

PetroFalcon Corporation

Interim Consolidated Financial Statements

(Unaudited)

June 30, 2006 and 2005

(expressed in U.S. dollars)

The accompanying unaudited interim consolidated financial statements of PetroFalcon Corporation for the three and six months ended June 30, 2006 and 2005, have been prepared by management and approved by the Audit Committee and the Board of Directors of the Company.

PetroFalcon Corporation
Interim Consolidated Balance Sheets
(Unaudited)

(expressed in U.S. dollars)

	June 30, 2006	December 31, 2005
	\$	\$
Assets		
Current assets		
Cash	11,018,055	9,297,444
Accounts receivable (note 3)	7,298,616	14,378,285
Income tax recoverable	1,712,935	412,423
Future income tax	1,116,772	1,082,375
	<hr/>	<hr/>
	21,146,378	25,170,527
Property and equipment	<hr/>	<hr/>
	49,575,846	46,004,470
	<hr/>	<hr/>
	70,722,224	71,174,997
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	2,424,214	4,801,490
Current portion of long term debt (note 7)	10,069,767	10,081,395
	<hr/>	<hr/>
	12,493,981	14,882,885
Future income tax	769,833	769,833
Long-term debt (note 7)	4,000,000	8,000,000
Provision for asset retirement obligation	1,381,923	522,557
	<hr/>	<hr/>
	18,645,737	24,175,275
Shareholders' equity		
Capital stock (note 6)	47,522,094	40,797,542
Warrants (note 6)	118,571	118,571
Contributed surplus (note 6)	4,501,020	3,268,067
Retained earnings (deficit)	<hr/>	<hr/>
	(65,198)	2,815,542
	<hr/>	<hr/>
	52,076,487	46,999,722
	<hr/>	<hr/>
	70,722,224	71,174,997
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PetroFalcon Corporation

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

(expressed in U.S. dollars)

	Six months ended June 30,		Three months ended June 30,	
	2006 \$	2005 \$	2006 \$	2005 \$
Revenue (note 1, 11)	3,129,029	5,014,251	-	2,469,213
Expenses				
Operating and maintenance	1,140,947	1,307,126	176,488	683,191
General and administrative	1,364,571	1,835,405	442,063	957,911
Amortization, depletion and accretion	595,386	794,257	82,698	384,697
Stock-based compensation	1,277,149	897,000	687,149	453,000
	4,378,053	4,833,788	1,388,398	2,478,799
Income (loss) before financing income (expenses) and income tax	(1,249,024)	180,463	(1,388,398)	(9,586)
Financing income (expenses)				
Interest on bank loans	(1,288,050)	(261,091)	(474,541)	(162,613)
Interest on bank deposits	109,727	154,865	66,112	56,328
Gain on financing transactions (note 5)	-	1,355,972	-	680,233
Gain (loss) on foreign exchange	88,996	54,072	96,767	(2,977)
	(1,089,327)	1,303,818	(311,662)	570,971
Income before income tax	(2,338,351)	1,484,281	(1,700,060)	561,385
Income tax (note 9)	(542,389)	(434,149)	-	(133,080)
Net income (loss)	(2,880,740)	1,050,132	(1,700,060)	428,305
Retained earnings (deficit) – Beginning of period	2,815,542	1,805,939	1,634,862	2,427,766
Retained earnings (deficit) – End of period	(65,198)	2,856,071	(65,198)	2,856,071
Weighted average number of common shares outstanding	79,891,083	75,256,515	80,766,083	76,423,938
Basic and diluted earnings (loss) per share (note 13)	(0.03)	0.01	(0.02)	0.01

PetroFalcon Corporation

Interim Consolidated Statements of Cash Flows (Unaudited)

(expressed in U.S. dollars)

	Six months ended June 30,		Three months ended June 30,	
	2006 \$	2005 \$	2006 \$	2005 \$
Cash provided by (used in)				
Operating activities				
Net income (loss) for the period	(2,880,740)	1,050,132	(1,700,060)	428,305
Items not affecting cash				
Amortization, depletion and accretion	595,386	794,257	82,698	384,697
Foreign Exchange	(34,396)	-	(34,396)	-
Stock-based compensation	1,277,149	897,000	687,149	453,000
	(1,042,601)	2,741,389	(964,609)	1,266,002
Net change in non-cash working capital items				
Accounts receivable	9,872,689	(2,272,969)	1,926,085	(1,805,546)
Accounts payable and accrued liabilities	(2,794,291)	906,299	(3,539,272)	603,939
Income tax payable	(471,525)	111,206	(897,280)	77,775
	5,564,272	1,485,925	(3,475,076)	142,170
Financing activities				
Proceeds from private placement	-	4,000,000	-	4,000,000
Warrants (note 6)	-	118,571	-	118,571
Restricted Cash	-	(225,000)	-	(225,000)
Proceeds from (repayment of) bank loans	(11,628)	11,151,223	2,000,000	11,970,930
Proceeds received on exercise of share options and warrants	117,854	129,704	117,854	39,834
	106,227	15,174,498	2,117,854	15,904,335
Investing activities				
Purchase of West Falcon Hydrocarbons, S.R.L (note 4)	(2,016,214)	-	-	-
Acquisition of property and equipment	(1,772,508)	(23,784,653)	(718,153)	(11,054,177)
Movement in non-cash working capital from investing activities	(161,166)	8,513,416	2,571,686	932,402
	(3,949,888)	(15,271,237)	1,853,533	(10,121,775)
Net increase in cash during the period	1,720,610	1,389,186	496,311	5,924,730
Cash – Beginning of period	9,297,444	20,445,802	10,521,743	15,910,258
Cash – End of period	11,018,054	21,834,988	11,018,054	21,834,988
Supplementary information				
Interest paid, net	1,113,397	335,271	1,039,539	226,645
Income tax paid	788,233	330,609	448,472	132,161

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

1 Description of business

PetroFalcon Corporation (“PetroFalcon” or the “Corporation”) is engaged in the exploration, development, production and management of oil and natural gas properties through its indirect wholly-owned subsidiaries, Vinccler Oil and Gas, C.A. (“Vinccler Venezuela”) and West Falcon Hydrocarbons, S.R.L (“West Falcon”) in Venezuela. PetroFalcon’s revenues for the first three months ended March 31, 2006, were derived from the East Falcon Block under the Operating Service Agreement (“OSA”) with Petróleos de Venezuela, S.A. (“PDVSA”), the state oil company of Venezuela.

On March 31, 2006, Vinccler Venezuela reached an initial agreement with the Venezuelan government with respect to its oil and natural gas rights in Venezuela. Vinccler Venezuela signed a Memorandum of Understanding (“MOU”) with PDVSA and its affiliated entity, Corporación Venezolana del petróleo (“CVP”), to create the Empresa Mixta, which will hold all operating rights to the West Falcon Block and the East Falcon Block. It is currently intended that the name of the Empresa Mixta will be Petrocumarebo (recently changed from the previous Petromiranda). The transition to the Empresa Mixta converts Vinccler Venezuela’s interests in the East Falcon Block and West Falcon Block, covering more than 800,000 acres in northwestern Venezuela, into a single development entity, and it gives the Empresa Mixta the exclusive right to produce and sell oil and associated natural gas from the two blocks.

On May 5, 2006, the National Assembly of Venezuela published in its Official Gazette the Accord that authorizes the incorporation of the Empresa Mixta and the conversion of the Operating Services Agreements for both the East Falcon Block and the West Falcon Block. The Accord also confirmed the 40% proposed ownership of Vinccler Venezuela such that the ownership structure of the Empresa Mixta will be 40% held by Vinccler Venezuela and 60% held by CVP.

The Petrocumarebo contract has not yet been executed, and the final agreements have not yet been fully negotiated between the parties. However, the MOU establishes the following general structure for Petrocumarebo:

- Petrocumarebo will pay a royalty at the rate of 33.3% on oil and natural gas production
- Petrocumarebo will have an applicable income tax rate of 50%
- Petrocumarebo will have a term of 20 years
- Vinccler Venezuela will receive dividends from Petrocumarebo in US dollars on a quarterly basis derived from its 40% participation
- The effective date of Petrocumarebo is April 1, 2006

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

- Vinccler Venezuela will be responsible for 40% of Petrocumarebo's approved 2006 capital expenditure budget of \$40.7 million and 40% of the operating expenses

Vinccler Venezuela has agreed with PDVSA to continue operating the East Falcon Block and the West Falcon Block during a transitional period starting April 1, 2006 until the Empresa Mixta is incorporated ("Transitional Period Terms") under the following general terms:

- Vinccler Venezuela will be reimbursed 100% by PDVSA for capital expenditures and expenses incurred related to the East and West Falcon blocks
- Vinccler Venezuela will continue delivering the oil and natural gas production from the East Falcon Block and the West Falcon Block to PDVSA, which will be invoiced by the Empresa Mixta once Petrocumarebo is incorporated

However, the Transitional Period Terms do not address the allocation of revenue and, therefore, PetroFalcon, through Vinccler Venezuela, is not yet in a position to record any revenue for the quarter ended June 30, 2006.

Although Management expects that upon completion of the conversion of the Empresa Mixta, there will be an adjustment between the parties to obtain the same economic result as if the conversion had been completed on April 1, 2006, Management has decided, in consultation with the auditors, that PetroFalcon will not be able to include the results of the Empresa Mixta operations in our consolidated financial statements unless and until the conversion to the Empresa Mixta is complete with Vinccler Venezuela holding an equity interest of 40%.

2 Significant accounting policies

The interim consolidated financial statements include the accounts of the Corporation 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, 2005.

Petrocumarebo's Incorporation Act Project ("Incorporation Act") in the MOU indicates that both parties agree to contractually share the continuing power to determine its strategic operating, investing and financing policies. When accounting for Vinccler Venezuela's interests in Petrocumarebo, it is essential that the Corporation reflect the substance and underlying economic reality of its interest. Management expects that once the Empresa Mixta is officially incorporated the Corporation will account for its interest in PetroCumarebo using proportionate consolidation method.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

3 Accounts Receivable

At June 30, 2006, PetroFalcon had \$7.3 million in accounts receivable (\$14.4 million as at December 31, 2005) of which \$2 million represents credit for IVA (Value Added Taxes) incurred as a result of the Corporation's expenditures as of June 30, 2006; and \$3.8 million which represents the reimbursements for expenses and capital investments incurred by Vinccler Venezuela during the Transitional Period related to Petrocumarebo's operations during the three months ended June 30, 2006. Vinccler Venezuela will continue to pay 100% of the operating expenses and capital investments for the East and West Falcon blocks, with subsequent reimbursements expected from PDVSA (see note 1).

4 Acquisition of West Falcon Block

Effective March 21, 2006, Vinccler Venezuela completed the acquisition of West Falcon. The purchase price consisted of a cash payment of \$ 2.55 million and 1.75 million common shares of the Corporation (see note 6).

The business combination has been accounted for using the purchase method of accounting. The following table summarizes the purchase price allocation for the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition. The below amounts are estimates and are subject to refinement.

Cash	533,859
Accounts receivable	1,914,796
Property, plant and equipment	3,263,112
Income tax recoverable	828,989
Accounts payable	(578,181)
Asset retirement obligations	<u>(850,000)</u>
Total net assets acquired	<u>5,112,575</u>

5 Gain on financing transactions

During the six months ended June 30, 2005, the Company's subsidiary, Vinccler Venezuela, realized a foreign exchange gain of \$1,355,972 as a result of the acquisition and disposal of US dollar denominated Venezuelan government bonds. During the three months ended June 30, 2005, Vinccler Venezuela realized a foreign exchange gain of \$680,233. No gains on financing transactions were recorded during the three and six months ended June 30, 2006.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(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, 2005	77,631,407	40,797,542
Issue of shares (note 4)	1,750,000	2,562,501
Conversion of long term debt (note 7)	2,639,651	4,000,000
Exercise of share options	129,700	117,854
Transfer from contributed surplus		44,197
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As at June 30, 2006	82,150,758	47,522,094

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 which may be declared.

Stock option plan

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

	June 30, 2006		June 30, 2005	
	Share Options	Weighted- average exercise price CDN\$	Share Options	Weighted- average exercise price CDN\$
Outstanding – December 31	8,896,194	1.86	7,420,000	1.67
Granted	1,660,000	1.79	1,601,500	2.39
Exercised	(129,700)	1.04	(256,573)	0.54
Cancelled	(135,000)	2.08	-	-
	<hr/>		<hr/>	
Outstanding – June 30	10,291,494	1.92	8,764,927	1.83
	<hr/>		<hr/>	
Options exercisable – June 30	6,416,814	1.58	4,300,093	1.19

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

A summary of stock options outstanding at June 30, 2006, is set out below:

Exercise price	Outstanding stock options		Exercisable stock options
	Number	Weighted average remaining contractual life	Number
\$0.50	250,000	2.20 years	250,000
\$0.72	100,000	0.90 years	100,000
\$1.00	3,318,654	7.20 years	3,225,320
\$1.30	13,340	7.50 years	6,672
\$1.55	580,000	9.72 years	137,500
\$1.93	980,000	9.75 years	245,000
\$2.05	30,000	9.33 years	-
\$2.20	290,000	8.00 years	193,332
\$2.35	1,885,000	8.20 years	1,256,663
\$2.38	300,000	9.25 years	-
\$2.39	1,544,500	8.95 years	668,994
\$3.28	1,000,000	8.40 years	333,333
	<u>10,291,494</u>		<u>6,416,814</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	3.33%
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 IFC financing. 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 June 30, 2006, 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 4) at a total cost of CDN\$2.984 million (\$2.563 million).

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

Conversion of long-term debt

On April 20, 2006, PetroFalcon issued 2,639,651 common shares at a price of CDN\$1.77 per share as a result of the conversion of \$4,000,000 of long-term debt (see note 7).

7 Long-term debt

The Corporation's debt consists of the following:

	Three months ended	
	June 30,	
	2006	2005
	\$	\$
Short-term local bank loans bearing interest at an average of 14%, due within 90 days	10,069,767	5,976,744
Due to International Finance Corporation bearing interest at Libor plus 1% (5.44%), with maturity in 2011	4,000,000	8,000,000
	<u>14,069,767</u>	<u>13,976,744</u>
Short -term	10,069,767	5,976,744
Long -term	<u>4,000,000</u>	<u>8,000,000</u>

Short-term local bank loans \$10,069,767 consisted of Vinccler Venezuela's lines of credit with Venezuelan banks to meet its short-term working capital and local currency financing.

On June 26, 2005, the Corporation reached an agreement with the International Finance Corporation ("IFC"), the private sector arm of the World Bank, pursuant to which the IFC will provide up to \$36 million in loans to Vinccler Venezuela for the development of the Corporation's oil and gas properties. During the second quarter of 2005, the IFC disbursed \$12 million from the "C" Loan. Principal repayments on the "C" Loan are due in 2011. Interests are payable semi-annually on May 15 and November 15 at the London Inter Bank Offered Rate ("Libor") plus 1% for the "C" Loan from June 27, 2005, the date of the full disbursement of the "C" loan. IFC is also entitled to receive three percent of Vinccler Venezuela's cash flow ("Additional Interest") so long as it does not exceed 10% per annum of the principal amount of the "C" loan on an aggregate accumulated basis. On April 5, 2006, the IFC provided notice pursuant to the terms of the "C" Loan Agreement of its intention to convert \$4 million of its outstanding loan into common shares of PetroFalcon Corporation. The IFC received 2,639,651 shares of PFC at a price of CDN \$1.77 per share based on the market weighted average share price over the previous 20 trading days to the notice date. The IFC has now converted \$8 million of the original \$12 million disbursed in 2005 into common shares of PetroFalcon Corporation. Following this conversion, the remaining outstanding principal due to IFC is \$4 million.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

8 Related party transactions and balances

Pacific Oil and Gas, LLC and Venezolana de Inversiones y Construcciones Clerico, C.A. are controlled by officers of PetroFalcon. For the three months ended June 30, 2006, the Corporation paid to Pacific Oil and Gas, LLC, controlled by PetroFalcon's Chief Financial Officer, Clarence Cottman and the Corporation's President, William Gumma, \$210,000 for professional services (\$210,000 for the three months ended June 30, 2005). For the six months ended June 30, 2006, the Corporation paid to Pacific Oil and Gas, LLC, \$420,000 (\$420,000 for the six months ended June 30, 2005).

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 June 30, 2006, PetroFalcon did not receive services from Venezolana de Inversiones y Construcciones Clerico, C.A. (\$378,994 during the three months ended June 30, 2005). During the six months ended June 30, 2006 the Corporation was invoiced \$11,669 for construction services (\$1.18 million for the six months ended June 30, 2005).

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.

9 Income Tax

During the six months ended June 30, 2006, the Corporation recorded a current income tax expense of \$542,389 (\$434,149 during the six months ended June 30, 2005) .

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 years ended December 31, 2001 to 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 an additional income tax expense of \$542,389 for the years ended December 31, 2001 to 2004.

During the three months ended June 30, 2006, the SENIAT performed a revision to Vinccler Venezuela's income tax expense for the fiscal year ended December 31, 2005. The revision concluded with no amount due to the SENIAT (See note 13).

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

10 Financial instruments

The Corporation is exposed to fluctuations in commodity prices, interest rates and Canada/U.S. dollar 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 and six months ended June 30, 2006, the Company did not hold or issue any derivative financial instruments. The Company's financial assets and liabilities as at June 30, 2006 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.

11 Economic dependence

Prior to April 1, 2006, payments to the Corporation from PDVSA under the OSA and its Gas Addendum were the primary source of revenues. During Vinccler Venezuela's Transitional Period, the Corporation depends on reimbursements from PDVSA for investments and expenses incurred related to the East and West Falcon blocks. Any material failure of PDVSA to fulfill its obligations would have a material adverse effect on the Corporation's business, financial condition and results of operations.

Once Petrocumarebo is officially incorporated, the Corporation will depend on quarterly dividend payments derived from its 40% interest. Any material failure of Petrocumarebo to pay dividends would have a material adverse effect on the Corporation's business, financial condition and results of operations.

12 Earnings (loss) per share

	Six months ended		Three months ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net (loss) income	(\$2,880,740)	\$1,050,132	(\$1,700,060)	\$428,305
Weighted average number of shares	79,891,083	75,256,515	80,766,083	76,423,938
Stock Options and Warrants*	4,261,994	8,864,927	4,261,994	7,864,927
Basic (loss) earnings per share	(\$0.03)	\$0.01	(\$0.02)	\$0.01
Diluted (loss) earnings per share*	(\$0.03)	\$0.01	(\$0.02)	\$0.01

* The calculation of diluted earnings per common share excludes 6,129,500 options outstanding during the three and six months ended June 30, 2006 and 1,000,000 of options outstanding during the three months ended June 30, 2005, as these would have been anti-dilutive to the calculation.

PetroFalcon Corporation

Notes to Interim Consolidated Financial Statements

(Unaudited) For the three and six months ended June 30, 2006 and 2005

(expressed in U.S. dollars)

13 Subsequent Events

On July 26, 2006, Vinccler Venezuela received a resolution from the SENIAT with respect to the review of the income tax return for the years ended December 31, 2005, resulting in no amounts due to the SENIAT. The resolution includes SENIAT's objections to items affecting Vinccler Venezuela's outstanding tax credits for \$50,000, which will continue through a revision process.