FALCON OIL & GAS LTD.

Interim Condensed Consolidated Financial Statements

Three Months Ended March 31, 2012 and 2011

(Presented in U.S. Dollars)

FALCON OIL & GAS LTD.
Interim Condensed Consolidated Statements of Financial Position
(Unaudited)

(thousands of US dollars)		March 31, 2012		December 31, 2011
Assets				
Current assets:				
Cash and cash equivalents	$	12,014	$	15,358
Restricted cash		51		51
Accounts receivable		517		1,602
Prepaid expenses		269		330
Inventory held for sale		577		628
Total current assets		13,428		17,969
Non-current assets:				
Exploration and evaluation assets (Note 6)		70,690		70,977
Property, plant and equipment		5,176		5,224
Other assets		802		731
Total non-current assets		76,668		76,932
Total assets	$	90,096	$	94,901
Liabilities				
Current liabilities:				
Accounts payable and accrued expenses	$	1,957	$	3,836
Decommissioning provision (Note 12)		150		150
Total current liabilities		2,107		3,986
Non-current liabilities:				
Convertible debentures (Note 9)		6,663		5,960
Derivative liabilities (Note 10)		1,557		3,314
Decommissioning provision (Note 12)		8,114		8,663
Total non-current liabilities		16,334		17,937
Total liabilities		18,441		21,923
Equity				
Share capital (Note 7)		339,006		339,006
Contributed surplus		40,182		39,654
Deficit		(318,598)		(316,838)
Equity attributable to common shareholders		60,590		61,822
Non-controlling interest		11,065		11,156
Total equity		71,655		72,978
Total liabilities and equity	$	90,096	$	94,901

The notes are an integral part of these condensed consolidated financial statements.

FALCON OIL & GAS LTD.
Interim Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

	Three Months Ended March 31,	
(thousands of US dollars)	2012	2011
Revenue:		
Oil and natural gas revenue	$ 6	$ 8
Other income	137	145
	143	153
Expenses:		
Exploration and evaluation expenses	685	300
Production and operating expenses	5	10
Depletion and depreciation	67	94
General and administrative expenses	1,545	1,768
Share based compensation	528	435
	2,830	2,607
Results from operating activities	(2,687)	(2,454)
Finance income (Note 4)	1,777	214
Finance expense (Note 4)	(941)	(718)
Net finance expenses	836	(504)
Net loss and comprehensive loss for the period	$ (1,851)	$ (2,958)
Net loss attributable to:		
Common shareholders	$ (1,760)	$ (2,900)
Non-controlling interest	(91)	(58)
Net loss and comprehensive loss for the period	$ (1,851)	$ (2,958)
Net loss per share attributable to common shareholders:		
Basic and diluted (Note 8)	$ Nil	$ Nil

The notes are an integral part of these condensed consolidated financial statements.

FALCON OIL & GAS LTD.
Interim Condensed Consolidated Statements of Changes in Equity
(Unaudited)

(thousands of US dollars)	Share capital	Contributed surplus	Deficit	Equity attributable to common shareholders	Non-controlling interest	Total equity
Balance at January 1, 2011	$ 331,215	$ 37,874	$ (282,277)	$ 86,812	$ 11,422	$ 98,234
Issuance of stock	168	(168)	–	–	–	–
Options exercised	15	(7)	–	8	–	8
Share based compensation	–	435	–	435	–	435
Net loss for the period	–	–	(2,900)	(2,900)	(58)	(2,958)
Balance at March 31, 2011	$ 331,398	$ 38,134	$ (285,177)	$ 84,355	$ 11,364	$ 95,719
Balance at January 1, 2012	$ 339,006	$ 39,654	$ (316,838)	$ 61,822	$11,156	$ 72,978
Share based compensation	–	528	–	528	–	528
Net loss for the period	–	–	(1,760)	(1,760)	(91)	(1,851)
Balance at March 31, 2012	$ 339,006	$ 40,182	$ (318,598)	$ 60,590	$ 11,065	$ 71,655

The notes are an integral part of these condensed consolidated financial statements.

FALCON OIL & GAS LTD.
Interim Condensed Consolidated Statements of Cash Flows
(Unaudited)

(thousands of US dollars)	Three Months Ended March 31, 2012	2011
Cash flows from operating activities:		
Net loss for the period	$ (1,851)	$ (2,958)
Adjustments for:		
Share based compensation	528	435
Depletion and depreciation	67	94
Net financing (income) expenses	(836)	504
Other	(76)	36
Change in non-cash working capital (Note 5)	1,035	324
Interest received	20	7
Net cash used in operating activities	(1,113)	(1,558)
Cash flows from investing activities:		
Exploration and evaluation assets	(2,324)	(231)
Acquisition of furniture and equipment	(18)	(9)
Acquisition of other assets	–	(180)
Net cash used in investing activities	(2,342)	(420)
Cash flows from financing activities:		
Proceeds from exercise of share options	–	8
Net cash from financing activities	–	8
Change in cash and cash equivalents	(3,455)	(1,970)
Effect of exchange rates on cash and cash equivalents	111	40
Cash and cash equivalents, beginning of period	15,358	7,274
Cash and cash equivalents, end of period	$ 12,014	$ 5,344

The notes are an integral part of these condensed consolidated financial statements.

1. Reporting Entity

Falcon Oil & Gas Ltd. (the "Company" or "Falcon") was incorporated under the laws of British Columbia, and has producing petroleum and natural gas properties in Alberta, Canada and exploration projects in Hungary, Australia and South Africa.

The Company is in the business of acquiring, exploring and developing petroleum and natural gas properties which, by its nature, involves a high degree of risk, and there can be no assurance that current exploration programs will result in profitable operations. The recoverability of the carrying value of the petroleum and natural gas properties and the Company's continued existence is dependent upon the preservation of its interests in the underlying properties, the discovery of economically recoverable reserves, the achievement of profitable operations, or the ability of the Company to obtain financing or, alternatively, upon the Company's ability to economically dispose of its interests. Certain of the Company's petroleum and natural gas properties are subject to the risks associated with foreign investment, including increases in taxes and royalties, renegotiation of contracts, currency exchange fluctuations and political uncertainty.

2. Basis of Presentation and Preparation

(a) Statement of compliance:

These interim condensed consolidated financial statements are unaudited and have been prepared in accordance with IAS 34 'Interim Financial Reporting' ("IAS 34") using accounting policies consistent with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). The condensed consolidated interim financial statements do not, however, include all of the information required for full annual financial statements prepared under IFRS.

The condensed consolidated financial statements are presented in United States dollars and tabular amounts, except as otherwise indicated, are presented in thousands of dollars.

(b) Basis of measurement:

The condensed consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value (as discussed in Note 4).

(c) Going Concern:

For the three months ended March 31, 2012, the Company incurred a net loss of $1.9 million and operating cash outflows of $1.1 million and, as at March 31, 2012, had a deficit of $318.6 million. The Company's ability to continue as a going concern in the short term is dependent upon its ability to raise additional capital from the sale of additional common shares or other debt or equity instruments and/or to secure an industry partner for its operations in Hungary and South Africa. There is no assurance that additional capital will be available to the Company on acceptable terms or at all, or that an industry partner will be secured.

2. Basis of Presentation and Preparation (continued)

The Company has worked on securing joint venture funding for its operations in the Makó Trough located in Hungary. On June 9, 2011, the Company entered into a Letter of Intent with Naftna Industrija Srbije, j.s.c. Novi Sad ("NIS") for the earning of an interest by NIS in producing the Algyö play within Falcon's Makó production license in Hungary. The transaction is subject to the execution of a definitive agreement with NIS. In the longer term, the recoverability of the carrying value of the Company's long-lived assets is dependent upon the Company's ability to preserve its interest in the underlying petroleum and natural gas properties, the discovery of economically recoverable reserves, the achievement of profitable operations, and the ability of the Company to obtain financing to support its acquisition, exploration, development and production activities.

These consolidated financial statements are prepared in accordance with IFRS appropriate for a going concern. The going concern basis of accounting assumes the Company will continue to realize the value of its assets and discharge its liabilities and other obligations in the ordinary course of business. There is uncertainty as to whether the Company will be able to realize its assets and discharge its liabilities in the normal course of operations. Should the Company be required to realize the value of its assets in other than the ordinary course of business, the net realizable value of its assets may be materially less than the amounts shown in the consolidated financial statements. These consolidated financial statements do not include any adjustments to the amounts and classifications of assets and liabilities that may be necessary should the Company be unable to repay its liabilities and meet its other obligations in the ordinary course of business or continue operations, and those adjustments may be material.

(d) Use of estimates and judgments:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected.

3. Significant Accounting Policies

The interim financial statements have been prepared following the same accounting policies and methods of computation as the audited financial statements of the Company for the year ended December 31, 2011. The interim financial statements and notes thereto should be read in conjunction with the 2011 annual financial statements.

(thousands of US dollars)

4. Finance income and expenses

	Three Months Ended March 31, 2012	2011
Finance income:		
Interest income on bank deposits	$ 20	$ 7
Derivative gains – unrealized	1,757	207
	1,777	214
Finance expenses:		
Interest on loans and borrowings	(808)	(507)
Accretion of provisions	(56)	(68)
Net foreign exchange loss	(77)	(143)
	(941)	(718)
Net finance income (expenses)	$ 836	$ (504)

5. Supplemented cash flow information

Changes in non-cash working capital is comprised of:

	Three Months Ended March 31, 2012	2011
Source (use) of cash:		
Accounts receivable	$ 1,125	$ 222
Prepaid expenses and other	61	93
Inventory held for sale	51	–
Accounts payable and accrued expenses	(202)	9
	$ 1,035	$ 324

(thousands of US dollars)

6. Exploration and evaluation assets

	Hungary	Australia	South Africa	Total
Balance as at January 1, 2011	$ 46,497	$ 52,258	$ –	$ 98,755
Additions	2,259	15,572	–	17,831
Impairment	(26,000)	–	–	(26,000)
Proceeds from farm-out transaction, net of transaction costs	–	(19,609)	–	(19,609)
Balance as at December 31, 2011	22,756	48,221	–	70,977
Additions	7	306	–	313
Decommissioning provision	(600)	–	–	(600)
Balance as at March 31, 2012	$ 22,163	$ 48,527	$ –	$ 70,690

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proven or probable reserves. Additions represent the Company's costs incurred on E&E assets during the period.

7. Share capital

As at March 31, 2012 and December 31, 2011, the Company was authorized to issue an unlimited number of common shares, without par value.

The following is a reconciliation of issued and outstanding common shares:

	Number of shares	Share capital
Balance as at January 1, 2011	602,216,800	$ 331,215
Issuance of shares in a private placement, net of offering costs	87,050,000	6,924
Issuance of shares to two former officers	5,000,000	648
Options exercised	50,000	15
Shares issued to employees and consultants	676,800	107
Issuance of shares in a private placement to officers and a director	660,900	97
Balance as at March 31, 2012 and December 31, 2011	695,654,500	$ 339,006

(thousands of US dollars)

8. Net loss per share

Net loss per share – basic was calculated as follows:

	Three Months Ended March 31, 2012	2011
Net loss for the period	$ (1,760)	$ (2,900)
Weighted average number of common shares – basic		
Issued common shares as at beginning of period	695,654,500	602,216,800
Share options exercised	–	36,667
Effect of shares issued	–	355,556
Weighted average number of common shares – basic	695,654,500	602,609,023

All outstanding convertible securities, options and warrants were excluded from the calculation of net loss per share as the effect of these assumed conversions and exercises was anti-dilutive.

9. Convertible debentures

The face value of the convertible debentures, due on maturity at June 30, 2013, is $10,751 (CDN$10,719).

10. Derivative liabilities

Derivative liabilities consist of the fair value of the convertible debt conversion feature, the fair value of the private placement warrants and the fair value of the Hess warrants. Changes in the fair value of the derivative liabilities are recorded as part of net finance expenses. The composition of the derivative liabilities as at March 31, 2012 and December 31, 2011, and the changes therein for the three months and the year then ended, respectively, are as follows:

Fair value of:	Convertible Debt Conversion Feature	Private Placement Warrants	Hess Warrants	Total
Balance as at January 1, 2011	$ 775	$ –	$ –	$ 775
Fair value of derivatives	–	6,541	945	7,486
Derivative gains - unrealized	(734)	(3,889)	(324)	(4,947)
Balance as at December 31, 2011	41	2,652	621	3,314
Derivative gains - unrealized	(27)	(1,499)	(231)	(1,757)
Balance as at March 31, 2012	$ 14	$ 1,153	$ 390	$ 1,557

(thousands of US dollars)

11. Share based compensation

The Company, in accordance with the policies of the TSX-V, may grant options to directors, officers, employees and consultants, to acquire up to 10% of the Company's issued and outstanding common stock. The exercise price of each option is based on the market price of the Company's stock at the date of grant, which may be less a discount in accordance with TSX-V policies. The exercise price of all options granted has been based on the market price of the Company's stock at the date of grant, and no options have been granted at a discount to the market price. The options can be granted for a maximum term of five years. The Company records compensation expense over the vesting period based on the fair value at the grant date of the options granted. These amounts are recorded as contributed surplus. Any consideration paid on the exercise of these options together with the related contributed surplus associated with the exercised options is recorded as share capital.

A summary of the Company's stock option plan as at March 31, 2012 and December 31, 2011, and changes during the three months and the year then ended, is presented below:

	2012		2011	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding as at beginning of period	29,764,500	$ 0.41	21,764,500	$ 1.81
Granted	–	–	17,810,000	0.15
Expired	(378,333)	0.98	(8,623,333)	1.28
Forfeited	(449,167)	1.01	(1,136,667)	0.46
Exercised	–	–	(50,000)	0.16
Outstanding as at end of period	28,937,000	$ 0.42	29,764,500	$ 0.41
Exercisable as at end of period	14,976,000	$ 0.57	15,021,000	$ 0.57

There were no options granted during the three months ended March 31, 2012 (2011 – nil). Of the options granted during the year ended December 31, 2011, all vest 1/3 at the date of grant, with the remainder vesting ratably at the anniversary date over the two years thereafter.

On May 1, 2012, the Company granted options to purchase an aggregate 6,000,000 common shares of Falcon at an exercise price of $0.10 (CDN$0.10) per share. The options vest 1/3 ratably at the anniversary date over three years, and have an expiry date of May 1, 2017.

(thousands of US dollars)

12. Decommissioning Provision

A reconciliation of the decommissioning provision for the three months ended March 31, 2012 and for the year ended December 31, 2011 is provided below:

		2012		2011
Balance as at beginning of period	$	8,813	$	6,310
Revision to provisions		(600)		2,236
Accretion		51		267
Balance as at end of period	$	8,264	$	8,813
Current	$	150	$	150
Long-term		8,114		8,663
Balance as at end of period	$	8,264	$	8,813

The Company's decommissioning provision results from its ownership interest in oil and natural gas assets. The total decommissioning provision is estimated based on the Company's net ownership interest in the wells, estimated costs to reclaim and abandon these wells and the estimated timing of the costs to be incurred in future years. The Company has estimated the net present value of the decommissioning provision to be $8,264 as at March 31, 2012 (2011 – $8,813) based on an undiscounted total future liability of $13,124 (2011 – $13,124). These payments are expected to be made over the next 20 years with the majority of costs to be incurred between 2027 and 2031. The discount factor, being the risk free rate related to the liability, was 3.00% as at March 31, 2012 (2011 – 2.57%).

13. Segment Information

All of the Company's operations are in the petroleum and natural gas industry with its principal business activity being in the acquisition, exploration and development of petroleum and natural gas properties. The Company has producing petroleum and natural gas properties located in Canada and considers the results from its operations to relate to the petroleum and natural gas properties. The Company has unproven petroleum and natural gas properties in Hungary and Australia. An analysis of the Company's geographic areas is as follows:

(thousands of US dollars)

13. Segment Information (continued)

	Canada	United States	Hungary	Australia	South Africa	Total
Three months ended March 31, 2012:						
Revenue	$ 3	$ –	$ 3	$ –	$ –	$ 6
Net income (loss)	241	(620)	(1,055)	(333)	(84)	(1,851)
Balance as at March 31, 2012:						
Capital assets	–	150	27,188	48,527	–	75,865

	Canada	United States	Hungary	Australia	South Africa	Total
Three months ended March 31, 2011:						
Revenue	$ 8	$ –	$ –	$ –	$ –	$ 8
Net income (loss)	(1,311)	(403)	(979)	(209)	(56)	(2,958)
Balance as at March 31, 2011:						
Capital assets	42	252	51,603	53,258	–	105,155