

**FALCON OIL & GAS LTD.**

Interim Consolidated Financial Statements

Six Months Ended June 30, 2010 and 2009

(Presented in U.S. Dollars)

**FALCON OIL & GAS LTD.**  
**INTERIM CONSOLIDATED BALANCE SHEETS**  
(U.S. Dollars, in thousands)  
(Unaudited)

<b>ASSETS</b>	<b>June 30, 2010</b>	<b>December 31, 2009</b>
<b>Current assets</b>		
Cash and cash equivalents	\$ 10,156	\$ 11,804
Restricted cash	51	1,184
Amounts receivable (Note 4)	1,842	2,955
Prepays and other	260	720
Inventory available for sale	3,737	4,196
Total current assets	16,046	20,859
<b>Property and equipment</b>		
Petroleum and natural gas properties, net (Note 3)	221,248	207,889
Pipeline and facilities	3,888	3,888
Furniture and equipment, net	1,888	2,086
Total property and equipment	227,024	213,863
<b>Other assets</b>	6,140	8,277
<b>Total assets</b>	\$ 249,210	\$ 242,999

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

**FALCON OIL & GAS LTD.**  
**INTERIM CONSOLIDATED BALANCE SHEETS (CONTINUED)**  
(U.S. Dollars, in thousands)  
(Unaudited)

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued expenses	\$ 1,921	\$ 2,683
<b>Long-term liabilities</b>		
Convertible debentures (Note 5)	4,919	4,031
Asset retirement obligations (Note 6)	6,317	6,106
Total long-term liabilities	11,236	10,137
<b>Total liabilities</b>	13,157	12,820
<b>Shareholders' equity (Note 7)</b>		
Share capital	331,215	331,215
Contributed surplus	35,015	31,829
Equity component of convertible debentures (Note 5)	5,057	5,057
Deficit	(146,387)	(137,922)
	224,900	230,179
Non-controlling interest	11,153	-
Total shareholders' equity	236,053	230,179
<b>Total liabilities and shareholders' equity</b>	\$ 249,210	\$ 242,999

**Going concern (Note 1)**

**Commitments and contingencies (Notes 1 & 12)**

**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)**  
**INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS,**  
**COMPREHENSIVE LOSS AND DEFICIT**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Petroleum revenue</b>	\$ -	\$ 9	\$ 12	\$ 20
<b>Costs and expenses</b>				
Production costs	4	18	9	19
General and administrative	3,066	3,556	6,602	6,423
Stock-based compensation	1,805	1,570	3,186	2,962
Impairment of petroleum and natural gas properties	-	45	-	45
Depreciation, depletion and accretion	204	213	430	413
	<u>5,079</u>	<u>5,402</u>	<u>10,227</u>	<u>9,862</u>
<b>Other income (expense)</b>				
Interest expense	(671)	-	(1,335)	-
Interest income	13	115	30	267
Gain (loss) on foreign exchange	(231)	1,486	(158)	1,983
Other income (expense)	(155)	98	(112)	110
	<u>(1,044)</u>	<u>1,699</u>	<u>(1,575)</u>	<u>2,360</u>
<b>Net loss and comprehensive loss</b>	<u>\$ (6,123)</u>	<u>\$ (3,694)</u>	<u>\$ (11,790)</u>	<u>\$ (7,482)</u>
<b>Net loss and comprehensive loss attributable to:</b>				
Owners of the Company	\$ (5,749)	\$ (3,694)	\$ (11,416)	\$ (7,482)
Non-controlling interest	(374)	-	(374)	-
<b>Net loss and comprehensive loss</b>	<u>\$ (6,123)</u>	<u>\$ (3,694)</u>	<u>\$ (11,790)</u>	<u>\$ (7,482)</u>
<b>Deficit, beginning of period</b>	\$(143,589)	\$ (77,782)	\$(137,922)	\$ (73,994)
Net loss and comprehensive loss	(5,749)	(3,694)	(11,416)	(7,482)
Non-controlling interest dilution gain	2,951	-	2,951	-
<b>Deficit, end of period</b>	<u>\$(146,387)</u>	<u>\$ (81,476)</u>	<u>\$(146,387)</u>	<u>\$ (81,476)</u>
<b>Net loss per common share – basic and diluted</b>	<u>\$ (0.010)</u>	<u>\$ (0.006)</u>	<u>\$ (0.019)</u>	<u>\$ (0.012)</u>
<b>Weighted average number of common shares outstanding – basic and diluted</b>	<u>602,216,801</u>	<u>595,832,021</u>	<u>602,216,801</u>	<u>595,815,751</u>

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

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities</b>				
Net loss inclusive of non-controlling interest	\$ (6,123)	\$ (3,694)	\$ (11,790)	\$ (7,482)
Items not involving cash:				
Stock-based compensation	1,805	1,570	3,186	2,962
Depreciation, depletion and accretion	204	213	430	413
Impairment of petroleum and natural gas properties	-	45	-	45
(Gain) loss on foreign exchange	231	(1,486)	158	(1,983)
Accretion on convertible debentures	316	-	632	-
Amortization of deferred financing costs	93	-	185	-
Other	(1)	-	1	-
Changes in non-cash working capital accounts				
Amounts receivable	15	2,731	1,040	8,496
Prepays and other	124	(19)	466	378
Inventory available for sale	433	147	459	147
Other assets	343	-	442	-
Accounts payable and accrued expenses	(551)	(7,061)	(258)	(7,691)
Net cash provided by (used in) operating activities	<u>(3,111)</u>	<u>(7,554)</u>	<u>(5,049)</u>	<u>(4,715)</u>
<b>Cash flows from investing activities</b>				
Petroleum and natural gas properties	(843)	(1,519)	(2,193)	(2,557)
Furniture and equipment	(12)	(101)	(23)	(168)
Other assets	-	(223)	-	(223)
Net cash provided by (used in) investing activities	<u>(855)</u>	<u>(1,843)</u>	<u>(2,216)</u>	<u>(2,948)</u>
<b>Cash flows from financing activities</b>				
Restricted cash	580	(1,020)	1,132	(1,020)
Proceeds from unit offering, net	-	8,985	-	8,971
Proceeds from unit offering by subsidiary, net	4,546	-	4,447	-
Net cash provided by (used in) financing activities	<u>5,126</u>	<u>7,965</u>	<u>5,579</u>	<u>7,951</u>
<b>Effect of exchange rate on cash</b>	<u>(196)</u>	<u>186</u>	<u>38</u>	<u>40</u>
<b>Cash and cash equivalents</b>				
<b>Net increase (decrease)</b>	964	(1,246)	(1,648)	328
<b>Beginning of period</b>	9,192	27,121	11,804	25,547
<b>End of period</b>	<u>\$ 10,156</u>	<u>\$ 25,875</u>	<u>\$ 10,156</u>	<u>\$ 25,875</u>

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Supplemental schedule of cash flow information:</b>				
Cash paid for interest	\$ 510	\$ -	\$ 510	\$ -
<b>Supplemental disclosures of non-cash investing and financing activities</b>				
Acquisition of 25% working interest in Beetaloo Basin:				
Issuance of stock in Falcon Oil & Gas Australia Limited	\$ 10,000	\$ -	\$ 10,000	\$ -
JIB receivable (Note 3)	1,725	-	1,725	-
	<u>\$ 11,725</u>	<u>\$ -</u>	<u>\$ 11,725</u>	<u>\$ -</u>
Services exchanged for stock in Falcon Oil & Gas Australia Limited	\$ 170	\$ -	\$ 170	\$ -
Acquisition of 25% working interest in Beetaloo Basin:				
Note receivable	\$ -	\$ 5,000	\$ -	\$ 5,000
Other assets	-	405	-	405
Asset retirement obligation	-	(98)	-	(98)
	<u>\$ -</u>	<u>\$ 5,307</u>	<u>\$ -</u>	<u>\$ 5,307</u>
Agent warrants issued in Unit offering reflected in other assets and share capital	\$ -	\$ 263	\$ -	\$ 263
<b>Inventory available for sale reclassified to petroleum and natural gas properties</b>	<u>\$ -</u>	<u>\$ 600</u>	<u>\$ -</u>	<u>\$ 600</u>

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

**FALCON OIL & GAS LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2010**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

**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 June 30, 2010, the Company has producing petroleum and natural gas properties in Alberta, Canada and exploration projects in Hungary and Australia. The Company’s exploration projects in Hungary and Australia continue to be evaluated, and management believes that the carrying costs of these projects are recoverable. Should the Company be unsuccessful in these exploration activities, the carrying cost of these prospects may be charged to operations.

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

**GOING CONCERN**

For the six months ended June 30, 2010, the Company incurred a net loss attributable to the owners of the Company of \$11,416 and, as at June 30, 2010, had a deficit of \$146,387 and working capital of \$14,125. The Company has focused on securing equity financing and a joint venture partner for its operations in the Beetaloo Basin located in the Northern Territory, Australia, and a joint venture partner 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 and/or direct financing of its’ subsidiaries (See Note 7 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, and ongoing operations.

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, liabilities and expenses that may be necessary should the Company be unable to realize its assets, repay its liabilities and meet its other obligations in the ordinary course of business or continue operations.

**FALCON OIL & GAS LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2010**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**BASIS OF PRESENTATION**

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

The interim consolidated financial statements of the Company have been prepared by management in accordance with accounting principles generally accepted in Canada. The interim consolidated financial statements have been prepared following the same accounting policies and methods of computation as the consolidated financial statements for the year ended December 31, 2009. The disclosures which follow are incremental to the disclosures included in the December 31, 2009 consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2009.

**COMPARATIVE FIGURES**

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

**BUSINESS COMBINATIONS, CONSOLIDATED FINANCIAL STATEMENTS AND NON-CONTROLLING INTERESTS**

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

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

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

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

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



**FALCON OIL & GAS LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2010**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

**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	Australia	South Africa	Total
<b>December 31, 2009</b>	<b>\$ 168,528</b>	<b>\$ 47</b>	<b>\$ 39,314</b>	<b>\$ -</b>	<b>\$ 207,889</b>
Acquisition costs	-	-	11,718	16	11,734
Exploration costs	744	-	717	163	1,624
Development costs	-	1	-	-	1
<b>June 30, 2010</b>	<b><u>\$ 169,272</u></b>	<b><u>\$ 48</u></b>	<b><u>\$ 51,749</u></b>	<b><u>\$ 179</u></b>	<b><u>\$ 221,248</u></b>

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.

**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 and appraise 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 Company has filed the required "Closing Report" within six months from the expiration of the license, and intends to file an application for the mining plot related to the Exploration Licenses by year end.

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.

**FALCON OIL & GAS LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2010**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

**NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)**

**AUSTRALIA**

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

Under a revised work program approved by the Northern Territory of Australia Government, Department of Resources in June 2010, the Company’s required minimum work program obligations, in order to continue to hold the underlying Permits in the Beetaloo Basin, is to expend \$200, \$10,100 and \$5,000 during the years ending December 31, 2010, 2011 and 2012, respectively.

**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 or before the end of the one year period, Falcon has the exclusive option to apply for an exploration permit covering all or a portion of the TCP. Upon receipt of an approved exploration permit, the Company will be required to make a minimum payment of approximately \$400, plus an approved work program. The TCP covers approximately 7.5 million acres and is located approximately 120 miles northeast of Cape Town, South Africa.

**NOTE 4 – AMOUNTS RECEIVABLE**

Amounts receivable at June 30, 2010 and December 31, 2009 is comprised of the following:

	<b>2010</b>	<b>2009</b>
Joint interest owners	\$ 180	\$ 856
VAT and GST	1,122	1,131
Sale of inventory	-	350
Other	540	618
	<u>\$ 1,842</u>	<u>\$ 2,955</u>

**FALCON OIL & GAS LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2010**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

**NOTE 5 – CONVERTIBLE DEBENTURES**

Convertible debentures at June 30, 2010 and December 31, 2009 are comprised of the following:

	<b>2010</b>	<b>2009</b>
Face amount	\$ 9,272	\$ 9,272
Discount – equity component of convertible debentures	(5,057)	(5,057)
Accretion on convertible debentures	1,264	632
Foreign exchange adjustment	564	493
Offering costs attributable to convertible debentures	(1,494)	(1,494)
Amortization of offering costs attributable to convertible debentures	<u>370</u>	<u>185</u>
	<u>\$ 4,919</u>	<u>\$ 4,031</u>

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

**NOTE 6 – ASSET RETIREMENT OBLIGATIONS**

At June 30, 2010, 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 six months ended June 30, 2010 and the year ended December 31, 2009 were as follows:

	<b>2010</b>	<b>2009</b>
Asset retirement obligations – beginning of period	\$ 6,106	\$ 5,285
Liabilities incurred	-	583
Revisions to estimates	-	-
Liabilities settled	-	-
Liabilities conveyed	-	(97)
Accretion	<u>211</u>	<u>335</u>
Asset retirement obligations – end of period	<u>\$ 6,317</u>	<u>\$ 6,106</u>

**NOTE 7 – SHAREHOLDERS' EQUITY**

**AUTHORIZED**

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

**FALCON OIL & GAS LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2010**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

**NOTE 7 – SHAREHOLDERS’ EQUITY (CONTINUED)**

**WARRANTS**

A summary of the number of common shares reserved pursuant to the Company’s outstanding share purchase warrants for the six months ended June 30, 2010 and the year ended December 31, 2009 is as follows:

	<b>2010</b>	<b>2009</b>
Balance, beginning of period	1,250,550	4,288,750
Agent warrants	-	1,250,550
Warrants exercised	-	(3,440,000)
Warrants expired	-	(848,750)
Balance, end of period	<u>1,250,550</u>	<u>1,250,550</u>

Common shares reserved for share purchase warrants outstanding as of June 30, 2010 are as follows:

<b>Number of Shares</b>	<b>Exercise Price</b>	<b>Expiry Date</b>
<u>1,250,550</u>	\$0.52 (CDN\$0.60)	June 30, 2011

**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. There were no options granted during the six months ended June 30, 2010 and 2009.

A summary of the Company’s stock option plan as of June 30, 2010 and December 31, 2009, and changes during the six months and the year then ended, is presented below:

	<b>2010</b>		<b>2009</b>	
	<b>Options</b>	<b>Weighted- Average Exercise Price</b>	<b>Options</b>	<b>Weighted- Average Exercise Price</b>
Outstanding at beginning of period	41,975,000	\$1.48	46,950,000	\$1.90
Granted	-	-	-	-
Exercised	-	-	-	-
Expired	(15,500,000)	\$0.25	(3,195,000)	\$3.11
Forfeited	<u>-</u>	-	<u>(1,780,000)</u>	\$2.07
Outstanding at end of period	<u>26,475,000</u>	\$2.21	<u>41,975,000</u>	\$1.48
Options exercisable at end of period	<u>20,902,800</u>	\$2.42	<u>32,576,000</u>	\$1.40

**FALCON OIL & GAS LTD.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2010**  
**(U.S. Dollars, in thousands, except share and per share amounts)**  
**(Unaudited)**

**NOTE 7 – SHAREHOLDERS’ EQUITY (CONTINUED)**

The following summarizes information about stock options outstanding and exercisable at June 30, 2010:

<b>Options Outstanding</b>	<b>Options Exercisable</b>	<b>Exercise price</b>	<b>Weighted average remaining contractual life</b>	<b>Expiry date</b>
2,450,000	2,450,000	\$0.50	0.31 years	October 21, 2010
7,949,000	7,949,000	\$3.98	0.85 years	May 7, 2011
4,291,000	3,432,800	\$2.83	1.44 years	December 9, 2011
600,000	360,000	\$0.54	2.13 years	August 17, 2012
1,000,000	600,000	\$0.98	2.85 years	May 6, 2013
<u>10,185,000</u>	<u>6,111,000</u>	\$1.19	2.93 years	June 5, 2013
<u>26,475,000</u>	<u>20,902,800</u>			

At June 30, 2010, the weighted average remaining contractual life of stock options outstanding was 1.80 years.

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 date for non-employees using the Black-Scholes option-pricing model.

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

**FALCON AUSTRALIA OFFERING**

In January 2010, Falcon Australia commenced the private placement sale of up to 50 million shares of its common stock (“FA Share”) to sophisticated or professional investors within the meaning of sections 708(8) and 708(11) of the Corporations Act 2001 (Australia) pursuant to an Offer Memorandum (the “Offer”), at a price of \$1.00 per FA Share with an attached option. Each option entitles the holder to acquire one additional FA Share in respect of each FA Share sold, exercisable at \$1.25 for a period of three years from date of issue. The acting broker to the Offer received as a brokerage fee 6.5% of the funds raised in the Offer together with Options (on the same terms as issued to investors), calculated at 6.5% of the number of shares issued in the Offer. The July 31, 2010 closing date has been extended to September 30, 2010, and may be terminated earlier at the discretion of Falcon Australia.

In June 2010, Falcon Australia closed on initial gross proceeds from the Offer of \$4,896, before costs of the offering of \$588. The proceeds from the Offer are to be utilized for operations in Australia.

Subsequent to June 30, 2010, and as of July 31, 2010, an additional \$775 of gross proceeds from the Offer has been received, and is being held in escrow by the acting broker.

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**NOTE 7 – SHAREHOLDERS’ EQUITY (CONTINUED)**

NON-CONTROLLING INTEREST

At June 30, 2010, non-controlling interest in Falcon Australia is comprised of the following:

	<b>Shares</b>	<b>Amount</b>
Issuance of shares to Sweetpea for 25% working interest	50,000,000	\$ 10,984
Issuance of shares for services	250,000	55
Sale of shares pursuant to offer memorandum	4,895,659	1,075
Costs of offer memorandum	-	(587)
Net loss attributable to non-controlling interest	-	(374)
	<u>55,145,659</u>	<u>\$ 11,153</u>

Deficit has been credited \$2,951 for the dilution gain attributable to the change in ownership of Falcon Australia.

**NOTE 8 – RELATED PARTY TRANSACTIONS**

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

During the six months ended June 30, 2010, the Company incurred \$69 (2009-\$181) to a current director (2009 – two directors) for advisory and consulting services rendered.

**NOTE 9 – SEGMENT INFORMATION**

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

	<b>Hungary</b>	<b>Canada</b>	<b>Australia</b>	<b>United States</b>	<b>South Africa</b>	<b>Total</b>
<b>Six Months ended June 30, 2010</b>						
Revenue	\$ -	\$ 12	\$ -	\$ -	\$ -	\$ 12
Net income (loss)	(2,582)	(4,823)	(2,158)	(1,853)	-	(11,416)
<b>As of June 30, 2010</b>						
Capital assets	174,616	48	51,749	432	179	227,024
				<b>United States</b>	<b>Romania</b>	<b>Total</b>
<b>Six Months ended June 30, 2009</b>						
Revenue	\$ -	\$ 20	\$ -	\$ -	\$ -	\$ 20
Net income (loss)	(455)	(3,278)	(88)	(3,616)	(45)	(7,482)
<b>As of June 30, 2009</b>						
Capital assets	217,470	55	33,745	604	-	251,874

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**NOTE 10 – FINANCIAL INSTRUMENTS**

**(a) Fair value**

The fair value of financial instruments at June 30, 2010 and December 31, 2009 is summarized in the following table. Fair value estimates are made at the balance sheet date, based on relevant quoted market and other information about the financial instruments.

	<b>June 30, 2010</b>		<b>December 31, 2009</b>	
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
Financial assets:				
<i>Held for trading</i>				
Cash and cash equivalents and restricted cash	\$ 10,207	\$ 10,207	\$ 12,988	\$ 12,988
<i>Loans and receivables</i>				
Amounts receivable	1,842	1,842	2,955	2,955
Financial liabilities:				
<i>Other financial liabilities</i>				
Accounts payable and accrued liabilities	1,921	1,921	2,683	2,683
Convertible debentures (face value - \$9,272)	4,919	8,576	4,031	10,217

**(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, currency risk and interest rate risk. 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 four financial institutions. The Company periodically evaluates the credit worthiness of financial institutions, and maintains cash accounts only in large high quality financial institutions, thereby reducing 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 since year end.

*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 significantly since year end.

*Currency Risk*

Financial instruments that impact the Company's net income (loss) and comprehensive income (loss) due to currency fluctuations include Canadian dollar, Hungarian forint, Euro and Australian dollar denominated cash

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**NOTE 10 – FINANCIAL INSTRUMENTS (CONTINUED)**

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 market-rate borrowings or investments.

*Fair Value Estimation*

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

**NOTE 11 – MANAGEMENT OF CAPITAL**

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

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

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

**NOTE 12 – 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.



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**NOTE 12 – COMMITMENTS AND CONTINGENCIES (CONTINUED)**

(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.

(c) COMMITMENTS

Under a revised work program approved by the Northern Territory of Australia Government, Department of Resources in June 2010, the Company’s required minimum work program obligations, in order to continue to hold the underlying Permits in the Beetaloo Basin, is to expend \$200, \$10,100 and \$5,000 during the years ending December 31, 2010, 2011 and 2012, respectively.