dollars)

The accompanying unaudited interim consolidated financial statements of PetroFalcon Corporation (the "Corporation") for the three months ended March 31, 2007, and 2006, have been prepared by Management and approved by the Audit Committee of the Corporation.

PetroFalcon Corporation
Interim Consolidated Balance Sheets
(Unaudited)

(expressed in U.S. dollars)

	March 31, 2007	December 31, 2006
	\$	\$
Assets		
Current assets		
Cash	9,759,202	11,894,574
Accounts receivable	12,131,755	13,297,485
Income tax recoverable	1,567,843	1,454,140
	<u>23,458,800</u>	<u>26,646,199</u>
Property and equipment (note 5)	<u>54,051,124</u>	<u>50,538,243</u>
	<u>77,509,924</u>	<u>77,184,442</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	11,414,120	10,022,193
Income tax payable (note 10)	459,654	459,654
Short-term debt (note 8)	12,452,326	11,912,791
	<u>24,326,100</u>	<u>22,394,638</u>
Provision for future employee benefits	575,375	546,130
Provision for asset retirement obligation	442,784	431,983
	<u>25,344,259</u>	<u>23,372,751</u>
Shareholders' equity		
Capital stock (note 7)	51,608,746	51,547,584
Warrants (note 7)	118,571	118,571
Contributed surplus (note 7)	6,763,303	6,025,665
Accumulated deficit	<u>(6,324,955)</u>	<u>(3,880,129)</u>
<i>Going Concern (note 1)</i>	<u>52,165,665</u>	<u>53,811,691</u>
	<u>77,509,924</u>	<u>77,184,442</u>

PetroFalcon Corporation

Interim Consolidated Statements of Operations, Comprehensive Income and Retained Earnings (Unaudited)

(expressed in U.S. dollars)

	Three months ended March 31,	
	2007	2006
	\$	\$
Revenue		
Oil and gas	1,292,082	3,129,029
Royalties	(430,651)	-
Special advantage tax	(215,390)	-
	<u>646,041</u>	<u>3,129,029</u>
Expenses		
Operating, maintenance and transportation	1,097,557	964,459
General and administrative	1,674,065	922,508
Amortization, depletion and accretion	189,450	512,688
Stock-based compensation (note 7)	737,638	590,000
	<u>3,698,710</u>	<u>2,989,655</u>
(Loss) Income before other income (expenses) and income taxes	<u>(3,052,669)</u>	<u>139,374</u>
Other income (expenses)		
Interest on long-term debt	(367,255)	(813,509)
Interest on bank deposits	93,595	43,615
Gain on financing transactions (note 6)	860,465	-
Gain (Loss) on foreign exchange	21,038	(7,771)
	<u>607,843</u>	<u>(777,665)</u>
Loss before income taxes	(2,444,826)	(638,291)
Income taxes (note 10)	-	(542,389)
Net loss and comprehensive loss	(2,444,826)	(1,180,680)
Retained earnings (accumulated deficit) – Beginning of period	<u>(3,880,129)</u>	<u>2,815,542</u>
Retained earnings (accumulated deficit) – End of period	<u>(6,324,955)</u>	<u>1,634,862</u>
Basic and diluted loss per share (note 13)	(0.03)	(0.02)
<i>Going Concern (note 1)</i>		

PetroFalcon Corporation

Interim Consolidated Statements of Cash Flows (Unaudited)

(expressed in U.S. dollars)

	Three months ended	
	March 31,	
	2007	2006
	\$	\$
Cash provided by (used in)		
Operating activities		
Net loss	(2,444,826)	(1,180,680)
Items not affecting cash		
Amortization, depletion and accretion	189,450	512,688
Stock-based compensation	737,638	590,000
	<u>(1,517,738)</u>	<u>(77,992)</u>
Net change in non-cash working capital items		
Accounts receivable	1,165,701	7,946,604
Accounts payable and accrued liabilities	15,409	744,981
Income taxes (payable) recoverable – net	(113,702)	425,755
	<u>(450,330)</u>	<u>9,039,348</u>
Financing activities		
Issuance (repayment) of long-term debt	539,535	(2,011,627)
Issue of shares	61,162	-
	<u>600,697</u>	<u>(2,011,627)</u>
Investing activities		
Purchase of West Falcon Hydrocarbons, S.R.L.	-	(2,016,214)
Acquisition of property and equipment	(3,691,501)	(1,054,356)
Movement in non-cash working capital from investing activities	1,405,762	(2,732,852)
	<u>(2,285,739)</u>	<u>(5,803,422)</u>
Net (decrease) increase in cash during period	(2,135,372)	1,224,299
Cash – Beginning of period	11,894,574	9,297,444
Cash – End of period	9,759,202	10,521,743
Supplementary information		
Interest paid	285,918	73,858
Income taxes paid	507,289	339,761

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

1 Going Concern

These interim consolidated financial statements have been prepared in accordance with Canadian GAAP on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Corporation be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The Corporation reported a net loss of \$2.4 million for the three months ended March 31, 2007, and the Corporation had a working capital deficit of \$867,300 at March 31, 2007. The Corporation's ability to continue as a going concern is dependent upon the Corporation'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 Corporation will be successful with any of these initiatives. The accompanying interim consolidated financial statements 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 Corporation be unable to continue as a going concern.

The Corporation depends on annual dividend payments, and potential quarterly loans against those dividends, derived from its 40% interest in PetroCumarebo. Any material failure of PetroCumarebo to be paid for the oil and natural gas production delivered to PDVSA would affect PetroCumarebo's ability to pay dividends, which would have a material adverse effect on the Corporation's business, financial condition and results of operations. In addition, any decision by PetroCumarebo not to pay dividends to its shareholders would have a material adverse effect on the Corporation's business, financial condition and results of operations.

2 Description of business

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").

PetroFalcon's revenues for the 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").

On September 29, 2006, Vinccler Venezuela and Corporación Venezolana del Petróleo ("CVP"), an affiliate of PDVSA, 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. Effective April 1, 2006, Vinccler Venezuela's East Falcon OSA and West Falcon OSA were contributed to the Empresa Mixta, PetroCumarebo. Therefore, PetroFalcon's revenues and earnings for the three months ended March 31, 2007, were

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

derived from Vinccler Venezuela's proportional share of PetroCumarebo's revenues and earnings.

PetroCumarebo Payments

As of March 31, 2007, Vinccler Venezuela has been reimbursed by PDVSA for the operating and capital expenditures advanced by Vinccler Venezuela on behalf of PetroCumarebo during the transition to the Empresa Mixta in the second, third and fourth quarters of 2006 ("the Transition Period"). Effective January 1, 2007, PetroCumarebo is 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 expected to 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 Transition Period, PetroCumarebo was not able to invoice PDVSA for oil production delivered during the Transition Period until March 29, 2007 (an amount totaling approximately \$12.3 million net of royalties). Under the terms of the Conversion Contract, PetroCumarebo is entitled to payment from PDVSA within 45 days of submitting an invoice. However, as of May 11, 2007, PetroCumarebo has not yet been paid by PDVSA for the first oil production invoice. In addition, PetroCumarebo has not yet invoiced PDVSA for natural gas production delivered during the Transition Period (an amount expected to be approximately \$1.7 million net of royalties), because it has not received confirmation from the Venezuelan Ministry of Energy and Petroleum ("MEP") for the natural gas volumes delivered during this period. Management does not have any information as to the expected timing of these payments, but PetroCumarebo does expect to be paid by PDVSA for all oil and natural gas delivered since April 1, 2006. Once the initial invoicing process for the Transition Period is complete, PetroCumarebo will process its backlog of invoices for the first quarter of 2007 (expected to equal approximately \$2.3 million for oil and \$26,000 for natural gas net of royalties) and proceed to invoice PDVSA for oil and natural gas deliveries on a monthly basis going forward.

PDVSA has paid royalties on the oil and natural gas production on behalf of PetroCumarebo during the second, third and fourth quarters of 2006, as well as the first quarter of 2007, and PDVSA has reimbursed Vinccler Venezuela for 100% of the operating and capital expenditures advanced during the Transition 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.

3 Significant accounting policies

The interim consolidated financial statements include the accounts of the Corporation, its wholly owned subsidiaries and its 40% jointly controlled investment in PetroCumarebo, S.A. 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

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

the consolidated financial statements for the year ended December 31, 2006, except as described in note 4.

4 Change in accounting policy

The Corporation adopted CICA Handbook Section 3855, “Financial Instruments – Recognition and Measurement”, along with two companion standards, Section 1530 “Comprehensive Income” and Section 3865 “Hedges”, effective January 1, 2007, which includes the following changes:

- Establish a new measure of income – comprehensive income. Comprehensive income represents the entire change in the net assets of an entity for a period, other than changes attributable to transactions with owners.
- Require an entity to account for certain financial assets and liabilities at fair value.
- Define derivative and expand the concept to include certain non financial items.
- Require an entity to account separately for certain derivatives embedded in non derivative contracts.
- Establish principles that determine when an entity should recognize a financial asset or liability.
- Prohibit accounting for debt issue costs as deferred charges.
- Require an entity to calculate the effective interest rate using its best estimate of cash flows and the expected life of the instrument rather than the contractual cash flows or contractual life of the instrument.
- Establish the framework to recognize and measure impairment in financial assets.
- Require an entity to recognize a guarantee at its fair value at the date of its issue, regardless of the probability of payment.
- Require the recognition of hedge ineffectiveness in earnings when it arises.

There is no effect of adopting these standards since the Corporation’s carrying value of financial assets and liabilities approximate the fair value.

5 Acquisition of joint property rights

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. Under the terms of the agreement effective January 1, 2007, Chevron remains operator and

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

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 the negotiation and execution of an assignment agreement and a joint operating agreement between Chevron and Vincler 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.

On March 9, 2007, Vincler Venezuela paid Chevron \$2.2 million in cash, which is 30% of Chevron's total costs related to the Cardon III Block before the effective date. Under the agreement, all funds paid by Vincler Venezuela to Chevron will be returned without interest if MEP approval is denied.

6 Gain on financing transactions

During the three months ended March 31, 2007, Vincler Venezuela recorded a gain of \$860,000 as a result of the purchase and sale of US dollar denominated Venezuelan government bonds. No gain on financing transaction was recorded during the three months ended March 31, 2006.

7 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, 2006	86,331,336	51,547,584
Issue of shares	100,000	61,162
As at March 31, 2007	<u>86,431,336</u>	<u>51,608,746</u>

Common stock

The common shares of PetroFalcon are all of the same class, have voting rights and entitle shareholders to receive dividends as and when declared by the Board of Directors. In the event of a liquidation, dissolution or winding up, the shareholders are entitled to receive equal distributions of net assets or any dividends that may be declared.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

Stock option plan

The following is a summary of the status of PetroFalcon's stock option plan and changes during the three months ending:

	March 31, 2007		December 31, 2006	
	Share Options	Weighted- average exercise price CDN\$	Share Options	Weighted- average exercise price CDN\$
Outstanding – Beginning of period	10,406,494	1.85	8,896,194	1.86
Granted	-	-	1,925,000	1.72
Exercised	(100,000)	0.72	(149,700)	1.04
Cancelled	(70,000)	2.02	(265,000)	1.91
Outstanding – End of period	10,236,494	1.95	10,406,494	1.85
Options exercisable – End of period	7,540,149	1.68	7,302,649	1.68

A summary of stock options outstanding at March 31, 2007, is set out below:

Exercise price CDN\$	Outstanding stock options		Exercisable stock options
	Number	Weighted average remaining contractual life	Number
\$0.50	250,000	0.81 years	250,000
\$1.00	3,298,654	6.19 years	3,298,654
\$1.13	75,000	9.38 years	25,000
\$1.23	150,000	9.74 years	-
\$1.30	13,340	6.50 years	13,340
\$1.45	40,000	9.25 years	20,000
\$1.55	450,000	8.94 years	337,500
\$1.93	980,000	9.00 years	735,000
\$2.05	30,000	8.58 years	10,000
\$2.20	290,000	7.00 years	193,332
\$2.35	1,850,000	7.20 years	1,233,330
\$2.38	300,000	8.50 years	100,000
\$2.39	1,509,500	8.20 years	657,327
\$3.28	1,000,000	7.68 years	666,666
	<u>10,236,494</u>		<u>7,540,149</u>

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with weighted average assumptions for grants as follows:

Risk free interest rate	3.33%
Expected volatility	60%
Dividends yield rate	0.00%
Weighted average expected life of options	5 years

Issue of warrants

On June 28, 2005, PetroFalcon issued 100,000 warrants with an exercise price of CDN\$2.17 per warrant in connection with the financing done by the World Bank's private investment arm, the International Finance Corporation ("IFC"). There were no proceeds received by the Corporation from the issue of warrants. Each warrant is exercisable into one common share of PetroFalcon until June 30, 2007. As of March 31, 2007, these warrants remained outstanding.

West Falcon equity payment

On March 21, 2006, PetroFalcon issued 1,750,000 common shares at a price of CDN\$1.71 per share as part of the purchase of West Falcon (see note 2) at a total cost of CDN\$2.984 million (\$2.563 million).

8 Short-term debt

The Corporation's short-term debt consists of the following:

	March 31, 2007	December 31, 2006
Due to Venezolana de Inversiones y Construcciones Clérico, C.A. (Vinccler Construction) with no specific terms of repayment, unsecured and non-interest bearing (see note 9)	350,000	350,000
Unsecured bank loans bearing interest at 12%, 90 days revolving basis, payable in Bolivars	12,102,326	11,562,791
	<u>12,452,326</u>	<u>11,912,791</u>

Short-term local bank loans consisted of Vinccler Venezuela's lines of credit with Venezuelan banks to meet its short-term working capital and local currency financing.

9 Related party transactions and balances

Pacific Oil and Gas, LLC and Venezolana de Inversiones y Construcciones Clérico, C.A. are controlled by officers of PetroFalcon. For the three months ended March 31, 2007, the Corporation paid Pacific Oil and Gas, LLC, controlled by PetroFalcon's Vice Chairman, Clarence Cottman and PetroFalcon's President, William Gumma, \$135,000 for professional services, compared to \$210,000 for the three months ended March 31, 2006.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

PetroFalcon also receives construction services provided by Venezolana de Inversiones y Construcciones Clerico, C.A., an independent operating construction company controlled by the Corporation's Chairman of the Board and Chief Executive Officer, Juan Francisco Clerico. During the three months ended March 31, 2007, PetroFalcon did not receive services from Venezolana de Inversiones y Construcciones Clerico, C.A. (compared to \$11,619 during the three months ended March 31, 2006). 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 March 31, 2007.

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.

10 Income Tax

During the three months ended March 31, 2007, the Corporation did not record a current income tax expense (\$542,389 during the three months ended March 31, 2006).

During 2005, Vinccler Venezuela received tax assessments from the National Integrated Customs and Tax Administration Service ("SENIAT"), the Venezuelan tax authorities, with respect to the income tax returns for the four years ended December 31, 2004, for a total of \$3.3 million (Bs.7.7 billion), 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%). On January 26, 2006, Vinccler Venezuela filed a discharge claim with SENIAT. During the three months ended March 31, 2006, Vinccler Venezuela received the final settlement resulting in additional income tax expense of \$542,389 for the four years ended December 31, 2004.

11 Financial instruments

The Corporation is exposed to fluctuations in commodity prices, interest rates and Canada/U.S. dollars and Venezuelan Bolivar/U.S. dollar exchange rates. The Corporation, where appropriate, utilizes financial instruments to manage its exposure to these risks. During the three months ended March 31, 2007, the Corporation did not hold or issue any derivative financial instruments. The Corporation's financial assets and liabilities as at March 31, 2007, included cash, accounts receivable and accounts payable. Fair values approximate carrying values unless otherwise stated. Additionally, the Corporation's financial instruments include long-term debt that bears interest at market-related rates, which approximates fair value.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three months ended March 31, 2007, and 2006

(expressed in U.S. dollars)

12 Commitments and contingencies

At March 31, 2007, the Corporation's significant commitments were derived from its participation in PetroCumarebo, which had one drilling rig contracted for 8 months expiring July 2007 for \$22,000 per month; two compressors leased for a total of \$7,242 per month; and four compressors leased for a period of 5 years with total payments of \$103,000 per month.

13 Earnings per share

	Three months ended	
	March 31,	
	2007	2006
Net loss	(2,444,826)	(1,180,680)
Weighted average number of common shares	86,381,336	78,506,407
Stock options and warrants*	250,000	4,391,694
Basic (loss) earnings per share	(\$0.03)	(\$0.02)
Diluted (loss) earnings per share*	(\$0.03)	(\$0.02)

* The calculation of diluted earnings per common share excludes 9,986,494 options, and 100,000 warrants outstanding during the three months ended March 31, 2007, and 6,257,000 options outstanding in the three months ended March 31, 2006, as these would have been anti-dilutive to the calculation.