FALCON OIL & GAS LTD.

Consolidated Financial Statements

Years Ended December 31, 2010 and 2009

(Presented in U.S. Dollars)

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INDEPENDENT AUDITORS' REPORT

To the Shareholders

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Falcon Oil & Gas Ltd. ("the Company"), which comprise the consolidated balance sheet as at December 31, 2010, the consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2010, and the results of its consolidated operations and its consolidated cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which describes that the Company's cash requirements in 2011 exceed available capital resources at December 31, 2010. Therefore the Company's ability to continue as a going concern is dependent upon raising additional capital. This condition, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

Other Matter

The consolidated financial statements of Falcon Oil & Gas Ltd. for the year ended December 31, 2009, were audited by another auditor who expressed an unmodified opinion on those statements on April 29, 2010.

KPMG LLP Chartered Accountants
Calgary, Canada
April 29, 2011

FALCON OIL & GAS LTD.
CONSOLIDATED BALANCE SHEETS
December 31, 2010 and 2009
(U.S. Dollars, in thousands)

	2010	2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 7,274	$ 11,804
Restricted cash	51	1,184
Amounts receivable (Note 4)	1,025	2,955
Prepaids and other	391	720
Inventory available for sale (Note 5)	1,678	4,196
Total current assets	10,419	20,859
Property and equipment		
Petroleum and natural gas properties (Note 3)	99,262	207,889
Pipeline and facilities	3,831	3,888
Furniture and equipment, net	1,646	2,086
Total property and equipment	104,739	213,863
Other assets	714	8,277
Total assets	$ 115,872	$ 242,999

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

FALCON OIL & GAS LTD.
CONSOLIDATED BALANCE SHEETS (CONTINUED)
December 31, 2010 and 2009
(U.S. Dollars, in thousands)

	2010	2009
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 5,571	$ 2,683
Long-term liabilities		
Convertible debentures (Note 6)	4,519	4,031
Asset retirement obligations (Note 7)	6,893	6,106
Total long-term liabilities	11,412	10,137
Total liabilities	16,983	12,820
Commitments and contingencies (Notes 1 & 14)		
Shareholders' equity (Notes 6 & 8)		
Share capital	331,215	331,215
Contributed surplus	36,150	31,829
Equity component of convertible debentures	5,057	5,057
Deficit	(284,955)	(137,922)
	87,467	230,179
Non-controlling interest	11,422	-
	98,889	230,179
Total liabilities and shareholders' equity	$ 115,872	$ 242,999

Going concern (Note 1)

Subsequent events (Note 15)

On behalf of the Board:

"*Gregory Smith*", Director **"*Robert Macaulay*", Director**

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

FALCON OIL & GAS LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
Years Ended December 31, 2010 and 2009
(U.S. Dollars, in thousands, except share and per share amounts)

	2010	2009
Petroleum revenue	$ 28	$ 69
Costs and expenses		
Production costs	26	43
General and administrative	11,323	13,294
Stock based compensation (Note 8)	4,321	5,452
Impairment of petroleum and natural gas properties (Note 3)	127,000	45,045
Depreciation, depletion, amortization and accretion	832	842
Write-down of inventory available for sale	1,186	1,559
Write off of receivable (Note 3)	4,345	-
	149,033	66,235
Other income (expense)		
Interest expense	(1,065)	(879)
Interest income	45	333
Gain (loss) on foreign exchange	(842)	2,573
Other income (expense)	(386)	211
	(2,248)	2,238
Net loss and comprehensive loss	$ (151,253)	$ (63,928)
Net loss and comprehensive loss attributable to:		
Owners of the Company	$ (150,716)	$ (63,928)
Non-controlling interest	(537)	-
Net loss and comprehensive loss	$ (151,253)	$ (63,928)
Net loss per common share – basic and diluted	$ (0.250)	$ (0.107)
Weighted average number of common shares outstanding – basic and diluted	602,216,801	598,214,479

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

FALCON OIL & GAS LTD.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
Years Ended December 31, 2010 and 2009
(U.S. Dollars, in thousands, except share amounts)

	Shares	Share Capital	Contributed Surplus	Equity Component of Convertible Debentures	Deficit
January 1, 2009	595,799,301	$ 331,179	$ 24,005	$ -	$ (73,994)
Common shares issued for cash (Note 6)	2,977,500	1,030	263	5,057	-
Common shares issued upon exercise of warrants	3,440,000	1,275	-	-	-
Share issuance costs	-	(160)	-	-	-
Agents warrants (Note 8)	-	(2,109)	2,109	-	-
Stock based compensation	-	-	5,452	-	-
Net loss	-	-	-	-	(63,928)
December 31, 2009	602,216,801	331,215	31,829	5,057	(137,922)
Settlement with stock to be issued (Note 8)	-	-	648	-	-
Stock based compensation	-	-	3,673	-	-
Non-controlling interest dilution gain (Note 8)	-	-	-	-	3,683
Net loss	-	-	-	-	(150,716)
December 31, 2010	602,216,801	$ 331,215	$ 36,150	$ 5,057	$ (284,955)

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

FALCON OIL & GAS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2010 and 2009
(U.S. Dollars, in thousands)

	2010	2009
Cash flows from operating activities		
Net loss	$ (151,253)	$ (63,928)
Adjustments to reconcile net loss to net cash used in operating activities		
Stock based compensation	4,321	5,452
Depreciation, depletion and accretion	832	842
Impairment of petroleum and natural gas properties	127,000	45,045
Write off of receivable	4,345	-
Unrealized foreign exchange (gain) loss	842	(2,573)
Accretion of equity component of convertible debentures	(334)	632
Amortization of deferred financing costs	371	185
Other	89	-
Changes in non-cash working capital accounts		
Amounts receivable	1,994	9,437
Prepaids and other	384	900
Writedown of inventory available for sale	1,186	1,559
Inventory available for sale	1,331	497
Other assets	843	(14)
Accounts payable and accrued expenses	(442)	(10,298)
Net cash provided by (used in) operating activities	(8,491)	(12,264)
Cash flows from investing activities		
Petroleum and natural gas properties	(3,100)	(8,836)
Pipeline and facilities	56	-
Furniture and equipment	(51)	(226)
Increase in other assets	-	(2,381)
Net cash used in investing activities	(3,095)	(11,443)
Cash flows from financing activities		
(Increase) decrease in restricted cash	1,132	(1,184)
Proceeds from unit offering	-	10,302
Proceeds from unit offering by subsidiary, net	5,591	-
Proceeds from exercise of warrants and stock options	-	1,275
Offering costs	-	(1,530)
Net cash provided by financing activities	6,723	8,863
Effect of exchange rate on cash and cash equivalents	333	1,101
Net decrease in cash and cash equivalents	(4,530)	(13,743)
Cash and cash equivalents, beginning of year	11,804	25,547
Cash and cash equivalents, end of year	$ 7,274	$ 11,804

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

FALCON OIL & GAS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended December 31, 2010 and 2009
(U.S. Dollars, in thousands)

	2010	2009
Supplemental schedule of cash flow information:		
Cash paid for interest	$ 1,092	$ 569
Supplemental disclosures of non-cash investing and financing activities:		
Acquisition of 25% working interest in Beetaloo Basin:		
Issuance of stock in Falcon Oil & Gas Australia Limited	$ 10,000	$ -
JIB receivable (Note 3)	1,725	-
	$ 11,725	$ -
Services exchanged for stock in Falcon Oil & Gas Australia Limited	$ 170	$ -
Petroleum and natural gas properties acquired in exchange for a note receivable and other assets	$ -	$ 5,308

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

NOTE 1 – ORGANIZATION AND GOING CONCERN

Falcon Oil & Gas Ltd. ("Falcon") was incorporated under the laws of British Columbia on January 18, 1980.

As of December 31, 2010, the Company has producing petroleum and natural gas properties in Alberta, Canada and exploration projects in Hungary and Australia. The Company's exploration projects in Hungary and Australia continue to be evaluated, and management believes that the carrying costs of these projects are recoverable. Should the Company be unsuccessful in these exploration activities, the carrying cost of these prospects may be charged to operations.

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.

GOING CONCERN

For the year ended December 31, 2010, the Company incurred a net loss of $150,716 and, as at December 31, 2010, had a deficit of $284,955 and working capital of $4,848. The Company's 2011 cash requirements for operations and spending required to maintain its Australian permits exceed available capital resources at December 31, 2010. As a result, the Company's ability to continue as a going concern is dependent upon its ability to raise additional capital and secure an industry partner for its operations in Australia and Hungary.

The Company has been focused on securing equity financing and joint venture funding for its operations in the Beetaloo Basin located in the Northern Territory, Australia, and joint venture funding for its operations in the Makó Trough located in Hungary. As discussed in Note 15, on April 28, 2011, the Company entered into an Evaluation and Participation Agreement with Hess Australia (Beetaloo) Pty. Ltd. for the Beetaloo Basin project.

Additional capital may also be sought from existing shareholders and/or from the sale of additional common shares or other debt or equity instruments. As discussed in Note 15, on April 11, 2011 the Company completed a non-brokered private placement for aggregate proceeds of CDN$13,058. There is no assurance that additional capital will be available to the Company on acceptable terms or at all.

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 Canadian generally accepted accounting principles ("Canadian GAAP") 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying consolidated financial statements include Falcon and its wholly owned subsidiaries: Mako Energy Corporation ("Mako"), a Delaware company, TXM Oil and Gas Exploration Kft., a Hungarian limited liability company doing business as TXM Energy, LLC ("TXM"), TXM Marketing Trading & Service, LLC ("TXM Marketing"), a Hungarian limited liability company, and Falcon Oil & Gas Australia Limited ("Falcon Australia") (collectively "the Company"). All significant intercompany transactions and balances have been eliminated on consolidation.

The accompanying consolidated financial statements have been prepared in accordance with Canadian GAAP and are presented in United States dollars.

PETROLEUM AND NATURAL GAS PROPERTIES

The Company utilizes the full cost method of accounting for petroleum and natural gas properties. Under this method, subject to a limitation based on estimated value, all costs associated with property acquisition, exploration and development, including costs of unsuccessful exploration, are capitalized within a cost center. No gain or loss is recognized upon the sale or abandonment of undeveloped or producing petroleum and natural gas properties unless the sale represents a significant portion of petroleum and natural gas properties and the gain significantly alters the relationship between capitalized costs and proved petroleum and natural gas reserves of the cost center, unless such a disposition would alter the depletion and depreciation rate by 20% or more.

Depreciation, depletion and amortization of petroleum and natural gas properties is computed on the units of production method based on proved reserves and production volumes before royalties. Amortizable costs include estimates of future development costs of proved undeveloped reserves.

Capitalized costs of petroleum and natural gas properties may not exceed an amount equal to the present value of the estimated future net cash flows from proved petroleum and natural gas reserves plus the cost, or estimated fair market value, if lower, of unproved properties. Should capitalized costs exceed this ceiling, impairment is recognized. The present value of estimated future net cash flows is computed by applying forecast prices of petroleum and natural gas to estimated future production of proved petroleum and natural gas reserves as of year end, less estimated future expenditures to be incurred in developing and producing the proved reserves and assuming continuation of existing economic conditions.

The Company's unproved properties are excluded from costs subject to depletion and are evaluated quarterly by management for the possibility of potential impairment. If unproved properties are considered to be impaired, they will be reclassified to proved properties and included in the ceiling test and the depreciation, depletion and amortization calculations on a country-by-country basis.

The amounts reflected as petroleum and natural gas properties represent costs to date, and are not necessarily indicative of present or future values. The recoverability of these amounts and any additional amounts required to place the Company's properties into commercial production are dependent upon certain factors. These factors include the existence of reserves sufficient for commercial production and the Company's ability to obtain the required financing necessary to develop its petroleum and natural gas properties.

ASSET RETIREMENT OBLIGATIONS

The Company recognizes the fair value of obligations associated with the retirement of long-lived assets in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is adjusted over time for changes in the value of the liability through accretion charges which are included in depletion, depreciation and accretion expense.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROPERTY AND EQUIPMENT

Furniture and equipment is recorded at cost. Depreciation and amortization is recorded using the straight-line method over the estimated useful lives of the related assets of two to seven years. Pipeline and facilities are recorded at cost, and will be depreciated upon commencement of production. Expenditures for replacements, renewals, and betterments are capitalized. Maintenance and repairs are charged to operations as incurred.

REVENUE RECOGNITION

The Company recognizes petroleum and natural gas revenues from its interests in producing wells as petroleum and natural gas is produced and sold from these wells and ultimate collection is reasonably assured. Interest income is recognized as earned and when collection is reasonably assured.

IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets, other than petroleum and natural gas properties, are assessed for impairment when events and circumstances warrant. The carrying value of a long-lived asset is impaired when the carrying amount exceeds the estimated undiscounted net cash flow from use and fair value. In that event, the amount by which the carrying value of an impaired long-lived asset exceeds its fair value is charged to operations. The Company has not recognized any impairment losses on non petroleum and natural gas long-lived assets.

INCOME TAXES

Income taxes are recorded using the liability method. Under this method, current income taxes are recognized for the estimated income taxes payable for the year. Future income tax assets and liabilities are recognized for the estimated income tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are recognized using enacted or substantively enacted income tax rates. Future income tax assets are recognized with respect to deductible temporary differences and loss carry forwards only to the extent that their realization is considered more likely than not.

USE OF ESTIMATES

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company's consolidated financial statements are based on a number of significant estimates, including petroleum and natural gas reserve quantities which are the basis for the calculation of depreciation, depletion, amortization and impairment of petroleum and natural gas properties, and timing and costs associated with its asset retirement obligations.

The petroleum and natural gas industry is subject, by its nature, to environmental hazards and clean-up costs. At this time, management knows of no substantial costs from environmental accidents or events for which the Company may be currently liable. In addition, the Company's petroleum and natural gas business makes it vulnerable to changes in wellhead prices of crude oil and natural gas. Such prices have been volatile in the past and can be expected to be volatile in the future. By definition, proved reserves are based on forecasted petroleum and natural gas prices and estimated reserves. Price declines reduce the estimated value of proved reserves and increase annual depreciation, depletion and amortization expense (which is based on proved reserves).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. All outstanding convertible securities, options and warrants were excluded from the calculation of net loss per common share as the effect of these assumed conversions and exercises was anti-dilutive.

STOCK BASED COMPENSATION

The Company records compensation expense over the vesting period based on the fair value of options granted to employees, directors and consultants. These amounts are recorded as contributed surplus. Any consideration paid by employees, directors or consultants on the exercise of these options is recorded as share capital together with the related contributed surplus associated with the exercised options.

CASH EQUIVALENTS

For purposes of reporting cash flows, the Company considers as cash equivalents all highly liquid investments with a maturity of three months or less at the time of purchase.

INVENTORY AVAILABLE FOR SALE

Inventory available for sale is carried at the lower of cost or net realizable value using the specific identification method. Write downs to net realizable value may be reversed, to the extent of the original write down, if there is clear evidence of an increase in value due to a change in circumstances.

TRANSLATION OF FOREIGN CURRENCIES

The Company's foreign operations, conducted through its subsidiaries, are of an integrated nature and, accordingly, the temporal method of foreign currency translation is used for conversion of foreign-denominated amounts into U.S. dollars. Monetary assets and liabilities are translated into U.S. dollars at the rates prevailing on the balance sheet date. Other assets and liabilities are translated into U.S. dollars at the rates prevailing on the transaction dates. Revenues and expenses arising from foreign currency transactions are translated into U.S. dollars at the rates prevailing on the transaction dates. Exchange gains and losses are recorded as income or expense in the year in which they occur.

DEFERRED FINANCING COSTS

Deferred financing costs are reflected as a reduction to the carrying value of the underlying obligations, and are amortized over the lives of the related obligations using the effective interest method.

CAPITALIZED INTEREST

Interest is capitalized on petroleum and natural gas investments in unproved properties and exploration and development activities that are in progress and qualify for capitalized interest. Capitalized interest is calculated by multiplying the Company's weighted-average interest rate on debt by the amount of qualifying costs. For projects under construction that carry their own financing, interest is calculated using the interest rate related to the project financing. Interest and related costs are capitalized until each project is complete. Capitalized interest cannot exceed gross interest expense. As petroleum and natural gas costs excluded from the depletion, depreciation and amortization base are transferred to unproved or proved properties, any associated capitalized interest is also transferred.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

COMPARATIVE FIGURES

Certain comparative figures have been reclassified, where applicable, to conform to the current year's presentation. Such reclassifications had no effect on the Company's net loss in any of the years presented.

NEW CANADIAN ACCOUNTING STANDARDS

Business Combinations, Consolidated Financial Statements and Non-Controlling Interests

The CICA issued three new accounting standards in January 2009: Section 1582, Business Combinations ("Section 1582"), Section 1601, Consolidated Financial Statements ("Section 1601"), and Section 1602, Non-controlling Interests ("Section 1602"). These new standards will be effective for fiscal years beginning on or after January 1, 2011.

Section 1582 replaces Section 1581, Business Combinations, and establishes standards for the accounting for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard IFRS 3 – Business Combinations. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011.

Sections 1601 and 1602 together replace Section 1600, Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27 – Consolidated and Separate Financial Statements and applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.

In August 2009, the CICA issued certain amendments to Section 3251, Equity. The amendments apply to entities that have adopted Section 1602, Non-controlling interests ("Section 1602"). The amendments require separate presentation on the consolidated statements of operations and comprehensive loss of loss attributable to owners of the Company and those attributable to non-controlling interests. The amendments also require that non-controlling interests be presented separately as a component of equity.

Although not mandatory until the year beginning January 1, 2011, the Company has adopted Sections 1582, 1601 and 1602, and reflected the impact of Section 1602 in the accompanying consolidated financial statements. There was no impact as a result of the adoption of Sections 1582 and 1601.

International Financial Reporting Standards

The AcSB has determined that Canadian accounting standards for publicly-listed companies will converge with International Financial Reporting Standards ("IFRS") effective for interim and annual periods beginning on or after January 1, 2011. The adoption of IFRS in 2011 will require restatement for comparative purposes of figures presented for the 2010 fiscal year. The Company understands there may be material differences between Canadian GAAP and IFRS, and is therefore carrying out a project with a view to understanding the possible future effects of the transition to IFRS.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES

Interests in petroleum and natural gas proven and unproven properties include the following acquisition, exploration and development costs:

	Hungary	Canada	Romania	Australia	South Africa	Total
December 31, 2009	**$ 168,528**	**$ 47**	**$ -**	**$ 39,314**	**$ -**	**$ 207,889**
Acquisition costs	-	-	-	11,725	16	11,741
Exploration costs	4,624	-	-	1,201	447	6,272
Development costs	-	-	-	-	-	-
Asset retirement obligation	345	-	-	18	-	363
Impairment loss	(127,000)	-	-	-	-	(127,000)
Depletion and depreciation	-	(3)	-	-	-	(3)
December 31, 2010	**$ 46,497**	**$ 44**	**$ -**	**$ 52,258**	**$ 463**	**$ 99,262**

	Hungary	Canada	Romania	Australia	South Africa	Total
January 1, 2009	**$ 210,926**	**$ 74**	**$ 29**	**$ 25,991**	**$ -**	**$ 237,020**
Acquisition costs	-	-	16	5,734	-	5,750
Exploration costs	2,047	-	-	7,400	-	9,447
Development costs	-	(5)	-	-	-	(5)
Asset retirement obligation	394	-	-	189	-	583
Impairment loss	(45,000)	-	(45)	-	-	(45,045)
Cost of ExxonMobil	161	-	-	-	-	161
Depletion and depreciation	-	(22)	-	-	-	(22)
December 31, 2009	**$ 168,528**	**$ 47**	**$ -**	**$ 39,314**	**$ -**	**$ 207,889**

For the year ended December 31, 2010, capitalized interest was nil (2009-$464).

The Company's Canadian properties are all proven and are subject to a ceiling test; the Company's properties in Hungary and Australia are unproven.

Impairment

The Company determined that the carrying value of the Hungarian petroleum and natural gas properties exceeded its estimated recoverable amount. Consequently, for the year ended December 31, 2010, the Company reflected an impairment of petroleum and natural gas properties of $127,000 (2009 - $45,045) in its consolidated statement of operations, with a corresponding reduction to petroleum and natural gas properties in the consolidated balance sheet.

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

For the year ended December 31, 2010, associated with its property in Hungary, the Company has reflected as a charge to the consolidated statement of operations costs of $4,345 (2009 – nil), with a corresponding reduction to a receivable resulting from a prior production development agreement previously recorded as other assets in the consolidated balance sheet.

HUNGARY

The Company holds a long-term Mining Plot (the "Production License") granted by the Hungarian Mining Authority. The lands within the Production License were formerly part of the Company's two petroleum and natural gas exploration licenses – the Tisza License and the Makó License (collectively, the "Exploration Licenses"). The Production License, covering approximately 245,700 acres, gives TXM the exclusive right to explore for petroleum and natural gas on properties located in south central Hungary near the town of Szolnok. The Production License further gives the Company the exclusive right to commercially develop petroleum and natural gas within the area covered by that license.

The balance of the Exploration Licenses outside of the Production License expired on December 31, 2009, and was not eligible for extension. A "Closing Report" submitted in 2010 was accepted by the Mining Authority, and the Company no longer has any Exploration Licenses.

AUSTRALIA

On April 23, 2010, Falcon Australia received notice (the "Notice") from the Department of Resources, Northern Territory Government, that it became the registered owner of the final 25% working interest in four exploration permits ("the Permits"), comprising 7,000,000 acres in the Beetaloo Basin, Northern Territories, Australia, in which it already had a 75% working interest in. The final transfer of ownership was pursuant to Binding Heads of Agreement (the "Agreement") entered into on December 7, 2009, between Falcon and Falcon Australia, and PetroHunter Energy Corporation and Sweetpea Petroleum Pty Ltd ("Sweetpea"), PetroHunter's wholly owned subsidiary, (collectively "PetroHunter"). PetroHunter is a related entity, as the largest single shareholder of PetroHunter at the time of the transaction was also the President and CEO of the Company at that time. Under the Agreement, Falcon Australia issued to Sweetpea 50 million common shares of Falcon Australia (valued at $10 million) and Sweetpea settled a $1,725 obligation to Falcon Australia, for its share of joint interest billings to re-enter the Shenandoah-1 well, as additional consideration for the transfer of Sweetpea's undivided 25% working interest in the Permits. Falcon has been issued 150 million shares of Falcon Australia for conversion of a portion ($30,000) of Falcon Australia's debt payable to Falcon, which approximates Falcon's initial acquisition cost previously paid to Sweetpea for the 75% working interest in the Permits held by Falcon Australia as of the date of the Agreement. Falcon Australia now owns 100% of the Permits.

Under a revised work program approved by the Northern Territory of Australia Government, Department of Resources in June 2010, the Company's required minimum work program obligations, in order to continue to hold the underlying Permits in the Beetaloo Basin, is to expend $6,400 and $8,700 during the years ending December 31, 2011 and 2012, respectively.

As discussed in Note 15, on April 28, 2011 the Company entered into an Evaluation and Participation Agreement with Hess Australia (Beetaloo) Pty. Ltd.

CANADA

The Company has working interests ranging from 12.76% to 25% in four producing petroleum and natural gas wells in Alberta, Canada. During the year ended December 31, 2010, the Company has recorded depreciation, depletion and amortization expense of $3 (2009-$22).

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

SOUTH AFRICA

On October 27, 2009, Falcon secured a Technical Cooperation Permit (the "TCP") to evaluate the Karoo Basin in central South Africa. Falcon had up to one year to conduct a technical appraisal of the area covered by the TCP, which did not include any well or seismic work obligations. At or before the end of the one year period, Falcon had the exclusive option to apply for an exploration permit covering all or a portion of the TCP. Falcon submitted its application which was accepted on September 7, 2010. Upon receipt of an approved exploration permit, the Company will be required to make a minimum payment of approximately $400, and obtain an approved work program. The TCP covers approximately 7.5 million acres and is located approximately 120 miles northeast of Cape Town, South Africa.

NOTE 4 – AMOUNTS RECEIVABLE

Amounts receivable at December 31, 2010 and 2009 is comprised of the following:

	2010	2009
Joint interest owners	$ 214	$ 856
VAT and GST	271	1,131
Sale of inventory available for sale	-	350
Other	540	618
	$ 1,025	$ 2,955

NOTE 5 – INVENTORY AVAILABLE FOR SALE

Inventory available for sale consists of drill pipe, casing and tubing and is reflected as a current asset at its estimated net realizable value.

During the year ended December 31, 2010, the Company acquired inventory of $65, received $1,397 (2009-$497) from the sale of inventory available for sale and charged to operations $1,186 (2009-$1,559) as a write down to the carrying cost of the inventory to estimated net realizable value of $1,678 (2009-$4,196).

NOTE 6 – CONVERTIBLE DEBENTURES

On June 30, 2009, the Company completed an offering, on a best efforts basis, pursuant to a short form prospectus filed with the securities regulatory authorities in the provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Nova Scotia and New Brunswick, of 11,910 units at a price of $865 (CDN$1,000) per unit (the "Offering"). Each unit consisted of one 11% convertible unsecured debenture in the principal amount of $779 (CDN$900) (each, a "Debenture") that matures on the fourth anniversary of its issuance (June 30, 2013) pursuant to the terms of a trust indenture dated June 30, 2009 (the "Trust Indenture"), and 250 common shares in the capital of Falcon (the "Unit Shares") (collectively, a "Unit"). The Debentures bear interest at an annual rate of 11% calculated and payable semi-annually in arrears on January 1 and July 1 in each year commencing January 1, 2010. The Debentures are unsecured direct obligations of the Company. In certain circumstances the Trust Indenture may restrict the Company from incurring additional indebtedness for borrowed money or from mortgaging, pledging or charging its property to secure any additional indebtedness.

NOTE 6 – CONVERTIBLE DEBENTURES (CONTINUED)

Optional Conversion Privilege

Each Debenture may be convertible into common shares of the Company ("Debenture Shares") at the option of the Debenture holder (the "Optional Conversion Privilege") at any time prior to the close of business on the earlier of the maturity date and the business day immediately preceding the date fixed by the Company for redemption of the Debentures (either of such dates, the "Optional Conversion Date"), at a conversion price of CDN$0.60 per common share (the "Conversion Price"), being a conversion ratio of approximately 1,667 Debenture Shares for each CDN$1,000 principal amount of Debentures. The Conversion Price is subject to adjustment upon the occurrence of certain events. Debenture holders converting their Debentures will receive accrued and unpaid interest in cash thereon up to, but not including, the Optional Conversion Date. No fractional shares will be issued. Notwithstanding the foregoing, no Debentures may be converted during the 10 business days preceding and including January 1 and July 1 in each year, commencing January 1, 2010 as the registers of the Indenture Trustee (as defined in the Trust Indenture) will be closed during such periods.

Automatic Conversion Features

If during the two year period following the closing the volume weighted average trading price of the common shares is CDN$0.85 or greater for 20 consecutive trading days, the Debentures will automatically be converted (with no further action on the part of the holder) at the Conversion Price to Debenture Shares and Debenture holders will be entitled to receive accrued and unpaid interest, in cash, to the end of the first 12 month period or 24 month period after closing, as the case may be.

The Offering was conducted by an independent agent (the "Agent"). The Agent and members of any selling group were paid a cash commission equal to 6.25% of the aggregate gross proceeds of the Offering, and received non-transferrable warrants (the "Agent Warrants") to purchase 1,250,550 Falcon common shares. Each Agent Warrant entitles the holder thereof to acquire one Falcon common share for a period of two years following the closing of the Offering (June 30, 2011), at an exercise price of $0.52 (CDN$0.60).

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 6 – CONVERTIBLE DEBENTURES (CONTINUED)

The following is a summary of the Units sold under the Offering, and the convertible debentures and share capital issued subsequent to the filing of the final short form prospectus in respect of the Offering:

	US$	CDN$
The Offering:		
Units issued	11,910	11,910
Price per unit	$ 865	$ 1,000
Gross proceeds	$ 10,302	$ 11,910
Shares:		
Number of unit shares issued at $0.35 (CDN$0.40) per share	2,977,500	2,977,500
Number of Agent Warrants to acquire shares at $0.52 (CDN$0.60) per share	1,250,550	1,250,550
Allocation of gross proceeds:		
Convertible debentures	$ 4,215	$ 4,873
Equity component of convertible debentures	5,057	5,846
	9,272	10,719
Share capital	1,030	1,191
	$ 10,302	$ 11,910
Value ascribed to Agent Warrants	$ 263	$ 303
Offering costs:		
Allocated to deferred financing costs	$ 1,494	$ 1,722
Allocated to equity	160	190
	$ 1,654	$ 1,912

As of December 31, 2010 and 2009, convertible debentures consist of the following:

	2010	2009
Face amount, at issuance	$ 9,272	$ 9,272
Equity component of convertible debentures	(5,057)	(5,057)
Accretion of equity component of convertible debentures	299	632
Foreign currency translation adjustment	943	493
Offering costs attributable to convertible debentures	(1,494)	(1,494)
Amortization of offering costs attributable to convertible debentures	556	185
	$ 4,519	$ 4,031

The accretion of the equity component of the convertible debt and the amortization of offering costs are included in interest expense over the term of the convertible debentures.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 6 – CONVERTIBLE DEBENTURES (CONTINUED)

The value ascribed to the Agent Warrants and to the equity component of the convertible debentures was the fair value at the date of the Offering using the Black-Scholes model, based on the following assumptions:

	Equity component of convertible debentures	Agent Warrants
Expected lives	4.00 years	2.00 years
Risk-free interest rate	1.20%	1.20%
Annualized volatility	121.19%	121.19%
Dividend rate	nil	nil

NOTE 7 – ASSET RETIREMENT OBLIGATIONS

At December 31, 2010, the estimated total undiscounted amount required to settle the asset retirement obligations was $9,480. Costs for asset retirement have been calculated assuming an inflation rate ranging from 3.0% to 5.0%. These obligations will be settled based on the estimated useful lives of the underlying assets, which extend up to 20 years into the future. Obligations have been discounted using a credit-adjusted risk-free interest rate ranging from 6.5% to 11.0%. Changes to asset retirement obligations for the years ended December 31, 2010 and 2009 were as follows:

	2010	2009
Asset retirement obligations – beginning of year	$ 6,106	$ 5,285
Liabilities incurred	363	583
Revisions to estimates	-	-
Liabilities settled	-	-
Liabilities conveyed	-	(97)
Accretion	424	335
Asset retirement obligations – end of year	$ 6,893	$ 6,106

NOTE 8 – SHAREHOLDERS' EQUITY

AUTHORIZED

The Company has authorized an unlimited number of common shares, without par value.

ISSUANCES

See Note 6 regarding the issuance of 2,977,500 common shares in connection with the Offering.

On August 3, 2010 and November 10, 2010, the Company agreed to issue 1,000,000 and 4,000,000 shares of common stock, respectively, to two past officers valued at $168 and $480, respectively. Total charges of $648 are reflected in stock based compensation in the consolidated statement of operations, with a corresponding credit to contributed surplus. Subsequent to December 31, 2010, the 1,000,000 shares were issued, and the 4,000,000 shares have yet to be issued.

As discussed in Note 15, on April 11, 2011, the Company completed a private placement of units.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 8 – SHAREHOLDERS' EQUITY (CONTINUED)

WARRANTS

A summary of the number of common shares reserved pursuant to the Company's outstanding share purchase warrants for the years ended December 31, 2010 and 2009 is as follows:

	2010	**2009**
Balance, beginning of year	1,250,550	4,288,750
Agent Warrants (Note 6)	-	1,250,550
Warrants exercised	-	(3,440,000)
Warrants expired	-	(848,750)
Balance, end of year	1,250,550	1,250,550

Common shares reserved for share purchase warrants outstanding as of December 31, 2009 are as follows:

Number of Shares	**Exercise Price**	**Expiry Date**
1,250,550	$0.52 (CDN$0.60)	June 30, 2011

In 2009, the Company reclassified from share capital to contributed surplus $2,109, the value of certain unexercised share purchase warrants issued to agents in connection with certain previous offerings by the Company. The reclassification was based on the estimated fair value of such warrants as of the issuance date using the Black-Scholes option-pricing model.

STOCK BASED COMPENSATION

The Company, in accordance with the policies of the TSX Venture Exchange ("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 of options granted. These amounts are recorded as contributed surplus. Any consideration paid on the exercise of these options is recorded as share capital together with the related contributed surplus associated with the exercised options. Of the options granted during the year ended December 31, 2010, all vest 1/3 at the date of grant, with the remainder vesting ratably at the anniversary date over the two years thereafter. There were no options granted during the year ended December 31, 2009.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 8 – SHAREHOLDERS' EQUITY (CONTINUED)

A summary of the Company's stock option plan as of December 31, 2010 and 2009, and changes during the years then ended, is presented below:

	2010		2009	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	41,975,000	$1.90	46,950,000	$1.90
Granted	5,725,000	$0.16	-	-
Exercised	-	-	-	-
Expired	(23,908,500)	$0.87	(3,195,000)	$3.11
Forfeited	(2,027,000)	$1.44	(1,780,000)	$2.07
Outstanding at end of year	21,764,500	$1.81	41,975,000	$1.48
Options exercisable at end of year	14,402,633	$2.35	32,576,000	$1.40

The following summarizes information about stock options outstanding and exercisable at December 31, 2010:

Options Outstanding	Options Exercisable	Exercise price	Weighted average remaining contractual life	Expiry date
5,999,000	5,999,000	$3.98	0.35 years	May 7, 2011
1,641,000	1,312,800	$2.83	0.94 years	December 9, 2011
600,000	360,000	$0.54	1.62 years	August 17, 2012
1,000,000	600,000	$0.98	2.35 years	May 6, 2013
7,335,000	4,401,000	$1.19	2.43 years	June 5, 2013
4,189,500	1,396,500	$0.16	4.66 years	August 30, 2015
1,000,000	333,333	$0.15	4.98 years	December 24, 2015
21,764,500	14,402,633			

At December 31, 2010, the weighted average remaining contractual life of stock options outstanding was 2.26 years.

The weighted average fair value of the options granted during the year ended December 31, 2010 was $0.16.

The Company measures compensation costs using the fair value-based method for employee and non-employee stock options. Compensation costs have been determined based on the fair value of the options at the grant date, for employees, and at the balance sheet for non-employees using the Black-Scholes option-pricing model.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 8 – SHAREHOLDERS' EQUITY (CONTINUED)

The following assumptions were used for stock options granted:

	2010
Expected life of options	3.25 to 5.00 years
Risk-free interest rate	2.06% to 2.44%
Annualized volatility	112.18% to 113.76%
Dividend rate	Nil
Estimated forfeiture rate	Nil

Option-pricing models require the use of estimates and assumptions including the expected volatility of the Company's share price, the expected life of the option and the risk free interest rate. Changes in the underlying assumptions can materially affect the fair value estimates.

FALCON AUSTRALIA OFFERING

In January 2010, Falcon Australia commenced the private placement sale of up to 50 million shares of its common stock ("FA Share") to sophisticated or professional investors within the meaning of sections 708(8) and 708(11) of the Corporations Act 2001 (Australia) pursuant to an Offer Memorandum (the "Offer"), at a price of $1.00 per FA Share with an attached option. Each option entitles the holder to acquire one additional FA Share in respect of each FA Share sold, exercisable at $1.25 for a period of three years from date of issue. The acting broker to the Offer received as a brokerage fee 6.5% of the funds raised in the Offer together with Options (on the same terms as issued to investors), calculated at 6.5% of the number of shares issued in the Offer. In June and November 2010, Falcon Australia closed on gross proceeds from the Offer of $4,896 and $1,218, respectively, before costs of the Offer of $646. The proceeds from the Offer are to be utilized for operations in Australia. Giving effect to the closings of the Offer and the Agreement, Falcon has a 72.7% interest in Falcon Australia.

NON-CONTROLLING INTEREST

At December 31, 2010, non-controlling interest in Falcon Australia is comprised of the following:

	Shares	**Amount**
Issuance of shares to Sweetpea for 25% working interest	50,000,000	$ 9,553
Issuance of shares for services	280,000	95
Sale of shares pursuant to offer memorandum	6,113,237	2,982
Costs of offer memorandum	-	(671)
Net loss attributable to non-controlling interest	-	(537)
	56,393,237	$ 11,422

Deficit has been credited $3,683 for the dilution gain attributable to the change in ownership of Falcon Australia.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 9 – RELATED PARTY TRANSACTIONS

Unless otherwise stated, transactions between related parties are measured at the exchange amount, being the amount of consideration agreed to between the parties.

In 2010 and 2009, the Company entered into certain agreements and transactions with PetroHunter, a related entity, whose largest single shareholder at that time was also the President and CEO of the Company at that time, including the acquisition of working interests in the Beetaloo Basin Project. See Note 3.

During the year ended December 31, 2010 and 2009, the Company incurred $128 (2009-$325) to a current director (2009 – two directors) of the Company for advisory and consulting services rendered.

NOTE 10 – 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:

	Canada	United States	Hungary	Australia	South Africa	Total
Year ended December 31, 2010						
Revenue	$ 24	$ -	$ 4	$ -	$ -	$ 28
Net income (loss)	(8,379)	(2,640)	(137,099)	(2,598)	-	(150,716)
As of December 31, 2010						
Capital assets	44	286	51,688	52,258	463	104,739

	Canada	United States	Hungary	Australia	Romania	Total
Year ended December 31, 2009						
Revenue	$ 39	$ -	$ 30	$ -	$ -	$ 69
Net income (loss)	(10,247)	(2,812)	(50,225)	(599)	(45)	(63,928)
As of December 31, 2009						
Capital assets	47	533	173,969	39,314	-	213,863

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 11 –FINANCIAL INSTRUMENTS

(a) Fair value

The fair value of financial instruments at December 31, 2010 and 2009 is summarized in the following table. Fair value estimates are made at the balance sheet date, based on relevant quoted market and other information about the financial instruments.

	December 31,			
	2010		2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Held for trading				
Cash and cash equivalents, and restricted cash	$ 7,325	$ 7,325	$ 12,988	$ 12,988
Loans and receivables				
Amounts receivable	1,025	1,025	2,955	2,955
Financial liabilities:				
Other financial liabilities				
Accounts payable and accrued liabilities	5,571	5,571	2,683	2,683
Convertible debentures	4,519	9,227	4,031	8,791

(b) Financial risk disclosures

The Company thoroughly examines the various financial instrument risks to which it is exposed and assesses the impact and likelihood of those risks. These risks may include credit risk, liquidity risk, market risk and other price risks. Where material, these risks are reviewed and monitored by the Board of Directors.

Credit Risk

The Company's credit risk is limited to cash and receivables. The Company maintains cash accounts at three financial institutions. The Company periodically evaluates the credit worthiness of financial institutions, and maintains cash accounts only in large high quality financial institutions, thereby minimizing exposure for deposits in excess of federally insured amounts. On occasion, the Company may have cash in banks in excess of federally insured amounts. The Company believes that credit risk associated with cash is minimal. Receivables are not significant to the Company. The Company's credit risk has not changed significantly from the prior year.

Liquidity Risk

The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its planned capital expenditures. The Company's overall liquidity risk has not changed from the prior year. Also see Note 1.

Currency Risk

Financial instruments that impact the Company's net income (loss) and comprehensive income (loss) due to currency fluctuations include Canadian dollar, Hungarian forint, Euro and Australian dollar denominated cash and cash equivalents, accounts receivable, reclamation deposits, accounts payable, and capital commitments for Hungarian and Australian operations.

NOTE 11 –FINANCIAL INSTRUMENTS (CONTINUED)

The Company has a CDN$4.5 million convertible debenture, which exposes Falcon to fluctuations in exchange rates between Canadian and U.S. dollars. Such an exposure does also arise as a result of revenue being realized in and expense items, including certain general and administrative and production costs and interest expense on the convertible debt, being incurred in Canadian dollars. A one cent strengthening/weakening of the Canadian dollar against the U.S. dollar would decrease/increase total shareholders' equity and income/loss by less than $100.

The Company's exposure to other currencies, including the Hungarian forint, Euro and Australian dollar does not result in a significant change to total shareholders' equity and income when the respective currencies strengthen or weaken by one cent against the U.S. dollar.

Interest Rate Risk

The Company is not exposed to interest rate risk as it has no outstanding short term borrowings or investments.

Fair Value Estimation

The carrying value less impairment provision, if necessary, of trade receivables and payables approximate their fair values.

NOTE 12 – MANAGEMENT OF CAPITAL

The Company's objectives when managing capital are to safeguard its ability to continue as a going concern in order to explore and develop its petroleum and natural gas properties. The Company manages the components of shareholders' equity and its cash as capital, and makes adjustments to these components in response to the Company's business objectives and the economic climate. To maintain or adjust its capital structure, the Company may issue new common shares or debt instruments, or borrow money or acquire or convey interests in other assets. The Company does not anticipate the payment of dividends in the foreseeable future.

The Company's investment policy is to hold excess cash in highly-liquid, short-term instruments, such as bankers' acceptances and guaranteed investment certificates issued by major Canadian chartered banks or United States financial institutions, with initial maturity terms of less than three months from the original date of acquisition, selected with regard to the Company's anticipated liquidity requirements.

The Company does not expect its current capital resources will be sufficient to meet future acquisition, exploration, development and production plans, operating requirements and convertible debenture obligations, and is dependent upon future debt and equity, or joint venture arrangements, to meet the obligations. See Note 1.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 13 – INCOME TAXES

Income tax expense or recovery is the sum of the Company's provisions for current income taxes and differences between the opening and ending balances of its future income taxes.

The provision for income taxes differs from the amount that would have been obtained by applying the statutory income tax rate of 28.5% (2009 – 30.0%) to the Company's income (loss) before income taxes for the year. For the years ended December 31, 2010 and 2009, the difference results from the following items:

	2010	2009
Expected income tax (recovery)	$ (42,954)	$ (19,179)
Effect of foreign income tax rates	25,171	4,814
Change in effective tax rates	8,129	(62)
Effect of change in foreign exchange rates	(3,427)	(647)
Unrecognized benefit of loss carryforwards	(685)	3,338
Non-deductible stock-based compensation	1,184	1,636
Equity component of convertible debentures and deferred financing costs	11	220
Other	(113)	82
Change in valuation allowance	12,684	9,798
Provision for income taxes	$ –	$ –

The income tax effects of temporary differences that give rise to significant portions of future income tax assets and liabilities at December 31, 2010 and 2009 are as follows:

	2010	2009
Future income tax assets		
Non-capital losses and resource deductions	$ 31,682	$ 23,645
Petroleum and natural gas properties	2,767	-
Other	1,163	-
Less: Valuation allowance	(35,612)	(22,928)
Future income tax liabilities	–	717
Petroleum and natural gas properties	–	717
	$ –	$ –

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 13 – INCOME TAXES (CONTINUED)

The Company has accumulated loss carryforwards at December 31, 2010 to reduce future years' taxable income as follows:

		2010	Expiration
Canada			
Non-capital losses	$	20,463	2015 to 2030
Resource deductions		2,377	No expiration
		22,840	
United States		11,332	2027 to 2030
Hungary		26,985	No expiration
Australia		66,469	No expiration
	$	127,626	

The benefit of the Company's income tax assets has not been recognized in the Company's accounts as it cannot be reasonably estimated at this time if it is more likely than not that such benefit will be realized.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

(a) ENVIRONMENTAL

Petroleum and natural gas producing activities are subject to extensive environmental laws and regulations. These laws, which are constantly changing, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefit are expensed. Liabilities for expenditures of a non-capital nature are recorded when environmental assessment and/or remediation is probable, and the costs can be reasonably estimated.

(b) CONTINGENCIES

The Company may, from time to time, be involved in various claims, lawsuits, disputes with third parties, or breach of contract incidental to the operations of its business. Except for the following-described dispute, the Company is not currently involved in any claims, disputes, litigation or other actions with third parties which it believes could have a material adverse effect on its financial condition or results of operations.

On November 10, 2009, as amended on March 16, 2011, the Company was served with a Complaint by a former vendor of TXM (the "Vendor") arising out of a dispute related to TXM's alleged failure to pay for certain oilfield equipment. Falcon and TXM intend to vigorously defend against the claim as well as make any appropriate counter claims against the Vendor.

On October 15, 2010, the High Court of Justice, Queen's Bench Division, Commercial Court in the United Kingdom ruled that jurisdiction for this matter is to be in the United Kingdom ("UK"), and not Hungary as claimed by TXM. TXM has filed an appeal to have the lower court order reversed and, if upheld, this would stop all proceedings in the UK. The Company is filing for arbitration in Hungary, even as the lower court order is being appealed. There is no assurance that the Company will prevail in the appeal process or that arbitration in Hungary will be granted.

(U.S. Dollars, in thousands, except share and per share amounts)

NOTE 14 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

Although the Company is of the opinion that it has a meritorious defense to the claim by the vendor, management has determined that an appropriate estimate of the potential liability should be recorded should the Company not prevail in the matter. Accordingly, the December 31, 2010 financial statements include an obligation of $3,700, including estimated interest and fees, related to this claim that is reflected as a charge to petroleum and natural gas properties with a corresponding increase to accounts payable and accrued expenses.

(c) LEASE COMMITMENTS

In April 2006, the Company entered into a lease agreement for office space in Denver, Colorado, for the period from June 2006 through June 2011; and in September 2006 entered into a lease for office space in Budapest, Hungary, for the period from July 2007 through 2013. The Company is obligated to pay the following minimum future rental commitments under non-cancelable operating leases with a remaining term of at least one year:

Year ending December 31,	
2011	$ 138
2012	138
2013	116
	$ 392

(d) AUSTRALIA WORK PROGRAM

Under a work program approved by the Northern Territory of Australia Government, Department of Resources, on March 31, 2010, the Company is obligated to complete minimum work requirements by expending the following amounts in order to continue to hold the underlying permits in the Beetaloo Basin Project (the “Work Program”).

Year ending December 31,	
2011	$ 6,400
2012	8,700
	$ 15,100

NOTE 15 – SUBSEQUENT EVENTS

PRIVATE PLACEMENT

On April 11, 2011, Falcon issued 87,050,000 units (the “Units”) at $0.16 (CDN$0.15) per unit by way of a non-brokered private placement for aggregate gross proceeds of CDN$13,058. Each Unit consists of one common share in the capital of Falcon (each, a “Common Share”) and three-quarters of one Common Share purchase warrant (each, a “Warrant”), each whole Warrant being exercisable into a Common Share for a period of 36 months from the date of its issuance at an exercise price of $0.19 (CDN$0.18) per share. A finders’ fee of $149 is due to a non-related entity.

NOTE 15 – SUBSEQUENT EVENTS (CONTINUED)

BEETALOO BASIN PROJECT - JOINT VENTURE

On April 28, 2011, Falcon Australia entered into an Evaluation and Participation Agreement (the "E&P Agreement") with Hess Australia (Beetaloo) Pty Ltd. ("Hess"). By the terms of the E&P Agreement, Hess will pay $17.5 million to Falcon Australia as a participation fee for the exclusive right to conduct operations for the exploration, drilling, development and production of hydrocarbons from three of the four Permits, and excluding an area comprising 100,000 acres surrounding the Shenandoah-1 well (the "Area of Interest"). In addition, Hess will pay Falcon $2.5 million as consideration for warrants to acquire 10,000,000 common shares in the capital of Falcon at an exercise price of CDN$0.19 per share.

Hess shall acquire seismic data, at its sole cost of at least $40.0 million, over the Area of Interest within 18 months of the execution of the E&P Agreement. After acquiring the seismic data, Hess shall have the right to acquire a 62.5% working interest in the Area of Interest. If Hess acquires the working interest, they commit to drill and evaluate five exploration wells at their sole cost, one of which must be a horizontal well. All costs to plug and abandon the five exploration wells will also be borne solely by Hess. The drilling and evaluation of the five exploration wells must meet the minimum work requirements of the Work Program (see Note 14). Costs to drill wells after the five exploration wells will be borne 62.5% by Hess and 37.5% by Falcon Australia.

By December 31, 2011, Falcon Australia must test and complete the Shenandoah-1 well at their sole cost, and in accordance with the Work Program. After testing and completion, Falcon Australia must provide Hess copies of the data obtained from such activities, and Hess must pay Falcon Australia $2.0 million for the data.

The Company will pay a "success fee" to two advisors in the aggregate amount of 5% for services provided in conjunction with the E&P Agreement with Hess. The success fee is based on the cash or cash-equivalent value of any net amount received directly or indirectly by the Company, including the participation fee, cost of seismic data commitment and cost of drilling commitment.

The transaction as a whole is subject to receipt of all governmental and regulatory consents, including the TSX-V.