

Management's Discussion and Analysis

The following discussion and analysis as provided by the management of PetroFalcon Corporation (the "Company") should be read in conjunction with the Company's audited consolidated financial statements for the years ending December 31, 2003 and 2002. The discussion in the MD&A focuses on the operating and financial results for 2003 and 2002 and provides an outlook for 2004. Estimates and forward-looking information are based on assumptions of future events and actual results may vary from these estimates.

MD&A contains the term "cash flow from operations", which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian Generally Accepted Accounting Principles (GAAP) as an indicator of the Company's performance. PetroFalcon's determination of "cash flow from operations" may not be comparable to that reported by other companies. The reconciliation between net earnings and "cash flow from operations" can be found in the audited Consolidated statements of cash flows in the 2003 and 2002 audited annual financial statements. The Company also presents cash flow from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of earnings per share. All amounts are in US Dollars unless otherwise indicated.

For the purposes of calculating unit costs, unit netbacks and combined production and revenue, natural gas has been converted to a barrel of oil equivalent (boe) using a conversion rate of six thousand cubic feet equal to one barrel (6:1) unless otherwise stated.

Production and Revenue

For the year ended December 31, 2003, average production was 551 boe/d. This average production was comprised of 404 bbls/d of oil and 882 mcf/d of natural gas. Natural gas was only produced for three months at the end of 2003. At the end of 2003, PetroFalcon had 9 producing oil wells, 4 shut-in gas wells and 3 shut-in oil wells.

PetroFalcon anticipates an increase in production volumes of oil during 2004. The incremental production is dependent on the capital drilling and recompletion program on existing properties. The Company expects a substantial increase in natural gas production in early 2005 from the La Vela and Cumarebo fields.

PetroFalcon recorded revenue in the amount of \$ 3.2 million for the year ended December 31, 2003 compared to \$ 2.4 million for the year ended December 31, 2002. The average prices received were: \$19.05 per barrel of oil, \$0.90 per mcf for natural gas, for a combined revenue price of \$16.13 per boe. In 2002, the Company's average price for oil was \$16.50 per barrel and the Company had no natural gas production. The Company currently has no hedging contracts and benefited from the strength in oil prices during the year. Oil and natural gas production are delivered to Petroleos de Venezuela (PDVSA) and Company receives payment in accordance with its operating service agreement with PDVSA. In its 2004 forecast, PetroFalcon uses commodity prices of \$30.00 per barrel WTI for oil (\$18.30 net to the Company) and \$0.90 per mcf for natural gas. The oil price forecast is a conservative estimate based on actual prices to date and the forward price of light sweet crude oil. The gas price is the contracted price under the Company's contract with PDVSA.

All the Company's revenues are received in US Dollars.

Royalties

PetroFalcon's oil and gas production is not subject to any royalties.

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Operating Costs

(\$000s except boe amounts)

	2003	2002
Operating costs	1,400	991
Average cost (\$ per boe)	6.96	6.01

Total operating expenses are anticipated to increase in 2004 as a result of production growth. On a per unit basis, costs are expected to remain reasonably consistent in 2004.

General and Administrative Costs

(\$000s except boe amount)

	2003	2002
Expenses:	1,651	1,158
Average cost (\$ per boe)	8.21	7.02

General and administrative costs increased by 43% to \$1.6 million in 2003 from \$1.2 million in 2002. Increased general and administrative costs are due to the additional staff and incremental costs associated with the Company's exploration and development growth plans. The increase in general and administrative costs compared to the previous year also reflects the fact that PetroFalcon became a reporting company in 2003. PetroFalcon is currently staffed to support higher production levels and the Company expects these costs to decrease on a per boe basis as the production increases in 2004.

PetroFalcon does not capitalize general and administrative costs.

Amortization and Depreciation

(\$000s except boe amount)

	2003	2002
Depletion	534	575
Depreciation	108	66
Total	642	641
Depletion rate (\$ per boe)	3.19	3.88

Depletion and depreciation for 2003 was \$.642 million versus \$.641 million in 2002. The DD&A expense per unit is expected to remain relatively constant during 2004.

Interest Income and Expense

At December 31, 2003 PetroFalcon had \$4.5 million in cash and short-term deposits compared to \$1.7 million at year-end 2002. Interest income increased by 350% from \$18,429 in 2002 to \$87,537 in 2003. The year-over-year increase is due to the receipt of proceeds for the equity issue that increased the cash balance.

In 2003, PetroFalcon incurred interest expense of \$.623 million versus \$.556 million in 2002. Interest expense is expected to decline in 2004 due to lower debt levels.

In 2003, the Company recorded an exchange gain of \$.623 million, a gain on bond sales of \$.644 million and other income of \$.702 million on the repayment of a debt. The company expects to continue to record exchange and bond sale gains in 2004 due to currency controls in Venezuela. The bad debt repayment is a one time event based on partial repayment of the Zelitt loan.

Income Taxes

(\$000s)

	2003	2002
Current tax	84	0

The Company's wholly owned operating subsidiary has a tax loss carry forward of \$.847 million available until 2005.

The Company's taxability in 2004 will depend on a number of factors including the extent of operating expenditures, interest expense, general and administrative costs, and incremental income associated with new production and oil prices.

Capital Budget 2004

PetroFalcon anticipates a base capital budget of \$28.75 million in 2004.

(\$000s)

	2004	2003
Venezuelan development expense		
- Drilling	5,500	787
- Workovers	3,500	594
- Facilities	10,300	1,800
- Pipelines	7,500	500
- Equipment	200	117
Venezuelan exploration expense		0
- Sidetrack	1,000	0
- Seismic	500	0
- Geochem Study	250	0
Total	28,750	3,798

Cash Flow from Operations and Net Earnings

(\$000s except per share data)

	2003	2002
Cash flow from operations	1,541	(196)
Cash flow		
Per basic share	0.03	(0.01)
Per diluted share	0.03	(0.01)
Net income (loss)	561	(836)
Per basic share	0.01	(0.02)
Per diluted share	0.01	(0.02)

The increase for net earnings is primarily due to exchange gains in 2003.

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Operating Netback

(\$ per boe)

	2003	2002
Sales price	16.13	16.50
Royalties	0	0
Operating	(6.96)	(6.01)
Operating netback	9.17	10.49

Quarterly Information

The following table sets forth selected consolidated financial information of the Corporation for the last eight quarters:

(\$000s, except per share amounts)	2003				2002			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
		*restated	*restated					
Gross Revenue	1,314	1,053	548	328	575	568	651	571
Net earnings (loss)	565	653	(439)	(218)	(88)	(536)	(167)	(45)
Net income (loss) per share basic	0.01	0.01	(0.01)	(0.02)	0.00	(0.01)	0.00	0.00
Net income (loss) per share diluted	0.01	0.01	(0.01)	(0.02)	0.00	(0.01)	0.00	0.00

* restated for change in accounting policy for stock based compensation.

Liquidity and Capital Resources

PetroFalcon completed a private placement of 6,500,000 Special Warrants in June 2003 at a price of CND\$1.00 per special warrant for gross proceeds of CND\$6.5 million. PetroFalcon's \$3.8 million capital expenditure program in 2003 was primarily funded by the issuance of June 2003 Special Warrants with additional funding from working capital and cash flow from operations.

- PetroFalcon completed a private placement of 10,240,000 Special Warrants in March 2004 at a price of CND\$2.20 per special warrant for gross proceeds of CND\$22.5 million. In March 2004, The Company received CND\$8.6 million from the exercise of 6.9 million warrants issued pursuant to the Special Warrant financing. PetroFalcon expects to utilize these combined proceeds, working capital and cash flow from operations to fund 2004 capital expenditures.

At December 31, 2003, PetroFalcon had 52,853,379 outstanding and issued common shares, 69,248,228 shares on a fully diluted basis and 11,441,600 outstanding warrants. At the end of the first quarter 2004, PetroFalcon had 71,083,682 outstanding and issued common shares, 79,363,228 shares on a fully diluted basis and 4,039,546 outstanding warrants.

At December 31, 2003, PetroFalcon had \$4.5 million in cash and short-term deposits and a working capital surplus of \$2.8 million. At year-end 2002, PetroFalcon had \$1.7 million in cash and short-term deposits and working capital deficit of \$.8 million. At year-end 2003, total debt was \$4.2 million. At March 31, 2004, PetroFalcon had \$27.3 million in cash and short term deposits and a working capital surplus of \$ 27.2 million.

Ceiling Test

In accordance with the Canadian Institute of Chartered Accountant's full cost accounting guidelines, the Company performs an annual ceiling test calculation, whereby the net book value of the Company's oil and natural gas properties is compared to the estimated future value of its proved reserves. Reserves were valued based upon December 2003 average constant prices. At December 31, 2003 the ceiling test revealed that no write-down was required.

Related Party Transactions

The Company had related party transactions of \$.66 million in 2003 versus \$.132 million in 2002. The higher costs reflect the substantial increase in activity by the Company in 2003 versus 2002. These costs are for services from Vinccler, CA and Pacific Petroleum, LLC, companies controlled by senior management, in support of the Company. These charges are based on actual expenditures by Vinccler and Pacific for construction, engineering, geological, geophysical, logistical, administrative and financial support of PetroFalcon.

Changes in Accounting Policy

During 2003, the Company adopted the new CICA standard for expensing stock options. The impact of this change was to increase expenses and contributed surplus by \$338,550, which represented the current year's cost associated with options issued during 2003.

During 2003, the CICA issued section 3110, "Asset Retirement Obligations", which is effective for periods beginning on or after January 1, 2004. The new standard requires that companies recognize the liability associated with future site reclamation costs in the financial statements. Under the standard, these obligations are initially measured at fair value and subsequently adjusted for the accretion of discount and any changes in underlying cash flows. The asset retirement cost is capitalized to the related asset and amortized into earnings over the life of the asset. This change in accounting policy will be adopted by the Company during the 3 month period ended March 31, 2004. The Company estimates a charge to earnings of approximately \$9,000 per quarter in 2004.

Cash Flow Sensitivities

The following table sets out the sensitivity of PetroFalcon's cash flow from operations to changes in key operational assumptions, based on our projections for 2004:

	Cash Flow	
Approximate impact in 2004	\$000s	\$/ share
Natural gas		
Change of \$0.10 per mcf in average price	NM	NM
Change of 1,000 mcf day of production	328	0.004
Oil		
Change of \$1.00 per barrel in WTI average price	148	0.02
Change of 100 bbls/d of production	668	0.09

Business Conditions and Risk

The business of exploration, development and acquisition of oil and natural gas reserves involves a number of uncertainties and, as a result, PetroFalcon is exposed to a number of risks inherent in the oil and natural gas industry. Operationally, the Company faces technical risks that are associated with finding, developing and producing these oil and natural gas reserves. Additional risks include economic changes, environmental and safety concerns, and access to processing facilities. The financial risks that are not within PetroFalcon's control are the fluctuations in commodity prices and interest rates.

All PetroFalcon's operations are located in Venezuela and it is subject to all the risks associated with operating in a foreign country.

PetroFalcon mitigates all these risks through the competence of the management team, adequate insurance coverage, and safety and environmental programs that meet or exceed regulations.