

## MANAGEMENT DISCUSSION & ANALYSIS

### SECOND QUARTER 2009

---

The following management discussion and analysis (“MD&A”) is prepared as of August 12, 2009. This MD&A, as provided by the management of PetroFalcon Corporation (“PetroFalcon”, the “Company” or “we”), should be read in conjunction with the Company’s unaudited interim consolidated financial statements for the three and six months ended June 30, 2009 and 2008, together with the audited consolidated financial statements for the years ended December 31, 2008 and 2007. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”). Estimates and forward-looking information are based on assumptions of future events and actual results may vary from these estimates; see “Cautionary Statement Regarding Forward-Looking Information”. All dollar amounts are expressed in US dollars (“USD”).

In 2007, the Company reviewed the accounting for foreign currency transactions in Venezuela due to the increasing spread between the official rate and the implied market rate in Venezuela. It was determined that as a consequence of the rapid decline in the valuation of the Venezuelan Bolivar (“Bs”) as reflected in the implied market for foreign currencies in Venezuela that the method of translation from Bolivars to US dollars using the official rate was no longer appropriate. In addition, effective January 1, 2008, the currency unit of the monetary system of Venezuela dropped three zeros, and all amounts are now denominated in a new smaller scale of Bolivars. For the six months ended June 30, 2009, and 2008, the Bolivar balances were translated at implied market rates of 6.60 Bs/USD and 3.45 Bs/USD, respectively.

For the purposes of calculating Mixed Company production, natural gas has been converted to a barrel of oil equivalent (“boe”) using a conversion rate of six thousand cubic feet (“mcf”) equal to one barrel (6:1) based on an energy equivalency conversion method primarily applicable at the burner tip and which does not represent a value equivalency at the wellhead. This conversion to boe may be misleading, particularly if used in isolation.

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

---

Forward-looking information and statements are included throughout this MD&A and include, but are not limited to, statements with respect to the Venezuelan joint venture mixed companies, PetroCumarebo and Baripetrol (“Mixed Companies”); oil and natural gas production; general and administrative expenses; future drilling; planned growth and development; contractual obligations; new projects; forecasted production; future plans, objectives and results. The above constitute forward-looking information, within the meaning of applicable Canadian securities legislation, which involves risks, uncertainties and assumptions, including, without limitation, risks associated with operating exclusively in a foreign jurisdiction; being a minority partner in a Mixed Company; being dependent on dividends from a Mixed Company; the imposition of higher royalties and income taxes; the impact of general economic conditions in Venezuela and world-wide industry conditions, including the adoption of environmental, tax and other laws and changes in how they are interpreted and enforced; the existence of operating risks in finding, developing and producing oil and natural gas; volatility of oil and natural gas prices; oil and natural gas product supply and demand; processing facility access; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; stock market volatility; commodity prices; interest rates; opportunities available to or pursued by the Company; and other factors, many of which are beyond our control.

All such forward-looking information is based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. The foregoing factors, assumptions and risks are not exhaustive and are further discussed in PetroFalcon’s most recent annual information form available on SEDAR at [www.sedar.com](http://www.sedar.com). Actual results, performance or achievements could differ materially from those expressed in, or implied by, such forward-looking information and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking information will transpire or occur, or if any of them do so, what benefits will be derived from them. Investors should not place undue reliance on forward-looking information. Statements relating to “reserves” are also deemed to be forward-looking information as they involve the implied assessment, based on certain estimates and assumptions that the reserves described can be profitably produced in the future. Except as required by law, PetroFalcon and its subsidiary do not intend to update or revise any forward-looking information, whether as a result of new information, future events or otherwise. The information contained in this MD&A is expressly qualified by this cautionary statement.

## PETROFALCON'S BUSINESS ENVIRONMENT

---

### *Description of Business*

PetroFalcon Corporation is engaged in the exploration, development, production and management of oil and natural gas properties. Through its wholly-owned Venezuelan subsidiary, Vinccler Oil and Gas, C.A. (“Vinccler Venezuela”), PetroFalcon owns 40% of PetroCumarebo, S.A. (“PetroCumarebo”) and 5% of Baripetrol, S.A. (“Baripetrol”). Effective July 22, 2009, Vinccler Venezuela was renamed PFC Oil and Gas, C.A. (“PFC Venezuela”).

PetroCumarebo holds all of the operating rights to the East and West Falcon blocks, an area of approximately 838,000 acres in north-western Venezuela. The Falcon area is strategically located in close proximity to the Paraguana Refinery Complex (“PRC”), one of the largest refinery complexes in the world. The oil and gas produced from the East and West Falcon blocks is sold to the state-owned oil and gas company, Petróleos de Venezuela, S.A. (“PDVSA”), and is either trucked or shipped by pipelines to the PRC.

Baripetrol holds all of the operating rights to the Colon Block, an area of approximately 297,000 acres in western Venezuela. The oil and gas produced from the Colon Block is sold to PDVSA and shipped by pipelines to PDVSA’s distribution network.

PDVSA has announced its intention to decrease the number of mixed companies by merging individual mixed companies that have common characteristics, such as location and the types of crude oil produced, into new, larger mixed companies. PDVSA will maintain a 60% participation in these new mixed companies, and the private parties will negotiate their pro forma interest based on each private party’s estimated fair value derived from the potential future dividends from the mixed companies. It is not yet known whether this consolidation process will impact PetroCumarebo or Baripetrol.

### *Renewable Energy Investment – Agreement to Acquire Etrion*

On August 11, 2009, PetroFalcon announced the signing of a share purchase agreement for the acquisition of 90% of the outstanding shares of Solar Resources Holding Sarl (“Etrion”), a private renewable energy independent power producer, from Lorito Holdings Srl (“Lorito”) and related parties. Lorito is an investment company wholly owned by a Lundin family trust and holds 24% of the shares of Lundin Petroleum AB (“Lundin Petroleum”), which indirectly owns 45% of PetroFalcon.

Etrion is a private renewable energy independent power producer based in Geneva, Switzerland. Etrion was founded in 2008 and is owned 82.7% by Lorito, 11.5% by management and 5.8% by other individuals. Etrion is focused on developing, financing, building, owning and operating global electrical power plants based on renewable sources of energy, including solar photovoltaic, solar thermal and wind.

Subject to certain conditions, including receipt of all required regulatory approvals, PetroFalcon intends to acquire 90% of Etrion from the current shareholders at cost for 2.3 million Euros in cash (equivalent to \$3.26 million). Included in this amount, PetroFalcon is purchasing 4.425% of Etrion from Ashley Heppenstall, a Director of PetroFalcon and the President and CEO of Lundin

Petroleum, at cost for 115,434 Euros (equivalent to \$163,524). PetroFalcon will also advance a loan to Etrion in the amount of 1.35 million Euros (equivalent to \$1.91 million) in order to repay an equivalent amount advanced to Etrion by Lorito. The remaining 10% of Etrion will continue to be held by Marco Northland, the Vice Chairman and CEO of Etrion.

Upon closing, PetroFalcon intends to appoint Mr. Northland as the CEO and a Director of PetroFalcon. Subject to shareholder approval, PetroFalcon also intends to continue its incorporation from Alberta to British Columbia and to re-name the Company, "Etrion Corporation". The Company plans to move its operational base to Europe and to seek additional opportunities in the renewable energy sector, while maintaining its existing oil and gas assets in Venezuela.

The agreement for the purchase of 90% of Etrion is subject to the required regulatory approvals, including without limitation, the approval of the Toronto Stock Exchange ("TSX"). Under the rules of the TSX, certain aspects of the transaction will require approval by disinterested shareholders. For more details about the acquisition, please refer to the Management Information Circular that will be sent to shareholders and available on SEDAR in advance of the Company's Annual and Special Meeting ("AGM") to be held in Toronto on September 10, 2009. The acquisition is expected to close immediately following the AGM.

### ***PetroFalcon's Industry Performance***

There was a severe decline in global crude oil prices during the second half of 2008, and oil prices remained at lower levels in the first quarter of 2009, decreasing the oil prices received by the Mixed Companies. During the second quarter of 2009, oil prices made a significant recovery but it is uncertain if they will remain stable. The stability of future oil markets is subject to a variety of factors including political considerations, worldwide economic conditions and actions of the Organization of Petroleum Exporting Countries ("OPEC") and other major oil producing countries. It is very difficult to correctly project future prices in the current economic environment, and the Company anticipates a significant level of volatility over the next twelve to twenty-four months.

## PETROCUMAREBO AND BARIPETROL 2009 Q2 PRODUCTION

---

The following tables outline the gross production for each of PetroCumarebo and Baripetrol in which PetroFalcon holds a 40% and 5% interest, respectively.

### *PetroCumarebo Production Summary:*

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>
<b>Average daily production</b>		
Oil - bbls/d	734	932
Natural gas - mcf/d	11,790	15,285
<b>Total – boe/d</b>	<b>2,669</b>	<b>3,479</b>

*Note: Production is shown before royalties of 33.33%. PetroFalcon owns 40% of PetroCumarebo.*

As detailed in the table above, PetroCumarebo's average gross production from both the East and West Falcon blocks for the three months ended June 30, 2009, was 2,669 boe/d. For the comparable period ended June 30, 2008, PetroCumarebo's average gross production was 3,479 boe/d. Production decreased due to natural reservoir decline, increased water production and paraffin problems.

PetroCumarebo produces light sweet crude oil that sells at a premium to most of the oil produced in Venezuela. PetroCumarebo's oil production from the East and West Falcon blocks is delivered to PDVSA at a weighted average price of approximately 100% of the price of West Texas Intermediate ("WTI") crude oil.

Payment from PDVSA to PetroCumarebo is 100% in US dollars for crude oil and natural gas liquids and 100% in Bolivars for methane gas. Potential dividends from PetroCumarebo to PetroFalcon will be in US dollars and are at the discretion of the shareholders of PetroCumarebo, depending on net and available profits. To date, PetroFalcon has not received any dividends from PetroCumarebo for the Company's 40% interest in PetroCumarebo. Management expects to receive dividends for PetroCumarebo's operations in 2007 and 2008, but the timing of these dividends is uncertain.

***Baripetrol Production Summary:***

	<b>Three months ended June 30, 2009</b>	<b>Three months ended June 30, 2008</b>
<b>Average daily production</b>		
Oil - bbls/d	9,071	9,622
Natural gas - mcf/d	7,185	5,897
<b>Total – boe/d</b>	<b>10,268</b>	<b>10,605</b>

*Note: Production is shown before royalties of 33.33%. PetroFalcon owns 5% of Baripetrol.*

As detailed in the table above, Baripetrol's average gross production from the Colon Block for the three months ended June 30, 2009, was 10,268 boe/d. For the comparable period ended June 30, 2008, Baripetrol's average gross production was 10,605 boe/d. Production has been maintained at consistent levels due to the drilling of the LPT-16 and LPT-17 wells.

Baripetrol's oil production is delivered to PDVSA at an average price that is approximately 92% of WTI.

Payment from PDVSA to Baripetrol is 100% in US dollars for crude oil and natural gas liquids and 100% in Bolivars for methane gas. Dividends from Baripetrol to PetroFalcon are paid in US dollars and are at the discretion of the shareholders of Baripetrol, depending on net and available profits. During the year ended December 31, 2008, PetroFalcon received \$2.9 million in dividends from Baripetrol for operations between January and December 2007. Management expects to receive a dividend for Baripetrol's 2008 operations, but the timing of the dividend is uncertain.

## PETROCUMAREBO AND BARIPETROL 2009 CAPITAL EXPENDITURES

The Mixed Companies, PetroCumarebo and Baripetrol, operate as independent entities with seconded technical staff from shareholders. The Mixed Companies fund their capital expenditures through their own cash flow, to the extent available, or through cash calls to shareholders, including PetroFalcon, if no other sources of financing are available. The Mixed Company shareholders intend that PetroCumarebo and Baripetrol be self-funding and rely on internally-generated cash flow to fund operations. To date, the Mixed Companies have not made a cash call to PetroFalcon for capital expenditures. This could change if oil and gas price realizations decrease and will be further addressed in future filings if necessary.

Based on prior experience and current oil prices, total 2009 capital expenditures are expected to be self-funded by the Mixed Companies' respective cash flow, and we would not expect the Mixed Companies to make cash calls to PetroFalcon to fund their capital programs.

If oil prices decline and PetroCumarebo and Baripetrol are not able to fund their capital expenditures through their respective cash flow or other forms of financing, the Company's maximum expected commitment for 2009 capital expenditures is limited to the Company's share of the gross capital expenditure budgets outlined below.

### *PetroCumarebo 2009 Capital Expenditures:*

(\$000s)	Gross Initial Budget 2009	Gross Revised Budget 2009	Gross Actual Incurred June 30, 2009
<b>Drilling and Work-overs</b>			
- La Vela	18,110	12,312	16,120
- Cumarebo	6,610	5,262	850
- West Falcon	-	-	-
- Total Drilling and Work-overs	24,720	17,574	16,970
<b>Processing Facilities and Infrastructure</b>			
- La Vela	2,233	2,233	-
- Cumarebo	1,600	1,600	-
- West Falcon	537	537	-
Total Processing Facilities and Infrastructure	4,370	4,370	-
<b>Total Capital Budget</b>	<b>29,090</b>	<b>21,944</b>	<b>16,970</b>

*Note: PetroFalcon owns 40% of PetroCumarebo. Budgeted capital expenditures are shown on a gross basis for PetroCumarebo. PetroFalcon does not expect cash calls from PetroCumarebo for any portion of the 2009 capital expenditures. However, if PetroCumarebo's cash flow is not sufficient to cover its capital expenditures, or if no other sources of financing are available, PetroFalcon could be responsible for 40% of such expenditures. Historically, PetroCumarebo has been able to fund its capital expenditures budget through its own cash flow or other forms of financing without cash calls to PetroFalcon.*

PetroCumarebo's revised 2009 capital budget is \$21.9 million, which includes drilling one development well in La Vela (LV-24), four work-overs (two in La Vela and two in Cumarebo) and eight coiled tubing jobs (three in La Vela, three in Cumarebo and two in Mamon). PetroCumarebo also plans to construct La Vela and Cumarebo central process de-bottlenecking facilities. In the second quarter of 2009, PetroCumarebo finished drilling the LV-24 well in the

La Vela Field and subsequently stopped drilling activities in order to reassess the economics of the drilling program to date. The revised budget includes the cost to demobilize the rig.

***Baripetrol 2009 Capital Expenditures:***

(\$000s)	Gross Initial Budget 2009	Gross Actual Incurred June 30, 2009
<b>Seismic, Drilling and Work-overs</b>		
- La Palma	30,351	17,117
- Socuavo	-	770
- Las Cruces	-	840
- Total Drilling and Work-overs	30,351	18,727
<b>Processing Facilities and Infrastructure</b>		
- La Palma	-	-
- Socuavo	3,200	-
- Las Cruces	-	858
- Colina Station	800	-
- Total Processing Facilities and Infrastructure	4,000	-
<b>Total Capital Budget</b>	<b>34,351</b>	<b>19,585</b>

*Note: PetroFalcon owns 5% of Baripetrol. Budgeted capital expenditures are shown on a gross basis for Baripetrol. PetroFalcon does not expect cash calls from Baripetrol for any portion of the 2009 capital expenditures. However, if Baripetrol's cash flow is not sufficient to cover its capital expenditures, or if no other sources of financing are available, PetroFalcon could be responsible for 5% of such expenditures. Historically, Baripetrol has been able to fund its capital expenditures budget through its own cash flow or other forms of financing without cash calls to PetroFalcon.*

Baripetrol's 2009 gross capital budget is \$34.4 million, which includes drilling four development wells in La Palma, twelve work-overs, the construction of a natural gas dehydration plant for the Socuavo field's gas production and the upgrading of facilities in the La Colina flow station. At current oil prices, Baripetrol is expected to fund these capital expenditures from operating cash flow without cash calls to PetroFalcon.

In the second quarter of 2009, Baripetrol successfully drilled the second well in the La Palma Field, LPT-17, with an initial average oil production of 4,200 bbls/d. Currently, Baripetrol is drilling the LPT-18 well in the La Palma Field.

## SUMMARY OF QUARTERLY RESULTS

---

The following table contains selected consolidated financial information for PetroFalcon over the last eight quarters:

(\$000s, except per share amounts)	2009		2008				2007	
	Q1	Q2	Q1	Q2	Q3	Q4	Q3	Q4
Revenue	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Net loss	(1,552)	(1,447)	(1,675)	(4,412)	(7,121)	(9,982)	(119)	(1,617)
Loss per share basic and diluted	(0.01)	(0.01)	(0.01)	(0.03)	(0.04)	(0.06)	(0.00)	(0.02)

Under the cost method of accounting, PetroFalcon does not recognize its share of revenues, expenses, assets or liabilities from PetroCumarebo or Baripetrol and instead only recognizes income from these investments to the extent that dividends are received from PetroCumarebo or Baripetrol. As a result, PetroFalcon has no revenues for the three and six month periods ended June 30, 2009, and 2008. See “Critical Accounting Policies and Estimates”.

During the six month period ended June 30, 2008, PetroFalcon received \$1.9 million in dividends from Baripetrol for operations between January and September 2007. The dividends were credited against the historical cost of the investment instead of being recognized as income during the year ended December 31, 2008, because the dividends were related to pre-acquisition earnings.

### *PetroFalcon’s financial results and position*

For the three and six month periods ended June 30, 2009, the Company reported a net loss of \$1.4 million (loss per share of \$0.01) and \$3.0 million (loss per share of \$0.02), respectively, compared to a net loss of \$4.4 million (loss per share of \$0.03) and \$6.1 million (loss per share of \$0.04) for the three and six month periods ended June 30, 2008, respectively.

As of June 30, 2009, PetroFalcon had \$29.8 million in cash and short-term deposits, working capital of \$30.0 million, no debt and no expected cash calls from its oil and gas investments in Venezuela for 2009 capital expenditures.

## GENERAL AND ADMINISTRATIVE (“G&A”) EXPENSE

(\$000s)	Three months ended		Six months ended	
	2009	June 30, 2008	2009	June 30, 2008
Salary and compensation benefits	560	589	1,187	1,150
Corporate and professional fees	541	512	804	1,073
Technical service agreement	67	94	230	215
Insurance	24	70	254	199
Travel expenses	69	143	153	234
Write-offs of receivables and other assets	30	73	30	73
Office, listing and filing expenses	82	85	224	253
Total G&A Expenses	1,373	1,566	2,882	3,197

PetroFalcon’s G&A expenses were \$1.4 million during the three month period ended June 30, 2009, compared to \$1.6 million during the three month period ended June 30, 2008. PetroFalcon’s G&A expenses were \$2.9 million during the six month period ended June 30, 2009, compared to \$3.2 million during the six month period ended June 30, 2008. The net decrease was due mainly to a general lower level of activity and a continued focus on cost reductions, including a decrease in travel expenses and compensation to officers.

PetroFalcon does not capitalize general and administrative expenses.

## DEPRECIATION, DEPLETION AND AMORTIZATION (“DD&A”) EXPENSE

(\$000s)	Three months ended		Six months ended	
	2009	June 30, 2008	2009	June 30, 2008
Depreciation, depletion and amortization	57	26	116	52

For the three month period ended June 30, 2009, PetroFalcon’s DD&A expense was \$57,431, compared to \$26,299 for the three month period ended June 30, 2008. For the six month period ended June 30, 2009, PetroFalcon’s DD&A expense was \$115,630, compared to \$51,711 for the six month period ended June 30, 2008. The increase was due to the relocation and refurbishment of the Company’s Venezuelan office, a commitment entered into in June 2008 when the Company expected to grow substantially.

## STOCK-BASED COMPENSATION EXPENSE

---

(\$000s)	Three months ended		Six months ended	
	2009	June 30, 2008	2009	June 30, 2008
Stock-based compensation	41	26	67	775

During the three month period ended June 30, 2009, the Company recorded \$41,498 in stock-based compensation expense compared to \$26,288 during the three months ended June 30, 2008.

As of June 30, 2009, the number of outstanding stock options was 9,673,640, compared to 9,133,660 outstanding stock options as of June 30, 2008. The net increase in stock options outstanding was due mainly to options granted to employees and directors in May 2009, and resulted in a higher stock-based compensation expense during the three month period ended June 30, 2009.

PetroFalcon's stock option agreements have a change of control provision that causes all stock options to vest immediately when more than 20% of the Company is purchased. As a result, all of the Company's outstanding stock options immediately vested at the closing of the Lundin transaction on February 1, 2008.

## INTEREST INCOME

---

(\$000s)	Three months ended		Six months ended	
	2009	June 30, 2008	2009	June 30, 2008
Interest income	69	278	205	170

At June 30, 2009, PetroFalcon had \$29.8 million in cash and short-term deposits compared to \$24.1 million at June 30, 2008. During the three month period ended June 30, 2009, the Company recorded interest income in the amount of \$69,194, compared to \$278,053 during the three month period ended June 30, 2008. There was a significant decrease in the interest rates during the second quarter of 2009 that directly affected the interest income received from the Company's short-term investments.

During the six month period ended June 30, 2009, the Company recorded interest income in the amount of \$205,270, compared to \$170,365 during the six month period ended June 30, 2008. The increase during the six month period was due mainly to the collection in January 2009 of interest from Chevron related to the reimbursements of the amounts invested in the Cardon III offshore project.

## INCOME TAXES

---

During the three and six months ended June 30, 2009, and 2008, PetroFalcon recorded no income tax expense since the Company had no taxable income for these periods.

## LIQUIDITY AND CAPITAL RESOURCES

---

As of June 30, 2009, PetroFalcon had \$29.8 million in cash and short-term deposits, \$30.0 million of working capital and no debt. At December 31, 2008, PetroFalcon had \$26.7 million in cash, \$32.9 million of working capital and no debt.

At June 30, 2009, PetroFalcon had \$1.0 million in current accounts receivable compared to \$7.0 million at December 31, 2008. At June 30, 2009, the Company had \$0.9 million in accounts payable compared to \$0.9 million at December 31, 2008.

As of August 12, 2009, PetroFalcon had 158,501,120 issued and outstanding common shares and 171,138,093 common shares on a fully diluted basis. As of June 30, 2009, PetroFalcon had 158,501,120 issued and outstanding common shares and 171,138,093 common shares on a fully diluted basis. As of December 30, 2008, PetroFalcon had 158,501,120 issued and outstanding common shares and 172,384,780 common shares on a fully diluted basis.

### *PetroFalcon's Liquidity Analysis*

PetroFalcon has substantial cash on hand and expects to generate cash flow by receiving dividends from its oil and gas investments. As of August 12, 2009, PetroFalcon has approximately \$29 million in net cash. According to PetroFalcon's calculations, the Company should receive a total of approximately \$8 million in dividends from Baripetrol and PetroCumarebo for 2008 operations, but the payment of these dividends is uncertain. If these dividends are delayed or are never paid, the Company's cash on hand more than covers its cash requirements for the foreseeable future. Based on prior experience and current oil prices, PetroFalcon does not expect cash calls from PetroCumarebo or Baripetrol for 2009 capital expenditures.

The 2009 capital expenditure budgets for PetroCumarebo and Baripetrol are discussed under the heading, "PetroCumarebo and Baripetrol 2009 Capital Expenditures".

PetroFalcon has entered into an agreement to acquire 90% of Etrion from the current shareholders at cost for 2.3 million Euros (\$3.26 million) in cash. PetroFalcon will also advance a loan to Etrion in the amount of 1.35 million Euros (\$1.91 million) in order to repay an equivalent amount advanced to Etrion by Lorito (see *Renewable Energy Investment - Agreement to Acquire Etrion* under the heading, "PetroFalcon's Business Environment"). In addition to PetroFalcon's corporate G&A expense, which is currently estimated pro forma for the acquisition at \$6.0 million for 2009, PetroFalcon's only budgeted cash commitment for 2009 is the acquisition cost of Etrion outlined above. If the Company makes other acquisitions or if oil and gas price realizations are significantly reduced, financing requirements may change, and potential sources of financing would be further addressed in future filings.

## **RISK FACTORS**

---

The Company's activities expose it to a variety of financial risks: credit risk, liquidity risk, market risk (including interest rate, foreign currency and commodity price risk) and other risks. Risk management is carried out by the Company's management team with guidance from the Audit Committee under policies approved by the Board of Directors. The Board of Directors also provides regular guidance for overall risk management.

### ***Credit risk***

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to value-added tax receivable and tax credits of the wholly-owned subsidiary with the Venezuelan tax authorities and third party credits. The Company has no concentration of credit risk. Value added tax receivables are collectable from the Venezuelan government and are in good standing as of June 30, 2009. Management believes that the credit risk with respect to financial instruments attributable to value added tax receivables is moderate. On July, 30, 2009 PFC Oil and Gas, C.A. (formerly Vinccler Oil and Gas, C.A.) received \$70,676 as the proceeds of the sale of a portion of its income tax credits available for sale as of June 30, 2009.

In addition, the majority of the Company's cash and cash equivalents are on deposit with one highly-rated chartered bank in Canada. A lesser amount is held at banks in Curacao, and Venezuela.

### ***Liquidity risk***

At June 30, 2009, the Company had sufficient funds to settle current liabilities. All of the Company's accounts payable and accrued liabilities have contractual maturities of less than 30 days, except for severance employee benefits, and are subject to normal trade terms. The Company's subsidiary's lines of credit are based on contractual terms between related companies and with a Venezuelan financial institution.

### ***Market risk***

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates and oil prices.

#### ***(i) Interest rate risk***

PetroFalcon has significant cash balances and short-term investments, with the latter having a variable annual interest rates from 0.50% to 2.20%. The Company's current policy is to invest excess cash in investment grade short-term deposit certificates issued by banks. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

### *(ii) Foreign currency risk*

PetroFalcon's functional currency is the US dollar. Any dividends received from its oil and gas investments are in US dollars, and major purchases are transacted in US dollars. The Company maintains US dollar bank accounts in Canada and Curacao. The Company funds some of its subsidiary's operating and administrative expenses in Venezuelan Bolivars from its US dollar bank accounts. The Company recognizes the foreign currency transactions of its Venezuelan subsidiary at the implied market rate in Venezuela, which had a spread of 207% over the official rate as of June 30, 2009. The Company has exposure to the volatility of the implied market rate in Venezuela that may result in significant foreign exchange gains or losses from its Venezuelan subsidiary.

### *(iii) Commodity price risk*

Oil price risk is the potential adverse impact on the Company's dividends from its oil and gas investments due to oil price movements and volatility. The Company closely monitors oil prices to determine the appropriate course of action to be taken by the Company, to the extent possible, through its participation on the board of directors of PetroCumarebo and in the private party consortium in Baripetrol.

### ***Other risks***

#### *International operations*

PetroFalcon participates in oil and gas projects located in Venezuela. Oil and gas exploration, development and production activities, including joint ventures in emerging markets, are subject to significant political and economic uncertainties that may adversely affect the Company's performance. Uncertainties include, but are not limited to, expropriation, nationalization, renegotiation or nullification of existing or future concessions and contracts, a change in crude oil or natural gas pricing policies, a change in taxation policies, and the imposition of currency controls. These uncertainties, all of which are beyond the Company's control, could have a material adverse effect on PetroFalcon's business prospects and results of operations. In addition, if legal disputes arise related to oil and gas concessions acquired by the Company, PetroFalcon could be subject to the jurisdiction of courts other than those of Canada. The Company's recourse may be very limited in the event of a breach by a government or government authority of an agreement governing a concession in which PetroFalcon acquires an interest. The Company may require licenses or permits from various governmental authorities to carry out future exploration, development and production activities. There can be no assurance that PetroFalcon will be able to obtain all necessary licenses and permits when required.

#### *Dividends*

PetroFalcon's only source of near-term revenues is potential dividends from its 40% interest in PetroCumarebo and its 5% interest in Baripetrol. Under Venezuelan law, dividends can only be declared to the extent a company has net and available profits as stated in its approved financial statements. Therefore, if there are sufficient net and available profits, subject to prior approval of shareholders, PetroFalcon, through PFC Oil and Gas, C.A. (formerly Vinccler Oil and Gas, C.A.), may receive annual dividends in US dollars, or quarterly loans against those projected

dividends. If the Mixed Companies' boards of directors do not propose dividends, the Mixed Companies' shareholders do not approve dividends, or the Mixed Companies do not have net and available profits to declare dividends, PetroFalcon cannot expect to receive payment from the Mixed Companies. Dividends from the Mixed Companies must be proposed by four out of the five board members (80%), and each of PFC Oil and Gas, C.A. ("PFC Venezuela") (formerly Vinccler Oil and Gas, C.A.) and Baripetrol's private party consortium (which includes Tecpetrol, Perenco and PFC Venezuela) have two out of five board seats (40%) in the respective Mixed Companies. Dividends proposed by the board of the Mixed Companies must be approved by a qualified majority (75%) of its respective shareholders, and PFC Venezuela and Baripetrol's private party consortium each only account for 40% of the respective shareholders. Furthermore, given the current economic environment and its potential impact on the oil and gas business, PDVSA and the Venezuelan government, the timing and amount of dividends from the Mixed Companies is uncertain.

## **RELATED PARTY TRANSACTIONS**

---

### ***Pacific Oil and Gas***

Pacific Oil and Gas, LLC ("Pacific Oil and Gas") is controlled by PetroFalcon's Vice Chairman, Clarence Cottman, and PetroFalcon's President and Chief Executive Officer, William Gumma. The Company paid Pacific Oil and Gas for the three months ended June 30, 2009 and 2008, \$135,000 and \$135,000, respectively. The Company paid Pacific Oil and Gas for the six months ended June 30, 2009 and 2008, \$324,000 and \$270,000, respectively. These payments include the salaries of Mr. Gumma and PetroFalcon's Chief Financial Officer, Garrett Soden, as well as administrative services from Pacific Oil and Gas.

### ***Lundin Services BV***

PetroFalcon also receives technical services from Lundin Services BV, a wholly owned subsidiary of Lundin Petroleum. Lundin Petroleum indirectly owns 45% of the Company, and Lundin Petroleum's CEO, Ashley Heppenstall, is a board member of PetroFalcon. For the three month periods ended June 30, 2009 and 2008, the Company paid Lundin Services BV for professional services in the amount of \$5,440 and nil, respectively. For the six month periods ended June 30, 2009 and 2008, the Company paid Lundin Services BV for professional services in the amount of \$12,890 and nil, respectively. These payments for professional services include oil and gas geology, reserve and legal advice for PetroFalcon's business development activities.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

---

The Company made assumptions in applying critical accounting estimates that were uncertain at the time the accounting estimate was made and may have a significant effect on the financial statements of the Company. The preparation of these consolidated financial statements is based on the accounting policies and practices consistent with those used in the preparation of the Company's annual consolidated financial statements as at December 31, 2008. See the Company's "2008 Annual Report".

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

---

During the three and six months ended June 30, 2009, there were no changes to internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")**

---

In January 2006, the Canadian Institute of Chartered Accountants ("CICA") Accounting Standards Board ("AcSB") formally adopted the strategy of replacing Canadian GAAP with IFRS for Canadian enterprises with public accountability. The conversion timetable calls for financial reporting under IFRS for accounting periods commencing on or after January 1, 2011. On February 13, 2008, the AcSB confirmed that the use of IFRS will be required in 2011 for publicly accountable profit-oriented enterprises. IFRS will be required for PetroFalcon's interim and annual financial statements for the fiscal year beginning January 1, 2011. The Company is currently working on the diagnostic phase of the conversion project to IFRS, identifying likely differences between Canadian GAAP and IFRS through a revision of the current accounting policies and the potential impact on the consolidated financial statements of the Company. Once completed the diagnostic phase, the management of the Company will start the component evaluation phase by quantifying all of the identified differences (if any) in order to prepare an opening balance sheet under IFRS by December 31, 2009.

## **ADDITIONAL INFORMATION**

---

Additional information regarding the Company, including its annual information form, reserves information about PetroCumarebo and Baripetrol and annual report, may be found on the SEDAR website at [www.sedar.com](http://www.sedar.com) or by visiting the Company's website at [www.petrofalcon.com](http://www.petrofalcon.com).