FALCON OIL & GAS LTD.

(A Development Stage Company)

Consolidated Financial Statements

Years Ended December 31, 2009 and 2008

(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. at December 31, 2009 and 2008, and the 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, these consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"*Hein & Associates LLP*"
Denver, Colorado
April 29, 2010

FALCON OIL & GAS LTD.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS
December 31, 2009 and 2008
(U.S. Dollars, in thousands)

	2009	2008
ASSETS		
Current assets		
Cash and cash equivalents	$ 11,804	$ 25,547
Restricted cash (Notes 2 & 6)	1,184	-
Amounts receivable (Note 4)	2,955	10,365
Prepaids and other	720	1,537
Inventory available for sale (Note 5)	4,196	6,852
Total current assets	20,859	44,301
Property and equipment		
Petroleum and natural gas properties (Note 3)	207,889	237,020
Pipeline and facilities	3,888	3,888
Furniture and equipment, net	2,086	2,343
Total property and equipment	213,863	243,251
Other assets (Note 3)	8,277	11,150
Total assets	$ 242,999	$ 298,702

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

FALCON OIL & GAS LTD.
(A Development Stage Company)
CONSOLIDATED BALANCE SHEETS (CONTINUED)
December 31, 2009 and 2008
(U.S. Dollars, in thousands)

	2009	2008
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 2,683	$ 12,227
Long-term liabilities		
Convertible debentures (Note 6)	4,031	-
Asset retirement obligations (Note 7)	6,106	5,285
Total long-term liabilities	10,137	5,285
Total liabilities	12,820	17,512
Commitments and contingencies (Notes 1 & 14)		
Shareholders' equity (Notes 6 & 8)		
Share capital	331,215	331,179
Contributed surplus	31,829	24,005
Equity component of convertible debentures	5,057	-
Deficit accumulated during development stage	(137,922)	(73,994)
Total shareholders' equity	230,179	281,190
Total liabilities and shareholders' equity	$ 242,999	$ 298,702

Going concern (Note 1)

Subsequent event (Note 15)

On behalf of the Board:

"Gregory Smith" ____________________,Director **"Thomas Harris"_________________, Director**

The accompanying 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, 2009 and 2008
(U.S. Dollars, in thousands, except share and per share amounts)

	2009	2008
Petroleum revenue	$ 69	$ 60
Direct costs		
Production costs	43	34
Depreciation, depletion, amortization and accretion	357	378
	400	412
Costs and expenses		
Accounting	766	852
Depreciation and amortization	485	450
Consulting	1,279	1,459
Director fees	258	258
Investor relations	1,190	610
Legal costs	1,448	1,553
Office and administrative	2,697	2,544
Payroll and related costs	3,668	2,908
Stock based compensation (Note 8)	5,452	8,481
Travel and promotion	1,988	2,309
Write-down of inventory available for sale	1,559	2,610
	20,790	24,034
Other income (expense)		
Interest expense	(879)	-
Interest income	333	1,548
Impairment of petroleum and natural gas properties (Note 3)	(45,045)	(6,970)
Gain (loss) on foreign exchange	2,573	(5,273)
Other income (expense)	211	(368)
	(42,807)	(11,063)
Loss before income taxes	(63,928)	(35,449)
Provision for income taxes (Note 13)	-	(462)
Net loss and comprehensive loss	$ (63,928)	$ (35,911)
Net loss per common share – basic and diluted	$ (0.107)	$ (0.063)
Weighted average number of common shares outstanding – basic and diluted	598,214,479	566,507,134

The accompanying 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, 2009 and 2008

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

	Shares	Share Capital	Contributed Surplus	Equity Component of Convertible Debentures	Deficit Accumulated During Development Stage
January 1, 2008	565,199,163	$ 310,635	$ 15,524	$ -	$ (38,083)
Exercise of warrants	1,711,250	674	-	-	-
Stock based compensation of options	-	-	8,481	-	-
Conversion of special warrants into common shares (Note 8)	28,888,888	20,000	-	-	-
Share issuance costs	-	(130)	-	-	-
Net loss	-	-	-	-	(35,911)
December 31, 2008	595,799,301	331,179	24,005	-	(73,994)
Common shares issued for cash (Note 6)	2,977,500	1,030	263	5,057	-
Common shares issued upon exercise of warrants	3,440,000	1,275	-	-	-
Share issuance costs	-	(160)	-	-	-
Agents warrants (Note 8)	-	(2,109)	2,109	-	-
Stock based compensation	-	-	5,452	-	-
Net loss	-	-	-	-	(63,928)
December 31, 2009	602,216,801	$ 331,215	$ 31,829	$ 5,057	$ (137,922)

The accompanying 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, 2009 and 2008
(U.S. Dollars, in thousands)

	2009	2008
Cash flows from operating activities		
Net loss	$ (63,928)	$ (35,911)
Adjustments to reconcile net loss to net cash used in operating activities		
Stock based compensation	5,452	8,481
Depreciation, depletion and accretion	842	828
Impairment of petroleum and natural gas properties	45,045	6,970
Writedown of inventory available for sale	1,559	2,610
Unrealized foreign exchange (gain) loss	(2,573)	5,273
Accretion of equity component of convertible debentures	632	-
Amortization of deferred financing costs	185	-
Other	-	464
Changes in non-cash working capital accounts		
Amounts receivable	9,437	(12,457)
Prepaids and other	900	454
Inventory available for sale	497	4,995
Other assets	(14)	(5,353)
Accounts payable and accrued expenses	(10,298)	15,214
Net cash provided by (used in) operating activities	(12,264)	(8,432)
Cash flows from investing activities		
Petroleum and natural gas properties	(8,836)	(32,679)
Pipeline and facilities	-	(139)
Furniture and equipment	(226)	(761)
Proceeds from ExxonMobil, net of transaction costs	-	21,316
Note receivable – PetroHunter	-	(5,000)
Increase in other assets	(2,381)	-
Net cash used in investing activities	(11,443)	(17,263)
Cash flows from financing activities		
Increase in restricted cash	(1,184)	-
Proceeds from unit offering	10,302	-
Proceeds from exercise of warrants and stock options	1,275	674
Offering costs	(1,530)	(130)
Net cash provided by financing activities	8,863	544
Effect of exchange rate on cash and cash equivalents	1,101	(5,294)
Net decrease in cash and cash equivalents	(13,743)	(30,445)
Cash and cash equivalents, beginning of year	25,547	55,992
Cash and cash equivalents, end of year	$ 11,804	$ 25,547

The accompanying 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, 2009 and 2008
(U.S. Dollars, in thousands)

	2009	2008
Cash and cash equivalents is comprised of:		
Cash	$ 11,804	$ 25,547
Restricted cash (Notes 2 & 6)	1,184	-
	$ 12,988	$ 25,547
Supplemental schedule of cash flow information:		
Cash paid for interest	$ -	$ -
Cash paid for income taxes	$ 525	$ -
Supplemental disclosures of non-cash investing and financing activities:		
Petroleum and natural gas properties acquired with special warrants	$ -	$ 20,000
Petroleum and natural gas properties acquired in exchange for a note receivable and other assets	$ 5,308	$ -
Petroleum and natural gas property costs in accounts payable	$ 770	$ 624

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

NOTE 1 – ORGANIZATION AND GOING CONCERN

Falcon Oil & Gas Ltd. ("Falcon"), 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 (CICA) Accounting Guideline No. 11.

As of December 31, 2009, the Company has producing petroleum and natural gas properties in Alberta, Canada and exploration projects in Hungary and Australia. The Company's exploration projects in Hungary and Australia continue to be evaluated, and management believes that the carrying costs of these projects are recoverable. Should the Company be unsuccessful in these exploration activities, the carrying cost of these prospects may be charged to operations.

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

GOING CONCERN

For the year ended December 31, 2009, the Company incurred a net loss of $63,928 and, as at December 31, 2009, had a deficit accumulated during the development stage of $137,922 and working capital of $18,176. The Company has been focused on securing equity financing and joint venture funding for its operations in the Beetaloo Basin located in the Northern Territory, Australia, and joint venture funding for its operations in the Makó Trough located in Hungary.

In the near term, the Company's ability to continue as a going concern is dependent upon its ability to raise additional capital to fund its operations. Additional capital may be sought from existing shareholders and/or from the sale of additional common shares or other debt or equity instruments (See Note 15 below). There is no assurance such additional capital will be available to the Company on acceptable terms or at all.

In the longer term, the recoverability of the carrying value of the Company's long-lived assets is dependent upon the Company's ability to preserve its interest in the underlying petroleum and natural gas properties, the discovery of economically recoverable reserves, the achievement of profitable operations, and the ability of the Company to obtain financing to support its acquisition, exploration, development and production activities.

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") appropriate for a going concern. The going concern basis of accounting assumes the Company will continue to realize the value of its assets and discharge its liabilities and other obligations in the ordinary course of business. Should the Company be required to realize the value of its assets in other than the ordinary course of business, the net realizable value of its assets may be materially less than the amounts shown in the consolidated financial statements. These consolidated financial statements do not include any adjustments to the amounts and classifications of assets and liabilities that may be necessary should the Company be unable to repay its liabilities and meet its other obligations in the ordinary course of business or continue operations.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying consolidated financial statements include Falcon and its wholly owned subsidiaries: Mako Energy Corporation ("Mako"), a Delaware company, 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 on consolidation.

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

PETROLEUM AND NATURAL GAS PROPERTIES

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

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

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

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

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

REVENUE RECOGNITION

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

IMPAIRMENT OF LONG-LIVED ASSETS

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

INCOME TAXES

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

USE OF ESTIMATES

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

NET INCOME (LOSS) PER COMMON SHARE

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

STOCK BASED COMPENSATION

The Company has a stock 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.

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, 2009 includes $1,184 (2008-nil) on deposit principally as escrowed interest payments to holders of Falcon's convertible debentures. See Note 6.

INVENTORY AVAILABLE FOR SALE

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

TRANSLATION OF FOREIGN CURRENCIES

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

DEFERRED FINANCING COSTS

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CAPITALIZED INTEREST

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

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 ACCOUNTING STANDARDS

Goodwill and intangible assets

Effective on January 1, 2009, the Company adopted Section 3064, "Goodwill and intangible assets" ("Section 3064"). 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 did not have a significant effect on the Company's consolidated financial statements.

Credit risk and fair value of financial assets and liabilities

In January 2009, the CICA issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". The EIC provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities. This standard was applied by the Company effective January 1, 2009 and did not have a significant effect on the Company's consolidated financial statements.

Financial instruments – recognition and measurement

During 2009, the CICA amended Section 3855 "Financial Instruments – Recognition and Measurement". This revised standard was applied by the Company effective for the year ended December 31, 2009, and the application did not have a significant effect on the Company's consolidated financial statements.

Financial instruments – disclosures

During 2009, the CICA amended Section 3862, "Financial Instruments – Disclosures", which requires enhanced disclosures of the fair values of financial instruments. Financial instruments recognized at fair value on the consolidated balance sheet must now be classified in fair value hierarchy levels based on their valuations. This revised standard was applied by the Company effective for the year ended December 31, 2009, and the requirements of the revised standard are included in Note 11.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

NEW CANADIAN ACCOUNTING STANDARDS

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

Business Combinations, Consolidated Financial Statements and Non-Controlling Interests

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

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

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

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, 2008	**$ 210,926**	**$ 74**	**$ 29**	**$ 25,991**	**$ -**	**$ 237,020**
Acquisition costs	-	-	16	5,734	-	5,750
Exploration costs	2,047	-	-	7,400	-	9,447
Development costs	-	(5)	-	-	-	(5)
Asset retirement obligation	394	-	-	189	-	583
Impairment loss	(45,000)	-	(45)	-	-	(45,045)
Cost of ExxonMobil	161	-	-	-	-	161
Depletion and depreciation	-	(22)	-	-	-	(22)
December 31, 2009	**$ 168,528**	**$ 47**	**$ -**	**$ 39,314**	**$ -**	**$ 207,889**

	Hungary	Canada	Romania	Australia	United States	Total
January 1, 2008	**$ 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**

The Company's Canadian properties are all proven and are subject to a ceiling test; the Company's properties in Hungary and Australia are unproven. Capitalized interest totaled $464 (2008-nil) for the year ended December 31, 2009.

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

HUNGARY

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

The Exploration Licenses expired on December 31, 2009 and are not eligible for extension. However, under Hungarian laws applicable to oil and gas exploration licenses, the licensee has the first priority in obtaining a mining plot covering all or part of the area, but is not guaranteed that it will receive a mining plot. The process requires the filing of a "Closing Report" within six months from the expiration of the license, and the filing of an application for the mining plot within the second six-month period.

In October 2009, the Hungarian Mining Authority granted the Company's application to expand the depths under the Production License. When originally issued in May 2007, the upper depth of the Production License was defined as 9,186 feet (2,800 meters) from the surface, and extended to the basement of the Basin Centered Gas Accumulation (the "BCGA"). As a result of additional technical analysis, including extensive review of 3D seismic and the data obtained from the wells previously drilled within the Production License, the amended Production License now incorporates depths beginning at 7,546 feet (2,300 meters) throughout the entire Production License. This revision makes the Production License depth consistent with other mining plots in the immediate area.

Agreement with ExxonMobil

On April 10, 2008, Falcon and TXM entered into a Production and Development Agreement (the "PDA"), as amended, with ExxonMobil Corporation affiliate Esso Exploration International Limited ("ExxonMobil") under which TXM and ExxonMobil became joint owners in a specified portion (the "Contract Area") of the Production License. Pursuant to a pre-existing agreement between ExxonMobil and MOL Hungarian Oil and Gas Plc. ("MOL"), and ExxonMobil's rights under the PDA, ExxonMobil sold one-half of its interest in the Contract Area to MOL, effective April 10, 2008. ExxonMobil, MOL and TXM also entered into a joint operating agreement (the "JOA"), dated April 10, 2008, governing operations not expressly addressed in the PDA. At that time, ExxonMobil became operator of the Contract Area under the JOA.

On October 30, 2009, Production Ventures East Hungary Kft., an affiliate of ExxonMobil ("Production Ventures"), completed certain operations on the Földeák-1 well, at which time the well was temporarily suspended. The conclusion of these operations was also the completion of the Initial Work Program, and the expenditure of Production Ventures' and MOL's $50 million financial obligation under the PDA. Production Ventures and MOL had 120 days from completion of the Initial Work Program to evaluate the results and, on February 19, 2010, provided notice that they would not proceed to the next phase of the PDA, the Appraisal Work Program, and would exit the PDA.

In accordance with the PDA, ExxonMobil's and MOL's respective participating interests in the Contract Area, the Földeák-1 well, and all other interests automatically reverted to TXM, and TXM became operator of the Contract Area.

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

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

Impairment

As of December 31, 2009, the Company determined that the carrying value of the Hungarian petroleum and natural gas properties exceeded its estimated fair value. Consequently, during the fourth quarter of 2009, the Company reflected an impairment of petroleum and natural gas properties of $45,000 in its consolidated statement of operations, with a corresponding reduction to petroleum and natural gas properties in the consolidated balance sheet as of December 31, 2009.

AUSTRALIA

On September 30, 2008, Falcon and Falcon Australia consummated the acquisition of an undivided 50% working interest in an aggregate 7,000,000-acre prospect in four Exploration Permits (collectively, the "Permits") in the Beetaloo Basin Project in the Northern Territory, Australia (the "Beetaloo Basin Project") pursuant to the terms of a Purchase and Sale Agreement, as amended on October 31, 2008 (together, the "Beetaloo PSA") with PetroHunter Energy Corporation and certain of its affiliates (collectively, "PetroHunter"), each of which is a non-arm's length party for the purposes of the TSX-V (See Note 9 below).

The purchase price was $25,000, $5,000 of which was paid in cash, and $20,000 of which was paid in Falcon's 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).

On June 11, 2009, pursuant to a Second Purchase and Sale Agreement (the "Second PSA") entered into with PetroHunter, the Company completed the acquisition of an additional undivided 25% working interest in the Beetaloo Basin Project. Under the terms of the Second PSA, the principal consideration paid by the Company for the acquisition was the exchange of the $5,000 note receivable from PetroHunter that was reflected as other assets at December 31, 2008. In addition, the Company paid certain vendors who had provided goods or rendered services for the Beetaloo Basin Project, prior to the Company's acquisition of its 50% interest in September 2008, in exchange for inventory and operator bonds of approximately the same value, and relinquished its rights to the unexpended testing and completion funds of approximately $874 as discussed below. On closing of this transaction, the Company became operator of the Beetaloo Basin Project, and PetroHunter and the Company entered into an escrow agreement governing the release of all remaining Falcon common shares previously issued to PetroHunter. The acquisition was reflected at the exchange value.

The following is a summary of the consideration paid by the Company to PetroHunter under the Second PSA:

Note receivable	$ 5,000
Beetaloo Basin Project:	
Vendor payments	1,215
Inventory	(971)
Operator bonds	(469)
Buckskin Mesa Project:	
Unexpended testing and completion funds	874
Asset retirement obligation	(97)
Total	$ 5,552

In July 2009, the Company re-entered the Shenandoah-1 well and reached a depth of 8,904 feet (2,714 meters) on October 11, 2009. Following further evaluation of the results, the Company plans to test the well in 2010.

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

On December 7, 2009, Falcon and Falcon Australia entered into a Binding Heads of Agreement (the "Agreement") with PetroHunter and Sweetpea Petroleum Pty Ltd ("Sweetpea"), PetroHunter's wholly owned subsidiary, wherein Falcon Australia will issue to Sweetpea common shares of Falcon Australia in consideration for the transfer of Sweetpea's undivided 25% working interest in the Permits. The Company will enter into a Master Services Agreement (the "MSA") related to the operations of the Permits. Under the terms of the Agreement, Falcon will be issued 150 million shares of Falcon Australia for conversion of a portion ($30,000) of Falcon Australia's debt payable to Falcon, which approximates Falcon's initial acquisition cost previously paid to Sweetpea for the 75% working interest in the Permits held by Falcon Australia as of the date of the Agreement, and Sweetpea will be issued 50 million shares of Falcon Australia for its remaining 25% working interest in the Permits. On April 23, 2010, Falcon Australia received notice (the "Notice") from the Department of Resources, Northern Territory Government, that the registration of the transfer of the remaining 25% interest in the Permits was completed, satisfying all conditions precedent to closing. Pursuant to the Notice, Falcon Australia now owns 100% of the Permits.

The MSA shall provide that Falcon Australia will be delegated sole authority and responsibility for all daily operations of the Permits. A monthly management fee shall be paid to Falcon out of the proceeds of a private placement of Falcon Australia shares of common stock (see Note 15) at a rate of $200 to $500 per month, based on funds raised in the Falcon Australia private placement. The term of the MSA will be for a period of one year, with any extension occurring upon mutual agreement.

At December 31, 2009, Sweetpea owed Falcon Australia $1,800 for its share of joint interest billings to re-enter the Shenandoah-1 well. This amount is reflected in other assets in the accompanying 2009 financial statements and will be reclassified to petroleum and natural gas properties at closing, as partial consideration for the acquisition by Falcon Australia of Sweetpea's remaining 25% working interest in the Permits

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, 2009, the Company has recorded depreciation, depletion and amortization expense of $22 (2008-$39).

UNITED STATES

On October 31, 2008, the Company consummated the acquisition of an undivided 25% working interest in five wells, including the 40-acre tract surrounding each of the wells (collectively, the "Five Wells"), from PetroHunter situated within PetroHunter's 20,000-acre Buckskin Mesa project (the "Buckskin Mesa Project") located in the Piceance Basin, Colorado, and agreed to undertake a testing and completion program in respect of the Five Wells pursuant to the terms of the Purchase and Sale Agreement (the "Buckskin PSA"). Under the Buckskin 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. After performance of the testing and completion work, the Company had up to 60 days to review and analyze the results and, at its election, could exercise an option (the "Buckskin Mesa Option") to acquire an additional undivided 25% working interest in the Five Wells (for a total of 50%) and an undivided 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 had not been expended, and was reflected as other assets at December 31, 2008. On June 11, 2009, pursuant to the Second PSA, the Company relinquished its rights to the unexpended testing and completion funds, and reassigned the undivided 25% working interest in the Five Wells to PetroHunter. The Company was relieved of all obligations related to the Five Wells, including reclamation and plugging and abandonment. For the year ended December 31, 2008, the Company 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)

SOUTH AFRICA

On October 27, 2009, Falcon secured a Technical Cooperation Permit (the "TCP") to evaluate the Karoo Basin in central South Africa. Falcon has up to one year to conduct a technical appraisal of the area covered by the TCP, which does not include any well or seismic work obligations. At the end of the one year period, Falcon has the option to apply for an exploration license covering all or a portion of the TCP upon the payment of $400. The TCP covers approximately 7.5 million acres and is located approximately 120 miles northeast of Cape Town, South Africa.

NOTE 4 – AMOUNTS RECEIVABLE

Amounts receivable at December 31, 2009 and 2008 is comprised of the following:

	2009	2008
Joint interest owners	$ 856	$ 6,541
VAT – Hungary	961	-
GST – Australia	132	2,500
GST – Canada	38	67
Sale of inventory available for sale	350	1,133
Other	618	124
	$ 2,955	$ 10,365

NOTE 5 – INVENTORY AVAILABLE FOR SALE

Inventory available for sale consists of drill pipe, casing and tubing and is reflected as a current asset at its estimated net realizable value. During the year ended December 31, 2008, $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.

During the year ended December 31, 2009, the Company received $497 from the sale of inventory available for sale at approximately its carrying value, and transferred $600 of inventory available for sale from the Makó Trough to the Beetaloo Basin that is reflected in petroleum and natural gas properties. At December 31, 2009, the Company charged to operations $1,559 as a write down to the carrying cost of the inventory to estimated net realizable value of $4,196.

NOTE 6 – CONVERTIBLE DEBENTURES

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

NOTE 6 – CONVERTIBLE DEBENTURES (CONTINUED)

Optional Conversion Privilege

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

Automatic Conversion Features

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

Redemption

The Debentures will not be redeemable before the date that is 10 days prior to one year following the closing. The Company will have the one time option, exercisable within five days of such date and subject to providing prior written notice to the Debenture holders, to redeem the outstanding Debentures (in whole or in part) 30 days following delivery of such notice, in cash, at a redemption price equal to 110% of their principal amount plus accrued and unpaid interest thereon up to but excluding the redemption date.

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

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

NOTE 6 – CONVERTIBLE DEBENTURES (CONTINUED)

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

	US$	CDN$
The Offering:		
Units issued	11,910	11,910
Price per unit	$ 865	$ 1,000
Gross proceeds	$ 10,302	$ 11,910
Shares:		
Unit shares issued at $0.35 (CDN$0.40) per share	2,977,500	2,977,500
Agent Warrants to acquire shares at $0.52 (CDN$0.60) per share	1,250,550	1,250,550
Allocation of gross proceeds:		
Convertible debentures	$ 4,215	$ 4,873
Equity component of convertible debentures	5,057	5,846
	9,272	10,719
Share capital	1,030	1,191
	$ 10,302	$ 11,910
Value ascribed to Agent Warrants	$ 263	$ 303
Offering costs:		
Allocated to deferred financing costs	$ 1,494	$ 1,722
Allocated to equity	160	190
	$ 1,654	$ 1,912
One year of escrowed interest payments at 11% per annum reflected in restricted cash	$ 1,020	$ 1,179

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

Face amount	$ 9,272
Discount – equity component of convertible debentures	(5,057)
Accretion of discount – equity component of convertible debentures	632
Foreign currency translation adjustment	493
Offering costs attributable to convertible debentures	(1,494)
Amortization of offering costs attributable to convertible debentures	185
	$ 4,031

The discount and the offering costs are being accreted and amortized to interest expense over the term of the convertible debentures.

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

NOTE 6 – CONVERTIBLE DEBENTURES (CONTINUED)

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

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

NOTE 7 – ASSET RETIREMENT OBLIGATIONS

At December 31, 2009, the estimated total undiscounted amount required to settle the asset retirement obligations was $8,796. Costs for asset retirement have been calculated assuming an inflation rate ranging from 3.0% to 5.0%. These obligations will be settled based on the estimated useful lives of the underlying assets, which extend up to 20 years into the future. Obligations have been discounted using a credit-adjusted risk-free interest rate ranging from 6.5% to 11.0%. Changes to asset retirement obligations for the years ended December 31, 2009 and 2008 were as follows:

	2009	2008
Asset retirement obligations – beginning of year	$ 5,285	$ 5,140
Liabilities incurred	583	145
Revisions to estimates	-	(339)
Liabilities settled	-	-
Liabilities conveyed	(97)	-
Accretion	335	339
Asset retirement obligations – end of year	$ 6,106	$ 5,285

NOTE 8 – SHAREHOLDERS' EQUITY

AUTHORIZED

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

ISSUANCES

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

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

NOTE 8 – SHAREHOLDERS' EQUITY (CONTINUED)

WARRANTS

A summary of the number of common shares reserved pursuant to the Company's outstanding share purchase warrants for the years ended December 31, 2009 and 2008 is as follows:

	2009	2008
Balance, beginning of year	4,288,750	8,518,150
Agent Warrants (Note 6)	1,250,550	-
Warrants exercised	(3,440,000)	(1,711,250)
Warrants expired	(848,750)	(2,518,150)
Balance, end of year	1,250,550	4,288,750

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

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

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

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 at a price of CDN$0.72 per share.

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 year ended December 31, 2008, all vest 20% at the date of grant, with the remainder vesting ratably at the anniversary date over the four years thereafter. There were no options granted during the year ended December 31, 2009.

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

NOTE 8 – SHAREHOLDERS' EQUITY (CONTINUED)

A summary of the Company's stock option plan as of December 31, 2009 and 2008, and changes during the years then ended, is presented below:

	2009		2008	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	46,950,000	$1.90	36,090,000	$1.90
Granted	-	-	13,610,000	$1.09
Exercised	-	-	-	-
Expired	(3,195,000)	$3.11	(1,342,000)	$3.45
Forfeited	(1,780,000)	$2.07	(1,408,000)	$2.91
Outstanding at end of year	41,975,000	$1.48	46,950,000	$1.59
Options exercisable at end of year	32,576,000	$1.40	29,986,000	$1.37

The following summarizes information about stock options outstanding and exercisable at December 31, 2009:

Options Outstanding	Options Exercisable	Exercise price	Weighted average remaining contractual life	Expiry date
15,500,000	15,500,000	$0.25	0.25 years	April 2, 2010
2,450,000	2,450,000	$0.50	0.80 years	October 10, 2010
7,949,000	6,359,200	$3.98	1.35 years	May 7, 2011
4,291,000	3,432,800	$2.83	1.94 years	December 9, 2011
600,000	360,000	$0.54	2.62 years	August 17, 2012
1,000,000	400,000	$0.98	3.35 years	May 6, 2013
10,185,000	4,074,000	$1.19	3.43 years	June 5, 2013
41,975,000	32,576,000			

At December 31, 2009, the weighted average remaining contractual life of stock options outstanding was 1.54 years.

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

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

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

NOTE 8 – SHAREHOLDERS' EQUITY (CONTINUED)

The following assumptions were used for stock options granted:

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

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

NOTE 9 – RELATED PARTY TRANSACTIONS

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

In 2008 and 2009, the Company entered into certain agreements and transactions with PetroHunter, a related entity, whose largest single shareholder is also the President and CEO of the Company, including the acquisition of working interests in the Beetaloo Basin Project and the Buckskin Mesa Project. See Note 3.

During the year ended December 31, 2009, the Company incurred $325 (2008-$372) to two current directors (2008 – three directors) of the Company for advisory and consulting services rendered.

NOTE 10 – SEGMENT INFORMATION

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

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

NOTE 10 – SEGMENT INFORMATION (CONTINUED)

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

	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

NOTE 11 –FINANCIAL INSTRUMENTS

(a) Fair value

The fair value of financial instruments at December 31, 2009 and 2008 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,			
	2009		2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Held for trading				
Cash and cash equivalents	$ 12,988	$ 12,988	$ 25,547	$ 25,547
Loans and receivables				
Amounts receivable	2,955	2,955	10,365	10,365
Financial liabilities:				
Other financial liabilities				
Accounts payable and accrued liabilities	2,683	2,683	12,227	12,227

NOTE 11 –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 short term borrowings or investments.

Fair Value Estimation

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

NOTE 12 – MANAGEMENT OF CAPITAL

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

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

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

NOTE 12 – MANAGEMENT OF CAPITAL (CONTINUTED)

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

NOTE 13 – INCOME TAXES

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

The provision for income taxes differs from the amount that would have been obtained by applying the statutory income tax rate of 30% (2008 – 31.0%) to the Company's income (loss) before income taxes for the year. For the years ended December 31, 2009 and 2008, the difference results from the following items:

		2009		2008
Expected income tax (recovery)	$	(19,179)	$	(11,132)
Effect of foreign income tax rates		4,814		88
Change in effective tax rates		(62)		(211)
Effect of change in foreign exchange rates		(647)		3,154
Unrecognized benefit of loss carryforwards		3,338		4,344
Non-deductible stock-based compensation		1,636		2,629
Equity component of convertible debentures		220		-
Other		82		1,128
Change in valuation allowance		9,798		-
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, 2009 and 2008 are as follows:

		2009		2008
Future income tax assets				
Non-capital losses and resource deductions	$	23,645	$	19,887
Less: Valuation allowance		(22,928)		(13,130)
Future income tax liabilities		717		6,757
Petroleum and natural gas properties and other		717		6,757
	$	-	$	–

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

NOTE 13 – INCOME TAXES (CONTINUED)

The Company has accumulated loss carryforwards at December 31, 2009 to reduce future years' taxable income as follows:

		2009	Expiration
Canada			
Non-capital losses	$	16,008	2010 to 2029
Resource deductions		2,385	No expiration
		18,393	
United States		4,430	2029
Hungary		14,202	No expiration
Australia		40,178	No expiration
	$	77,203	

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

NOTE 14 – COMMITMENTS AND CONTINGENCIES

(a) ENVIRONMENTAL

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

(b) CONTINGENCIES

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

On November 10, 2009, the Company was served with a Complaint by a former vendor of TXM (the "Vendor"), claiming that the Company owes the Vendor approximately $3.2 million, plus interest, arising out of a dispute related to TXM's alleged failure to pay for certain oilfield equipment. Falcon and TXM have advised the Vendor, and continue to assert, that the claim is without merit and that they intend to vigorously defend against it as well as make any appropriate counter claims against the Vendor. The accompanying financial statements do not include any obligation related to this claim.

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

NOTE 14 – 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 ending December 31,	
2010	$ 924
2011	774
2012	621
2013	259
	$ 2,578

(d) AUSTRALIA WORK PROGRAM

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

Year ending December 31,	
2010	$ 6,400
2011	3,900
2012	5,000
	$ 15,300

NOTE 15 – SUBSEQUENT EVENT

In January 2010, Falcon Australia commenced the private placement sale of up 50 million shares of its common stock (“FA Share”) to sophisticated or professional investors within the meaning of sections 708(8) and 708(11) of the Corporations Act 2001 (Australia) pursuant to an Offer Memorandum (the “Offer”), at a price of $1.00 per FA Share with an attached option. Each option entitles the holder to acquire one additional FA Share in respect of each FA Share sold, exercisable at $1.25 for a period of three years from date of issue. Closing is expected to occur on or about June 30, 2010. As of April 23, 2010 all conditions precedent to closing, including consent from the Northern Territory government for the transfer to Falcon Australia of the remaining undivided 25% working interest from Sweetpea to Falcon Australia, have been satisfied (See Note 3). The acting broker to the Offer will receive as a brokerage fee 6.5% of the funds raised in the Offer together with Options (on the same terms as issued to investors), calculated at 6.5% of the number of shares issued in the Offer.