



Building Value in Venezuela

MANAGEMENT'S DISCUSSION & ANALYSIS

FIRST QUARTER 2005

May 13, 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 interim consolidated financial statements for the three months ended March 31, 2005. 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 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.

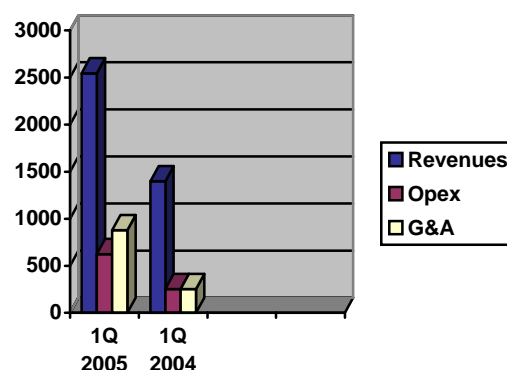
Investors should not place undue reliance on forward-looking statements as the plans, intentions or expectations upon which they are based may not occur. Statements relating to “reserves” or “resources” are deemed to be forward-looking statements, as they involve the implied assessment, based on certain 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 March 31, 2005, average production was 917 bbls/d of oil. The gas produced during the three months ended March 31, 2005, was used only for operations including fuel and gas lift. For the three months ended March 31, 2004, average production was 695 bbls/d of oil.

During the three months ended March 31, 2005, PetroFalcon had 9 producing oil wells, 3 shut-in gas wells and 6 shut-in oil wells.

The Company expects an 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 \$2.54 million for the three months ended March 31, 2005, compared to \$1.37 million for the three months ended March 31, 2004. The average price received for the three months ended March 31, 2005 was \$30.83 per barrel of oil. For the three months ended March 31, 2004, the average price for oil was \$21.70 per barrel.

The increase in revenue during the three months ended March 31, 2005, was due to higher levels of production, 82,562 bbls for the period ended March 31, 2005, as compared to 63,257 bbls for the period ended March 31, 2004, as well as higher average prices, \$30.83 per bbl for the period ended March 31, 2005 as compared to \$21.70 per bbl for the period ended March 31, 2004.

The Company had no derivative contracts and consequently benefited from strong oil prices during the three months ended March 31, 2005. 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.

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)	First Quarter 2005	First Quarter 2004
Operating Expenses (including-maintenance and transportation)	624	424
Average expense (\$ per boe)	7.56	6.71

For the three months ended March 31, 2005, operating expenses were higher, compared to the three months ended March 31, 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 first quarter 2004. 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 EXPENSE

At March 31, 2005, PetroFalcon had \$19.51 million in cash and short-term deposits (\$3.6 million of which is considered restricted) compared to \$27.3 million at March 31, 2004. Interest income increased to \$98,537 in the three months ended March 31, 2005, compared to \$31,687 in the three months ended March 31, 2004, due to higher average balances in the first quarter of 2005.

During the three months ended March 31, 2005, PetroFalcon incurred interest expense of \$98,478 as compared to \$94,796 during the three months ended March 31, 2004.

During the three months ended March 31, 2005, PetroFalcon recorded an exchange gain of \$57,049 on the conversion in foreign currencies to US dollars, as well as a gain on bond sales of \$675,739.

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 Occidental 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 VOG maintain a balance of \$1 million with BE. As of March 31, 2005, the BOD line of credit had an available balance of \$1.24 million and the BE line of credit had an available balance of \$1.48 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)	First Quarter 2005	First Quarter 2004
Expenses	877	391
Average expense (\$ per boe)	10.63	6.18

General and administrative costs increased to \$0.877 million during the three months ended March 31, 2005, from \$0.391 million during the three months ended March 31, 2004. The increase in general and administrative costs during the three months ended March 31, 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 2005.

PetroFalcon does not capitalize general and administrative costs.

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

(\$000s except boe amount)	First Quarter 2005	First Quarter 2004
Depletion, Depreciation, Amortization and Accretion	410	258
Depletion Rate (\$ per boe)	4.96	4.08

The DDA&A expense per unit during the three months ended March 31, 2005 was higher compared to the three months ended March 31, 2004, due to an increase in projected capital expenditures which commenced in 2005. DDA&A is expected to remain relatively constant during 2005.

INCOME TAXES

(\$000s)	First Quarter 2005	First Quarter 2004
Consolidated Tax Expense	301	0

VOG accrued Venezuelan income taxes in the amount of \$0.301 million for the three months ended March 31, 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.

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 Corporation to achieve its stated business objectives

(\$000s)	Original 2005	Revised 2005	As of March 31, 2005
Drilling			
- La Vela	20,066	10,000	7,064
- Cumarebo	8,470	9,000	605
- Prospects	-	6,000	-
- Total Drilling	28,536	25,000	7,669
Central Processing Facilities			
- La Vela	23,612	7,000	2,980
- Cumarebo	2,926	3,000	-
- Total Central Processing Facilities	26,538	10,000	2,980
- Seismic Acquisition	2,086	2,200	1,679
- Geochemical Study	200	-	-
Total Capital Budget	57,360	37,200	12,328

The primary cause for the lower Capital Budget is a reduction in expenditures for gas facilities and a focus on oil facilities at the La Vela field

DRILLING

The Company has concluded drilling operations on the La Vela 9X well at a total depth of 7,490 feet. Logs and test data indicate potential oil and gas zones at depths between 3,000 and 4,000 feet. Intermediate 9 5/8 inch casing, which has been set to 7,200 feet, will allow the option of future directional drilling of deeper targets and the immediate production testing of upper potential reservoirs. The Company is currently drilling at the LV 10X location.

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

CENTRAL PROCESSING FACILITIES

PetroFalcon has commenced the procurement of equipments and materials to be installed in what will be the 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 ACQUISITION

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

FUNDS FROM OPERATIONS

(\$000s except per share data)	First Quarter 2005	First Quarter 2004
Cash flow from operations	1,475	1,800
Per basic share	0.02	0.03
Net income	622	1,411
Per basic share	0.01	0.03
Working capital	12,404	23,569

OPERATING NETBACK

(\$ per boe)	First Quarter 2005	First Quarter 2004
Sales price	30.83	21.70
Operating expenses	(7.56)	(6.71)
Operating netback	23.27	14.99

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			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Revenue	2,545	2,864	2,082	1,677	1,373	1,314	1,053	548
Net income (loss)	622	964	193	(455)	1,411	558	645	(445)
Earnings (loss) per share basic	0.01	0.01	0.00	(0.01)	0.03	0.01	0.01	(0.01)
Earnings (loss) per share diluted	0.01	0.01	0.00	(0.01)	0.03	0.01	0.01	(0.01)

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

Increased revenue was due to higher levels of production, 82,562 bbls in the first quarter of 2005 as compared to 63,257 bbls in the first quarter of 2004, and higher average prices of \$30.83 in the first quarter of 2005 as compared to \$21.70 in the first quarter of 2004.

LIQUIDITY AND CAPITAL RESOURCES

As March 31, 2005, PetroFalcon had 75,334,801 outstanding and issued common shares, and 82,598,228 common shares on a fully diluted basis. At the end of the fourth quarter of 2004, PetroFalcon had 75,178,228 outstanding and issued common shares, and 82,598,228 common shares on a fully diluted basis.

As March 31, 2005, PetroFalcon had \$19.51 million in cash and short term deposits, including \$3.6 million in restricted cash and a working capital surplus of \$12.40 million. At March 31, 2005, PetroFalcon's total debt was \$2.0 million. 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 had total debt of \$2.83 million.

At March 31, 2005, Petrofalcon had \$9.8 million in Accounts Payable of which \$3.7 million represent the accrued portion of capital expenditures not yet billed.

PetroFalcon has a single capital expenditure commitment, namely, a drilling contract for one year which the Company signed in January 2005. As of March 31, 2005, the Company is

committed to making a minimum further expenditure of \$5.4 million under the capital expenditure commitment.

Other than disclosed herein, the Company does not currently have banking facilities. However, the Company will become subject to certain covenants upon finalization of the International Finance Corporation (“IFC”) Loan Facility.

The Company has reached an agreement with the IFC, the commercial lending 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. The disbursements under the facility are subject to a number of conditions and consist of an “A” loan, “Standby Facility” loan and a “C” loan of \$14 million, \$10 million and \$12 million, respectively. Principal repayments are expected to start mid-2007 with repayment occurring in annual instalments. At IFC’s option, the repayments of the “C” loan may be converted into common shares of the Company pursuant to the terms of the IFC agreement. Interest will be payable semi-annually on May 15 and November 15 and will accrue at the London Inter Bank Offered Rate (“Libor”) plus 4.5% for the “A” Loan and Standby Facility Loans, and Libor plus 1% for the C Loan from the date of the first disbursement of each loan. The facility contains a number of covenants that VOG must fulfill including the satisfaction of minimum financial tests, compliance with IFC and World Bank environmental and social policies and compliance with restrictions on the use and application of the proceeds.

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.

RELATED PARTY TRANSACTIONS

For the three months ended March 31, 2005 the Company paid \$210,000 (\$165,000 during the three months ended March 31, 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 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 months ended March 31, 2005 the Company accrued payables to Venezolana de Inversiones y Construcciones Clerico, C.A., an independent operating construction company controlled by the Company’s Chairman Juan Francisco Clerico, for \$800,000. These charges are for construction 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

SUBSEQUENT EVENTS

Subsequent to the quarter end, Vinccler Oil and Gas, C.A. ("VOG") received notice from the Ministry of Energy and Petroleum in Venezuela ("MEP") and PDVSA that existing relationships governed by operating services agreements are to be migrated into joint ventures pursuant to the 2001 Venezuelan Organic Hydrocarbon Law ("OHL") through negotiations with the various operating service agreement parties. It is the understanding of the Company that pursuant to the OHL, (i) VOG will transfer its operating service agreement for the East Falcon Unit ("VOG OSA") to an "Empresa Mixta" or mixed company incorporated pursuant to the laws of Venezuela in exchange for a 49% interest in the Empresa Mixta; and (ii) PDVSA will obtain the remaining 51% interest in the Empresa Mixta in exchange for contributing other oil and gas interests and assets to it. The Company understands that this restructuring may also include the issuance of a gas license to the Empresa Mixta or VOG. It is currently contemplated that a technical and economical evaluation of the East Falcon Unit and other fields and assets will be conducted on a joint basis by MEP, PDVSA and VOG and will commence during the second quarter. The Company has been advised that PDVSA intends to conclude the OHL negotiations within the next six months.

It has also come to the attention of VOG that the total amount of payments to be accrued to each operating service agreement contractor during the 2005 calendar year will not exceed 66.67% of the value of the hydrocarbons produced within the respective contracted area. The Company has conducted a statistical analysis on the historical and current fees received by VOG pursuant to the VOG OSA and these fees approximate 67% of the value of the hydrocarbons produced. Therefore, the Company does not anticipate any material adverse impact as a result of the implementation of this decision.

In addition, the Company has been advised that 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 also announced that it will audit companies that have operating service agreements, however, the Company does not know the timing or impact of such audit.

As a result of these various governmental amendments, the operating results of the Company may be adversely impacted, however, at this time the economic impact and actual timing of the implementation of these are unknown to the Company.

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.