



Building Value in Venezuela

MANAGEMENT'S DISCUSSION & ANALYSIS

THIRD QUARTER 2005

November 9, 2005

The following management discussion and analysis (“MD&A”), as provided by the management of PetroFalcon Corporation (“PetroFalcon” or the “Company”), should be read in conjunction with the Company's unaudited interim consolidated financial statements for the three and nine months ended September 30, 2005, and the audited consolidated financial statements for the year ended December 31, 2004. Those financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”) Estimates and forward-looking information are based on assumptions of future events and actual results may vary from these estimates.

This MD&A contains the terms “cash flow from operations” and “operating netback”, which should not be considered alternatives to, or more meaningful than cash flow from operating activities and net income as determined in accordance with Canadian GAAP as an indicator of the Company's performance. PetroFalcon's determination of “cash flow from operations” is defined as cash from operating activities before changes from non-cash working capital items and “operating netback” is defined as revenue less operating, maintenance and transportation expenses and may not be comparable to that reported by other companies. PetroFalcon 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 dollar amounts are expressed in US Dollars.

FORWARD-LOOKING STATEMENTS & ESTIMATES

Certain statements contained in this MD&A constitute forward-looking statements. These statements relate to future events of PetroFalcon's future performance. All statements other than statements of historical fact may be forward-looking statements and may include statements pertaining to projections of market prices and costs, supply and demand for oil and natural gas, the quantity of reserves, oil and natural gas production levels, capital expenditure programs, treatment under governmental regulatory, taxation regimes and exchange rates, and expectations regarding PetroFalcon's ability to raise capital and to continually add to reserves through acquisitions and developments. Statements regarding these matters involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. PetroFalcon believes that the expectations reflected in its forward-looking statements are reasonable but no assurance can be

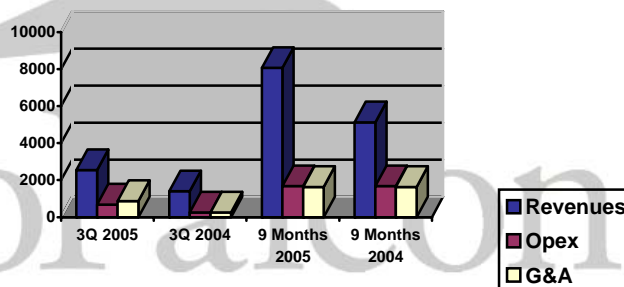
given that expectations will prove to be correct and forward-looking statements included in this MD&A should not be unduly relied upon. Forward-looking statements speak only as of the date of this MD&A and actual results could differ materially from those anticipated in forward-looking statements.

Investors should not place undue reliance on forward-looking statements as the plans, intentions or expectations upon which they are based may not occur. Statements relating to “reserves” or “resources” are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions that the resources and reserves described can be profitably produced in the future. The forward-looking statements contained herein are expressly qualified by this cautionary statement.

PRODUCTION AND REVENUE

For the three months ended September 30, 2005, average production was 826 bbls/d of oil. The gas produced during the three months ended September 30, 2005, was used only for operations including fuel and gas lift. For the three months ended September 30, 2004, average production was 830 bbls/d of oil.

For the nine months ended September 30, 2005, average production was 853 bbls/d of oil. The gas produced during the nine months ended September 30, 2005, was used only for operations including fuel and gas lift. For the nine months ended September 30, 2004, average production was 764 bbls/d of oil.



During the three months ended September 30, 2005, PetroFalcon had 9 producing oil wells, 3 shut-in gas wells and 6 shut-in oil wells. The Company also had two new wells at the La Vela field that were being production tested during the period.

The Company expects an increase in oil and natural gas production during the fourth quarter of 2005 and into 2006 from the La Vela and Cumarebo fields as shut-in gas production commences due to development drilling activity, which is scheduled for both fields.

PetroFalcon recorded revenue in the amount of \$3.06 million for the three months ended September 30, 2005, compared to \$2.08 million for the three months ended September 30, 2004. The average price received for the three months ended September 30, 2005 was \$40.20 per barrel of oil. For the three months ended September 30, 2004, the average price for oil was \$27.26 per barrel.

During the nine months ended September 30, 2005, PetroFalcon recorded revenue in the amount of \$8.07 million, compared to \$5.13 million for the nine months ended September 30, 2004. The average price received for the nine months ended September 30, 2005 was \$34.77 per barrel of

oil. For the nine months ended September 30, 2004, the average price for oil was \$24.51 per barrel.

The increase in revenue during the nine months ended September 30, 2005, was due to higher levels of production, 232,079 bbls for the nine months ended September 30, 2005, as compared to 209,331 bbls for the nine months ended September 30, 2004, as well as higher average prices, \$34.77 per bbl for the nine months ended September 30, 2005 as compared to \$24.51 per bbl for the nine months ended September 30, 2004.

The Company had no derivative contracts and consequently benefited from strong oil prices during the three and nine months ended September 30, 2005. Oil and natural gas production are delivered to Petroleos de Venezuela S.A. ("PDVSA") and the Company's wholly owned subsidiary Vinccler Oil and Gas, C.A. ("VOG") receives payment in accordance with its Operating Service Agreement ("OSA") with PDVSA.

VOG signed an agreement on August 4, 2005, with PDVSA agreeing to migrate the OSA to a mixed company ("Empresa Mixta"). Negotiations with the Ministry of Energy and Petroleum ("MEP") on the conversion of the current OSA to an Empresa Mixta, which will be jointly owned by the Company and PDVSA CVP, are proceeding as expected. Technical teams are well into the net asset evaluation phase of the process, the results of which will form the basis governing each party's contribution to the Empresa Mixta. The objective of this process is to preserve net asset value before and after contractual migration. The Company is working closely with the Ministry of Energy and Petroleum ("MEP") and PDVSA to conclude the negotiations and migration in accordance with the time frame established by the Venezuelan government.

Payment from PDVSA under the OSA is made 75% in US Dollars and 25% in Bolivars (the official Venezuelan currency). To date, PDVSA has made all payments owed to VOG in a timely manner.

ROYALTIES

The Company's oil and gas production is not subject to any royalties. In the future, when the Company migrates to an Empresa Mixta, the Company estimates that its share of oil and gas production will become subject to royalty payment, which is expected to be thirty percent (30%).

OPERATING EXPENSES

(\$000s except boe amount)	Three months ended September 30, 2005	Three months ended September 30, 2004
Operating Expenses (including-maintenance and transportation)	805	709
Average expense (\$ per boe)	10.59	9.29

(\$000s except boe amount)	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Operating Expenses (including-maintenance and transportation)	2,112	1,672
Average expense (\$ per boe)	9.10	7.98

For the three months ended September 30, 2005, operating expenses were \$804,754 as compared to \$709,415 during the three months ended September 30, 2004. For the nine months ended September 30, 2005, operating expenses increased to \$2,111,880 compared to \$1,671,594 during the nine months ended September 30, 2004 due to increased volumes of oil production at Cumarebo and La Vela Fields as compared to production being exclusively at Cumarebo Field during the nine months ended September 30, 2004. The Company expects to continue increasing oil production and commence natural gas sales in the fourth quarter of 2005. Higher production levels are expected to decrease per boe operating expenses in the fourth quarter of 2005 and during 2006 as fixed costs are spread over greater boe production.

GENERAL AND ADMINISTRATIVE EXPENSES

(\$000s except boe amount)	Three months ended September 30, 2005	Three month ended September 30, 2004
Expenses	703	672
Average expense (\$ per boe)	9.25	8.80

(\$000s except boe amount)	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Expenses	2,538	1,631
Average expense (\$ per boe)	10.94	7.79

General and administrative costs were relatively constant, \$703,063 during the three months ended September 30, 2005, as compared to \$671,750 during the three months ended September 30, 2004. During the nine months ended September 30, 2005, general and administrative expense was \$2,538,468 as compared to \$1,630,944 during the nine months ended September 30, 2004. The increase in general and administrative costs during the nine months ended September 30, 2005, is related to an increase in the number of employees and third party consultants required to effect the Company's growth strategy. General and administrative costs per boe are expected to decline as production increases in the fourth quarter of 2005 and during 2006.

PetroFalcon does not capitalize general and administrative costs.

DEPLETION, DEPRECIATION, AMORTIZATION AND ACCRETION ("DDA&A")

(\$000s except boe amount)	Three months ended September 30, 2005	Three months ended September 30, 2004
Depletion, Depreciation, Amortization and Accretion	362	324
Depletion Rate (\$ per boe)	4.77	4.24

(\$000s except boe amount)	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Depletion, Depreciation, Amortization and Accretion	1,157	877
Depletion Rate (\$ per boe)	4.98	4.19

For the three months ended September 30, 2005 DDA&A was \$362,349 as compared to \$324,114 for three months ended September 30, 2004. For the nine months ended September 30, 2005 DDA&A was \$1,156,606 as compared to \$876,608 during the nine months ended September 30, 2004. The DDA&A expense during the three and nine months ended September 30, 2005 was higher compared to the three and nine months ended September 30, 2004, due to an increase in project capital expenditures which commenced in 2005. DDA&A per boe is expected to remain relatively constant during 2005 and in 2006.

INTEREST INCOME AND EXPENSE

At September 30, 2005, PetroFalcon had \$15.08 million in cash and short-term deposits (\$1 million of which is considered restricted) compared to \$26.6 million at September 30, 2004. During the three months ended September 30, 2005, the company recorded interest income in the amount of \$57,910 as compared to \$54,019 during the three months ended September 30, 2004. Interest income increased to \$212,774 in the nine months ended September 30, 2005, compared to \$206,520 in the nine months ended September 30, 2004.

PetroFalcon incurred interest expense of \$286,887 during the three months ended September 30, 2005 as compared to \$104,906 during the three months ended September 30, 2004. During the nine months ended September 30, 2005, the Company incurred interest expense of \$547,978 as compared to \$273,240 during the nine months ended September 30, 2004. The increase in interest expense is due to higher average debt during the three and nine months ended September 30, 2005.

PetroFalcon recorded an exchange gain of \$117,344 during the nine months ended September 30, 2005, and \$63,272 during the three months ended September 30, 2005 on the conversion of

foreign currencies to US dollars. The Company recorded a gain on bond sales of \$2,149,941 during the nine months ended September 30, 2005 and \$793,969 during the three months ended September 30, 2005.

On August 1, 2005, VOG extended its line of credit with Banco Exterior (“BE”) to 10 billion Bolivars (US\$4.66 million) which requires that VOG maintains a minimum balance of \$1 million. As of September 30, 2005, the BE line of credit had an available balance of \$1.36 million. On August 10, 2005, the Company repaid Banco Occidental de Descuento (“BOD”) its existing line of credit and had the related Letter of Credit for \$2.6 million released. On August 31, 2005, the Company renewed a line of credit of Bs.5 billion (\$2.33 million) with BOD which requires VOG to maintain a balance of \$1 million. As of September 30, 2005, the new BOD line of credit was fully available. VOG utilizes lines of credit with Venezuelan banks to meet its short term working capital and local currency financing needs.

INCOME TAXES

(\$000s)	Three months ended September 30, 2005	Three months ended September 30, 2004
Consolidated Tax Expense	(200)	-

(\$000s)	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Consolidated Tax Expense	(634)	-

VOG recorded a deferred income tax expense of \$200,000 in the three months ended September 30, 2005 result. Deferred tax is based on a timing difference in the Company’s consolidated expense due to a capitalized portion reflected under the Canadian GAAP of \$423,013 for the three months ended September 30, 2005, and \$1,362,000 for the nine months ended September 30, 2005. Consolidated tax expense was \$634,148 for the nine months ended September 30, 2005. VOG’s taxability depends on a number of factors including the extent of operating expenditures, interest expensed, general and administrative costs and incremental income associated with new production and oil prices.

The Company has been advised that the SENIAT, the Venezuelan income tax authority, has stated that the income tax rates for activities conducted under the various operating service agreements in Venezuela, including the VOG OSA, will increase from 34% to 50%. The SENIAT has concluded auditing VOG, however, the results or impact of such audit is unknown at this time.

CAPITAL BUDGET FOR 2005

The following table outlines the Capital Budget for 2005. There may be circumstances, where for sound business reasons, a reallocation of funds may be necessary in order for the Company to achieve its stated business objectives.

(\$000s)	2005 (Revised end 1 st Quarter)	2005 (Revised end 2 nd Quarter)	Incurred As of September 30, 2005
Drilling			
- La Vela	10,000	13,000	12,545
- Cumarebo	9,000	3,600	1,282
- Prospects	6,000	1,800	433
- Total Drilling	25,000	18,400	14,260
Central Processing Facilities			
- La Vela	7,000	8,500	9,116
- Cumarebo	3,000	2,000	495
- Total Central Processing Facilities	10,000	10,500	9,611
- Seismic Acquisition	2,200	2,200	2,387
Total Capital Budget	37,200	31,100	26,258

DRILLING

The Company has completed the drilling of two wells in the La Vela Field, the LV-10 and LV-9.

The LV-10 well was drilled and pipe was set to a total depth of 9,990 feet. Based on electric logs, the well encountered approximately 240 feet of potentially productive reservoir in the deep portion of the well. This potential pay is in addition to the approximately 150 feet of potential reservoir encountered in the shallow Caujarao and Socorro formations. The company completed production testing from the LV-10 well and discovered a shallow oil and gas field in the southern part of the La Vela structure. Management estimates that the aggregate test results in the LV-10 well could add reserves totaling approximately 20 million barrels of oil and 25 billion cubic feet of natural gas. The LV-9 well will be put on production during the fourth quarter of 2005.

The Company is building drilling pads, permitting drilling locations and currently negotiating with drilling contractors for the mobilization of a rig to resume development drilling at the Cumarebo and La Vela fields during the first quarter 2006.

CENTRAL PROCESSING FACILITIES

At the La Vela Field, construction of the early production facility capable of 5000 bbls/d of oil and 15 mmcf/d of natural gas is on schedule and due for completion in mid November. The new processing facility is adjacent to the LV-6X well on the La Vela Sur anticline. At the Cumarebo Field, facilities modifications are underway. The Company plans to upgrade the existing facilities at the Cumarebo Field to process 20 mmcf/d of natural gas. The Cumarebo Field facilities are capable of processing up to 10,000 bbls/d of oil.

The purpose of installing and upgrading the central processing facilities is to gather the natural gas and oil production from La Vela and Cumarebo fields and deliver natural gas produced into the PDVSA's Interconexión Centro Occidente ("ICO") gas pipeline. Gas sales are expected to commence in mid November 2005. Oil will continue to be delivered by trucks to PDVSA's Paraguana Refinery Complex.

SEISMIC ACQUISITION

Seismic data acquisition at Cumarebo and La Vela fields and adjacent prospects was completed in the first quarter of 2005. The seismic data processing was completed during the second quarter of 2005 and is currently being interpreted. The new seismic data is expected to better define the Company's prospects and delineate drilling locations at the two existing fields.

CASH FLOW FROM OPERATIONS

(\$000s except per share data)	Three months ended September 30, 2005	Three months ended September 30, 2004
Cash flow from operations	2,175	827
Per basic share	0.03	0.01
Net income	1,087	193
Per basic share	0.01	0.00

(\$000s except per share data)	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Cash flow from operations	4,917	2,647
Per basic share	0.06	0.04
Net income	2,137	1,148
Per basic share	0.03	0.02
Working capital	14,524	24,530

OPERATING NETBACK

(\$ per boe)	Three months ended September 30, 2005	Three months ended September 30, 2004
Sales price	40.20	27.26
Operating expenses	(10.59)	(9.29)
Operating netback*	29.61	17.97

* This is a non-GAAP measure of profitability

(\$ per boe)	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Sales price	34.77	24.51
Operating expenses	(9.10)	(7.98)
Operating netback*	25.67	16.53

QUARTERLY INFORMATION

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

(\$000s, except per share amounts)	2005			2004			2003	
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
								*restated
Revenue	3,055	2,469	2,545	2,864	2,082	1,677	1,373	1,314
Net income (loss)	1,087	428	622	964	193	(455)	1,411	558
Earnings (loss) per share basic	0.01	0.01	0.01	0.01	0.00	(0.01)	0.03	0.01
Earnings (loss) per share diluted	0.01	0.01	0.01	0.01	0.00	(0.01)	0.03	0.01

* restated for change in accounting policy for asset retirement obligations.

Increased revenue was due to higher levels of production, 232,079 bbls in the nine months ended September 30, 2005 as compared to 209,331 bbls in the nine months ended September 30, 2004, and higher average prices of \$34.77 in the nine months ended September 30, 2005 as compared to \$24.51 in the nine months ended September 30, 2004.

LIQUIDITY AND CAPITAL RESOURCES

As September 30, 2005, PetroFalcon had 77,526,407, outstanding and issued common shares, and 86,332,601 common shares on a fully diluted basis. At the end of the second quarter of 2005, PetroFalcon had 77,513,074 outstanding and issued common shares, and 86,378,001 common shares on a fully diluted basis.

As September 30, 2005, PetroFalcon had \$15.06 million in cash and short term deposits, including \$1 million in restricted cash and a working capital surplus of \$14.52 million. At September 30, 2005, PetroFalcon's total current debt was \$3.87 million and total long term debt was \$8 million. At June 30, 2005, PetroFalcon had \$25.66 million in cash and short term deposits, including \$3.82 million in restricted cash and a working capital surplus of \$14.78 million. At June 30, 2005, PetroFalcon had total current debt of \$5.97 million.

At September 30, 2005, PetroFalcon had \$7.28 million in accounts receivable of which 2.5 million represent IVA (Value Added Taxes) credit incurred as a result of the Company's investments during the period. At September 30, 2005, the Company had \$4.07 millions in accounts payable of which \$678,272 million represent the accrued portion of capital expenditures not yet billed.

During the second quarter, the Company 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 VOG for the development of the Company's oil and gas properties. During the second quarter of 2005, the IFC disbursed \$12 million from the "C" Loan. The disbursement of the remaining \$24 million (the "A" Loan) is subject to the completion of certain technical tests. At September 30, 2005, the outstanding principal due to IFC was \$8 million due to the conversion of \$4 million of loans into shares of PetroFalcon.

The planned growth and development activities for the next twelve months will require additional funds. Management of PetroFalcon anticipates that these funds will be obtained from cash flow from operations, lines of credit and the IFC loan facility, however, in the event that additional funds are required, the Company may determine that it is in the best interest to raise capital by way of completing debt or equity securities financings.

The Corporation is conducting business in Venezuela and certain corporate and structural matters are subject to Venezuelan legislation and negotiations with governmental authorities, including the creation of an Empresa Mixta. There can be no certainty on any matters respecting the Empresa Mixta and the ongoing structure until such time as the negotiations have been finalized, documents have been drafted and the appropriate and necessary governmental approvals have been obtained.

RELATED PARTY TRANSACTIONS

For the three months ended September 30, 2005 the Company paid \$210,000 (\$180,000 during the three months ended September 30, 2004) to Pacific Oil and Gas, LLC (“Pacific”), a company controlled by the Company’s Chief Financial Officer, Clarence Cottman and the Company’s President William Gumma, for professional services provided to PetroFalcon. For the nine months ended September 30, 2005 the Company paid \$630,000 (\$510,000 during the nine months ended September 30, 2004) to Pacific.

For the three months ended September 30, 2005, the Company incurred expenses of \$261,858 to Venezolana de Inversiones y Construcciones Clerico, C.A., an independent operating construction company controlled by the Company’s Chairman Juan Francisco Clerico. VOG was invoiced \$ 1.44 million during the nine months ended September 30, 2005. These charges are for construction work at the La Vela central processing facility, drilling locations and road repair.

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 management’s projections for 2005:

Approximate impact for year ending December 31, 2005	Cash Flow	
	\$000s	\$/share
<u>Natural Gas</u>		
Change of \$0.10 per mcf in average price	N/A	N/A
Change of 1,000 mcf day of production	478	0.006
<u>Oil</u>		
Change of \$1.00 per barrel in WTI average	428	0.006
Change of 100 bbls/d of production	1,059	0.014

ADDITIONAL INFORMATION

Additional information regarding the Company, including its annual information form, reserves information and annual report may be found on SEDAR at www.sedar.com or visit www.petrofalcon.com.

