

Management's Discussion and Analysis - First Quarter 2004

May 17, 2004

The following discussion and analysis as provided by the management of PetroFalcon Corporation (the "Company") should be read in conjunction with the Company's interim consolidated financial statements for the three months ending March 31, 2004 and 2003. The discussion in the MD&A focuses on the operating and financial results for those periods. 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 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 costs and expenses are expressed in US Dollars, unless otherwise noted.

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 three months ended March 31, 2004, average production was 695 bbls/d oil. There was no natural gas produced for the three months ending March 31, 2004. At the end of the first quarter 2004, 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 \$ 1.4 million for the three months ended March 31, 2004 compared to \$ 0.3 million for the three months ended March 31, 2003. The average price received was \$21.70 per barrel of oil. In the first quarter 2003, the Company's average price for oil was \$20.82 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 quarter. Oil and natural gas production are delivered to Petroleos de Venezuela (PDVSA) and the 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 of the Company's revenues are received in US Dollars.

Royalties

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

Operating Costs

(\$000s except boe amount)	First Quarter 2004	First Quarter 2003
Operating csts	424	253
Average cost (\$ per boe)	6.71	16.72

On a per unit basis, costs are expected to remain reasonably consistent for the remainder of 2004.

Interest Income and Expense

At March 31, 2004 PetroFalcon had \$27.3 million in cash and short-term deposits compared to \$4.5 million at year-end 2003. Interest income increased from \$5,369 in the first quarter 2003 to \$31,687 in the first quarter 2004. The increase is due to the receipt of proceeds for the equity issue that increased the cash balance.

In the first quarter 2004, PetroFalcon incurred interest expense of \$.095 million versus \$.193 million in the first quarter 2003. Interest expense is expected to continue declining in 2004 due to lower debt levels.

The Company recorded an exchange gain of \$.63 million and gain on bond sales of \$.676 million in the first quarter 2004. The Company expects to continue to record exchange and bond sale gains in 2004 due to currency controls in Venezuela.

General and Administrative Costs

(\$000s except boe amount)	First Quarter 2004	First Quarter 2003
Expenses	391	251
Average cost (\$ per boe)	6.18	16.59

General and administrative costs increased to \$.391 million in the first quarter 2004 from \$.251 million in the first quarter 2003. Increased general and administrative costs are due to the additional staff and incremental costs associated with the Company's exploration and development growth plans. Company expects these costs to remain constant on a per boe basis in 2004.

PetroFalcon does not capitalize general and administrative costs.

Depletion, Depreciation, and Amortization (DD&A)

(\$000s except boe amount)	First Quarter 2004	First Quarter 2003
Depletion, Depreciation and Accretion	258	83
Depletion rate (\$ per boe)	4.08	5.02

The DD&A expense per unit is expected to remain relatively constant during 2004.

Income Taxes

(\$000s)	First Quarter 2004	First Quarter 2003
Tax expense	0	0

The Company had a loss in the first quarter of 2003 and did not pay income tax in the first quarter 2004 because of a carry forward tax loss and because the gains on financing transactions are not taxable under the current taxation environment in Venezuela.

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

- Geochemical Study	250	0
Total	28,750	3,798

Cash Flow from Operations and Net Earnings

(\$000s except per share data)	First Quarter 2004	First Quarter 2003
Cash flow from operations	1,800	(142)
Cash flow		
Per basic share	0.03	0.00
Per diluted share	0.02	0.00
Net earnings		
Net income (loss)	1,411	(225)
Per basic share	0.03	0.00
Per diluted share	0.02	0.00

The increase in net earnings is primarily due to exchange gains in the first quarter 2004.

Operating Netback

(\$ per boe)	First Quarter 2003	First Quarter 2002
Sales price Royalties	21.70	20.82
Operating expenses	0	0
	(6.71)	(16.72)
Operating netback	14.99	4.10

Quarterly Information

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

(\$000s, except per share amounts)	2004	2003				2002			
	Q1	Q4 Restated	Q3 Restated	Q2 Restated	Q1 Restated	Q4 Restated	Q3 Restated	Q2 Restated	Q1 Restated
Gross Revenue	1,373	1,314	1,053	548	328	575	568	651	571
Net earnings (loss)	1,411	558	645	(445)	(225)	(95)	(542)	(174)	(52)
Net income (loss) per share basic	0.03	0.01	0.01	(0.01)	(0.02)	0.00	(0.01)	0.00	0.00

Net income (loss) per share diluted	0.02	0.01	0.01	(0.01)	(0.02)	0.00	(0.01)	0.00	0.00
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* restated for change in accounting policy for asset retirement obligations.

Liquidity and Capital Resources

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\$8.9 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 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. At March 31, 2004, PetroFalcon had total debt of \$ 2.2 million.

Related Party Transactions

The Company had related party transactions of \$.165 million in the first quarter 2004 versus \$.165 million in the first quarter 2003. These costs are for services from Pacific Petroleum, LLC, a company controlled by senior management, in support of the Company. These charges are based on actual expenditures by Vincler and Pacific for engineering, geological, geophysical, logistical, administrative and financial support of PetroFalcon.

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:

Approximate impact in 2004	Cash Flow	
	\$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 of 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 of these risks through the competence of the management team, adequate insurance coverage, and safety and environmental programs that meet or exceed regulations.

Additional Information

Additional information regarding the Company, including the annual information form, may be found on SEDAR at www.sedar.com.