

PetroFalcon Corporation

Interim Consolidated Financial Statements
(Unaudited)

June 30, 2008, and 2007
(expressed in U.S. dollars)

The accompanying unaudited interim consolidated financial statements of PetroFalcon Corporation (the “Company”) for the three and six months ended June 30, 2008, and 2007, have been prepared by Management and approved by the Audit Committee of the Company.

PetroFalcon Corporation
Interim Consolidated Balance Sheets
(Unaudited)

(expressed in U.S. dollars)

	June 30, 2008	December 31, 2007
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	24,164,155	4,773,930
Accounts receivable (note 5)	593,597	1,606,112
Income tax recoverable	1,111,897	958,807
Deposit in guarantee (note 1)	5,000,000	-
Prepaid expenses (notes 1 and 8)	4,614,750	-
	<hr/>	<hr/>
	35,484,399	7,338,849
Accounts receivable	1,775,473	785,242
Investments in oil and gas activities: (note 4)		
PetroCumarebo, S.A.	40,649,651	44,280,462
Baripetrol, S.A.	21,263,601	-
Cardon III	5,404,057	5,404,057
Other investments	350,000	350,000
Property and equipment	323,001	188,876
	<hr/>	<hr/>
	105,250,182	58,347,486
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	705,329	3,569,118
Short-term debt (note 7)	-	2,492,857
	<hr/>	<hr/>
	705,329	6,061,975
Shareholders' equity		
Capital stock (note 6)	107,511,978	51,680,606
Warrants (note 6)	1,867,386,	-
Contributed surplus (note 6)	8,720,457	8,072,330
Accumulated deficit	<hr/>	<hr/>
	(13,554,968)	(7,467,425)
	<hr/>	<hr/>
	104,544,853	52,285,511
	<hr/>	<hr/>
	105,250,182	58,347,486

PetroFalcon Corporation

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

(expressed in U.S. dollars)

	Three months ended June 30		Six months ended June 30	
	2008 \$	2007 \$ (as restated - see note 1)	2008 \$	2007 \$ (as restated - see note 1)
Expenses				
General and administrative	1,566,018	1,136,439	3,196,958	3,559,285
Depreciation, depletion and amortization	26,299	30,695	51,711	70,652
Stock-based compensation (note 6)	26,288	775,485	755,045	1,513,123
	<u>1,618,605</u>	<u>1,942,619</u>	<u>4,003,714</u>	<u>5,143,060</u>
Loss before financing (expenses) income and income tax	<u>(1,618,605)</u>	<u>(1,942,619)</u>	<u>(4,003,714)</u>	<u>(5,143,060)</u>
Financing (expenses) income				
Interest (expense) income, net	278,053	(127,866)	170,365	(401,526)
Foreign exchange gain	262,594	1,020,327	519,004	3,693,176
Guarantee fee (note 8)	(3,264,092)	-	(3,264,092)	-
Other (expense) income	(70,000)	-	490,894	-
	<u>(2,793,445)</u>	<u>892,461</u>	<u>(2,083,829)</u>	<u>3,291,650</u>
Net loss and comprehensive loss	<u>(4,412,050)</u>	<u>(1,050,158)</u>	<u>(6,087,543)</u>	<u>(1,851,410)</u>
Accumulated deficit – Beginning of period	<u>(9,142,918)</u>	<u>(4,681,381)</u>	<u>(7,467,425)</u>	<u>(3,880,129)</u>
Accumulated deficit – End of period	<u>(13,554,968)</u>	<u>(5,731,539)</u>	<u>(13,554,968)</u>	<u>(5,731,539)</u>
Basic and diluted loss per share (note 10)	<u>(0.03)</u>	<u>(0.01)</u>	<u>(0.04)</u>	<u>(0.02)</u>

PetroFalcon Corporation

Interim Consolidated Statements of Cash Flows (Unaudited)

(expressed in U.S. dollars)

	Three months ended June 30		Six months ended June 30	
	2008 \$	2007 \$ (as restated – see note 1)	2008 \$	2007 \$ (as restated – see note 1)
Cash provided by (used in)				
Operating activities				
Net loss	(4,412,050)	(1,050,158)	(6,087,543)	(1,851,410)
Items not affecting cash				
Depreciation, depletion and accretion	26,299	30,695	51,711	70,652
Other	-	(118,571)	-	(118,571)
Guarantee fee	3,264,092	-	3,264,092	-
Bad debt expense	72,923	-	72,923	-
Stock-based compensation	26,288	775,485	755,045	1,513,123
	(1,022,448)	(362,549)	(1,943,772)	(386,206)
Net change in non-cash working capital items				
Accounts receivable	612,734	(3,568,016)	(50,639)	7,142,986
Accounts payable and accrued liabilities	(3,128,684)	(247)	(2,863,788)	(9,672,732)
Income taxes recoverable / payable – net	(45,330)	(204,026)	(153,090)	118,866
Deposit in guarantee	(5,000,000)	-	(5,000,000)	-
	(8,583,728)	(4,134,838)	(10,011,289)	(2,797,086)
Financing activities				
Repayment of short-term debt	(2,084,388)	(987,114)	(2,492,857)	(6,044,905)
Proceeds received on exercise of share options and warrants	226,408	-	276,599	61,162
Acquisition of Lundin Latina de Petróleos, S.A.	-	-	26,263,541	-
	(1,857,980)	(987,114)	24,047,283	(5,983,743)
Investing activities				
Proceeds on sale of property and equipment	3,630,811	5,084,323	3,630,811	5,094,631
Acquisition of property and equipment	(175,151)	-	(186,580)	-
Receipt of Baripetrol dividend	-	-	1,910,000	-
Investment in affiliates	-	-	-	(2,225,626)
	3,455,660	5,084,323	5,354,231	(2,869,005)
Net (decrease) increase in cash during period				
	(6,986,048)	(37,629)	19,390,225	(5,911,824)
Cash – Beginning of period	31,150,203	6,020,379	4,773,930	11,894,574
Cash – End of period	24,164,155	5,982,750	24,164,155	5,982,750
Supplementary information				
Interest paid	371,058	285,918	588,852	285,918
Income taxes paid	-	507,289	-	507,289

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2008, and 2007

(expressed in U.S. dollars)

1 Description of business

PetroFalcon Corporation (“PetroFalcon” or the “Company”) is engaged in the exploration, development, production and management of oil and natural gas properties in Venezuela. Through its wholly-owned Venezuelan subsidiaries, Vinccler Oil and Gas, C.A. (“Vinccler Venezuela”) and Lundin Latina de Petróleos, S.A. (“Lundin Venezuela”), PetroFalcon owns 40% of PetroCumarebo, S.A. (“PetroCumarebo”) and 5% of Baripetrol, S.A. (“Baripetrol”).

PetroCumarebo accounting

Prior to January 1, 2007, PetroFalcon considered its investment in and relationship with PetroCumarebo to be one of joint control and accordingly accounted for its 40%-interest in PetroCumarebo using proportionate consolidation. In effect, PetroFalcon recognized 40% of PetroCumarebo’s revenues, expenses, assets and liabilities in PetroFalcon’s financial statements.

In 2007, PetroFalcon re-evaluated its relationship with PetroCumarebo and concluded that, for accounting purposes, effective January 1, 2007, PetroFalcon’s investment in PetroCumarebo does not currently meet the criteria for proportionate consolidation or equity method accounting. Accordingly, PetroFalcon has accounted for PetroCumarebo using the cost method of accounting as the investment has been classified by the Company as an available for sale equity instrument that is not actively traded in a public market. Under the cost method, PetroFalcon does not recognize its 40%-share of revenues, expenses, assets or liabilities from PetroCumarebo and instead only recognizes income from the investment to the extent that dividends are received from PetroCumarebo. As a result, PetroFalcon has no revenues for the three and six months ended June 30, 2008, and has restated the comparable periods in 2007.

Despite this change for accounting purposes, PetroFalcon remains an oil and gas company carrying on active operations in Venezuela, and Management does not consider PetroFalcon to be a company with only passive investments.

Acquisition of Lundin Latina de Petróleos, S.A.

On July 18, 2007, PetroFalcon announced the acquisition of 100% of the issued and outstanding shares of Lundin Venezuela from Lundin Petroleum BV (“Lundin BV”), as well as a private placement with Lundin BV.

Lundin Venezuela is a holding company incorporated in Venezuela that owns 5% of Baripetrol, a Venezuelan mixed company between Petróleos de Venezuela, S.A. (“PDVSA”), Tecpetrol de Venezuela, S.A. and Perenco Oil and Gas International Limited. Baripetrol operates the Colon Block, which includes approximately 297,000 acres in western Venezuela with current onshore production of oil and natural gas.

On February 1, 2008, PetroFalcon acquired 100% of the issued and outstanding shares of Lundin Venezuela from Lundin BV in consideration for the issuance of 57,254,505 common shares of the Company. Concurrent with the completion of the acquisition, Lundin BV subscribed for 6,665,995 units of the Company at a purchase price of CND\$0.80 for aggregate proceeds of \$5.1 million. Each unit consists of one common share and approximately 0.75 warrants, such that an

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aggregate of 5,000,000 warrants were issued. Each whole warrant expires on February 1, 2010, and is exercisable for one common share of the Company upon payment of CDN\$1.20 per share.

In connection with the above transactions, the Company paid a cash finder's fee in the amount of \$543,600 and issued an additional 569,284 common shares of the Company.

The cost of the acquisition includes PetroFalcon common shares with a fair value of \$0.77 (CDN\$0.80) per share, plus PetroFalcon's transaction cost of \$980,000, for a total cost of \$44,870,000.

The value of the PetroFalcon common shares issued was calculated using the average share price of PetroFalcon's shares during the five days before, the day of, and five days after the announcement of the acquisition.

The excess of the purchase consideration over the adjusted book values of Lundin Venezuela's assets and liabilities has been allocated to the 5% interest in Baripetrol.

The allocation of the purchase price is summarized in the table below:

Cost of purchase:

57,254,505 common shares of PetroFalcon	43,890,000
Acquisition costs	980,000
	<hr/>
	44,870,000

Allocation of the purchase price:

Cash and cash equivalents	257,141
Accounts receivables and other	114,886
Cash (settlement of account receivable from Lundin BV)	21,350,479
Investment in Baripetrol	23,173,601
Fixed assets	980
Account payables and accruals	(18,547)
Account payables to related companies	(8,540)
	<hr/>
	44,870,000

PetroCumarebo and Baripetrol dividends

Under Venezuelan law, dividends can only be declared to the extent that 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 may receive annual dividends in U.S. dollars, or quarterly loans against those projected dividends.

On March 4, 2008, Lundin Venezuela received a \$1.9 million dividend from Baripetrol for operations between January and September 2007. The dividend was credited against the historical cost of the investment instead of being recognized as income in the first quarter of 2008 because the dividend was related to earnings before the closing of the transaction.

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Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2008, and 2007

(expressed in U.S. dollars)

Venezuelan currency exchange rate

During the year ended December 31, 2007, the Company reviewed the accounting for foreign currency transactions in Venezuela due to the increasing spread between the official rate and the parallel implied market rate in Venezuela. It was determined that as a consequence of the rapid decline in the valuation of the Venezuelan Bolivar as reflected in the implied market for foreign currencies in Venezuela that the method of translation from Bolivars to U.S. dollars using the official rate was no longer appropriate. As a result, Management determined that Bolivar balances would be translated at implied market rates for the three and six months ended June 30, 2008, and 2007, as well as for the year ended December 31, 2007.

Anadarko transaction

On April 7, 2008, PetroFalcon announced the signing of a binding sale and purchase agreement for the acquisition of 100% of the issued and outstanding shares of Anadarko Venezuela Company (“Anadarko Venezuela”) from an affiliate of Anadarko Petroleum Corporation (“Anadarko Petroleum”).

PetroFalcon intends to acquire Anadarko Venezuela from Anadarko Petroleum for \$200 million in cash with a financial effective date of January 1, 2008. The agreement is subject to the approval of the Venezuelan Ministry of Energy and Petroleum (“MEP”).

Upon executing the sale and purchase agreement with Anadarko Petroleum, PetroFalcon delivered \$5 million (or 2.5% of the base purchase price) in cash to Anadarko Petroleum as a deposit for the transaction. This amount will be deducted from the purchase price at closing. According to the agreement, the cash deposit will be returned to PetroFalcon with interest if MEP approval is denied.

Anadarko Venezuela indirectly owns 18% of Petroritupano, S.A. (“Petroritupano”), a mixed company with PDVSA and Petrobras Energía, S.A. (“Petrobras”). In addition, Anadarko Venezuela holds a \$58 million voucher that can be used as credit with the Venezuelan government for new oil and gas investment opportunities.

Petroritupano has the exclusive right to explore, develop and produce oil and natural gas through 2025 from the Oritupano-Leona Block, which includes almost 340,000 acres in the Maturin sub-basin of eastern Venezuela with current onshore production of oil and natural gas.

Lundin Petroleum AB (“Lundin Petroleum”) has provided a guarantee to Anadarko Petroleum for the full purchase price. In consideration for the guarantee, PetroFalcon agreed to issue 17.1 million common shares of the Company to Lundin Petroleum or one of its subsidiaries, subject to regulatory approval. In April 2008, PetroFalcon issued 7.1 million of these shares to Lundin Petroleum, which, as of June 30, 2008, indirectly owned 45% of the issued and outstanding shares of the Company. If the transaction does not close, Lundin Petroleum will keep the initial 7.1 million shares. The remaining 10 million shares will be issued to Lundin Petroleum at closing of the acquisition.

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(Unaudited) For the three and six months ended June 30, 2008, and 2007

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PetroFalcon intends to fund the purchase price of the acquisition through third-party financing, which may be in the form of debt, equity or a combination thereof. If required, Lundin Petroleum has agreed to provide interim financing to PetroFalcon on commercial terms.

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, 2007, except as described in note 3.

3 Change in accounting policy

The CICA has issued four new standards that affect the financial disclosures and results of operations of the Company for interim and annual periods beginning January 1, 2008. The Company adopted the requirements commencing in the quarter ended March 31, 2008.

Section 1535, Capital disclosures, establishes standards for disclosing information about an entity's capital and how it is managed. Under this standard, the Company is required to disclose quantitative and qualitative information about its objectives, policies and processes for managing capital.

Sections 3862 and 3863, Financial instruments – disclosures and presentation, requires entities to disclose quantitative and qualitative information that enable users to evaluate (a) the significance of financial instruments for the Company's financial performance, and (b) the nature and extent of risks arising from financial instruments to which the Company is exposed during the period and at the balance sheet date, as well as Management's objectives, policies and procedures for managing such risks. The Company is required to disclose the measurement bases used and the criteria used to determine classification of financial instruments.

Section 1400, General standards on Financial Statement Presentation, has been amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The adoption of this standard had no impact on the Company's financial statements.

4 Investments

PetroCumarebo, S.A.

Effective April 1, 2006, Vincler Venezuela's Operating Service Agreements ("OSA") for the East and West Falcon blocks became a 40%-investment in the mixed company, PetroCumarebo.

On May 9, 2008, Vincler Venezuela received \$3.6 million from PDVSA related to capital expenditures incurred during the first quarter of 2006 under the former OSA. These costs had been considered as part of the investment cost in PetroCumarebo.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2008, and 2007

(expressed in U.S. dollars)

Baripetrol, S.A.

Effective February 1, 2008, the Company became the owner of 100% of the issued and outstanding shares of Lundin Venezuela, which owns a 5%-interest in the mixed company, Baripetrol.

Cardon III

On February 26, 2007, Vinccler Venezuela and Chevron Corporation (“Chevron”) announced signing 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 majority partner with a 70% interest. PDVSA retains the right to acquire up to 35% of the project after declaration of commerciality, and the transaction is subject to the approval of MEP.

On March 9, 2007, Vinccler Venezuela paid Chevron \$2.2 million, which included 30% of all Chevron’s costs related to the Cardon III Block before the effective date. On April 9, 2008, Vinccler Venezuela paid Chevron an additional \$3.2 million for 30% of the costs related to the Cardon III Block in 2007. According to the agreement, all funds paid by Vinccler Venezuela to Chevron will be returned with interest if MEP approval is denied.

Cardon IV

On March 12, 2008, PetroFalcon announced the signing of a letter of intent with Repsol, whereby Vinccler Venezuela will acquire 25% of the Cardon IV Block. The transaction is subject to the approval of MEP, as well as the negotiation and execution of a sale and purchase agreement.

Under the terms of the farm-in agreement, Vinccler Venezuela has no obligations relating to past capital expenditures on the Cardon IV Block and has paid nothing to date to Repsol.

5 Accounts receivable

At June 30, 2008, the current portion of accounts receivable mainly corresponds to reimbursements for expenses incurred by Lundin Venezuela for Baripetrol’s operations. The long-term portion of the receivable includes: \$1.1 million of value added tax (“VAT”) credit derived from the Company’s expenditures and \$0.6 million of VAT billed to PetroCumarebo.

At December 31, 2007, the Company had \$1.6 million of current accounts receivable related to inventory sold to PetroCumarebo. On May 6, 2008, Vinccler Venezuela received \$1.0 million from PetroCumarebo related to the inventory invoice. The long-term portion of the accounts receivable corresponds to VAT credit derived from the Company’s expenditures.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2008, and 2007

(expressed in U.S. dollars)

6 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 (for options exercised)	250,000	133,022
As at December 31, 2007	86,581,336	51,680,606
Private Placement	6,665,995	5,110,000
Acquisition of Lundin Venezuela	57,254,505	43,890,000
Issuance of broker's shares	569,284	436,400
Issuance of shares (for options exercised)	330,000	386,516
Agent's warrants	-	(1,867,386)
Guarantee fee paid to Lundin Petroleum	7,100,000	7,878,842
As at June 30, 2008	158,501,120	107,511,978

Contributed surplus

	\$
As at December 31, 2006	6,025,665
Stock-based compensation expense	2,046,665
As at December 31, 2007	8,072,330
Stock-based compensation expense	755,045
Issuance of shares (for options exercised)	(106,918)
As at June 30, 2008	8,720,457

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 after discharging all liabilities.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2008, and 2007

(expressed in U.S. dollars)

Acquisition of Lundin Venezuela

The Company issued 57,254,505 common shares at a price of CDN\$0.80 per share in connection with the Lundin Venezuela acquisition (see note 1).

Private placement

Concurrent with the acquisition of Lundin Venezuela, Lundin BV subscribed for 6,665,995 units of PetroFalcon at a purchase price of CDN\$0.80 per unit, resulting in additional proceeds to the Company of approximately \$5,110,000. Each unit consists of one common share and approximately 0.75 warrants, such that Lundin BV now holds an aggregate of 5,000,000 warrants. Each whole warrant expires on February 1, 2010, and is exercisable for one common share of PetroFalcon upon payment of CDN\$1.20 per share. The following assumptions were used in the Black-Scholes option pricing model for the fair value of the warrants:

Risk-free interest rate	3.13%
Expected volatility	110%
Dividend yield rate	0.00%
Expected life	2 years

Finder's fee

In connection with the acquisition and private placement, PetroFalcon paid a cash finder's fee in the amount of \$543,600 and issued 569,284 common shares of the Company to Nanes Delorme Capital Management, LLC, a boutique investment bank in New York City that is arm's length to the Company.

Stock option plan

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

	June 30, 2008		December 31, 2007	
	Share Options	Weighted Average Exercise Price CDN\$	Share Options	Weighted Average Exercise Price CDN\$
Outstanding – Beginning of period	10,796,494	1.81	10,406,494	1.85
Granted	250,000	1.00	1,070,000	1.00
Exercised	(330,000)	0.85	(250,000)	0.59
Forfeited	(1,582,834)	1.93	(430,000)	1.95
Outstanding – End of period	<u>9,133,660</u>	<u>1.80</u>	<u>10,796,494</u>	<u>1.81</u>
Options exercisable – End of period	<u>8,883,660</u>	<u>1.80</u>	<u>9,393,322</u>	<u>1.81</u>

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Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2008, and 2007

(expressed in U.S. dollars)

A summary of stock options outstanding at June 30, 2008, is set out below:

Exercise Price CDN\$	Outstanding Stock Options		Exercisable Stock Options
	Number	Weighted Average Remaining Contractual Life	Number
\$1.00	2,585,320	4.89 years	2,585,320
\$1.00	1,010,000	9.00 years	1,010,000
\$1.00	250,000	9.82 years	-
\$1.13	75,000	8.13 years	75,000
\$1.23	150,000	8.49 years	150,000
\$1.30	13,340	5.25 years	13,340
\$1.55	370,000	7.69 years	370,000
\$1.93	830,000	7.75 years	830,000
\$2.05	30,000	7.33 years	30,000
\$2.20	230,000	5.75 years	230,000
\$2.35	1,300,000	5.95 years	1,300,000
\$2.38	300,000	7.25 years	300,000
\$2.39	1,090,000	6.95 years	1,090,000
\$3.28	900,000	6.43 years	900,000
	<u>9,133,660</u>		<u>8,883,660</u>

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	3.51%
Expected volatility	87.36%
Dividend yield rate	0.00%
Weighted average expected life of options	5 and 10 years

7 Short-term debt

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

	June 30, 2008	December 31, 2007
Due to Vinccler Construction (see note 8) with no specific terms of repayment, unsecured and interest bearing at LIBOR plus 2%	-	350,000
Unsecured bank loans bearing average interest of 26% for 2008 and 20% for 2007; 90-day revolving basis, payable in Bolivars	-	2,142,857
	<u>-</u>	<u>\$2,492,857</u>

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8 Related party transactions and balances

Pacific Oil and Gas, LLC (“Pacific Oil and Gas”) and Venezolana de Inversiones y Construcciones Clerico, C.A. (“Vinccler Construction”) are controlled by officers of PetroFalcon. Pacific Oil and Gas is controlled by PetroFalcon’s Vice Chairman, Clarence Cottman, and PetroFalcon’s President and CEO, William Gumma. For the three months ended June 30, 2008, and 2007, the Company paid Pacific Oil and Gas for professional services in the amount of \$135,000. The Company paid Pacific Oil and Gas \$270,000 for the six months ended June 30, 2008, and 2007. These payments for professional services include the salaries of Mr. Gumma and PetroFalcon’s Chief Financial Officer, Garrett Soden, as well as the operating expenses for PetroFalcon’s technical office in Carpinteria, California.

PetroFalcon also receives construction services provided by Vinccler Construction, an independent operating construction company controlled by the Company’s Chairman, Juan Francisco Clerico. During the three and six months ended June 30, 2008, and 2007, PetroFalcon did not receive services from Vinccler Construction. On August 25, 2006, Vinccler Construction 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. On March 27, 2008, Vinccler Venezuela repaid this amount plus interest.

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.

Lundin Petroleum has provided a guarantee to Anadarko Petroleum for the full purchase price of Anadarko Venezuela. In consideration for the guarantee, PetroFalcon agreed to issue 17.1 million common shares of the Company to Lundin Petroleum or one of its subsidiaries, subject to regulatory approval. In April 2008, PetroFalcon issued 7.1 million of these shares to Lundin Petroleum, with a fair value of \$1.11 (CDN\$1.12) per share for a total amount of \$7,878,842. The remaining 10 million shares will be issued to Lundin Petroleum at closing of the transaction (see note 1). The guarantee fee amount has been amortized over the period of the guarantee from April 4, 2008, to October 31, 2008. During the three months ended June 30, 2008, the Company recorded expenses related to this guarantee in the amount of \$3.3 million.

9 Financial instruments and capital management

The Company is exposed to fluctuations in commodity prices, interest rates and Canadian/U.S. dollar and Venezuelan Bolivar/U.S. dollar exchange rates. The Company, where appropriate, utilizes financial instruments to manage its exposure to these risks. During the three and six months ended June 30, 2008, the Company did not hold or issue any derivative financial instruments.

The Company’s financial assets and liabilities as at June 30, 2008, included cash, accounts receivable, income tax recoverable, cash deposit (guarantee) and accounts payable.

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(expressed in U.S. dollars)

The fair value of cash and cash equivalents approximates their carrying value due to their short-term maturities.

The fair value of other financial assets and liabilities approximate their cost, due to either the short period to maturity or lack of an actively quoted market. Changes in the fair value of financial liabilities are due solely to fluctuations in interest rates, currency exchange rates and time value.

The Company has not incurred any fair value changes due to credit risk.

The Company defines capital as shareholders' equity, long-term debt (excluding non-recourse debt and transaction costs), short-term borrowings and non-controlling interests less cash and cash equivalents (excluding cash and cash equivalents from joint ventures and other interests not exclusively controlled by the Company).

The Company's objectives when managing capital are to maintain flexibility between providing liquidity for investment opportunities in the oil and gas sector in Venezuela and providing acceptable returns to shareholders. These objectives are primarily met through cash management and continuous review of attractive acquisition and development opportunities.

The Company currently has no externally imposed capital requirements.

At June 30, 2008, if the Bolivar had weakened or strengthened by 15% against the U.S. dollar, with all other variables held constant, post-tax income for the period would not have differed materially as a result of the change in the fair value of the Company's net monetary assets denominated in U.S. dollars.

At June 30, 2008, the Company had cash balances and no interest-bearing debt. The Company's current policy is to invest excess cash in investment-grade short-term deposits issued by Canadian banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2008, and 2007

(expressed in U.S. dollars)

10 Earnings (loss) per share

	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Net income (loss)	(\$4,412,050)	(\$1,050,158)	(\$6,087,543)	(\$1,851,410)
Weighted average number of common shares	157,447,823	86,381,336	143,264,472	86,381,336
Basic (loss) earnings per share	(0.03)	(0.01)	(0.04)	(0.02)
Diluted (loss) earnings per share*	(0.03)	(0.01)	(0.04)	(0.02)

* The calculation of diluted earnings per common share excludes options and warrants outstanding as the effect would be anti-dilutive.

11 Commitments and contingencies

The sale and purchase agreement with Anadarko Petroleum for the acquisition of Anadarko Venezuela establishes that if the agreement is terminated under certain circumstances and Anadarko becomes entitled to retain the cash deposit, the Company shall pay to Anadarko an additional amount equal to 17.5% of the base purchase price. This amount is covered under the guarantee provided by Lundin Petroleum.