



Building Value in Venezuela

MANAGEMENT DISCUSSION & ANALYSIS

SECOND QUARTER 2007

The following management discussion and analysis (“MD&A”) is prepared as of August 10, 2007. This 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 and six months ended June 30, 2007, and 2006 together with the audited consolidated financial statements for the years ended December 31, 2006, and 2005. 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.

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 where 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 (“USD”). Transactions and balances using Venezuelan Bolivars (“Bs”) are converted into US dollars using the temporal method at the official fixed exchange rate (2,150 Bs/USD).

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 (“mcf”) equal to one barrel (6:1).

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Except for statements of historical fact, all statements in this MD&A, including, without limitation, statements with respect to the Empresa Mixta; royalty payments; oil and natural gas production; general and administrative expenses; future income tax; future drilling; planned growth and development; contractual obligations; new projects; forecasted production; future plans; objectives and results constitute forward-looking information within the meaning of applicable Canadian securities legislation, which involve risks, uncertainties and assumptions including, without limitation, risks associated with operating exclusively in a foreign jurisdiction; being a minority partner in an Empresa Mixta; being dependent on dividends from an Empresa Mixta; 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 are not exhaustive and are further discussed in PetroFalcon's most recent annual information form available on SEDAR at 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 there from. Investors should not place undue reliance on forward-looking information. Statements relating to "reserves" or "resources" are also deemed to be forward-looking information 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. Except as required by law, PetroFalcon Corporation and its subsidiaries expressly disclaim any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise. In the event subsequent events prove past statements about current trends to be materially different, we may choose to issue a news release explaining the reasons for the difference and update the guidance on the anticipated impact on revenue, earnings and other key events.

The information contained in this MD&A is expressly qualified by this cautionary statement.

CURRENT STATUS OF OPERATIONS OF PETROFALCON

PetroFalcon Corporation is engaged in the exploration, development, production and management of oil and natural gas properties through its indirect wholly-owned subsidiary, Vinccler Oil and Gas, C.A. (“Vinccler Venezuela”), which owns 40% of the joint venture company (“Empresa Mixta”), PetroCumarebo, S.A. (“PetroCumarebo”).

Empresa Mixta Background

PetroFalcon’s revenues for the three months ended March 31, 2006, were derived from the East Falcon Block under the Operating Service Agreement (“East Falcon OSA”) with Petróleos de Venezuela, S.A. (“PDVSA”), the state-owned oil and gas company of Venezuela. Effective March 21, 2006, Vinccler Venezuela completed the acquisition of West Falcon Hydrocarbons, S.R.L. (“West Falcon”), a subsidiary of Samson International LLC, which owned a separate Operating Service Agreement for the West Falcon Block (“West Falcon OSA”).

On September 29, 2006, Vinccler Venezuela and Corporación Venezolana del Petróleo (“CVP”), an affiliate of PDVSA, executed the Empresa Mixta Conversion Agreement (“Conversion Contract”), which identified PetroCumarebo and confirmed the ownership structure as 40% held by Vinccler Venezuela and 60% held by CVP. Under the terms of the Conversion Contract, Vinccler Venezuela’s East Falcon OSA and West Falcon OSA were contributed to the Empresa Mixta PetroCumarebo effective April 1, 2006.

Therefore, PetroFalcon’s revenues for the three and six months ended June 30, 2007, were derived from Vinccler Venezuela’s proportional share of PetroCumarebo’s revenues. However, on a comparative basis, PetroFalcon was not able to recognize revenue in the comparable three months ended June 30, 2006, due to the fact that the conversion to the Empresa Mixta had not yet been completed.

PetroCumarebo Payments

PetroFalcon has recognized its proportional share of revenues for the value of oil and gas delivered by PetroCumarebo to PDVSA during the periods following the execution of the Conversion Contract.

PetroCumarebo was not able to invoice PDVSA until March 29, 2007, for oil production delivered April to December 2006 (an amount totaling approximately \$12.3 million net of royalties). As of August 10, 2007, PetroCumarebo has been paid for invoices relating to the six months of oil production from April to September 2006 (totaling approximately \$9.1 million net of royalties). In addition, PetroCumarebo has delivered invoices to PDVSA for the five months of oil production from January to May 2007 (totaling approximately \$4.5 million net of royalties). Payments of oil production invoices rendered for the months of October 2006 to May 2007 remain outstanding.

PetroCumarebo has still not yet invoiced PDVSA for natural gas production delivered since April 2006 (an amount expected to be approximately \$1.8 million net of royalties as of June 30,

2007), because it has not yet received confirmation from the Venezuelan Ministry of Energy and Petroleum (“MEP”) for the natural gas volumes delivered.

Management does not have any information as to the expected timing of these invoices and payments, but PetroCumarebo does expect to be paid by PDVSA for all oil delivered since October 2006 and all natural gas delivered since April 2006. Once the initial invoicing process is complete and a regular procedure has been established, PetroCumarebo expects to be paid for its backlog of invoices and will proceed to invoice PDVSA for oil and natural gas deliveries on a monthly basis going forward.

Under the terms of the Conversion Contract, PetroCumarebo is entitled to payment from PDVSA within 45 days of submitting an invoice. Given the sequence of events and the recent submission of the initial invoices to PDVSA, PetroCumarebo has a limited history of payment from PDVSA under the Conversion Contract. To date, amounts invoiced have not been paid by PDVSA in a timely manner in accordance with the terms of the Conversion Contract.

ICO Pipeline Update

PetroCumarebo delivers natural gas into PDVSA’s Interconnection Centro Occidente (“ICO”) natural gas pipeline, which then transports the natural gas to the nearby Paraguana Refinery Complex. On December 6, 2006, PDVSA’s ICO pipeline experienced a joint rupture between the La Vela and Cumarebo valve stations, and PDVSA closed the pipeline section leading to PetroCumarebo’s East Falcon Block. As a result, most of PetroCumarebo’s natural gas production is temporarily shut-in, but its wells and facilities are unaffected. Management has been advised that deliveries to the ICO pipeline from the La Vela Field are expected to begin by the end of the third quarter of 2007, but deliveries of natural gas from the Cumarebo Field will not resume until the fourth quarter of 2007.

As a result of the ICO pipeline rupture, PetroCumarebo now has approximately 28 million cubic feet of natural gas per day (“mmcf/d”) and 150 barrels of oil per day (“bbls/d”) shut-in from the East Falcon Block, 40% net to PetroFalcon being approximately 11 mmcf/d and 60 bbls/d.

New Business Update

Chevron

As previously disclosed, subject to the approval of MEP, PetroFalcon is acquiring a 30% interest from Chevron Corporation (“Chevron”) in the offshore natural gas license for the Cardon III Block (“Cardon III”) in the Gulf of Venezuela. Chevron completed 3-D seismic data acquisition on Cardon III in April 2007, and the data is currently being processed. Following the evaluation of the seismic data later this year, Chevron and Vincler Venezuela will decide whether to proceed with an exploration well in 2008. If successful, first commercial production of natural gas from Cardon III is expected in 2011.

Lundin Petroleum

As previously announced, PetroFalcon recently entered into a binding letter of intent (“Letter of Intent”) with Lundin Petroleum AB (“Lundin Petroleum”) to acquire 100% of the issued and outstanding securities of Lundin Latina de Petróleos, S.A. (“Lundin Venezuela”) for the aggregate purchase price of approximately \$44 million, payable by the issuance of approximately 57.3 million common shares of PetroFalcon at a price of CDN\$0.80 per share. The securities of Lundin Venezuela are held by a subsidiary of Lundin Petroleum.

Lundin Venezuela owns a 5% interest in Baripetrol, an Empresa Mixta with PDVSA, Tecpetrol and Perenco operating the Colon Unit in western Venezuela. In addition to the 5% interest in Baripetrol, Lundin Venezuela currently has assets including a cash position of approximately \$600,000 and an accounts receivable of \$21.4 million. Lundin Venezuela has advised PetroFalcon that it recently received a \$2.0 million dividend from Baripetrol for the 2006 fiscal year, for the benefit of the seller.

The acquisition is subject to a number of conditions, including without limitation, the negotiation of a definitive agreement, the receipt of required regulatory approvals, shareholders consent and required Venezuelan government approvals.

Concurrent with the closing of the acquisition, the accounts receivable will be paid, such that Lundin Venezuela will have \$22.0 million in cash. In addition, the Letter of Intent provides for the completion of a private placement of units of PetroFalcon for gross proceeds of approximately \$5.1 million at a price of CDN\$0.80 per unit resulting in the issuance of five million warrants and approximately 6.7 million common shares. Each warrant shall entitle the holder to acquire an additional common share of PetroFalcon at an exercise price of CDN\$1.20 for a period of 2 years from the date of issue.

PetroFalcon has retained the services of Nanes Delorme Capital Management LLC related to this acquisition and upon completion of the acquisition has agreed to pay a success fee consisting of \$543,600 and 569,284 common shares.

In summary, PetroFalcon will issue approximately 64 million shares to Lundin Petroleum, and PetroFalcon will receive a 5% interest in Baripetrol and approximately \$27 million in cash from the acquisition and private placement. Lundin Petroleum will own approximately 40% of the Company after closing and will nominate two representatives to join the Board of Directors of PetroFalcon.

Colombia Offshore

On July 30, 2007, PetroFalcon paid \$150,000 to Colombia’s Agencia Nacional de Hidrocarburos (“ANH”) to purchase the data package for Caribbean Round 2007, Colombia’s first offshore exploration bidding round. In September, Colombia is offering 13 blocks off the Caribbean coastline with an average size of approximately 720,000 acres. The properties stretch from offshore Guajira at the northern tip of Colombia to the northern end of the Uraba Gulf, including almost all of Colombia’s Caribbean coastline. The properties being offered are both deepwater

and shallow blocks, some of which are both onshore and offshore with similar geology to the Gulf of Venezuela.

PRODUCTION AND REVENUE

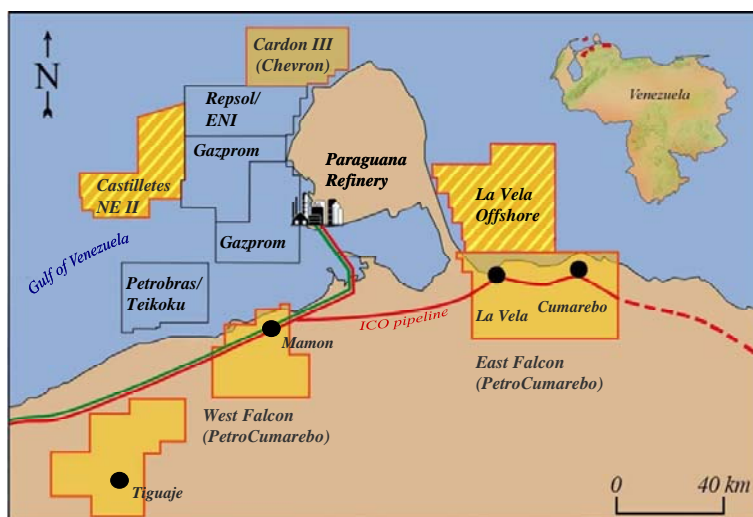
PETROCUMAREBO

For the three months ended June 30, 2007, PetroCumarebo's average gross production from both the East Falcon and West Falcon blocks was 870 barrels of oil equivalent per day ("boe/d"). PetroFalcon's 40% share before royalties was 348 boe/d. For the comparable period ended June 30, 2006, PetroCumarebo's average production was 1,485 boe/d, PetroFalcon's 40% share before royalties being 594 boe/d. The decrease in production in the most recent period is mainly due to the ICO pipeline closure on December 6, 2006.

Oil and gas production is expected to increase during the second half of 2007 from development drilling in the La Vela and Cumarebo fields, an aggressive workover campaign in both the East Falcon and West Falcon blocks, the completion of repairs to the ICO pipeline and the completion of new production facilities at La Vela and Cumarebo.

East Falcon Block

For the three months ended June 30, 2007, PetroCumarebo's average gross production from the East Falcon Block was 448 boe/d. PetroFalcon's 40% share before royalties was 179 boe/d. For the comparable period ended June 30, 2006, PetroCumarebo's average production in East Falcon was 1,078 boe/d, PetroFalcon's 40% share before royalties being 431 boe/d. The large decrease in production is mostly due to the ICO pipeline closure and subsequent shut-in of natural gas deliveries.



At June 30, 2007, the East Falcon Block had 14 producing oil wells, 4 shut-in oil wells (2 of which are waiting on pump changes), 4 producing natural gas wells used for gas lift at the Cumarebo Field and 6 shut-in natural gas wells (waiting on the ICO pipeline repair).

West Falcon Block

For the three months ended June 30, 2007, PetroCumarebo's average gross production from the West Falcon Block was 421 boe/d. PetroFalcon's 40% share before royalties was 168 boe/d. For the comparable period ended June 30, 2006, PetroCumarebo's average production in West Falcon was 406 boe/d, PetroFalcon's 40% share before royalties being 162 boe/d.

At June 30, 2007, the West Falcon Block had 13 producing oil wells, 3 shut-in oil wells, 4 producing natural gas wells and no shut-in natural gas wells.

PRODUCTION/SALES AND REVENUES

	PetroCumarebo (Gross)	PetroFalcon (Net)	
	Three months ended June 30, 2007	Three months ended June 30, 2007	Three months ended June 30, 2006
Daily production/sales			
Oil - bbls/d	808	323	410
Natural gas - mcf/d	371	148	1,104
Total – boe/d	870	348	594
Product pricing (\$)			
Oil - per bbl	64.87	64.87	66.30
Natural gas – per mcf	1.56	1.56	1.50
Revenue per boe	60.92	60.92	48.55
Total Revenues (\$000s)	4,821	1,925	NA

Note: Production is shown before royalties. PetroFalcon, through Vinccler Venezuela, owns 40% of PetroCumarebo. PetroFalcon was not able to recognize revenue in the comparable three months ended June 30, 2006, due to the fact that the Empresa Mixta conversion had not yet been completed. The decrease in production in the most recent period is mainly due to the ICO pipeline closure on December 6, 2006.

PetroCumarebo's gross revenues from the East Falcon Block and West Falcon Block for the three months ended June 30, 2007, were \$4.8 million. PetroFalcon's 40% share before royalties was \$1.9 million. PetroFalcon was not able to recognize revenue in the comparable three months ended June 30, 2006, as the Empresa Mixta conversion had not yet been completed.

The average price realized by PetroCumarebo for the three months ended June 30, 2007, was \$64.87 per barrel of oil and \$1.56 per mcf of natural gas. The combined average price for the three months ended June 30, 2007, was \$60.92 per boe. For the three months ended June 30, 2006, the average price realized by PetroFalcon was \$66.30 per barrel of oil and \$1.50 per mcf of natural gas, a combined average of \$48.55 per boe.

Oil and natural gas production is delivered to PDVSA, and it is expected that PetroCumarebo will receive payment for its deliveries as outlined in the Conversion Contract (see "PetroCumarebo Payments" above). The price per barrel of crude oil delivered is derived from detailed formulas outlined in the Conversion Contract. The formulas are specific to quality and gravity of crude oil delivered, and are based on different weightings of several global benchmark oil prices. These formulas equate on average to a price that is approximately 100% of WTI for East Falcon oil and 85% of WTI for West Falcon oil. PetroCumarebo produces light sweet crude oil that sells at a premium to most of the oil produced in Venezuela.

Payment from PDVSA to PetroCumarebo is 100% in US Dollars for crude oil and will be 100% in Bolivars for natural gas. The contractual price for natural gas is pegged to a US Dollar amount of \$1.56 per mcf (at the official fixed exchange rate, with an adjustment for inflation each year). Potential dividends from PetroCumarebo to Vinccler Venezuela will be 100% in US Dollars and are at the discretion of the shareholders of PetroCumarebo, depending on net and available profits.

ROYALTIES

PetroCumarebo's oil and gas production is subject to royalties calculated as 33.3% of gross revenues. PetroFalcon's share of royalties during the three months ended June 30, 2007, was \$641,534. The Company's share of royalties during the six months ended June 30, 2007, was \$1,072,185.

Following MEP instructions, PetroCumarebo invoices PDVSA for production delivered net of royalties. The royalty amount recorded is the value of the royalty paid in kind to the Venezuelan government by PetroCumarebo. The Company did not record revenues or royalties for production delivered during the comparable three months ended June 30, 2006, as the conversion to the Empresa Mixta had not yet been completed. The Company's oil and gas production was not subject to royalties under the OSAs prior to April 2006.

Under the terms of the Conversion Contract, PetroCumarebo is also subject to a "special advantage" tax, which requires that if in any year the aggregate amount of royalties, taxes and certain other contributions is less than 50% of the gross value of the hydrocarbons produced, PetroCumarebo must pay the Venezuelan government the difference. In the three months ended June 30, 2007, this amount equalled \$320,863 for PetroFalcon (40% of PetroCumarebo). In the six months ended June 30, 2007, this amount equalled \$536,254 for PetroFalcon. The Company was not subject to the special advantage tax during the comparable periods ended June 30, 2006.

OPERATING EXPENSES

(\$000s except boe amount)	Three months ended June 30, 2007	Three months ended June 30, 2006
Operating Expenses (including maintenance and transportation)	1,548	176
Average expense (\$ per boe)	48.90	NA

(\$000s except boe amount)	Six months ended June 30, 2007	Six months ended June 30, 2006
Operating Expenses (including maintenance and transportation)	2,646	1,141
Average expense (\$ per boe)	47.60	NA

Note: The per boe metrics were calculated using 31,657 boe net to PetroFalcon before royalties for the three months ended June 30, 2007, and 55,579 boe for the six months ended June 30, 2007. The decrease in production in the most recent period is mainly due to the ICO pipeline closure on December 6, 2006. Expenses during the previous periods were incurred before the completion of the Empresa Mixta and are not comparable.

Please see “Current Status of Operations of PetroFalcon”.

PetroFalcon’s operating expenses during the three months ended June 30, 2007, were \$1,548,139 (40% of PetroCumarebo plus other operating expenses outside of PetroCumarebo), including \$867,507 as a loss on the sale of inventory by Vinccler Venezuela to PetroCumarebo. Operating expenses for the three months ended June 30, 2006, were \$176,488. PetroFalcon’s operating expenses during the six months ended June 30, 2007, were \$2,645,696. Operating expenses for the six months ended June 30, 2006, were \$1,140,947. Operating expenses during the previous periods were incurred before the completion of the Empresa Mixta and are not comparable to recorded expenses for the periods ended June 30, 2007.

GENERAL AND ADMINISTRATIVE (“G&A”) EXPENSES

(\$000s except boe amount)	Three months ended June 30, 2007	Three months ended June 30, 2006
Expenses	1,748	442
Average expense (\$ per boe)	55.20	NA

(\$000s except boe amount)	Six months ended June 30, 2007	Six months ended June 30, 2006
Expenses	3,422	1,365
Average expense (\$ per boe)	61.56	NA

Note: The per boe metrics were calculated using 31,657 boe net to PetroFalcon before royalties for the three months ended June 30, 2007 and 55,579 boe for the six months ended June 30, 2007. The decrease in production in the most recent period is mainly due to the ICO pipeline closure on December 6, 2006. Expenses during the previous periods were incurred before the completion of the Empresa Mixta and are not comparable.

Please see “Current Status of Operations of PetroFalcon”.

PetroFalcon’s general and administrative expenses were \$1,747,557 during the three months ended June 30, 2007, as compared to \$442,063 during the three months ended June 30, 2006. PetroFalcon’s G&A expenses were \$3,421,621 during the six months ended June 30, 2007, as compared to \$1,364,571 during the six months ended June 30, 2006. G&A expenses during the previous periods were incurred before the completion of the Empresa Mixta and are not comparable to recorded expenses for the periods ended June 30, 2007.

The increase in G&A expense is mainly due to PetroFalcon recognizing the full cost of consultants and employees either seconded to PetroCumarebo or under the technical service agreement between Vinccler Venezuela and PetroFalcon. Under the terms of the Conversion Contract, the technical service agreement was transferred from Vinccler Venezuela to PetroCumarebo on April 1, 2006. PetroCumarebo paid PetroFalcon for technical service invoices in April, May and June 2006, but Management is currently renegotiating the terms of this contract and may not be able to collect from PetroCumarebo on subsequent amounts.

PetroFalcon does not capitalize general and administrative expenses.

AMORTIZATION, DEPLETION AND ACCRETION (“AD&A”)

(\$000s except boe amount)	Three months ended June 30, 2007	Three months ended June 30, 2006
Amortization, Depletion and Accretion	221	83
Depletion Rate (\$ per boe)	6.97	NA

(\$000s except boe amount)	Six months ended June 30, 2007	Six months ended June 30, 2006
Amortization, Depletion and Accretion	410	595
Depletion Rate (\$ per boe)	7.38	NA

Note: The per boe metrics were calculated using 31,657 boe net to PetroFalcon before royalties for the three months ended June 30, 2007, and 55,579 boe for the six months ended June 30, 2007. The decrease in production in the most recent period is mainly due to the ICO pipeline closure on December 6, 2006. Expenses during the previous periods were incurred before the completion of the Empresa Mixta and are not comparable.

Please see “Current Status of Operations of PetroFalcon”.

For the three months ended June 30, 2007, PetroFalcon’s AD&A was \$220,615 compared to AD&A of \$82,698 for the three months ended June 30, 2006. For the six months ended June 30, 2007, PetroFalcon’s AD&A was \$410,065 compared to AD&A of \$595,386 for the six months ended June 30, 2006. AD&A expenses during the previous periods were incurred before the completion of the Empresa Mixta and are not comparable to recorded expenses for the periods ended June 30, 2007.

INTEREST INCOME AND EXPENSE

At June 30, 2007, PetroFalcon had \$11.8 million in cash and short-term deposits compared to \$11.9 million at June 30, 2006. During the three months ended June 30, 2007, the Company recorded interest income in the amount of \$68,772 as compared to \$66,112 during the three months ended June 30, 2006. During the six months ended June 30, 2007, the Company recorded interest income in the amount of \$161,525 as compared to \$109,727 during the six months ended June 30, 2006.

PetroFalcon incurred interest expense of \$371,089 during the three months ended June 30, 2007, as compared to \$474,541 during the three months ended June 30, 2006. During the six months ended June 30, 2007, the Company recorded interest expense in the amount of \$737,502 as compared to \$1,288,050 during the six months ended June 30, 2006. The decrease in interest expense is primarily due to the conversion of the outstanding debt from the World Bank’s private investment arm, the International Finance Corporation (“IFC”).

STOCK-BASED COMPENSATION

During the three months ended June 30, 2007, the Company recorded \$775,485 in stock-based compensation expense as compared to \$687,149 during the three months ended June 30, 2006. During the six months ended June 30, 2007, the Company recorded \$1,513,122 in stock-based compensation expense as compared to \$1,277,149 during the six months ended June 30, 2006. The higher stock-based compensation expense was due to a greater number of stock options vesting during the periods.

INCOME TAXES

During the three month periods ended June 30, 2007, and 2006, PetroFalcon recorded no income tax expense. During the six months ended June 30, 2007, PetroFalcon recorded no income tax expense, compared to \$542,389 in the six months ended June 30, 2006.

During 2005, Vinccler Venezuela received tax assessments from the National Integrated Customs and Tax Administration Service (“SENIAT”), the Venezuelan tax authorities, with respect to the income tax returns for the years ended December 31, 2001, to 2004 for a total of \$3.3 million (Bs.7.7 billion), payable in nominal Bolivars. The revised tax assessment was mainly due to the SENIAT’s reinterpretation of Vinccler Venezuela’s business purpose. The SENIAT stresses that under its income tax laws, Vinccler Venezuela is an oil and gas producing company instead of an operating service company. Thus, the income tax expense for the audited years had to be recalculated at the rate of 50% (rather than the previous rate of 34%). On January 26, 2006, Vinccler Venezuela filed a discharge claim with SENIAT. During the three months ended June 30, 2006, Vinccler Venezuela received the final settlement resulting in additional income tax expense of \$542,389 for the four years ended December 31, 2004.

CAPITAL BUDGET FOR 2007

Please see “Current Status of Operations of PetroFalcon”.

The following tables outline PetroCumarebo’s capital budget for the year ended December 31, 2007, as well as Vinccler Venezuela’s commitment to Chevron on its new partnership in the Cardon III Block in the Gulf of Venezuela. The PetroCumarebo 2007 Budget represents the gross budget of the Empresa Mixta, of which Vinccler Venezuela will be responsible for 40%. Separately, the Cardon III Block’s budget represents the gross budget of the natural gas license for the Cardon III Block to date, as well as the planned expenditures for 2007, of which Vinccler Venezuela will be responsible for 30%.

If the Lundin Petroleum financing (see “Lundin Petroleum” in “New Business Update” above) is not successful, additional financing will be needed to meet these budget requirements in 2007. Funding may not be available on terms and conditions acceptable to the Company or PetroCumarebo. If funds are not available, Vinccler Venezuela risks defaulting on commitments to PetroCumarebo and Cardon III, which could result in interest charges or a dilution of Vinccler Venezuela’s equity interests.

PETROCUMAREBO BUDGET

(\$000s)	PetroCumarebo 2007 Initial Budget	PetroFalcon 40% Share	Incurred As of June 30,'07 (Gross)	Incurred As of June 30,'07 (Net)
Drilling				
- La Vela	14,700	5,880	17,300	6,920
- Cumarebo	5,700	2,280	-	-
- West Falcon	-	-	-	-
- Total Drilling	20,400	8,160	17,300	6,920
Processing Facilities and Infrastructure				
- La Vela	4,400	1,760	3,100	1,240
- Cumarebo	2,800	1,120	-	-
- West Falcon	-	-	-	-
- Total Processing Facilities	7,200	2,880	3,100	1,240
Total Capital Budget	27,600	11,040	20,400	8,160

The board of PetroCumarebo has recently approved an increase in the 2007 capital budget to \$39.2 million for the development of the East Falcon and West Falcon blocks. As of August 10, 2007, eight development wells have been successfully drilled in the La Vela Field in order to develop the shallow oil and gas reserves discovered by the LV-10 well in 2005. PetroCumarebo plans to spud the last 2007 well in the La Vela Field in the third quarter, through the entire stratigraphic column down to 8,500 feet. Afterwards, the rig will move to drill three wells in the Cumarebo Field on existing locations, possibly extending the limits of a proven gas/condensate reservoir in the northeast portion of the Cumarebo Field. In addition, an exploratory well in the San Patricio area of the East Falcon Block is being permitted in order to target potential new oil and gas reserves.

De-bottlenecking of the La Vela and Cumarebo processing facilities is included in the PetroCumarebo 2007 revised budget in order to increase the dew point processing plants' capacities to 20 mmcf/d in La Vela and 30 mmcf/d in Cumarebo. The 2007 revised budget also includes the commencement of engineering work on the La Vela processing facilities.

PETROCUMAREBO DRILLING

As previously announced, PetroCumarebo commenced drilling operations on November 30, 2006, at the La Vela Field in the East Falcon Block on Platform-A with the Pride 421 900 HP rig. Since beginning drilling operations, PetroCumarebo has drilled ten wells, completed eight,

tested five and will complete another shortly. Results for wells LV-11 (the first well drilled in La Vela) through LV-14 have already been announced in detail.

LV-15 well

The LV-15 well was drilled to be a specific gas producer from the Caujarao shallow gas formation. The well was successfully completed to a depth of 1,975 feet. The well was tested in the Caujarao gas sands at 1,000 and 1,100 feet, producing 3 mmcf/d on a one-inch choke with a well head flowing pressure of 220 pounds per square inch gauge (“psig”). The well is shut-in pending the ICO pipeline repair.

LV-16 well

The LV-16 well was successfully drilled to a depth of 3,187 feet. Electric logs showed a 45-foot hydrocarbon bearing sand in the lower Socorro formation. The well was successfully completed and tested in the lower Socorro sands producing 4 mmcf/d on a 3/8” choke with a well head flowing pressure of 1,050 psig. The well is shut-in pending the ICO pipeline repair.

LV-17 well

The LV-17 well was successfully drilled as a J-type directional well from the Platform B cluster towards the north in order to delineate the northern limit of the reservoirs found in the Caujarao and Socorro formations. LV-17 was drilled to a total depth of 3,344 feet, reaching the middle part of the Socorro formation. The wireline logs showed a total of 15 feet of gas-bearing sands in the upper Caujarao formation, 35 feet of oil sands in the lower Caujarao formation and 15 feet of gas sands in the middle Socorro formation. The well was successfully completed and tested in the lower Socorro sands producing 4 mmcf/d on a 3/8” choke with a well head flowing pressure of 1,050 psig. The well is shut-in pending the ICO pipeline repair.

LV-18 well

The LV-18 well was initially drilled vertically to 1,488 feet, with lost circulation and borehole swelling problems. The well was suspended after 7” casing was set at 1,480 feet. Operations resumed, and after reaching a total depth of 3,660 feet, the well is currently being logged. Mud log information suggests the presence of prospective sands in the upper and middle Socorro formation. The well was drilled directionally from Platform A towards the north to evaluate the northwestern flank of the La Vela southern anticline.

LV-19 well

The LV-19 well was drilled successfully as a J-type well from Platform A in order to evaluate the southeastern flank of the La Vela southern anticline, between Platform A and the LV-6X well. LV-19 reached a total depth of 2,989 feet in the bottom of the middle section of the Socorro formation. According to wireline logs, the well encountered 100 feet of hydrocarbon bearing sands; 25 feet in upper Caujarao, 55 feet in lower Caujarao and 20 feet in middle Socorro. The well will be tested after the completion of LV-18.

LV-20 well

The LV-20 well was drilled as a vertical hole from Platform A on a new pad located in the southeastern flank of the La Vela south anticline, downdip from Platform A but updip from LV-6X. The well was drilled to a total depth of 3,616 feet through the Socorro formation basal sands, with high gas shows and gas cut mud. These sands, also present in LV-10 and LV-6X, are composed of two sand bodies between 3,505 feet and 3,540 feet, with a total net hydrocarbon bearing section of 27 feet, according to the wireline logs. The well will be tested in these prospective sands, which, if successful, will represent a new reservoir in the La Vela south field. The well also encountered approximately 20 feet of hydrocarbon bearing sands in the Caujarao formation similar to those already tested in the previous wells.

PETROCUMAREBO PRODUCTION UPDATE

The current gross production of PetroCumarebo is approximately 1,200 bbls/d of oil, with 150 bbls/d of oil and 28 mmcf/d of natural gas shut-in due to PDVSA's ICO pipeline closure. Depending on the results of PetroCumarebo's drilling program and the timing of repairs to the ICO pipeline, PetroCumarebo's 2007 revised budget of \$39.2 million is estimated to significantly increase production for the East Falcon and West Falcon blocks to approximately 2,500 bbls/d of oil and 30 mmcf/d of gas (40% net to Vinccler Venezuela being 1,000 bbls/d of oil and 12 mmcf/d of natural gas).

CARDON III BUDGET

(\$000s)	Gross Cost	PetroFalcon 30% Share
Chevron Bid Bonus (2005)	5,600	1,680
Related Costs before January 1, 2007	1,800	540
530 km ² of 3-D Seismic (2007)	6,600	1,980
Total Cost to Drilling Decision	14,000	4,200

On January 24, 2007, Vinccler Venezuela signed a Heads of Terms agreement for the acquisition of 30% of the natural gas license for the Cardon III Block from Chevron. The acquisition is subject to the receipt of MEP approval within 12 months of the effective date of January 1, 2007. The total cost from bid bonus to a drilling decision on the Cardon III Block is estimated to be \$4.2 million net to PetroFalcon.

On March 9, 2007, Vinccler Venezuela paid Chevron \$2.2 million of this amount, which was 30% of Chevron's total costs related to Cardon III before the effective date. Under the agreement, all funds paid by Vinccler Venezuela to Chevron will be returned without interest if MEP approval is denied. If MEP approval is received, Vinccler Venezuela will have 30 working days to pay 30% of the Cardon III costs after the effective date, which will be approximately \$2.0 million net to PetroFalcon.

Chevron completed 3-D seismic data acquisition for Cardon III on April 14, 2007. Following the evaluation of the data later this year, Chevron and Vincler Venezuela will decide whether to proceed with an exploration well in 2008, at an additional estimated cost of \$3 million net to PetroFalcon. If successful, first commercial production of natural gas from Cardon III is expected in 2011.

CASH FLOW FROM OPERATIONS*

(\$000s except per share data)	Three months ended June 30, 2007	Three months ended June 30, 2006
Cash flow from operations*	(2,402)	(965)
Per basic share	(0.03)	(0.01)
Net (loss) income	(3,077)	(1,700)
Per basic share	(0.04)	(0.02)
Working capital	(1,945)	8,652

* This is a non-GAAP measure of profitability

OPERATING NETBACK

(\$ per boe)	Three months ended June 30, 2007	Three months ended June 30, 2006
Sales price	60.92	NA
Operating expenses	(48.90)	NA
Operating netback*	12.02	NA

* This is a non-GAAP measure of profitability

During the three months ended June 30, 2006, PetroFalcon did not recognize revenue from the Empresa Mixta and therefore did not have operating expenses associated with revenues.

LIQUIDITY AND CAPITAL RESOURCES

As of August 10, 2007, PetroFalcon had 86,581,336 issued and outstanding common shares and 97,527,830 common shares on a fully diluted basis.

As of June 30, 2007, PetroFalcon had 86,431,336 issued and outstanding common shares and 97,737,830 common shares on a fully diluted basis. As of December 31, 2006, PetroFalcon had 86,331,336 issued and outstanding common shares and 96,837,830 common shares on a fully diluted basis.

As of June 30, 2007, PetroFalcon had \$11.8 million in cash and short-term deposits and a working capital deficit of \$1.9 million. As of June 30, 2007, PetroFalcon's total short-term debt was \$10.9 million and total long-term debt was zero. At December 31, 2006, PetroFalcon had \$11.9 million in cash and short-term deposits and working capital of \$4.3 million. At December 31, 2006, PetroFalcon had total current debt of \$11.9 million and total long-term debt of zero.

At June 30, 2007, PetroFalcon had \$12.8 million in accounts receivable compared to \$13.3 million at December 31, 2006 (see "PetroCumarebo Payments" above). As of June 30, 2007, the Company had \$17.6 million in accounts payable compared to \$10.0 million at December 31, 2006. The increase in accounts payable is mainly a result of proportionally consolidating 40% of PetroCumarebo's obligations to PDVSA for the operating and capital expenditures paid by PDVSA on behalf of PetroCumarebo during the Transition Period and the six months ended June 30, 2007.

The planned growth and development activities for the next twelve months will require additional funds. PetroFalcon Management anticipates that these funds will be obtained from lines of credit and additional debt or equity securities financing (see "Lundin Petroleum" under "New Business Update" above). The Company cannot be certain that capital will be available when needed.

Please see Note 1 "Going Concern" in PetroFalcon's consolidated financial statements for the three and six months ended June 30, 2007.

SUMMARY OF QUARTERLY RESULTS

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

(\$000s, except per share amounts)	2005		2006				2007	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Revenue	3,055	3,256	3,129	NA	5,707	2,315	1,292	1,925
Net income (loss)	1,087	(1,128)	(1,181)	(1,700)	(1,313)	(2,502)	(2,445)	(3,077)
Earnings (loss) per share basic and diluted	0.01	(0.01)	(0.02)	(0.02)	(0.02)	(0.03)	(0.03)	(0.04)

Note: Q2 2006 revenue is shown as “NA”, because, under the Transitional Period terms, PetroFalcon did not recognize revenue from PetroCumarebo during the three months ended June 30, 2006. This revenue was subsequently recognized in Q3 2006.

RELATED PARTY TRANSACTIONS

Pacific Oil and Gas, LLC and Venezolana de Inversiones y Construcciones Clerico, C.A. (“Vinccler C.A.”) are controlled by officers of PetroFalcon. For the three months ended June 30, 2007, the Company paid Pacific Oil and Gas, LLC, controlled by PetroFalcon’s Vice Chairman, Clarence Cottman, and PetroFalcon’s President, William Gumma, \$135,000 for professional services, compared to \$210,000 for the three months ended June 30, 2006. These payments for professional services include the salaries of Mr. Gumma and PetroFalcon’s Chief Financial Officer, Garrett Soden, as well as the operating expenses for PetroFalcon’s technical office in Carpinteria, California. For the six months ended June 30, 2007, the Company paid to Pacific Oil and Gas, LLC \$270,000, compared to \$420,000 for the six months ended June 30, 2006.

PetroFalcon also receives construction services provided by Vinccler C.A., an independent operating construction company controlled by the Company’s Chairman and Chief Executive Officer, Juan Francisco Clerico. During the three month periods ended June 30, 2007, and 2006, PetroFalcon did not receive services from Vinccler C.A. During the six months ended June 30, 2007, PetroFalcon did not receive services from Vinccler, C.A., compared to \$11,669 during the six months ended June 30, 2006. On August 25, 2006, Vinccler C.A. paid on behalf of Vinccler Venezuela the amount of \$350,000 to purchase the data package for the Delta Caribe offshore natural gas bid process in Venezuela. This amount has not been repaid as of June 30, 2007.

These related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the three months ended June 30, 2007, there were no changes to internal controls over financial reporting that have materially affected, or are reasonably like to materially affect, the Company's internal controls over financial reporting.

ADDITIONAL INFORMATION

Additional information regarding the Company, including its annual information form, reserves information and annual report, may be found on the SEDAR website at **www.sedar.com** or by visiting the Company's website at **www.petrofalcon.com**.