

PetroFalcon Corporation

Interim Consolidated Financial Statements

(Unaudited)

September 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 nine months ended September 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)

	September 30, 2008	December 31, 2007
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	23,125,237	4,773,930
Accounts receivable (note 5)	5,674,909	1,606,112
Income tax recoverable	1,009,576	958,807
Prepaid expenses	601,568	-
	<hr/>	<hr/>
	30,411,290	7,338,849
Accounts receivable (note 5)	1,289,515	785,242
Investments in oil and gas activities: (note 4)		
PetroCumarebo, S.A.	40,649,651	44,280,462
Baripetrol, S.A.	20,222,313	-
Cardon III	5,404,057	5,404,057
Other investments	-	350,000
Property and equipment	367,273	188,876
	<hr/>	<hr/>
	98,344,099	58,347,486
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	891,268	3,569,118
Short-term debt (note 7)	-	2,492,857
	<hr/>	<hr/>
	891,268	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)	8,748,958	8,072,330
Accumulated deficit	(20,675,491)	(7,467,425)
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	97,452,831	52,285,511
	<hr/>	<hr/>
	98,344,099	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 September 30		Nine months ended September 30	
	2008 \$	2007 \$ (as restated - see note 1)	2008 \$	2007 \$ (as restated - see note 1)
Expenses				
General and administrative	2,167,365	1,534,999	5,364,323	5,094,284
Depreciation, depletion and amortization	35,716	26,603	87,427	97,255
Stock-based compensation (note 6)	28,501	256,608	783,546	1,769,731
	<u>2,231,582</u>	<u>1,818,210</u>	<u>6,235,296</u>	<u>6,961,270</u>
Loss before financing (expenses)	<u>(2,231,582)</u>	<u>(1,818,210)</u>	<u>(6,235,296)</u>	<u>(6,961,270)</u>
Financing (expenses) income				
Interest (expense) income, net	282,259	(142,394)	452,624	(543,920)
Foreign exchange (loss) gain	(556,450)	1,266,602	(37,446)	4,959,777
Guarantee fee (note 8)	(4,614,750)	-	(7,878,842)	-
Other (expense) income	-	575,373	490,894	575,374
	<u>(4,888,941)</u>	<u>1,699,581</u>	<u>(6,972,770)</u>	<u>4,991,231</u>
Net loss and comprehensive loss	<u>(7,120,523)</u>	<u>(118,629)</u>	<u>(13,208,066)</u>	<u>(1,970,039)</u>
Accumulated deficit – Beginning of period	<u>(13,554,968)</u>	<u>(5,731,539)</u>	<u>(7,467,425)</u>	<u>(3,880,129)</u>
Accumulated deficit – End of period	<u>(20,675,491)</u>	<u>(5,850,168)</u>	<u>(20,675,491)</u>	<u>(5,850,168)</u>
Basic and diluted loss per share (note 10)	<u>(0.04)</u>	<u>(0.00)</u>	<u>(0.09)</u>	<u>(0.02)</u>

PetroFalcon Corporation

Interim Consolidated Statements of Cash Flows (Unaudited)

(expressed in U.S. dollars)

	Three months ended September 30		Nine months ended September 30	
	2008 \$	2007 \$ (as restated – see note 1)	2008 \$	2007 \$ (as restated – see note 1)
Cash provided by (used in)				
Operating activities				
Net loss	(7,120,523)	(118,628)	(13,208,066)	(1,970,039)
Items not affecting cash				
Depreciation, depletion and accretion	35,716	26,603	87,427	97,255
Other	-	-	-	(118,571)
Guarantee fee	4,614,750	-	7,878,842	-
Bad debt expense	-	-	72,923	-
Other Investments	350,000	-	350,000	-
Stock-based compensation	28,501	256,608	783,546	1,769,731
	(2,091,556)	164,583	(4,035,328)	(221,624)
Net change in non-cash working capital items				
Accounts receivable	(4,595,354)	2,477,039	(4,645,993)	9,620,023
Accounts payable and accrued liabilities	185,938	(588,156)	(2,677,850)	(10,260,888)
Income taxes recoverable / payable – net	102,321	(487,306)	(50,769)	(368,440)
Deposit in guarantee	5,000,000	-	-	-
Prepaid expenses	(601,568)	-	(601,568)	-
	(2,000,219)	1,566,160	(12,011,508)	(1,230,929)
Financing activities				
Repayment of short-term debt	-	(1,725,293)	(2,492,857)	(7,770,198)
Proceeds received on exercise of share options and warrants	-	71,860	276,599	133,022
Acquisition of Lundin Latina de Petróleos, S.A.	-	-	26,263,541	-
	-	(1,653,433)	24,047,283	(7,637,176)
Investing activities				
Proceeds on sale of property and equipment	-	-	3,630,811	5,094,631
Acquisition of property and equipment	(79,986)	(214,355)	(266,566)	(214,352)
Receipt of Baripetrol dividend	1,041,287	-	2,951,287	-
Investment in affiliates	-	-	-	(2,225,626)
	961,301	(214,355)	6,315,532	2,654,653
Net (decrease) increase in cash during period	(1,038,918)	(301,628)	18,351,307	(6,213,452)
Cash – Beginning of period	24,164,155	5,982,750	4,773,930	11,894,574
Cash – End of period	23,125,237	5,681,122	23,125,237	5,681,122
Supplementary information				
Interest paid	-	815,605	588,852	1,101,523
Income taxes paid	-	847,232	-	1,354,521

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and nine months ended September 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 nine months ended September 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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(expressed in U.S. dollars)

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
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	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.

During the nine months ended September 30, 2008, Lundin Venezuela received \$2.9 million in dividends from Baripetrol for operations between January and December 2007. The dividends were credited against the historical cost of the investment instead of being recognized as income

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Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and nine months ended September 30, 2008, and 2007

(expressed in U.S. dollars)

during the nine months ended September 30, 2008, because the dividends were related to earnings before the closing of the transaction.

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 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 nine months ended September 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”) for \$200 million in cash. 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.

Anadarko Venezuela indirectly owns 18% of Petroritupano, S.A. (“Petroritupano”), a mixed company with PDVSA and Petrobras Energía, S.A. (“Petrobras”).

At the request of PetroFalcon, Lundin Petroleum AB (“Lundin Petroleum”) 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 September 30, 2008, indirectly owned 45% of the issued and outstanding shares of the Company.

Anadarko Petroleum has since terminated the sale and purchase agreement with PetroFalcon and returned the \$5 million cash deposit with interest (see note 11).

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.

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Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and nine months ended September 30, 2008, and 2007

(expressed in U.S. dollars)

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 enables 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.

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, Vincler Venezuela and Chevron Corporation ("Chevron") announced signing a Heads of Terms agreement whereby Vincler 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%

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

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(expressed in U.S. dollars)

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.

Vinccler Venezuela has since terminated the negotiation of a sale and purchase agreement with Repsol (see note 11).

5 Accounts receivable

At September 30, 2008, the current portion of accounts receivable included \$5.0 million of the cash deposit delivered to Anadarko (Deposit in Guarantee) (see note 1), \$0.2 million of advance to suppliers, \$0.1 million of interest and \$0.1 million of fiscal credits related to value added tax ("VAT"). The long-term portion of the receivable includes: \$0.9 million of VAT credit derived from the Company's expenditures and \$0.4 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.

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Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and nine months ended September 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	383,516
Agent's warrants	-	(1,867,386)
Guarantee fee paid to Lundin Petroleum	7,100,000	7,878,842
As at September 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	783,546
Issuance of shares (for options exercised)	(106,918)
As at September 30, 2008	8,748,958

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 nine months ended September 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:

	September 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	350,000	1.53	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	9,233,660	1.79	10,796,494	1.81
Options exercisable – End of period	8,883,660	1.80	9,393,322	1.81

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Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and nine months ended September 30, 2008, and 2007

(expressed in U.S. dollars)

A summary of stock options outstanding at September 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	4.64 years	2,585,320
\$1.00	1,010,000	8.75 years	1,010,000
\$1.13	75,000	7.88 years	75,000
\$1.23	150,000	8.24 years	150,000
\$1.30	13,340	5.00 years	13,340
\$1.37	100,000	9.87 years	-
\$1.55	370,000	7.44 years	370,000
\$1.59	250,000	9.57 years	-
\$1.93	830,000	7.50 years	830,000
\$2.05	30,000	7.08 years	30,000
\$2.20	230,000	5.50 years	230,000
\$2.35	1,300,000	5.70 years	1,300,000
\$2.38	300,000	7.00 years	300,000
\$2.39	1,090,000	6.70 years	1,090,000
\$3.28	900,000	6.18 years	900,000
	<u>9,233,660</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	3.46%
Expected volatility	75.86%
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:

	September 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 20% for 2007; 90-day revolving basis, payable in Bolivars	-	2,142,857
	<u>-</u>	<u>\$2,492,857</u>

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(expressed in U.S. dollars)

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 September 30, 2008, and 2007, the Company paid Pacific Oil and Gas for professional services in the amount of \$165,000 and \$135,000, respectively. The Company paid Pacific Oil and Gas for the nine months ended September 30, 2008, and 2007, \$435,000 and \$405,000, respectively. These payments include the salaries of Mr. Gumma and PetroFalcon’s Chief Financial Officer, Garrett Soden, as well as administrative services from Pacific Oil and Gas.

PetroFalcon occasionally receives construction services from Vinccler Construction, an independent operating construction company controlled by the Company’s Chairman, Juan Francisco Clerico. During the three and nine months ended September 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.

PetroFalcon also receives technical services from Lundin BV, a wholly-owned subsidiary of Lundin Petroleum. Lundin Petroleum indirectly owns 45% of PetroFalcon, and Lundin Petroleum’s CEO, Ashley Heppenstall, is a board member of PetroFalcon. For the three months ended September 30, 2008, and 2007, the Company paid Lundin BV for professional services in the amount of \$80,170 and nil, respectively. The Company paid Lundin BV for the nine months ended September 30, 2008, and 2007, \$80,170 and nil, respectively. These payments for professional services include oil and gas geology, reserve and legal advice for PetroFalcon’s business development activities.

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 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 were due at closing and, according to the agreement, will not be issued (see note 11). The initial shares have been expensed by the Company as a stock-based financing fee.

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(expressed in U.S. dollars)

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 nine months ended September 30, 2008, the Company did not hold or issue any derivative financial instruments.

The Company's financial assets and liabilities as at September 30, 2008, included cash and cash equivalents, accounts receivable, income tax recoverable, and accounts payable. 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 the short period to maturity. 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 September 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 September 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 nine months ended September 30, 2008, and 2007

(expressed in U.S. dollars)

10 Earnings (loss) per share

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net loss	(\$7,120,523)	(\$118,629)	(\$13,208,066)	(\$1,970,039)
Weighted average number of common shares	158,501,120	86,456,336	148,399,167	86,456,336
Basic loss per share	(0.04)	(0.00)	(0.09)	(0.02)
Diluted loss per share*	(0.04)	(0.00)	(0.09)	(0.02)

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

11 Subsequent events

In the fourth quarter of 2008, the Company terminated the negotiation of the sale and purchase agreement with Repsol for the proposed farm-in on the Cardon IV Block (see note 4).

PetroFalcon has paid nothing to date to Repsol and has no ongoing capital commitment for the Cardon IV Block.

On October 8, 2008, the Company announced in a press release that it had been advised that MEP denied approval for the acquisition of Anadarko Venezuela because PDVSA intends to acquire Anadarko Petroleum's interest in Petroritupano. Anadarko Petroleum subsequently terminated the sale and purchase agreement and returned PetroFalcon's \$5 million deposit with interest (see note 1). According to the guarantee agreement, Lundin Petroleum will keep the initial 7.1 million shares issued by PetroFalcon, but the remaining 10 million shares due at closing will not be issued.

On October 13, 2008, Vinccler Venezuela received a \$0.7 million loan from Banco Exterior to meet its short-term working capital needs. Vinccler Venezuela's local currency credit line is guaranteed by U.S. dollars.