FALCON OIL & GAS LTD.

(A Development Stage Company)

Interim Consolidated Financial Statements

Six Months Ended June 30, 2009 and 2008

(Presented in U.S. Dollars)

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

	June 30, 2009	December 31, 2008
ASSETS		
Current assets		
Cash and cash equivalents	$ 25,875	$ 25,547
Restricted cash (Note 6)	1,020	-
Amounts receivable (Note 4)	2,045	10,365
Prepaids and other	1,113	1,537
Inventory available for sale	6,105	6,852
Total current assets	36,158	44,301
Property and equipment		
Petroleum and natural gas properties (Note 3)	245,704	237,020
Pipeline and facilities	3,888	3,888
Furniture and equipment, net	2,282	2,343
Total property and equipment	251,874	243,251
Other assets	5,968	11,150
Total assets	$ 294,000	$ 298,702

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

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

	June 30, 2009	December 31, 2008
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 3,003	$ 12,227
Long-term liabilities		
Convertible debentures (Note 6)	2,739	-
Asset retirement obligations (Note 5)	5,356	5,285
Total long-term liabilities	8,095	5,285
Total liabilities	11,098	17,512
Commitments and contingencies (Notes 1 & 11)		
Shareholders' equity (Notes 6 & 7)		
Share capital	329,982	331,179
Contributed surplus	29,339	24,005
Equity component of convertible debentures	5,057	-
Deficit accumulated during development stage	(81,476)	(73,994)
Total shareholders' equity	282,902	281,190
Total liabilities and shareholders' equity	$ 294,000	$ 298,702

On behalf of the Board:

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Petroleum revenue	$ 9	$ 25	$ 20	$ 44
Direct costs				
Production costs	18	5	19	12
Depreciation, depletion and accretion	91	94	183	188
	109	99	202	200
Costs and expenses				
Accounting	206	281	309	405
Depreciation and amortization	122	112	230	215
Consulting	300	374	823	669
Director fees	66	67	132	134
Investor relations	243	181	407	341
Legal costs	444	325	756	808
Office and administrative	709	665	1,345	1,194
Payroll and related costs	1,010	720	1,745	1,394
Stock-based compensation	1,570	3,731	2,962	5,113
Travel and promotion	578	539	906	1,004
	5,248	6,995	9,615	11,277
Other income (expense)				
Interest income	115	451	267	852
Impairment of petroleum and natural gas properties	(45)	-	(45)	-
Gain (loss) on foreign exchange	1,486	(868)	1,983	(1,280)
Other income (expense)	98	-	110	-
	1,654	(417)	2,315	(428)
Net income (loss) and comprehensive income (loss)	$ (3,694)	$ (7,486)	$ (7,482)	$ (11,861)
Net income (loss) per common share – basic and diluted	$ (0.006)	$ (0.013)	$ (0.012)	$ (0.021)
Weighted average number of common shares outstanding – basic and diluted	595,832,021	566,217,955	595,815,751	565,705,713

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

FALCON OIL & GAS LTD.

(A Development Stage Company)

INTERIM CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

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

(Unaudited)

	Shares	Share Capital	Contributed Surplus	Equity Component of Convertible Debentures	Deficit Accumulated During Development Stage
January 1, 2009	595,799,301	$ 331,179	$ 24,005	$ -	$ (73,994)
Common shares issued in Unit offering	2,977,500	1,030	263	5,057	-
Costs of Unit offering	-	(118)	-	-	-
Agents warrants (Note 6)	-	(2,109)	2,109	-	-
Stock based compensation	-	-	2,962	-	-
Net loss	-	-	-	-	(7,482)
June 30, 2009	598,776,801	$ 329,982	$ 29,339	$ 5,057	$ (81,476)

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Cash flows from operating activities				
Net income (loss)	$ (3,694)	$ (7,486)	$ (7,482)	$ (11,861)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities				
Stock-based compensation	1,570	3,731	2,962	5,113
Depreciation, depletion and accretion	213	206	413	403
Impairment of petroleum and natural gas properties	45	-	45	-
(Gain) loss on foreign exchange	(1,486)	868	(1,983)	1,280
Changes in non-cash working capital accounts				
Amounts receivable	2,731	(4,116)	8,496	(3,512)
Prepaids and other	(19)	(285)	378	(360)
Inventory available for sale	147	2,531	147	2,531
Accounts payable and accrued expenses	(7,061)	2,109	(7,691)	1,228
Net cash provided by (used in) operating activities	(7,554)	(2,442)	(4,715)	(5,178)
Cash flows from investing activities				
Restricted deposits	-	-	-	192
Proceeds from ExxonMobil, net of transaction costs	-	24,801	-	24,801
Petroleum and natural gas properties	(1,519)	(352)	(2,557)	(13,620)
Pipeline and facilities	-	-	-	(17)
Property and equipment	(101)	(181)	(168)	(518)
Other assets	(223)	-	(223)	-
Net cash provided by (used in) investing activities	(1,843)	24,268	(2,948)	10,838
Cash flows from financing activities				
Restricted cash	(1,020)	-	(1,020)	-
Proceeds from unit offering	10,302	-	10,302	-
Offering costs	(1,317)	-	(1,331)	-
Proceeds from exercise of warrants and stock options	-	546	-	546
Net cash provided by (used in) financing activities	7,965	546	7,951	546
Effect of exchange rate on cash	186	177	40	(1,291)
Cash and cash equivalents				
Net increase (decrease)	(1,246)	22,549	328	4,915
Beginning of period	27,121	38,358	25,547	55,992
End of period	$ 25,875	$ 60,907	$ 25,875	$ 60,907

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

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Supplemental schedule of cash flow information				
Cash paid for interest	$ -	$ -	$ -	$ -
Cash paid for income taxes	$ -	$ -	$ -	$ -
Non-cash investing and financing activities				
Acquisition of 25% working interest in Beetaloo Basin:				
Note receivable	$ 5,000	$ -	$ 5,000	$ -
Other assets	405	-	405	-
Asset retirement obligation	(98)	-	(98)	-
	$ 5,307	$ -	$ 5,307	$ -
Agent warrants issued in Unit offering reflected in other assets and share capital	$ 263	$ -	$ 263	$ -
Inventory available for sale reclassified to petroleum and natural gas properties	$ 600	$ -	$ 600	$ -
Petroleum and natural gas property costs in accounts payable	$ 574	$ 6,836	$ 903	$ 6,836

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

NOTE 1 – ORGANIZATION

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 Accounting Guideline No. 11. Falcon's operations are also conducted through 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"), an Australian company (collectively the "Company").

The Company has producing petroleum and natural gas properties in Alberta, Canada and exploration projects in Hungary and Australia. All of the Company's exploration projects 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 projects 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.

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying consolidated financial statements include Falcon and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The unaudited interim consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") for interim financial information using the same accounting policies and methods of application as the audited consolidated financial statements of the Company for the year ended December 31, 2008, except as noted below, and are presented in United States dollars. The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the amounts reported in the interim consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The interim consolidated financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality. These unaudited interim consolidated financial statements do not include all the information and note disclosures required by Canadian GAAP for annual financial statements and therefore should be read in conjunction with the Company's most recently reported annual audited consolidated financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 or, in certain circumstances, accelerated if the obligations are refinanced or extinguished, using the effective interest method.

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 periods presented.

ADOPTION OF NEW CANADIAN ACCOUNTING STANDARDS

(a) 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.

NEW CANADIAN ACCOUNTING STANDARDS

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

(a) 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 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.

(b) 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.

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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
January 1, 2009	**$ 210,926**	**$ 74**	**$ 29**	**$ 25,991**	**$ -**	**$ 237,020**
Acquisition costs	-	-	-	5,696	-	5,696
Exploration costs	978	-	16	2,058	-	3,052
Development costs	-	(4)	-	-	-	(4)
Depletion and depreciation	-	(15)	-	-	-	(15)
Impairment of petroleum and natural gas properties	-	-	(45)	-	-	(45)
June 30, 2009	**$ 211,904**	**$ 55**	**$ -**	**$ 33,745**	**$ -**	**$ 245,704**

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

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

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

HUNGARY

The Company holds a long-term Mining Plot (the "Production License") granted by the Hungarian Mining Authority. The lands within the Production License were formerly part of the Company's two petroleum and natural gas exploration licenses – the Tisza License and the Mako License (collectively, the "Exploration Licenses"). The Production License and the Exploration Licenses, covering approximately 575,700 acres, give the Company the exclusive right to explore for petroleum and natural gas on properties located in south central Hungary near the town of Szolnok. The Production License further gives the Company the exclusive right to commercially develop petroleum and natural gas within the area covered by that license. The Exploration Licenses expire on December 31, 2009, and are not eligible for extension. However, under the 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 filing an application for the mining plot within the second six-month period.

The Company is currently evaluating: (a) applications for one or more new exploration licenses that would include a portion of the lands currently included in the Exploration Licenses, (b) an application to extend the boundaries of the Production License to include a portion of the lands currently included in the Exploration Licenses, and/or (c) an application for a new production license, to include a portion of the lands currently included in the Exploration Licenses.

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

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

On April 10, 2008, Falcon and TXM entered into the Production and Development Agreement (the “PDA”), as amended, with ExxonMobil Corporation affiliate Esso Exploration International Limited (“ExxonMobil”) under which Falcon 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 are also parties to a joint operating agreement (the “JOA”), dated April 10, 2008, which governs all operations of the Contract Area that are not expressly addressed in the PDA. ExxonMobil is the operator of the Contract Area under the JOA.

The Contract Area consists of approximately 184,300 acres, or 75% of the Company’s 246,000-acre Production License. The Contract Area is now owned jointly, with the Company owning a 33% undivided working interest and ExxonMobil and MOL each owning a 33.5% undivided working interest. However, the Company’s Hungarian subsidiary, TXM, remains as the registered owner of the Production License under the records of the Hungarian Mining Authority.

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.

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. 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	(98)
Total	$ 5,551

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

NOTE 3 – PETROLEUM AND NATURAL GAS PROPERTIES (CONTINUED)

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 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, at which time it could either retain its 25% interest in the Five Wells and acquire no greater interest, or it could exercise an option (the "Buckskin Mesa Option") to acquire an additional 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. 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 obligations.

NOTE 4 – AMOUNTS RECEIVABLE

Amounts receivable at June 30, 2009 and December 31, 2008 is comprised of the following:

	2009	2008
Joint interest owners	$ 230	$ 6,541
Value added tax ("VAT") – Hungary, and goods and services tax ("GST") – Australia and Canada	1,074	2,567
Sale of inventory available for sale	-	1,133
Operator bonds (see Note 3)	469	-
Other	272	124
	$ 2,045	$ 10,365

NOTE 5 – ASSET RETIREMENT OBLIGATIONS

At June 30, 2009, the estimated total undiscounted amount required to settle the asset retirement obligations was $6,779. Costs for asset retirement have been calculated assuming a 5.0% inflation rate. These obligations will be settled based on the estimated useful lives of the underlying assets, which extend up to 20 years into the future. This amount has been discounted using a credit-adjusted risk-free interest rate of 6.5%. Changes to asset retirement obligations for the six months ended June 30, 2009 and the year ended December 31, 2008 were as follows:

	2009	2008
Asset retirement obligations – beginning of period	$ 5,285	$ 5,140
Liabilities incurred	13	145
Revisions to estimates	(12)	(339)
Liabilities settled	-	-
Liabilities conveyed	(98)	-
Accretion	168	339
Asset retirement obligations – end of period	$ 5,356	$ 5,285

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.

Optional Conversion Privilege

Each Debenture will be convertible into common shares of the Company ("Debenture Shares") at the option of the Debentureholder (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$0.60per 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. Debentureholders 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 Debentureholders 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 Debentureholders, 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 Salman Partners Inc., as 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 at an amount equal to 6% of the sum of the 2,977,500 Unit Shares and the 17,865,000 Debenture 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).

(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	$ 1,476	$ 1,701
Allocated to equity	118	136
	$ 1,594	$ 1,837
One year of escrowed interest payments at 11% per annum reflected in restricted cash	$ 1,020	$ 1,179

As of June 30, 2009, convertible debentures consist of the following:

Face amount	$ 9,272
Discount – equity component of convertible debentures	(5,057)
Offering costs attributable to convertible debentures	(1,476)
	$ 2,739

The discount and the offering costs will be accreted 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 basis 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. The following assumptions were used to calculate fair value:

	Equity component of convertible debentures	Agent Warrants
Expected term	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 – 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.

WARRANTS

A summary of the number of common shares reserved pursuant to the Company's outstanding share purchase warrants for the six months and year ended June 30, 2009 and December 31, 2008 is as follows:

	2009	2008
Balance, beginning of period	4,288,750	8,518,150
Agent warrants (Note 6)	1,250,550	-
Warrants exercised	-	(1,711,250)
Warrants expired	-	(2,518,150)
Balance, end of period	5,539,300	4,288,750

Common shares reserved for share purchase warrants outstanding as of June 30, 2009, are as follows:

Number of Shares	Exercise Price	Expiry Date
4,288,750	$0.39 (CDN$0.40)	December 17, 2009
1,250,550	$0.52 (CDN$0.60)	June 30, 2011
5,539,300		

As of June 30, 2009, the Company reclassified from share capital to contributed surplus 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. The following is a summary of those warrants:

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

NOTE 7 – SHAREHOLDERS' EQUITY (CONTINUED)

Offering Date	Expiry Date	Number of Shares	Exercise Price	Value
March 14, 2006	March 14, 2008	1,281,900	$1.12(CDN$1.30)	$ 434
August 10 & 25, 2006	August 10 & 25, 2008	1,236,250	$3.12(CDN$3.50)	1,212
December 17, 2007	December 17, 2009	4,288,750	$0.39(CDN$0.40)	463
				$ 2,109

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 Falcon's common shares 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 Falcon's common shares 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 (there were no grants during the six months ended June 30, 2009), all vest 20% at the date of grant, with the remainder vesting ratably at the anniversary date over the four years thereafter.

A summary of the status of the Company's stock option plan as of June 30, 2009 and December 31, 2008, and changes during the six and twelve months then ended, respectively, is presented below:

	2009		2008	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of period	46,950,000	$1.59	36,090,000	$1.90
Granted	-	-	13,610,000	$1.09
Exercised	-	-	-	-
Expired	(35,000)	$2.60	(1,342,000)	$3.45
Forfeited	(40,000)	$2.01	(1,408,000)	$2.91
Outstanding at end of period	46,875,000	$1.62	46,950,000	$1.59
Options exercisable at end of period	34,625,800	$1.52	29,986,000	$1.37

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

NOTE 7 – SHAREHOLDERS' EQUITY (CONTINUED)

The following summarizes information about stock options outstanding and exercisable at June 30, 2009:

Options Outstanding	Options Exercisable	Exercise price	Weighted average remaining contractual life	Expiry date
15,500,000	15,500,000	$0.25	0.75 years	April 2, 2010
2,450,000	2,450,000	$0.50	1.31 years	October 21, 2010
10,289,000	8,231,200	$3.98	1.85 years	May 7, 2011
4,951,000	2,970,600	$2.83	2.44 years	December 9, 2011
600,000	240,000	$0.54	3.13 years	August 17, 2012
1,000,000	400,000	$0.98	3.85 years	May 6, 2013
12,085,000	4,834,000	$1.19	3.96 years	June 5, 2013
46,875,000	34,625,800			

At June 30, 2009, the weighted average remaining contractual life of stock options outstanding is 2.12 years.

The weighted average fair value of the options granted during the six months ended June 30, 2008 was $0.82; there were no options granted during the six months ended June 30, 2009.

The Company measures compensation costs using the fair value-based method for employee and non-employee stock options. Compensation costs have been determined based on the fair value of the options at the grant date, for employees, and at the balance sheet for non-employees using the Black-Scholes option-pricing model. The following assumptions were used for stock options granted during the six months ended June 30, 2008 (there were no grants during the six months ended June 30, 2009):

	2008
Expected term of options	3.50 to 5.00 years
Risk-free interest rate	3.37% to 3.45%
Annualized volatility	119.37%
Dividend rate	Nil
Estimated forfeiture rate	Nil

Stock based compensation expense for the six months ended June 30, 2009 of $2,962 (2008-$5,113) was recorded in the consolidated statements of operations.

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

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

NOTE 8 – RELATED PARTY TRANSACTIONS

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

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 six months ended June 30, 2009, the Company incurred $181 (2008-$222) to two current directors of the Company 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 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:

	Hungary	Canada	Romania	Australia	United States	Total
Six months ended June 30, 2009						
Revenue	$ -	$ 20	$ -	$ -	$ -	$ 20
Net income (loss)	(455)	(3,278)	(45)	(88)	(3,616)	(7,482)
As of June 30, 2009						
Capital assets	217,470	55	-	33,745	604	251,874

	Hungary	Canada	Romania	Australia	United States	Total
Six months ended June 30, 2008						
Revenue	$ -	$ 44	$ -	$ -	$ -	$ 44
Net income (loss)	(1,758)	(6,264)	-	-	(3,839)	(11,861)
As of June 30, 2008						
Capital assets	217,340	136	21	-	618	218,115

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

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS

(a) Fair value

The fair value of financial instruments at June 30, 2009 and December 31, 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.

	June 30, 2009		December 31, 2008	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Financial assets:				
Held for trading				
Cash and cash equivalents	$ 25,875	$ 25,875	$ 25,547	$ 25,547
Restricted cash	1,020	1,020	-	-
Loans and receivables				
Amounts receivable	2,045	2,045	10,365	10,365
Financial liabilities:				
Other financial liabilities				
Accounts payable and accrued liabilities	3,003	3,003	12,227	12,227
Loans				
Convertible debentures	2,739	9,272	-	-

(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, interest rate risk, market risk and other price risks. Where material, these risks are reviewed and monitored by Falcon's 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.

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

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 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 exposed to interest rate risk as it has outstanding borrowings, but has no short term investments.

Fair Value Estimation

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

NOTE 11 – COMMITMENTS AND CONTINGENCIES

(a) ENVIRONMENTAL

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

(b) CONTINGENCIES

The Company may, from time to time, be involved in various claims, lawsuits, disputes with third parties, actions involving allegations of discrimination, or breach of contract incidental to the operations of its business. The Company is not currently involved in any such incidental litigation which it believes could have a materially adverse effect on its financial condition or results of operations.