FALCON OIL & GAS LTD.

(A Development Stage Company)

Consolidated Financial Statements

Years Ended December 31, 2008 and 2007

(Presented in U.S. Dollars)

AUDITOR'S REPORT

To the Shareholders and the Board of Directors
Falcon Oil & Gas Ltd.

We have audited the consolidated balance sheets of Falcon Oil & Gas Ltd. and subsidiaries, a development stage company, as of December 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Falcon Oil & Gas Ltd. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"*Hein & Associates LLP*"
Denver, Colorado
April 28, 2009

FALCON OIL & GAS LTD.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS
December 31, 2008 and 2007
(U.S. Dollars, in thousands, except share and per share amounts)

	2008	2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 25,547	$ 55,672
Restricted cash (Note 2)	-	320
Amounts receivable (Note 4)	16,134	3,641
Prepaids and other	1,537	1,980
Inventory available for sale (Note 5)	6,852	10,782
Total current assets	50,070	72,395
Property and equipment		
Petroleum and natural gas properties (Note 3)	237,020	229,805
Pipeline and facilities	3,888	3,836
Furniture and equipment, net	2,343	2,032
Total property and equipment	243,251	235,673
Other assets (Note 6)	11,150	797
Total Assets	$ 304,471	$ 308,865
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 17,996	$ 14,649
Property contract payable (Note 3)	-	1,000
Total current liabilities	17,996	15,649
Asset retirement obligations (Note 7)	5,285	5,140
Total liabilities	23,281	20,789
Commitments and contingencies (Notes 1 & 15)		
Shareholders' equity (Note 8 & 9)		
Share capital	331,179	310,635
Contributed surplus	24,005	15,524
Deficit accumulated during development stage	(73,994)	(38,083)
Total shareholders' equity	281,190	288,076
Total liabilities and shareholders' equity	$ 304,471	$ 308,865

Subsequent event (Note 16)

On behalf of the Board:

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

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

FALCON OIL & GAS LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
Years Ended December 31, 2008 and 2007
(U.S. Dollars, in thousands, except share and per share amounts)

	2008	2007
Petroleum revenue	$ 60	$ 207
Direct costs		
Production costs	34	109
Depreciation, depletion and accretion	378	237
	412	346
Costs and expenses		
Accounting	852	710
Depreciation and amortization	450	340
Consulting	1,659	2,429
Director fees	258	176
Investor relations	610	1,201
Legal costs	1,353	2,064
Office and administrative	2,544	2,864
Payroll and related costs	2,908	2,908
Stock based compensation	8,481	3,458
Travel and promotion	2,309	2,672
Write-down of inventory available for sale	2,610	3,594
	24,034	22,416
Other income (expense)		
Interest income	1,548	2,568
Impairment of petroleum and natural gas properties	(6,970)	(847)
Gain (loss) on foreign exchange	(5,273)	7,987
Other expense	(368)	-
	(11,063)	9,708
Loss before income taxes	(35,449)	(12,847)
Provision for income taxes	(462)	-
Net loss and comprehensive loss	$ (35,911)	$ (12,847)
Net loss per common share – basic and diluted	$ (0.063)	$ (0.027)
Weighted average number of common shares outstanding – basic and diluted	566,507,134	467,986,379

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

FALCON OIL & GAS LTD.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Years Ended December 31, 2008 and 2007

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

	Shares	Share Capital	Contributed Surplus	Special Warrants	Deficit Accumulated During Development Stage
January 1, 2007	462,580,763	$ 273,068	$ 12,174	$ -	$ (25,236)
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)	-	-
Net loss	-	-	-	-	(12,847)
December 31, 2007	565,199,163	310,635	15,524	-	(38,083)
Exercise of warrants	1,711,250	674	-	-	-
Stock based compensation of options	-	-	8,481	-	-
Issuance of special warrants	-	-	-	20,000	-
Conversion of special warrants into common shares	28,888,888	20,000	-	(20,000)	-
Share issue costs	-	(130)	-	-	-
Net loss	-	-	-	-	(35,911)
December 31, 2008	595,799,301	$ 331,179	$ 24,005	$ -	$ (73,994)

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

FALCON OIL & GAS LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2008 and 2007
(U.S. Dollars, in thousands, except share and per share amounts)

	2008	2007
Cash flows from operating activities		
Net loss	$ (35,911)	$ (12,847)
Adjustments to reconcile net loss to net cash used in operating activities		
Stock based compensation	8,481	3,458
Depreciation, depletion and accretion	828	577
Impairment of petroleum and natural gas properties	6,970	847
Writedown of inventory available for sale	2,610	3,594
Unrealized foreign exchange (gain) loss	5,273	(7,987)
Other	464	-
Changes in non-cash working capital accounts		
Amounts receivable	(12,457)	10,419
Prepaids and other	454	(312)
Inventory available for sale	4,995	-
Other assets	(5,353)	-
Accounts payable and accrued expenses	15,214	67
Net cash provided by (used in) operating activities	(8,432)	(2,184)
Cash flows from investing activities		
Restricted deposits	-	(604)
Petroleum and natural gas properties	(32,679)	(127,143)
Pipeline and facilities	(139)	(554)
Property and equipment	(761)	(1,606)
Proceeds from ExxonMobil, net of transaction costs	21,316	-
Note receivable – PetroHunter	(5,000)	-
Net cash used in investing activities	(17,263)	(129,907)
Cash flows from financing activities		
Proceeds from sale of common stock	-	39,304
Proceeds from exercise of warrants and stock options	674	964
Offering costs	(130)	(2,809)
Net cash provided by financing activities	544	37,459
Effect of exchange rate on cash and cash equivalents	(5,294)	7,987
Net decrease in cash and cash equivalents	(30,445)	(86,645)
Cash and cash equivalents, beginning of period	55,992	142,637
Cash and cash equivalents, end of period	$ 25,547	$ 55,992

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

FALCON OIL & GAS LTD.
(A Development Stage Company)
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended December 31, 2008 and 2007
(U.S. Dollars, in thousands, except share and per share amounts)

	2008	2007
Cash and cash equivalents is comprised of:		
Cash	$ 25,547	$ 55,672
Restricted cash (Note 2)	-	320
	$ 25,547	$ 55,992
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	$ -
Petroleum and natural gas property costs in accounts payable	$ 624	$ 12,517

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

NOTE 1 – ORGANIZATION

Falcon Oil & Gas Ltd. ("Falcon" or the "Company"), incorporated under the laws of British Columbia on January 18, 1980, is considered a development stage company as defined by Canadian Institute of Chartered Accountants Accounting Guideline No. 11.

As of December 31, 2008, the Company has producing petroleum and natural gas properties in Alberta, Canada and exploration projects in Hungary, Romania, Australia and the United States. The Company's exploration projects in Hungary, Romania 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 oil 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 oil 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.

The recent events in the global financial markets have had a profound impact on the global economy. Virtually all industries, including the petroleum and natural gas industry, have been impacted by these market conditions, which have included: a sharp contraction in the credit markets resulting in a widening of credit risk spreads and higher costs of funding; a deterioration in the credit ratings of numerous financial institutions; devaluations and high volatility in global equity, commodity and foreign exchange markets with a corresponding lack of market liquidity; and a decline in the cycle that affects global economic activity. These events could have a significant impact on the Company. See Note 12 regarding financial instrument risks.

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. ("FOG-TXM"), 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 and balances have been eliminated in consolidation.

The accompanying consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are presented in United States dollars.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 form 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 property and included in the ceiling test and depletion calculations on a country by country basis.

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.

PROPERTY AND EQUIPMENT

Furniture, equipment and computer software 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 when placed in service. 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 generally accepted accounting principles 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 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 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 current petroleum and natural gas prices and estimated reserves. Price declines reduce the estimated value of proved reserves and increase annual amortization expense (which is based on proved reserves).

INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per share is based on the weighted average number of common shares outstanding during the period. Diluted income (loss) per 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 options and warrants were excluded from the calculation of loss per share as the effect of these assumed exercises was anti-dilutive.

SHARE BASED COMPENSATION

The Company has a share based compensation plan which is described in Note 8. 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 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.

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.

ADOPTION OF NEW CANADIAN ACCOUNTING STANDARDS

(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.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Presentation and Disclosure, 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Inventories

Handbook Section 3031, "Inventories" ("Section 3031"), which replaces Handbook Section 3030, Inventories, requires inventory to be carried at the lower of cost or 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.

NEW CANADIAN ACCOUNTING STANDARDS

The Accounting Standards Board ("AcSB") of the Canadian Institute of Chartered Accountants has issued new accounting standards that the Company is required to consider for adoption, as follows:

(a) Goodwill and intangible assets

Effective on January 1, 2009, the Company will adopt Section 3064 "Goodwill and intangible assets". Section 3064 replaces Sections 3062 "Goodwill and other intangible assets" and Section 3450 "Research and development costs". Section 3064 establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets including internally developed intangible assets. The adoption of Section 3064 is not anticipated to have a significant effect on the Company's consolidated financial statements.

(b) 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 monitoring this 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	United States	Total
December 31, 2007	**$ 229,671**	**$ 134**	**$ -**	**$ -**	**$ -**	**$ 229,805**
Acquisition costs	-	-	29	25,890	748	26,667
Exploration costs	6,586	-	-	52	6,126	12,764
Development costs	-	(21)	-	-	-	(21)
Inventory available for sale	(3,675)	-	-	-	-	(3,675)
Asset retirement obligation	(340)	-	-	49	96	(195)
Impairment loss	-	-	-	-	(6,970)	(6,970)
Proceeds from ExxonMobil, net of costs	(21,316)	-	-	-	-	(21,316)
Depletion and depreciation	-	(39)	-	-	-	(39)
December 31, 2008	**$ 210,926**	**$ 74**	**$ 29**	**$ 25,991**	**$ -**	**$ 237,020**

	Hungary	Canada	Romania	Australia	United States	Total
January 1, 2007	**$ 123,722**	**$ 55**	**$ -**	**$ -**	**$ -**	**$ 123,777**
Acquisition costs	-	-	-	-	-	-
Exploration costs	117,079	-	821	-	-	117,900
Development costs	-	140	-	-	-	140
Inventory available for sale	(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 reflected as property contract payable in the consolidated balance sheet at December 31, 2007 and paid in January, 2008.

Agreement with ExxonMobil

On April 10, 2008, the Company entered into a Production and Development Agreement (the "Agreement" or "PDA") 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 in the Mako Trough, Hungary. ExxonMobil originally acquired an undivided 67% working interest in the Contract Area under the terms of the Agreement. Pursuant to a pre-existing agreement between ExxonMobil and MOL Hungarian Oil and Gas Plc. ("MOL"), a publicly traded Hungarian oil and gas company, and ExxonMobil's rights under the PDA, ExxonMobil assigned one-half of its interest to MOL. Therefore, 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 of the Contract Area.

The Agreement (amended in December 2008 by the Company, ExxonMobil, and MOL, as discussed below) 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 $3,684. 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 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 $$37,500, and expend $37,500 on the Development Program.

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, ExxonMobil and MOL would each receive revenues and be responsible for its proportionate share of expenses within the Contract Area under a joint operating agreement.

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 December 31, 2008, amounts receivable include $6,000 as due from joint interest owners, and amounts payable include $1,000 for value added tax ("VAT") payable.

Amendment to Agreement with ExxonMobil

On December 8, 2008, the Company entered into an amendment (the "Amendment") to the Agreement with Exxon Mobil Corporation affiliate ExxonMobil Hungary (Mako) Limited ("ExxonMobil") and MOL. Under the Amendment, the parties agreed to three principal matters: (1) the parties have agreed to use reasonable efforts to combine their respective exploration licenses and mining plots to form one unit consisting of all or part of the Makó Trough, with discussions scheduled to commence in the second calendar quarter of 2009; (2) if ExxonMobil and MOL elect to proceed to the Appraisal Work Program, the parties agree to expand the area where wells may be located and apply a portion of the $100,000 Appraisal Work Program expenditures basin-wide in a combined work program, based on the optimum locations from a technical basin-wide appraisal standpoint; and (3) if ExxonMobil and MOL elect to proceed to the Development Work Program, the parties agree to pay an additional $75,000, of which $37,500 will be paid directly to the Company, and the balance of $37,500 (previously payable directly to Falcon) will be applied to the same expanded basin-wide area in a combined work program.

A portion of the remaining area adjacent to the Production License in the Makó Trough is covered by licenses held by MOL, and operated by ExxonMobil (the "MOL Area").

AUSTRALIA

On September 30, 2008, the Company consummated the acquisition of an undivided 50% working interest in an aggregate 7,000,000 acre prospect in four Exploration Permits (the "Permits") 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 was 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* SPECIAL WARRANTS in Note 8 below. In the event that the closing share price on the date that a receipt was issued for the final prospectus to qualify the distribution of the common shares underlying the convertible equity securities was below the closing share price on August 22, 2008, the convertible equity securities had an adjustment mechanism which provided PetroHunter with price protection of up to 20%.

PetroHunter serves as Operator of the Permits, 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 Permits comprising the 7,000,000 acres. The commitments required 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 of the Permits. The cost of all such work is borne equally by the Company and PetroHunter. *See* Note 16 below.

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

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, 2008, the Company has recorded depletion expense of $39 (2007-$31). For the year ended December 31, 2008, the Company did not record any impairment. For the year ended December 31, 2007, the Company recorded impairment of $26 as the carrying value of the Company's Canadian petroleum and natural gas 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" in exchange for 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 opted out of the second well, and has applied to have the Jiu Valley concession returned to the Romanian government. Consequently, for the year ended December 31, 2007, the Company reflected in its consolidated statement of operations impairment of petroleum and natural gas properties of $821.

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.

UNITED STATES

On August 25, 2008, the Company entered into a binding agreement with PetroHunter to acquire an undivided 25% working interest in five wells, including the 40-acre tract surrounding each of the wells (collectively, the "Five Wells") situated within PetroHunter's 20,000-acre Buckskin Mesa project ("Buckskin Mesa Project") located in the Piceance Basin, Colorado, and to undertake a testing and completion program in respect of the Five Wells. The Company consummated this acquisition on October 31, 2008.

Under the terms of the Purchase and Sales Agreement (the "PSA"), the Company agreed to pay 100% of the first $7,000 of testing and completion work to be undertaken in connection with the Five Wells. On November 12, 2008, the Company advanced the entire $7,000 to PetroHunter, and those funds were deposited into a separate operating account. After performance of the testing and completion work, the Company had up to 60 days to review and analyze the results, at which time it could either retain its 25% interest in the Five Wells and acquire no greater interest, or it could 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.

On February 24, 2009, the Company notified PetroHunter that it would not exercise the Buckskin Mesa Option. Of the $7,000 advanced to PetroHunter, approximately $874 has not been expended. As of December 31, 2008, the unexpended funds have been reflected as other assets in the Company's consolidated balance sheet. For the year ended December 31, 2008, the Company has reflected impairment of $6,970 in its consolidated statement of operations, equal to the $6,126 of testing and completion work, $748 of acquisition costs and $96 of assets associated with the retirement obligation.

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

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

CAPITAL EXPENDITURES

During the year ended December 31, 2008, the Company incurred $39,410 for additions to its petroleum and natural gas properties, of which $25,890 and $748 were for the acquisition of the Company's interests in the Permits in the Beetaloo Basin in Northern Territory, Australia and in the Buckskin Mesa Project in Colorado, respectively, and made cash payments on all petroleum and natural gas properties of $32,679, of which $12,517 and $1,000 represented amounts incurred and reflected in accounts payable and accrued expenses, and property contract payable, respectively, at December 31, 2007.

NOTE 4 – AMOUNTS RECEIVABLE

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

	2008	2007
Joint interest owners	$ 6,541	$ -
VAT – Hungary	5,769	2,572
GST – Australia	2,500	-
GST – Canada	67	103
Sale of inventory available for sale	1,133	-
Other	124	288
Due from related party (Note 8)	-	678
	$ 16,134	$ 3,641

NOTE 5 – INVENTORY AVAILABLE FOR SALE

Inventory available for sale consists of drill pipe, casing and tubing. As of December 31, 2007, a portion of the Company's inventory aggregating $14,376 was reclassified from petroleum and natural gas properties to available for sale, and carried at the lower of cost or net realizable value. At December 31, 2007, the Company charged to operations $3,594 as a write down to the carrying cost of the inventory to estimated net realizable value of $10,782.

During the year ended December 31, 2008, an additional $3,675 was reclassified from petroleum and natural gas properties to inventory available for sale, and the Company received $4,995 from the sale of inventory available for sale at approximately its carrying value. At December 31, 2008, the Company charged to operations $2,610 as a write down to the carrying cost of the inventory to estimated net realizable value of $6,852.

NOTE 6 – NOTE RECEIVABLE – PETROHUNTER

On October 1, 2008, the Company loaned PetroHunter $5,000 (the "PetroHunter loan") to pay certain vendors who rendered services on the Beetaloo Basin and Buckskin Mesa Project. The loan, reflected in other assets in the consolidated balance sheet at December 31, 2008, bears interest at 10% per annum, payable monthly. The due date was the earlier of (i) 45 days after the receipt of the (final) prospectus qualifying the distribution of the common shares in the capital of the Company underlying the convertible securities issued to PetroHunter as partial consideration under the Beetaloo Basin PSA; (ii) the occurrence of an Event of Default; and (iii) 120 days from the date of the loan (January 29, 2009). On December 29, 2009, the loan was amended to extend the due date until April 30, 2009.

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

NOTE 6 – NOTE RECEIVABLE – PETROHUNTER (CONTINUED)

The loan is collateralized by the following:

(a) A first mortgage on the Buckskin Mesa Project Five Wells;
(b) Of the 28,888,888 shares issued to PetroHunter in connection with the acquisition of the Beetaloo Basin:

  (1) 14,500,000 are held in escrow, with the proceeds from the sale to be irrevocably directed to the Company and applied on the account of the indebtedness;

  (2) 11,600,000 are available to PetroHunter as collateral for loans from third parties, and if PetroHunter obtains any such third party loans, the proceeds thereof shall be applied as follows: the first $4,000 shall be for PetroHunter's use as working capital in the normal course of business, the next $2,000 shall be paid to the Company to reduce the outstanding balance of the loan, and thereafter the proceeds shall be distributed successively 50% to each party until the earlier of being fully applied or until all accrued and unpaid interest and principal under the loan is fully paid; and

  (3) 2,788,888 are held in escrow and may be sold by PetroHunter, in which case the proceeds of any such sale shall be distributed solely to PetroHunter (with none distributed to the Company).

If the loan is not paid by April 30, 2009, in addition to all other remedies available to the Company, PetroHunter shall, upon the request of the Company, resign as operator under the Joint Operating Agreement executed in connection with the Beetaloo Basin PSA and shall appoint (or if applicable, vote in favor of) the Company as operator under that Joint Operating Agreement. *See* Note 16 below.

NOTE 7 – ASSET RETIREMENT OBLIGATIONS

At December 31, 2008, the estimated total undiscounted amount required to settle the asset retirement obligations was $6,875. 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 years ended December 31, 2008 and 2007 were as follows:

	2008	**2007**
Asset retirement obligations – beginning of period	$ 5,140	$ 1,759
Liabilities incurred	145	807
Revisions to estimates	(339)	2,435
Liabilities settled	-	(67)
Accretion	339	206
Asset retirement obligations – end of period	$ 5,285	$ 5,140

NOTE 8 – SHARE CAPITAL

AUTHORIZED

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

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

NOTE 8 – SHARE CAPITAL (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, 2008 and 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 December 31, 2008 are as follows:

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

SPECIAL WARRANTS

As partial consideration for the Beetaloo Basin acquisition, as described in Note 3, the Company issued $20,000 of equity securities (the "Special Warrants") automatically convertible into common shares of the Company for no additional consideration 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 that could be issued was 28,888,888. On December 22, 2008, the Company filed a (final) non-offering short form prospectus qualifying the distribution of the 28,888,888 common shares upon the conversion of the Special Warrants. The deemed price was CDN$0.72 per share.

NOTE 9 – 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. Of the options granted during the years ended December 31, 2008 and 2007, all vest 20% at the date of grant, with the remainder vesting ratably at the anniversary date over the four years thereafter.

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

NOTE 9 – STOCK-BASED COMPENSATION (CONTINUED)

A summary of the Company's stock option plan as of December 31, 2008 and 2007, and changes during the years then ended, is presented below:

	2008		2007	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	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 expired/forfeited	(2,750,000)	$3.16	(1,000,000)	$3.73
Outstanding at end of year	46,950,000	$1.59	36,090,000	$1.90
Options exercisable at end of year	29,986,000	$1.37	24,906,000	$1.20

The following summarizes information about stock options outstanding and exercisable at December 31, 2008:

Options Outstanding	Options Exercisable	Exercise price	Weighted average remaining contractual life	Expiry date
15,500,000	15,500,000	0.25	1.25 years	April 2, 2010
2,450,000	2,450,000	0.50	1.80 years	October 10, 2010
10,289,000	6,173,400	3.98	2.35 years	May 7, 2011
5,001,000	3,000,600	2.83	2.94 years	December 9, 2011
600,000	240,000	0.54	3.62 years	August 17, 2012
1,000,000	200,000	0.98	4.35 years	May 6, 2013
12,110,000	2,422,000	1.19	4.43 years	June 5, 2013
46,950,000	29,986,000			

At December 31, 2008, the weighted average remaining contractual life of stock options outstanding was 2.61 years.

The weighted average fair value of the options granted during the year ended December 31, 2008 was $0.90 (2007-$0.29).

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 9 – STOCK-BASED COMPENSATION (CONTINUED)

The following assumptions were used for stock options granted:

	2008	2007
Expected life of options	3.50 to 5.00 years	3.75 years
Risk-free interest rate	1.69% to 3.45%	4.51%
Annualized volatility	119%	71%
Dividend rate	nil	nil
Estimated forfeiture rate	nil	nil

Stock based compensation expense for the year ended December 31, 2008 of $8,481 (2007-$3,458) 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.

NOTE 10 – 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 entered into agreements with PetroHunter to acquire working interests in the Beetaloo Basin and the Buckskin Mesa Project. As described in Note 6, the Company loaned PetroHunter $5,000 to pay certain vendors who rendered services on the Beetaloo Basin and Buckskin Mesa Project.

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 invoiced the Company for these services at cost. The above described office sharing arrangement was mutually terminated effective February 1, 2008. As at December 31, 2008, PetroHunter owed the Company nil (2007-$678) for its share of net costs incurred under this arrangement.

During the year ended December 31, 2008, the Company incurred $180 (2007-$180) and $36 (2007-nil) to two current directors of the Company for advisory and consulting services rendered to TXM; and $156 (2007-$44) in consulting fees to a current director of the Company for advisory and consulting services rendered to Falcon.

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

NOTE 11 – 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 and Australia, and has evaluated petroleum and natural gas properties in the United States. An analysis of the Company's geographic areas is as follows:

	Hungary	Canada	Romania	Australia	United States	Total
Year ended December 31, 2008						
Revenue	$ -	$ 60	$ -	$ -	$ -	$ 60
Net income (loss)	(9,326)	(16,075)	-	(1)	(10,509)	(35,911)
As of December 31, 2008						
Capital assets	216,534	74	29	25,991	623	243,251

	Hungary	Canada	Romania	Australia	United States	Total
Year ended December 31, 2007						
Revenue	$ 137	$ 70	$ -	$ -	$ -	$ 207
Net income (loss)	(9,990)	448	(821)	-	(2,484)	(12,847)
As of December 31, 2007						
Capital assets	235,133	134	-	-	406	235,673

NOTE 12 –FINANCIAL INSTRUMENTS

(a) Fair value

The fair value of financial instruments at December 31, 2008 and 2007 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,			
	2008		2007	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Held for trading				
Cash and cash equivalents	$ 25,547	$ 25,547	$ 55,992	$ 55,992
Loans and receivables				
Amounts receivable	16,134	16,134	3,641	3,641
Financial liabilities:				
Other financial liabilities				
Accounts payable and accrued liabilities	17,996	17,996	14,649	14,649

NOTE 12 –FINANCIAL INSTRUMENTS (CONTINUED)

(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.

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 13 – 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.

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

NOTE 14 – 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 31.0% (2007 – 34.1%) to the Company's income (loss) before income taxes for the year. The difference results from the following items:

	2008	2007
Expected income tax (recovery)	$ (11,132)	$ (4,380)
Effect of foreign income tax rates	88	1,277
Change in effective tax rates	(211)	–
Effect of change in foreign exchange rates	3,154	–
Non-deductible stock-based compensation	2,629	1,179
Other	1,128	99
Unrecognized benefit of loss carryforwards	4,344	1,825
Local income taxes	462	–
Provision for income taxes	$ 462	$ –

The income tax effects of temporary differences that give rise to significant portions of future income tax assets and liabilities at December 31, 2008 and 2007 are as follows:

	2008	2007
Future income tax assets		
Inventory	$ –	$ 225
Non-capital losses and resource deductions	19,887	8,577
Less: Valuation allowance	(13,130)	(8,786)
	6,757	16
Future income tax liabilities		
Petroleum and natural gas properties and other	6,757	–
Capital assets	–	(16)
	6,757	(16)
	$ –	$ –

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

NOTE 14 – INCOME TAXES (CONTINUED)

The Company has accumulated loss carryforwards at December 31, 2008 to reduce future years' taxable income as follows:

		2008	Expiration
Canada			
Non-capital losses	$	6,232	2009 to 2029
Resource deductions		1,945	No expiration
		8,177	
United States		14,297	2028 to 2029
Hungary		9,386	No expiration
		21,196	Determinable by tax authorities
		30,582	
Australia		25,941	No expiration
	$	78,997	

The benefit of the Company's net tax asset 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 15 – 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.

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

NOTE 15 – COMMITMENTS AND CONTINGENCIES (CONTINUED)

(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 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 these non-cancelable operating leases:

Year ended December 31,	
2009	$ 915
2010	924
2011	774
2012	621
2013	259
Total	$ 3,493

NOTE 16 – SUBSEQUENT EVENT

On April 22, 2009, the Company entered into a non-binding letter of intent (the “LOI”) with PetroHunter which stipulates that the Company will acquire an additional undivided 25% working interest in the Beetaloo Basin project. Under the terms of the LOI, the principal consideration being paid by the Company for this transaction is the forgiveness of the PetroHunter loan. The LOI also stipulates that, on closing of this transaction, the Company will become operator of the Beetaloo Basin project, and that PetroHunter and certain of its affiliates and the Company will enter into an escrow agreement which will govern the release of all remaining common shares previously issued to PetroHunter. The closing of this transaction is subject to the execution of definitive agreements, the fulfillment of certain closing conditions, as well as the receipt of all required regulatory approvals. Closing of this transaction is expected to occur on or about May 25, 2009.