FALCON OIL & GAS LTD.

Interim Condensed Consolidated Financial Statements

Three and Nine Months Ended September 30, 2012 and 2011

(Presented in U.S. Dollars)

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

(thousands of US dollars)	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$ 5,554	$ 15,358
Restricted cash	319	51
Accounts receivable	516	1,602
Prepaid expenses and other	357	330
Inventory held for sale	483	628
Total current assets	7,229	17,969
Non-current assets:		
Exploration and evaluation costs (Note 6)	72,209	70,977
Property, plant and equipment	5,141	5,224
Other assets	934	731
Total non-current assets	78,284	76,932
Total assets	$ 85,513	$ 94,901
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	$ 2,303	$ 3,836
Decommissioning provision (Note 12)	130	150
Convertible debentures (Note 9)	8,102	-
Derivative liabilities (Note 10)	253	-
Total current liabilities	10,788	3,986
Non-current liabilities:		
Convertible debentures (Note 9)	-	5,960
Derivative liabilities (Note 10)	7,229	3,314
Decommissioning provision (Note 12)	8,863	8,663
Total non-current liabilities	16,092	17,937
Total liabilities	26,880	21,923
Equity		
Share capital (Note 7)	339,171	339,006
Contributed surplus	41,785	39,654
Deficit	(333,291)	(316,838)
Equity attributable to common shareholders	47,665	61,822
Non-controlling interest	10,968	11,156
Total equity	58,633	72,978
Total liabilities and equity	$ 85,513	$ 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)

(thousands of US dollars)	Three Months Ended, September 30, 2012	2011	Nine Months Ended September 30, 2012	2011
Revenue:				
Oil and natural gas revenue	$ 1	$ 7	$ 12	$ 24
Other income	-	80	238	360
	1	87	250	384
Expenses:				
Exploration and evaluation expenses	447	240	1,561	938
Production and operating expenses	18	6	30	25
Depletion, depreciation and amortization	57	129	295	307
General and administrative expenses	1,670	2,394	4,917	5,974
Share based compensation (Note 11)	763	430	2,204	1,994
Restructuring expense (Note 14)	62	-	674	-
Other expense	40	-	40	-
Reversal of litigation expense	-	-	-	(1,654)
	3,057	3,199	9,721	7,584
Results from operating activities	(3,056)	(3,112)	(9,471)	(7,200)
Finance income (Note 4)	15	3,050	53	4,094
Finance expenses (Note 4)	(5,877)	(697)	(7,223)	(2,360)
Net finance (expenses) income	(5,862)	2,353	(7,170)	1,734
Net loss and comprehensive loss for the period	$ (8,918)	$ (759)	$(16,641)	$ (5,466)
Net loss and comprehensive loss attributable to:				
Common shareholders	$ (8,891)	$ (645)	$(16,453)	$ (5,253)
Non-controlling interest	(27)	(114)	(188)	(213)
Net loss and comprehensive loss for the period	$ (8,918)	$ (759)	$(16,641)	$ (5,466)
Net loss per share attributable to common shareholders:				
Basic and diluted (Note 8)	$ (0.013)	$ (0.001)	$ (0.024)	$ (0.008)

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
Private placement of stock	6,924	–	–	6,924	–	6,924
Issuance of stock	648	(648)	–	–	–	–
Options exercised	15	(7)	–	8	–	8
Share based compensation	–	1,994	–	1,994	–	1,994
Stock bonus	–	107	–	107	–	107
Net loss for the period	–	–	(5,253)	(5,253)	(213)	(5,466)
Balance at September 30, 2011	$ 338,802	$ 39,320	$ (287,530)	$ 90,592	$ 11,209	$ 101,801
Balance at January 1, 2012	$ 339,006	$ 39,654	$ (316,838)	$ 61,822	$ 11,156	$ 72,978
Options exercised	165	(73)	–	92	–	92
Share based compensation	–	2,204	–	2,204	–	2,204
Net loss for the period	–	–	(16,453)	(16,453)	(188)	(16,641)
Balance at September 30, 2012	$ 339,171	$ 41,785	$ (333,291)	$ 47,665	$ 10,968	$ 58,633

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

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

	Nine Months Ended September 30, 2012	2011
(thousands of US dollars)		
Cash flows from operating activities:		
Net loss for the period	$ (16,641)	$ (5,466)
Adjustments for:		
Share based compensation	2,204	1,994
Stock bonus	-	107
Depletion, depreciation and amortization	295	307
Net financing expense (income)	7,170	(1,734)
Other	(636)	51
Change in non-cash working capital (Note 5)	1,308	(4,215)
Interest paid	(579)	(593)
Interest received	53	62
Net cash used in operating activities	(6,826)	(9,487)
Cash flows from investing activities:		
Exploration and evaluation costs	(2,827)	(6,267)
Proceeds from farm-out transaction, net	-	17,709
Acquisition of furniture and equipment	(21)	(133)
Other assets	-	(600)
Net cash from investing activities	(2,848)	10,709
Cash flows from financing activities:		
Increase in restricted cash	(268)	-
Proceeds from private placement of units offering, net	-	13,480
Proceeds from private placement of warrants	-	945
Proceeds from exercise of share options	90	8
Net cash from financing activities	(178)	14,433
Change in cash and cash equivalents	(9,852)	15,655
Effect of exchange rates on cash and cash equivalents	48	(471)
Cash and cash equivalents, beginning of period	15,358	7,274
Cash and cash equivalents, end of period	$ 5,554	$ 22,458

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) and the expensing of share options.

2. Basis of Presentation and Preparation (continued)

(c) Going Concern:

For the nine months ended September 30, 2012, the Company incurred a net loss of $16.6 million and operating cash outflows of $6.8 million and, as at September 30, 2012, had negative working capital of $3.6 million and a deficit of $333.3 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.

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. In July 2012, the Company and NIS concluded negotiations and have filed the proposed agreement with the Hungarian Ministry of Finance ("the Ministry") for a ruling on the tax and accounting treatment of the agreement. The Agreement between NIS and TXM was finalized, but not signed on the July 31, 2012, as the transaction remains subject to a favorable ruling of the negotiated tax and accounting treatment by the Hungarian Ministry of Finance. The company has now received the tax ruling, but has appealed one aspect of the tax treatment. The outcome of the appeal is not expected to affect the ability of TXM to sign the Agreement with NIS.

In the longer term, the recoverability of the carrying value of the Company's long-lived assets in Hungary and Australia 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 material uncertainty that may cast significant doubt 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.

(thousands of US dollars)

2. Basis of Presentation and Preparation (continued)

In preparing these condensed consolidated interim financial statements, the significant judgments made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those applied to the consolidated financial statement as at and for the year ended December 31, 2011.

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.

4. Finance income and expenses

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Finance income:				
Interest income on bank deposits	$ 15	$ 25	$ 53	$ 62
Derivative gains – unrealized	-	2,992	-	4,032
Net foreign exchange gain	-	33	-	-
	15	3,050	53	4,094
Finance expenses:				
Interest on loans and borrowings	(1,015)	(628)	(2,689)	(1,723)
Accretion of provisions	(53)	(69)	(170)	(206)
Derivative losses – unrealized	(4,776)	-	(4,168)	-
Net foreign exchange loss	(33)	-	(196)	(431)
	(5,877)	(697)	(7,223)	(2,360)
Net finance (expenses) income	$ (5,862)	$ 2,353	$ (7,170)	$ 1,734

5. Supplemented cash flow information

Changes in non-cash working capital is comprised of:

	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Source (use) of cash:		
Accounts receivable	$ 1,086	$ (747)
Prepaid expenses and other	(27)	30
Inventory held for sale	145	(1)
Accounts payable and accrued expenses	104	(3,497)
	1,308	(4,215)

(thousands of US dollars)

6. Exploration and evaluation costs

	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	-	1,201	-	1,201
Decommissioning provision	31	-	-	31
Balance as at September 30, 2012	$ 22,787	$ 49,422	$ -	$ 72,209

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 September 30, 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 December 31, 2011	695,654,500	339,006
Options exercised	600,000	165
Balance as at September 30, 2012	696,254,500	$ 339,171

8. Net loss per share

Net loss per share – basic was calculated as follows:

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net loss for the period	$ (8,891)	$ (645)	$(16,453)	$ (5,253)
Weighted average number of common shares – basic (in thousand)				
Issued common shares as at beginning of period	695,654	602,217	695,654	602,217
Shares issued in a private placement	-	87,050	-	56,120
Shares issued to two former officers	-	5,000	-	2,604
Share options exercised	196	50	66	46
Weighted average number of common shares – basic	695,850	694,317	695,720	660,987

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 $10.8 million (CDN$10.7 million).

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 September 30, 2012 and December 31, 2011, and the changes therein for the nine 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 losses - unrealized	212	3,562	394	4,168
Balance as at September 30, 2012	$ 253	$ 6,214	$ 1,015	$ 7,482

(thousands of US dollars)

10. Derivative liabilities (continued)

Fair value of:	Convertible Debt Conversion Feature	Private Placement Warrants	Hess Warrants	Total
Current	$ 253	$ –	$ –	$ 253
Long-term	–	6,214	1,015	7,229
Balance as at September 30, 2012	$ 253	$ 6,214	$ 1,015	$ 7,482

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 of September 30, 2012 and December 31, 2011 and changes during the nine 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	6,000,000	0.10	17,810,000	0.15
Expired	(978,333)	0.73	(8,623,333)	1.28
Forfeited	(949,167)	1.10	(1,136,667)	0.46
Exercised	(600,000)	0.15	(50,000)	0.16
Outstanding as at end of period	33,237,000	$ 0.35	29,764,500	$ 0.41
Exercisable as at end of period	21,390,333	$ 0.48	15,021,000	$ 0.57

During the nine months ended September 30, 2012, the Company granted 6.0 million options at an exercise price of $0.10 (CDN$0.10) (2011 – 17.8 million at $0.15 (CDN $0.15)) per share. Of the options granted during the nine months ended September 30, 2012, all vest 1/3 ratably at the anniversary date over three years, and have an expiry date of May 1, 2017. 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.

(thousands of US dollars)

The fair value of the granted options was estimated using a Black Scholes model with the following weighted average inputs:

	2012	2011
Fair value as at grant date	$ 0.08	$ 0.15
Share price	0.10	0.15
Exercise price	0.10	0.15
Volatility	104%	105% – 106%
Option life	5.00 years	5.00 years
Dividends	Nil	Nil
Risk-free interest rate	1.59%	2.23% – 2.44%

A forfeiture rate of 11% (2011 - 16%) is used when recording share based compensation. This estimate is adjusted based on the actual forfeiture rate.

12. Decommissioning Provision

A reconciliation of the decommissioning provision for the nine months ended September 30, 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	30	2,236
Accretion	170	267
Liabilities settled	(20)	–
Balance as at end of period	$ 8,993	$ 8,813
Current	$ 130	$ 150
Long-term	8,863	8,663
Balance as at end of period	$ 8,993	$ 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 $9 million as at September 30, 2012 (2011 – $8.8 million) based on an undiscounted total future liability of $13.1 million (2011 – $13.1 million). 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 2.42% as at September 30, 2012 (December 31, 2011 – 2.57%).

(thousands of US dollars)

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.

	Canada	United States	Hungary	Australia	Ireland	Total
Nine months ended September 30, 2012:						
Revenue	$ 6	$ -	$ 6	$ -	$ -	$ 12
Balance as at September 30, 2012:						
Capital assets	$ -	$ -	$ 27,921	$ 49,423	$ 6	77,350

	Canada	United States	Hungary	Australia	Ireland	Total
Nine months ended September 30, 2011:						
Revenue	$ 24	$ –	$ –	$ –	$ –	$ 24
Balance as at September 30, 2011:						
Capital assets	$ 37	$ 189	$ 53,309	$ 43,213	$ –	96,748

14. Corporate Headquarters Relocation

During the third quarter of 2012, the Company relocated its corporate headquarters from Denver, Colorado to Dublin, Ireland. In connection with that decision, all individuals and consultants in Denver were terminated. At September 30, 2012, the Company has recorded an estimate of the expenses related to this restructuring, including severance and employee related benefits, certain expenses, acceleration of the recognition of certain future expenses and acceleration of the depreciation of certain assets. The Denver office closed on September 28, 2012.

(thousands of US dollars)

14. Corporate Headquarters Relocation (continued)

The following is a summary of restructuring expenses related to the relocation of the corporate headquarters including the line in the consolidated statement of operations and comprehensive loss in which the expense is recognized:

		2012
Restructuring expense:		
Severance and health benefits	$	510
Rent expense, net of sublease		118
Other		46
Total restructuring expense		674
Share based compensation		1,078
Depreciation		114
Total	$	1,866

The resulting liabilities of $0.6 million are reflected in accounts payable and accrued expenses in the consolidated balance sheet as at September 30, 2012.