PetroFalcon Building Value in Venezuela

MANAGEMENT'S DISCUSSION & ANALYSIS YEAR ENDED DECEMBER 31, 2004

March 15, 2005

The following discussion and analysis, as provided by the management of PetroFalcon Corporation ("PetroFalcon" or the "Company"), should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2004. 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 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. 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 thousands of 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).

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. Forward-looking statements 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, 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 those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon. These statements speak only as of the date of this MD&A and actual results could differ materially from those anticipated in these forward-looking statements.

Investors should not place undue reliance on forward-looking statements as the plans, intentions or expectations upon which they are based might 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. PetroFalcon disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

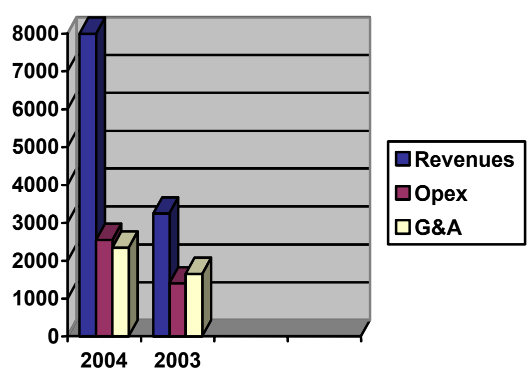
PRODUCTION AND REVENUE

For the year ended December 31, 2004, average production was 852 bbls/d of oil. The gas produced during the year ended December 31, 2004, was used only for operations including fuel and gas lift. For the year ended December 31, 2003, average production was 551 boe/d, comprised of 404 bbls/d of oil and 882 mcf/d of natural gas.

For the quarter ended December 31, 2004, average production was 1,058 bbls/d of oil. For the quarter ended December 31, 2003, average production was 862 boe/d, comprised of 730 bbls/d of oil and 792 mcf/d of natural gas.

At the end of the year 2004, PetroFalcon had nine producing oil wells, four shut-in gas wells and six shut-in oil wells.

The Company expects a substantial increase in oil and natural gas production in 2005 from the La Vela and Cumarebo fields due to development drilling activity scheduled for both fields.



PetroFalcon recorded revenue in the amount of $8.0 million for the year ended December 31, 2004, compared to $3.2 million for the year ended December 31, 2003. The average price received in 2004 was $26.07 per barrel of oil. For the year ended December 31, 2003, the average price for oil was $19.05 per barrel and $0.90 per MCF of gas, for a combined revenue price of $16.13 per boe. Revenues for the three months ended December 31, 2004, were $2.9 million compared to $1.3 million for the three months ended December 31, 2003. The average price received for the three months ended December 31, 2004 was $29.43 per barrel of oil and for the three months ended December 31, 2003, the average price received was $18.37 per barrel of oil and $0.90 per MCF of gas, for a combined revenue price of $15.84 per boe. The increase in revenue in 2004 was due to higher levels of production, 198,360 boe in 2003 as compared to 306,720 boe in 2004, as well as higher average prices, $16.13 per boe in 2003 as compared to $26.07 in 2004.

The Company had no derivative contracts during 2004 and consequently benefited from strong oil prices during fiscal 2004 and the fourth quarter of 2004. Oil and natural gas production are delivered to Petroleos de Venezuela S.A. ("PDVSA") and the Company receives payment in accordance with its operating service agreement with PDVSA.

In its 2005 forecast, PetroFalcon used a net price of $29.45 per barrel of oil and $1.33 per mcf for natural gas, for a combined forecast revenue price of $22.26 per boe. The oil price forecast is an estimate based on the fourth quarter 2004 actual price. The gas price is the price agreed to by the Company and 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 EXPENSES

($000s except boe amount)	Year Ended 2004	Year Ended 2003
Operating Expenses*	2,547	1,400
Average expense ($ per boe)	8.30	7.06

* *rounded to the nearest thousand*

($000s except boe amount)	Fourth Quarter 2004	Fourth Quarter 2003
Operating Expenses*	875	504
Average expense ($ per boe)	8.98	6.14

* *rounded to the nearest thousand*

For the year ended December 31, 2004, operating expenses were higher, compared to the year ended 2003, due to increased volumes of oil production and increased workover activity at La Vela and Cumarebo Fields. The Company expects to continue increasing oil production and commence natural gas sales in 2005. Higher production levels are expected to decrease per boe operating expenses in 2005 as fixed costs are spread over greater boe production.

INTEREST INCOME AND EXPENSES

At December 31, 2004, PetroFalcon had $24.05 million in cash and short-term deposits ($3.6 million of which is considered restricted) compared to $4.5 million at December 31, 2003. Interest income increased from $87,537 in the year ended 2003 to $292,580 in the year ended 2004. The year-over-year increase is due to receipt of proceeds of an equity issue in 2004 of $15,859,165, which increased the Company's cash balance.

In 2004, PetroFalcon incurred interest expense of $401,194 as compared to $622,617 in the year ended 2003. The decrease in interest expense is due to a lower average debt level during the year ended December 31, 2004, as compared to the year ended December 31, 2003. Interest expenses are projected to increase during 2005 due to expected disbursements on a loan facility from the International Finance Corporation.

In 2004, PetroFalcon recorded an exchange gain of $305,000 on the conversion of Canadian dollars to US dollars and a gain on bond sales of $1.35 million.

During the year ended December 31, 2004, Vinccler Oil and Gas, C.A. ("VOG"), PetroFalcon's wholly owned operating subsidiary, secured a line of credit of five billion Bolivar ($2.6 million) from Banco Ocidental del Descuento ("BOD"). This line of credit is secured by an irrevocable Letter of Credit ("LC") issued by HSBC Bank in favour of BOD which is 100% cash collateralized. VOG also secured a five billion Bolivar ($2.6 million) line of credit with Banco Exterior ("BE") which requires that PetroFalcon maintain a balance of $1 million with BE. As of December 31, 2004, the BOD line of credit had an available balance of $725,000 and the BE line of credit had an available balance of $1.6 million. The $2.6 million LC and the $1 million deposit with BE are considered restricted cash.

GENERAL AND ADMINISTRATIVE EXPENSES

($000s except boe amount)	Year Ended 2004	Year Ended 2003
Expenses*	2,395	1,651
Average expense ($ per boe)	7.80	8.32

* *rounded to the nearest thousand*

($000s except boe amount)	Fourth Quarter 2004	Fourth Quarter 2003
Expenses*	764	467
Average expense ($ per boe)	7.84	5.69

* *rounded to the nearest thousand*

General and administrative costs increased to $2.39 million during 2004, from $1.65 million during 2003. The increase in general and administrative costs during 2004 is related to the Company's first full year as a public TSX listed issuer and an increase in the number of employees required to effect the Company's growth strategy. General and administrative costs per boe are expected to decline as production increases in 2005.

PetroFalcon does not capitalize general and administrative costs.

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

($000s except boe amount)	Year Ended 2004	Year Ended 2003
Depletion, Depreciation, Amortization and Accretion*	1,285	669
Depletion Rate ($ per boe)	4.19	3.37

* *rounded to the nearest thousand*

($000s except boe amount)	Fourth Quarter 2004	Fourth Quarter 2003
Depletion, Depreciation, Amortization and Accretion*	408	268
Depletion Rate ($ per boe)	4.19	3.26

* *rounded to the nearest thousand*

The DDA&A expense per unit during the year ended December 31, 2004 was higher compared to the year ended December 31, 2003, due to an increase in projected capital expenditures starting in 2004. DDA&A is expected to remain relatively constant during 2005.

INCOME TAXES

($000s)	Year Ended 2004	Year Ended 2003
Consolidated Tax Expense*	265	84

* *rounded to the nearest thousand*

VOG expensed Venezuelan income taxes in the amount of $0.26 million for the year ended December 31, 2004.

VOG's taxability depends 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 FOR 2004

As of December 31, 2004, PetroFalcon has spent $9.252 million of its capital budget.

($000s)	Original 2004*	Actual 2004*
- Drilling	5,500	1,764
- Workovers	3,500	5,447
- Facilities	10,300	1,344
- Pipelines	7,500	408
- Equipment	200	0
- Sidetrack	1,000	0
- Seismic	500	181
- Geochemical Study	250	108
Total	**28,750**	**9,252**

* *all numbers are rounded to the nearest thousand*

Because of PDVSA's decision to bring the Central Western Interconection (the "ICO") gas pipeline to PetroFalcon's fields and due to a delay in the execution of the gas addendum, the 2004 budget was significantly reduced and planned expenditures have been deferred to the 2005 budget.

CAPITAL BUDGET FOR 2005

($000s)		Original 2005*
Drilling		
- La Vela	20,066	
- Cumarebo	8,470	
- Total Drilling		28,536
Central Processing Facilities		
- La Vela	23,612	
- Cumarebo	2,926	
- Total Central Processing Facilities		26,538
- Seismic		2,086
- Geochemical Study		200
Total Capital Budget		**57,360**

* *all numbers are rounded to the nearest thousand*

DRILLING

The drilling schedule for 2005 consists of nine locations, five of which are located in Cumarebo and four of which are located in La Vela.

CENTRAL PROCESSING FACILITIES:

PetroFalcon plans to install a central processing facility at the La Vela Field which will initially be capable of processing 50 mmcf/d of natural gas and 5,000 bbls/d of oil, and can be expanded to process up to 120 mmcf/d of natural gas and 10,000 bbls/d of oil.

PetroFalcon plans to upgrade the existing facilities at the Cumarebo Field to process 25 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 ICO gas pipeline. Oil will continue to be delivered by trucks to PDVSA's Paraguana refinery complex.

SEISMIC & GEOCHEMICAL STUDIES

Seismic and geochemical expenses are expected to increase the Company's prospects and delineate drilling locations.

CASH FLOW FROM OPERATIONS AND NET EARNINGS

($000s except per share data)	**Year Ended 2004**	**Year Ended 2003** (**restated)
Cash flow from operations		
Cash flow*	4,376	1,541
Per basic and diluted share	0.06	0.03
Net income*	2,113	533
Basic and diluted earnings per share	0.03	0.01

* *rounded to the nearest thousand*

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

($000s except per share data)	Fourth Quarter 2004	Fourth Quarter 2003* (**restated)
Cash flow from operations		
Cash flow*	1,729	971
Per basic share	0.02	0.02
Per diluted share	0.02	0.01
Net income*	965	558
Basic and diluted earnings per share	0.01	0.01

* *rounded to the nearest thousand*

** *restated to account for asset retirement obligations*

OPERATING NETBACK

($ per boe)	Year Ended 2004	Year Ended 2003
Sales price*	26.07	16.13
Operating expenses	(8.30)	(7.06)
Operating netback	17.77	9.07

OPERATING NETBACK

($ per boe)	Fourth Quarter 2004	Fourth Quarter 2003
Sales price**	29.43	15.84
Operating expenses	(8.98)	(6.14)
Operating netback	20.45	9.70

* *the sales price is the blended average with the revenues received for the oil produced and the gas expressed in barrels at 6:1*

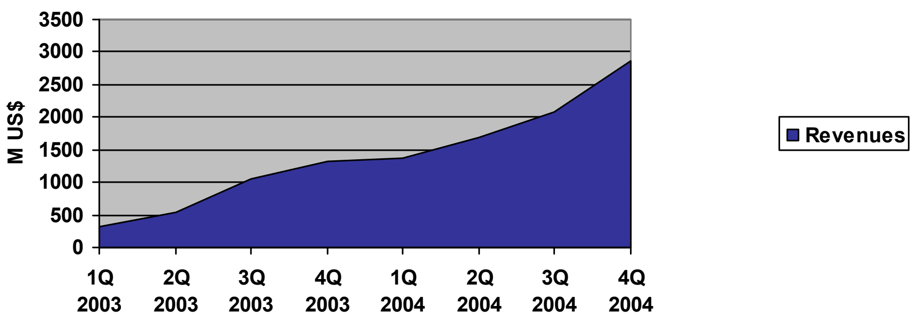
QUARTERLY INFORMATION

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

($000s, except per share amounts)	2004 Q4	2004 Q3	2004 Q2	2004 Q1	2003 Q4 *restated	2003 Q3 *restated	2003 Q2 *restated	2003 Q1 *restated
Revenue	2,864	2,082	1,677	1,373	1,314	1,053	548	328
Net income (loss)	964	193	(455)	1,411	558	645	(445)	(225)
Earnings (loss) per share basic	0.01	0.00	(0.01)	0.03	0.01	0.01	(0.01)	(0.01)
Earnings (loss) per share diluted	0.01	0.00	(0.01)	0.03	0.01	0.01	(0.01)	(0.01)

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

The figure below shows the pattern of PetroFalcon´s revenues.



Increases to revenue was due to higher levels of production, 198,360 boe in 2003 as compared to 306,720 boe in 2004, and higher average prices of $16.13 in 2003 as compared to $26.07 in 2004.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2004, PetroFalcon had 75,178,228 outstanding and issued common shares, and 82,598,228 common shares on a fully diluted basis. At the end of the third quarter of 2004, PetroFalcon had 73,926,536 outstanding and issued common shares, and 81,613,228 common shares on a fully diluted basis.

At December 31, 2004, PetroFalcon had $24.05 million in cash and short term deposits, including $3.6 million in restricted cash, and a working capital surplus of $23.57 million. At December 31, 2004, PetroFalcon’s total debt was $2.8 million. At September 30, 2004, PetroFalcon had $26.6 million in cash and short term deposits, including $2.6 million in restricted cash, and a working capital surplus of $23.2 million. At September 30, 2004, PetroFalcon had total debt of $2.7 million.

The Company has reached an agreement with the International Finance Corporation (“IFC”), the commercial lending arm of the World Bank, whereby the IFC will provide up to $36 million in loans to VOG for the development of the Company’s oil and gas properties.

Management of PetroFalcon believes that its available cash, cash flow from operations, lines of credit and IFC loan facility will be sufficient to fund the Company's planned growth and development activities.

RELATED PARTY TRANSACTIONS

For the year ended December 31, 2004 the Company paid $680,000 ($660,000 during 2003) to Pacific Oil and Gas, LLC ("Pacific"), a company controlled by Clarence Cottman and William Gumma, for services provided to PetroFalcon. Charges from related parties are based on actual expenditures by Pacific for engineering, geological, geophysical, logistical, administrative and financial support provided to PetroFalcon and VOG.

For the three month period ended December 31, 2004, PetroFalcon paid Pacific $180,000, and for the three months ended 2003 PetroFalcon paid Pacific $165,000.

CASH FLOW SENSITIVITIES

PetroFalcon's contractual obligations, including payments due for the next five years are as follows:

	Payments Due by Period ($000s)				
Contractual Obligations	Total	Less Than 1 Year	1-3 years	4-5 years	After 5 years
Debt	2,826	2,826	0	0	0
Capital Lease Obligations	0	0	0	0	0
Operating Leases	0	0	0	0	0
Purchase Obligations	2,714	2,714	0	0	0
Other Obligations	0		0	0	0
Total Contractual Obligations	**5,540**	**5,540**	**0**	**0**	**0**

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:

	Cash Flow	
Approximate impact in 2005	**$000s**	**$/share**
Natural Gas		
Change of $0.10 per mcf in average price	N/A	N/A
Change of 1,000 mcf day of production	478	0.006
Oil		
Change of $1.0 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 the annual information form, may be found on SEDAR at www.sedar.com or visit www.petrofalcon.com.