FALCON OIL & GAS LTD.

(A Development Stage Company)

Interim Consolidated Financial Statements

Nine Months Ended September 30, 2008 and 2007

(Presented in U.S. Dollars)

FALCON OIL & GAS LTD.
(A Development Stage Company)
INTERIM CONSOLIDATED BALANCE SHEETS
(U.S. Dollars, in thousands)
(Unaudited)

	September 30, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 45,171	$ 55,672
Restricted cash (Note 2)	-	320
Amounts receivable (Note 4)	6,035	3,641
Prepaids and other	1,348	1,980
Inventory available for sale (Note 2)	6,966	10,782
Total current assets	59,520	72,395
Property and equipment		
Petroleum and natural gas properties (Note 3)	240,329	229,805
Pipeline and facilities	3,991	3,836
Furniture and equipment, net	2,367	2,032
Total property and equipment	246,687	235,673
Other assets	664	797
Total Assets	$ 306,871	$ 308,865
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 4,208	$ 14,649
Property contract payable (Note 3)	-	1,000
Total current liabilities	4,208	15,649
Asset retirement obligations (Note 5)	5,394	5,140
Total liabilities	9,602	20,789
Commitments and contingencies (Note 11)		
Shareholders' equity (Note 6 & 7)		
Share capital	311,309	310,635
Contributed surplus	22,008	15,524
Special warrants	20,000	-
Deficit accumulated during development stage	(56,048)	(38,083)
Total shareholders' equity	297,269	288,076
Total liabilities and shareholders' equity	$ 306,871	$ 308,865
Subsequent events (Note 12)		

On behalf of the Board:

"David Fisher"____________________,Director **"Stephen Schultz"________________, Director**

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

FALCON OIL & GAS LTD.
(A Development Stage Company)
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS AND DEFICIT
(U.S. Dollars, in thousands, except share and per share amounts)
(Unaudited)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Petroleum revenue	$ 22	$ 26	$ 66	$ 162
Direct costs				
Production costs	5	70	17	84
Depreciation, depletion and accretion	97	10	285	19
	102	80	302	103
Costs and expenses				
Accounting	217	123	622	447
Depreciation and amortization	119	73	334	199
Consulting	489	647	1,258	1,873
Director fees	67	39	201	108
Investor relations	155	562	496	891
Legal costs	280	401	988	1,617
Office and administrative	554	459	1,748	1,585
Payroll and related costs	747	1,019	2,141	2,811
Stock-based compensation	1,371	875	6,484	2,508
Travel and promotion	560	761	1,564	2,082
	4,559	4,959	15,836	14,121
Other (income) expense				
Interest income	(367)	(324)	(1,219)	(2,180)
Abandonment and impairment of petroleum and natural gas properties	-	165	-	783
(Gain) loss on foreign exchange	1,832	(258)	3,112	(5,468)
	1,465	(417)	1,893	(6,865)
Net loss and comprehensive loss	(6,104)	(4,596)	(17,965)	(7,197)
Accumulated deficit, beginning of period	(49,944)	(27,837)	(38,083)	(25,236)
Accumulated deficit, end of period	$ (56,048)	$ (32,433)	$ (56,048)	$ (32,433)
Net loss per common share – basic and diluted	$ (0.011)	$ (0.010)	$ (0.032)	$ (0.016)
Weighted average number of common shares outstanding – basic and diluted	567,056,027	464,499,463	566,155,695	463,718,485

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

FALCON OIL & GAS LTD.
(A Development Stage Company)
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(U.S. Dollars, in thousands)
(Unaudited)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Cash flows from operating activities				
Net loss	$ (6,104)	$ (4,596)	$ (17,965)	$ (7,197)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities				
Stock-based compensation	1,371	875	6,484	2,508
Depreciation, depletion and accretion	216	83	619	218
Abandonment and impairment of petroleum and natural gas properties	-	165	-	783
Unrealized foreign exchange (gain) loss	1,832	(258)	3,112	(5,468)
Changes in non-cash working capital accounts				
Amounts receivable	1,126	7,146	(2,386)	8,610
Prepaids and other	731	370	371	341
Inventory available for sale	1,285	-	3,816	-
Accounts payable and accrued expenses	(1,296)	(1,534)	(68)	(49)
Net cash provided by (used in) operating activities	(839)	2,251	(6,017)	(254)
Cash flows from investing activities				
Restricted deposits	206	-	398	-
Acquisition of Beetaloo Basin	(5,279)	-	(5,279)	-
Acquisition of Buckskin Mesa Project	(239)	-	(239)	-
Petroleum and natural gas properties	(4,247)	(26,895)	(17,867)	(119,567)
Pipeline and facilities	(138)	(166)	(155)	(304)
Property and equipment	(150)	(91)	(668)	(485)
Proceeds from ExxonMobil, net of transaction costs	(3,351)	-	21,450	-
Net cash used in investing activities	(13,198)	(27,152)	(2,360)	(120,356)
Cash flows from financing activities				
Proceeds from exercise of warrants and stock options	128	-	674	751
Effect of exchange rate on cash	(1,827)	258	(3,118)	5,468
Net decrease in cash and cash equivalents	(15,736)	(24,643)	(10,821)	(114,391)
Cash and cash equivalents, beginning of period	60,907	52,890	55,992	142,638
Cash and cash equivalents, end of period	$ 45,171	$ 28,247	$ 45,171	$ 28,247

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

FALCON OIL & GAS LTD.
(A Development Stage Company)
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(U.S. Dollars, in thousands)
(Unaudited)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Supplemental schedule of cash flow information				
Cash paid for interest	$ -	$ -	$ -	$ -
Cash paid for income taxes	$ -	$ -	$ -	$ -
Supplemental disclosures of non-cash investing and financing activities				
Petroleum and natural gas properties acquired with special warrants	$ 20,000	$ -	$ 20,000	$ -
Petroleum and natural gas property costs in accounts payable	$ 2,137	$ 13,711	$ 2,137	$ 13,711

	September 30, 2008	December 31, 2007
Cash and cash equivalents is comprised of:		
Cash	$ 45,171	$ 55,672
Restricted cash (Note 2)	-	320
	$ 45,171	$ 55,992

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

NOTE 1 – ORGANIZATION

Falcon Oil & Gas Ltd. ("Falcon") was incorporated under the laws of British Columbia on January 18, 1980 for the purpose of acquiring, exploring, and developing petroleum and natural gas properties. Falcon is considered a development stage company as defined by Canadian Institute of Chartered Accountants Accounting Guideline No. 11.

As of September 30, 2008, the Company has producing petroleum and natural gas properties in Alberta, Canada and exploration projects in Hungary, Romania and Australia. Subsequent to September 30, 2008, the Company acquired a working interest in certain petroleum and natural gas wells in the United States. *See* Note 3 below. The Company's exploration projects in Hungary 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.

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, Falcon Oil & Gas USA, Inc. ("Falcon USA"), a Colorado 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, FOG-TXM Kft., a Hungarian limited liability company, JVX Energy S.R.L. ("JVX"), a Romanian limited liability company and Falcon Oil & Gas Australia Pty. Ltd. ("Falcon Australia") (collectively "the Company"). All significant intercompany transactions have been eliminated on consolidation.

The unaudited interim consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") for interim financial information using the same accounting policies and methods of application as the audited consolidated financial statements of the Company for the year ended December 31, 2007, except as noted below, and are presented in United States dollars. The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the interim consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The interim consolidated financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality. These unaudited interim consolidated financial statements do not include all the information and note disclosures required by Canadian GAAP for annual financial statements and therefore should be read in conjunction with the Company's most recently reported annual audited consolidated financial statements.

CHANGES IN ACCOUNTING POLICIES

(a) Capital Disclosures and Financial Instruments-Disclosures and Presentation

The Company adopted three new presentation and disclosure standards that were issued by the Canadian Institute of Chartered Accountants: Handbook Section 1535, Capital Disclosures ("Section 1535"), Handbook Section 3862, Financial Instruments-Disclosures ("Section 3862") and Handbook Section 3863, Financial Instruments-Presentation ("Section 3863").

Section 1535 requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital. Section 1535 specifies the disclosures of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments-Disclosure and Presentation, revising and enhancing its disclosure requirements and carrying forward unchanged its presentation requirements for financial instruments. Sections 3862 and 3863 place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

(b) Inventories

Handbook Section 3031, "Inventories" ("Section 3031"), which replaces Handbook Section 3030, Inventories, requires inventory to be carried at the lower of cost and net realizable value using, in certain cases, the specific identification method or either of the first-in, first-out or average cost methods. 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. Except for the new guidance on reversal of write downs, the Company's current practice for valuing inventories is substantially in accordance with the new standard, and therefore the adoption of Section 3031 did not result in a material impact on the Company's consolidated financial position and results of operations.

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. Restricted cash at December 31, 2007 includes $320 (2008-nil) on deposit principally as collateral for letters of credit issued by the Company.

INVENTORY

Inventory consists of drill pipe, casing and tubular available for sale. As of December 31, 2007, a portion of the Company's inventory aggregating $14,375 was reclassified from petroleum and natural gas properties to available for sale, and is carried at the lower of cost or net realizable value. At December 31, 2007, the Company charged to operations $3,593 as a write down to the carrying cost of the inventory to estimated net realizable value.

During the nine months ended September 30, 2008, the Company received $3,816 from the sale of inventory available for sale at approximately its carrying value.

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.

COMPARATIVE FIGURES

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

(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	United States	Total
December 31, 2007	**$ 229,671**	**$ 134**	**$ -**	**$ -**	**$ -**	**$ 229,805**
Acquisition costs	-	-	29	25,279	239	25,547
Exploration costs	6,433	-	-	-	-	6,433
Development costs	-	25	-	-	-	25
Proceeds from ExxonMobil, net of costs	(21,450)	-	-	-	-	(21,450)
Depletion and depreciation	-	(31)	-	-	-	(31)
September 30, 2008	**$ 214,654**	**$ 128**	**$ 29**	**$ 25,279**	**$ 239**	**$ 240,329**

	Hungary	Canada	Romania	Australia	United States	Total
December 31, 2006	**$ 123,722**	**$ 55**	**$ -**	**$ -**	**$ -**	**$ 123,777**
Acquisition costs	-	-	-	-	-	-
Exploration costs	117,079	-	821	-	-	117,900
Development costs	-	140	-	-	-	140
Inventory held for sale (Note 2)	(14,375)	-	-	-	-	(14,375)
Asset retirement obligation	3,245	(4)	-	-	-	3,241
Impairment loss	-	(26)	(821)	-	-	(847)
Depletion and depreciation	-	(31)	-	-	-	(31)
December 31, 2007	**$ 229,671**	**$ 134**	**$ -**	**$ -**	**$ -**	**$ 229,805**

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

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

HUNGARY

The Company holds two petroleum and natural gas exploration licenses – the Tisza License and the Mako License (collectively, the "Licenses"). The Licenses give the Company the exclusive right to explore for oil and gas on properties located in south central Hungary near the town of Szolnok. The Licenses were obtained from an unrelated entity, Prospect Resources, Inc. ("Prospect"). The prior term of the Licenses extended to December 2005 under both the Tisza and Mako Licenses. In December 2005, the Company received a two year extension on the Licenses through December 2007; a subsequent extension was granted through December 2009. In May 2007, a portion of each License was converted into one long-term production license (the "Production License"), with the balance of the acreage within the Licenses continuing as described above.

The Production License covers all petroleum and natural gas in the identified Basin Centered Gas Accumulation ("BCGA") resource underlying the Licenses, and remains in effect as long as the Company continues petroleum and natural gas operations, and continues to comply with all applicable laws and regulations.

All revenues from oil and gas sales from the Licenses and the Production License are subject to a royalty to the Hungarian government in the amount of 12% and an overriding royalty to Prospect in the amount of 5%. Prospect will also be paid a "success bonus" of 20% of gross revenue from the first well drilled under the original boundaries of the Tisza License up to $1,000, and will be paid a "success bonus" of 20% of gross revenue from the first well drilled under the original boundaries of the Mako License up to $1,000. Upon extension of the Mako License in 2005, Prospect earned a one-time bonus of $1,000, which was paid in January, 2008.

Agreement with ExxonMobil

On April 10, 2008, the Company entered into a Production and Development Agreement (the "Agreement") with Exxon Mobil Corporation affiliate Esso Exploration International Limited ("ExxonMobil") under which ExxonMobil became a joint owner with the Company of approximately 184,000 acres (the "Contract Area") in the Company's 246,000-acre long-term production license (the "Production License") in the Mako Trough, Hungary.

The Agreement provides for initial consideration of $25,000 to the Company, which was paid in April 2008, and for ExxonMobil to spend $50,000 to conduct an initial work program (the "Initial Work Program") to test one or more of the Company's existing wellbores or drill one or more new wells for such tests. Transaction costs were $3,550. After the Initial Work Program is completed, ExxonMobil may elect to withdraw, in which event it will reassign its entire interest in the Contract Area to the Company, or proceed to proceed to the next phase (the "Appraisal Work Program"), in which event it will pay the Company an additional $50,000 and will expend $100,000 on the Appraisal Work Program. After the Appraisal Work Program is completed, ExxonMobil will either reassign its entire interest to the Company or, if it elects to proceed to the next phase (the "Development Program"), it will pay the Company an additional $75,000.

The Company will incur no development costs within the Contract Area for ExxonMobil's commitments during the Initial Work Program or the Appraisal Work Program. Beginning with the Development Program, the Company and ExxonMobil would each receive revenues and be responsible for its proportionate share of expenses within the Contract Area under a joint operating agreement.

ExxonMobil originally acquired an undivided 67% working interest in the Contract Area under the terms of the Agreement, but it subsequently assigned half its interest to MOL, a publicly traded Hungarian oil and gas company The Production License, insofar as it covers the Contract Area, is now owned 33% by the Company, 33.5% by ExxonMobil, and 33.5% by MOL. ExxonMobil serves as Operator.

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

In June 2008, the Company completed a well intervention and repair of the Mako 6 well. Under the agreement with ExxonMobil, $5,000 of the costs incurred for this project will be reimbursed to the Company. At September 30, 2008, amounts receivable include $5,000 as due from joint interest owners.

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 nine months ended September 30, 2008, the Company has recorded depletion expense of $31 (2007-$18). In the September 2007 quarter, the Company recorded an impairment of $26 on its Canadian petroleum and natural gas properties, as the carrying value of the Company's Canadian properties exceeded the ceiling test under the full cost method of accounting.

ROMANIA

The Company entered into a farmout agreement (the "Farmout Agreement") in June 2005 with a related entity, on a coalbed methane property in the Jiu Valley of Romania, under which it would earn a 75% interest in the property.

Under the terms of the Farmout Agreement, the Company was obligated to pay 100% of the costs to drill two coalbed methane "earning wells" to earn a 75% working interest in the Jiu Valley property, with the right to opt out of the second well. As of December 31, 2007, the first exploratory well was plugged and abandoned. The Company has applied to have the Jiu Valley concession returned to the Romanian government.

In February 2008, the Company was notified that it has been contingently awarded a new concession, the "Anina Concession". The award is subject to negotiation and finalization of a concession agreement for the acreage. There is a minimal work program required under the Anina Concession, and the Company will have the option to withdraw at the end of each contract year.

AUSTRALIA

On September 30, 2008, the Company closed its purchase of an undivided 50% working interest in an aggregate 7,000,000 acre prospect in the Northern Territory, Australia (the "Beetaloo Basin") from a related party, PetroHunter Energy Corporation ("PetroHunter"). *See* Note 8 below.

The purchase price was $25,000, $5,000 of which was paid in cash as earnest money on August 25, 2008, and $20,000 of which paid on September 30, 2008 in equity securities convertible into shares on a one-for-one basis based on the closing price of the Company's shares on August 22, 2008. *See* Note 6 below. In the event that the closing share price on the date that a receipt is issued for the final prospectus to qualify the distribution of the common shares underlying the convertible equity securities (the "Receipt Date") is below the closing share price on August 22, 2008, the convertible equity securities have an adjustment mechanism which provides PetroHunter with price protection of up to 20%. In addition, the agreements provide for additional price protection, to a maximum of $3,500, if the share price on the Receipt Date is below 70% of the closing price on August 22, 2008.

PetroHunter serves as Operator of the Beetaloo Basin, although the joint operating agreement provides for a joint operating committee and for substantial direct involvement by the Company's managerial, technical and financial personnel. The Company and PetroHunter are subject to certain drilling commitments on the four exploration permits comprising the 7,000,000 acres. The commitments require the drilling of seven wells during 2009, five wells during 2010 and three wells during 2011. In addition, the parties must complete seismic evaluations on certain permits. The cost of all such work is borne equally by the Company and PetroHunter.

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

UNITED STATES

On August 25, 2008, the Company entered into a binding agreement with PetroHunter to acquire a 25% working interest in five wells ("Five Wells") located within PetroHunter's 20,000-acre Buckskin Mesa project ("Buckskin Mesa Project") located in the Piceance Basin, Colorado, and to undertake a completion and testing program in respect of the Five Wells. The Company closed this acquisition on October 31, 2008.

Under the terms of the Purchase and Sales Agreement, the Company agreed to pay 100% of the first $7,000 expended on completion and testing work in connection with the Five Wells. After completion and testing work has been performed, the Company has up to 60 days to review and analyze the results, at which time it will either retain its 25% interest in the Five Wells and acquire no greater interest or exercise an option (the "Buckskin Mesa Option") to acquire an additional 25% working interest in the Five Wells (for a total of 50%) and a 50% working interest in the remainder of the 20,000-acre Buckskin Mesa Project. If exercised, the Buckskin Mesa Option requires an aggregate $18,000 in spending commitments on behalf of both the Company and PetroHunter, subject to adjustments, pursuant to a drilling and development program that will be mutually agreed to by the Company and PetroHunter, and $25,000, payable to PetroHunter at the Company's option in cash, equity securities convertible into shares, or a combination thereof. If the Company elects to issue equity securities convertible into shares, they will be required to, among other things, obtain the prior approval of the TSX Venture Exchange ("TSX-V"). In addition, the Company will have an option to become the operator of the Buckskin Mesa Project. If it elects to become the operator, the Company must pay $3,500 in cash, equity securities convertible into shares, or a combination thereof.

One of the underlying agreements by which PetroHunter originally acquired its interest in Buckskin Mesa requires the payment of $1,500 to an unrelated third party on January 9, 2009, and further requires that:

(i) at least four wells be commenced by July 31, 2009;

(ii) at least five additional wells be commenced by December 31, 2009; and

(iii) at least eleven additional wells be commenced by December 31, 2010.

In lieu of drilling the wells, the requirement may be satisfied by the payment of $500 per well not commenced. If the foregoing requirements are not satisfied, the Company and PetroHunter will be required to assign to the Third Party their entire leasehold interest in Buckskin Mesa, other than the Five Wells and the 40 acres surrounding such wells.

During the nine months ended September 30, 2008, the Company incurred $32,005 for additions to its petroleum and natural gas properties, of which $25,279 and $239 were for the acquisition of the Beetaloo Basin in Northern Territory, Australia and the Buckskin Mesa project ("Buckskin Mesa Project") in Colorado, respectively, and made cash payments on all petroleum and natural gas properties of $23,385, of which $12,517 represents amounts incurred and accrued at December 31, 2007.

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

NOTE 4 – AMOUNTS RECEIVABLE

Amounts receivable at September 30, 2008 and December 31, 2007 is comprised of the following:

	2008	2007
Joint interest owners	$ 5,000	$ -
Value added tax (VAT) – Hungary	711	2,572
GST – Canada	193	103
Petroleum and natural gas revenue	8	16
Due from related party (Note 8)	-	678
Other	123	272
	$ 6,035	$ 3,641

NOTE 5 – ASSET RETIREMENT OBLIGATIONS

At September 30, 2008, the estimated total undiscounted amount required to settle the asset retirement obligations was $18,112. Costs for asset retirement have been calculated assuming a 5.0% inflation rate. These obligations will be settled based on the estimated useful lives of the underlying assets, which extend up to 20 years into the future. This amount has been discounted using a credit-adjusted risk-free interest rate of 6.5%. Changes to asset retirement obligations for the nine months ended September 30, 2008 and year ended December 31, 2007 were as follows:

	2008	2007
Asset retirement obligations – beginning of period	$ 5,140	$ 1,759
Liabilities incurred	-	807
Revisions to estimates	-	2,435
Liabilities settled	-	(67)
Accretion	254	206
Asset retirement obligations – end of period	$ 5,394	$ 5,140

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

NOTE 6 – SHARE CAPITAL

AUTHORIZED

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

ISSUED

	Shares	Amount	Contributed Surplus	Special Warrants
Balance, January 1, 2007	462,580,763	$273,068	$12,174	$-
Sale of common shares	100,000,000	39,304	-	-
Exercise of warrants	1,268,400	568	-	-
Exercise of options	1,350,000	396	-	-
Offering costs	-	(3,483)	-	-
Fair value of warrants	-	674	-	-
Stock based compensation of options	-	-	3,458	-
Contributed surplus reclassified on exercise of options	-	108	(108)	-
Balance, December 31, 2007	565,199,163	310,635	15,524	-
Exercise of warrants	1,711,250	674	-	-
Stock based compensation of options	-	-	6,484	-
Issuance of special warrants	-	-	-	20,000
Balance, September 30, 2008	566,910,413	$311,309	$22,008	$20,000

WARRANTS

A summary of the number of common shares reserved pursuant to the Company's outstanding share purchase warrants for the nine months ended September 30, 2008 and for the year ended December 31, 2007 is as follows:

	2008	2007
Balance, beginning of period	8,518,150	3,786,550
Underwriters warrants	-	6,000,000
Warrants exercised	(1,711,250)	(1,268,400)
Warrants expired	(2,518,150)	-
Balance, end of period	4,288,750	8,518,150

Common shares reserved for share purchase warrants outstanding as of September 30, 2008, are as follows:

Number of Shares	Exercise Price	Expiry Date
4,288,750	$0.39 (CDN$0.40)	December 17, 2009

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

NOTE 6 – SHARE CAPITAL (CONTINUED)

SPECIAL WARRANTS

As partial consideration for the Beetaloo Basin acquisition, as described in Note 3, the Company has issued $20,000 of equity securities (the "Special Warrants") convertible into shares of the company's common stock on a one-for-one basis based on the closing price of the Company's shares on August 22, 2008. The maximum number of shares to be issued is 28,888,888. The Company has filed a preliminary non-offering short form prospectus qualifying the distribution of up to 28,888,888 common shares issuable for no consideration upon the automatic exercise of the Special Warrants for a deemed price of CDN$0.72 per Special Warrant.

NOTE 7 – STOCK-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 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.

A summary of the status of the Company's stock option plan as of September 30, 2008 and December 31, 2007, and changes during the nine and twelve months then ended, respectively, is presented below:

	2008		2007	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of period	36,090,000	$1.90	37,840,000	$1.91
Options granted	13,610,000	$1.09	600,000	$0.54
Options exercised	-	-	(1,350,000)	$0.25
Options forfeited	(2,250,000)	$3.62	(1,000,000)	$3.73
Outstanding at end of period	47,450,000	$1.59	36,090,000	$1.90
Options exercisable at end of period	29,085,800	$1.32	24,906,000	$1.20

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

NOTE 7 – STOCK-BASED COMPENSATION (CONTINUED)

The following summarizes information about stock options outstanding and exercisable at September 30, 2008:

Options Outstanding	Options Exercisable	Exercise price	Weighted average remaining contractual life	Expiry date
15,500,000	15,500,000	0.25	1.50 years	April 2, 2010
2,450,000	2,450,000	0.50	2.05 years	October 10, 2010
10,289,000	6,173,400	3.98	2.60 years	May 7, 2011
5,001,000	2,000,400	2.83	3.19 years	December 9, 2011
600,000	240,000	0.54	3.88 years	August 17, 2012
1,000,000	200,000	0.98	4.60 years	May 6, 2013
12,610,000	2,522,000	1.10	4.66 years	May 30, 2013
47,450,000	29,085,800			

At September 30, 2008, the weighted average remaining contractual life of stock options outstanding was 2.88 years.

The weighted average fair value of the options granted during the nine months ended September 30, 2008 was $0.82. There were no grants during the nine months ended September 30, 2007.

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. The following assumptions were used for stock options granted:

	2008	2007
Expected term of options	3.50 to 5.00 years	3.75 years
Risk-free interest rate	3.17% to 3.37%	4.51%
Annualized volatility	119.37%	70.54%
Dividend rate	nil	nil

Stock based compensation expense for the nine months ended September 30, 2008 of $6,484 (2007-$2,508) was recorded in the statement of operations.

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.

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

NOTE 8 – 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.

The Company has entered into certain agreements and transactions with PetroHunter, a related entity, whose largest single shareholder is also the President and CEO of the Company. As described in Note 3, the Company has entered into agreements with PetroHunter to acquire working interests in the Beetaloo Basin located in the Northern Territory, Australia, and the Buckskin Mesa Project, located in the Piceance Basin, Colorado.

In June 2006, the Company entered into an Office Sharing Agreement with PetroHunter for office space in Denver, Colorado, of which the Company is the lessee. Under the terms of the agreement, PetroHunter and the Company shared, on an equivalent employee basis, all costs related to the office space, including rent, office operating costs, furniture and equipment and any other expenses related to the operations of the corporate offices. Certain employees of PetroHunter had also provided services to the Company, and PetroHunter has invoiced the Company for these services at cost. The above described office sharing arrangement was mutually terminated effective February 1, 2008. As at September 30, 2008 and December 31, 2007, PetroHunter owed the Company nil and $678, respectively, for its share of net costs incurred under this arrangement.

During the nine months ended September 30, 2008, the Company incurred $135 (2007-$135) to a current director of the Company for advisory and consulting services rendered to TXM; and $175 (2007-nil) in consulting fees to a current director of the Company for advisory and consulting services rendered to Falcon.

NOTE 9 – 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 unevaluated petroleum and natural gas properties in Hungary, Romania, Australia and the United States. An analysis of the Company's geographic areas at September 30, 2008 and 2007 is as follows:

	Hungary	Canada	Romania	Australia	United States	Total
Nine months ended September 30, 2008						
Revenue	$ -	$ 66	$ -	$ -	$ -	$ 66
Net income (loss)	(2,745)	(15,220)	-	-	-	(17,965)
As of September 30, 2008						
Capital assets	220,427	128	29	25,279	824	246,687
Nine months ended September 30, 2007						
Revenue	$ 109	$ 53	$ -	$ -	$ -	$ 162
Net income (loss)	(9,460)	3,021	(758)	-	-	(7,197)
As of September 30, 2007						
Capital assets	239,028	92	-	-	453	239,573

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS

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.

Capital Risk Management

The Company manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to shareholders through the optimization of the debt and equity balance. The Company's overall strategy remains unchanged from 2007.The capital structure of the Company consists solely of equity.

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 remote. 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 rigorous 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.

Currency Risk

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

Interest Rate Risk

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

Fair Value Estimation

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

NOTE 11 – 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, actions involving allegations of discrimination, or breach of contract incidental to the operations of its business. The Company is not currently involved in any such incidental litigation which it believes could have a materially adverse effect on its financial condition or results of operations.

NOTE 12 - SUBSEQUENT EVENTS

On October 1, 2008, the Company agreed to lend PetroHunter $5,000. Under the terms of the Loan Agreement, funds were advanced by the Company directly to certain creditors and vendors of PetroHunter who assigned leases in, provided goods to, or rendered services for the Beetaloo Basin and Buckskin Mesa Project. The loan bears interest at the rate of 10% per annum, and interest-only payments are due monthly. The maturity date is the earlier of: (i) 45 days after the Receipt Date (ii) 120 days from the date of the loan or (iii) an event of default. Collateral underlying the loan includes: (i) a first mortgage in the Five Wells and (ii) certain pledged common shares as follows: of the $20,000 of the Company's securities to be issued to PetroHunter, (a) $7,500 is to be pledged and held in a brokerage account designated by the Company, (b) $6,000 is to be available for PetroHunter to pledge as collateral for a loan with a third party and, of the proceeds received by PetroHunter, 50% must be paid to the Company to extinguish the then outstanding loan balance, and (c) all remaining common shares may be sold by PetroHunter and, of the proceeds received by PetroHunter, 50% must be paid to the Company to extinguish the then outstanding loan balance. To avoid an event of default, PetroHunter must comply with certain other covenants as stipulated in the Loan Agreement.