Falcon Oil & Gas Ltd.

Interim Condensed Consolidated Financial Statements
Three Months Ended 31 March 2013 and 2012

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Falcon Oil & Gas Ltd.
Interim Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

	Notes	**Three months ended 31 March 2013 $'000**	Three months ended 31 March 2012 $'000
Revenue			
Oil and natural gas revenue	3	**3**	6
		3	6
Expenses			
Exploration and evaluation expenses		**(198)**	(685)
Production and operating expenses		**(5)**	(5)
Depletion and depreciation	8	**(145)**	(67)
General and administrative expenses		**(1,185)**	(1,545)
Share based compensation	10	**(95)**	(528)
Other income		**237**	137
		(1,391)	(2,693)
Results from operating activities		**(1,388)**	(2,687)
Fair value (loss) / gain – outstanding warrants	14	**(1,881)**	1,730
Finance income	4	**8**	47
Finance expense	4	**(1,485)**	(941)
Net finance expense		**(1,477)**	(894)
Net loss and comprehensive loss for the period		**(4,746)**	(1,851)
Net loss and comprehensive loss attributable to:			
Equity holders of the company	3	**(4,701)**	(1,760)
Non-controlling interests		**(45)**	(91)
Net loss and comprehensive loss for the period		**(4,746)**	(1,851)
Net Loss per share attributable to equity holders of the company:			
Basic and diluted	5	**(0.007 cents)**	(0.003 cents)

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

Falcon Oil & Gas Ltd.
Interim Condensed Consolidated Statements of Financial Position
(Unaudited)

	Notes	At 31 March 2013 $'000	At 31 December 2012 $'000
Assets			
Non-current assets			
Exploration and evaluation assets	7	**72,643**	74,019
Property, plant and equipment	8	**5,511**	5,703
Trade and other receivables		**564**	1,265
		78,718	80,987
Current assets			
Cash and cash equivalents		**27,107**	2,884
Restricted cash		**362**	386
Trade and other receivables		**1,261**	1,756
		28,730	5,026
Total assets		**107,448**	86,013
Equity and liabilities			
Equity attributable to owners of the parent			
Share capital	9	**362,878**	339,334
Contributed surplus		**41,953**	41,858
Retained deficit		**(338,980)**	(334,279)
		65,851	46,913
Non-controlling interests		**10,837**	10,882
Total equity		**76,688**	57,795
Liabilities			
Non-current liabilities			
Derivative financial liabilities	14	**4,126**	5,292
Decommissioning provision	15	**10,608**	10,955
		14,734	16,247
Current liabilities			
Accounts payable and accrued expenses		**3,130**	3,122
Convertible debentures	13	**9,775**	8,773
Derivative financial liabilities	14	**3,071**	26
Decommissioning provision	15	**50**	50
		16,026	11,971
Total liabilities		**30,760**	28,218
Total equity and liabilities		**107,448**	86,013

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

Falcon Oil & Gas Ltd.
Interim Condensed Consolidated Statements of Changes in Equity
(Unaudited)

	Notes	Share capital $'000	Contributed surplus $'000	Retained deficit $'000	Equity interests of the parent $'000	Non - Controlling interests $'000	Total equity $'000
At 1 January 2012		339,006	39,654	(316,838)	**61,822**	11,156	**72,978**
Share based compensation		-	528	-	**528**	-	**528**
Net loss for the period		-	-	(1,760)	**(1,760)**	(91)	**(1,851)**
At 31 March 2012		339,006	40,182	(318,598)	**60,590**	11,065	**71,655**
At 1 January 2013		339,334	41,858	(334,279)	**46,913**	10,882	**57,795**
Private placement	9	23,544	-	-	**23,544**	-	**23,544**
Share based compensation		-	95	-	**95**	-	**95**
Net loss for the period		-	-	(4,701)	**(4,701)**	(45)	**(4,746)**
At 31 March 2013		362,878	41,953	(338,980)	**65,851**	10,837	**76,688**

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

Falcon Oil & Gas Ltd.
Interim Condensed Consolidated Statements of Cash Flows
(Unaudited)

		Three months ended 31 March	
	Notes	**2013 $'000**	2012 $'000
Cash flows from operating activities			
Net loss for the period		**(4,746)**	(1,851)
Adjustments for:			
Share based compensation		**95**	528
Depletion and depreciation		**145**	67
Fair value (loss) / gain – outstanding warrants		**1,881**	(1,730)
Net finance expense		**1,477**	894
Other		**(126)**	(76)
Contribution to past costs - Chevron	7	**1,000**	-
Change in non-cash working capital	6	**(168)**	1,035
Interest received	4	**6**	20
Net cash used in operating activities		**(436)**	(1,113)
Cash flows from investing activities			
Exploration and evaluation assets		**-**	(2,324)
Proceeds from farm-out transaction – NIS	7	**1,500**	-
Property, plant and equipment		**-**	(18)
Net cash generated by / (used in) investing activities		**1,500**	(2,342)
Cash flows from financing activities			
Proceeds from private placement – March 2013		**25,072**	-
Transaction costs relating to private placement – March 2013		**(1,762)**	-
Net cash from financing activities		**23,310**	-
Change in cash and cash equivalents		**24,374**	(3,455)
Effect of exchange rates on cash & cash equivalents		**(151)**	111
Cash and cash equivalents at beginning of period		**2,884**	15,358
Cash and cash equivalents at end of period		**27,107**	12,014

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

1. General Information

Falcon Oil & Gas Ltd. is an oil and gas company engaged in the acquisition, exploration and development of unconventional and conventional oil and gas assets. Falcon's interests are located in Australia, Hungary, South Africa and Canada.

Falcon is incorporated in British Columbia, Canada and headquartered in Dublin, Ireland with a technical team based in Budapest, Hungary. Falcon's Common Shares are traded on the TSX Venture Exchange (symbol: FO.V); AIM, a market operated by the London Stock Exchange (symbol: FOG) and ESM, a market regulated by the Irish Stock Exchange (symbol: FAC).

2. Accounting policies

Basis of preparation and operations

These Interim Condensed Consolidated Financial Statements ("Interim Statements") of Falcon Oil & Gas Ltd and its subsidiaries ("The Group") have been prepared in accordance with IAS 34 'Interim Financial Reporting' and, except as described below, on the basis of the same accounting principles as, and should be read in conjunction with, the Consolidated Financial Statements for the year ended 31 December 2012 (pages 8 to 16) as filed on the Canadian Securities Administrator's System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

The following interpretations or amended standards are mandatory for the first time for the financial year beginning 1 January 2013, and are either not relevant to the Group or they do not have any significant impact on the condensed interim Statements:

- Amendments to IAS 1, 'Presentation of financial statements'
- Amendments to IAS 19, 'Employee benefits'
- Amendments to IFRS 7 'Financial Instruments' on Asset and Liability Offsetting
- IFRS 10,'Consolidated Financial Statements'
- IFRS 11,'Joint arrangements'
- IFRS 12, 'Disclosure of Interest in Other Entities'
- IAS 27 (revised), ' Separate Financial Statements'
- IAS 28 (revised),'Investments in Associates and Joint Ventures'
- Improvements to IFRSs (2009-2011)
- IFRS 9,'Financial instruments'

The adoption of the requirements of IFRS 13 'Fair value Measurement' has resulted in additional disclosures in these interim statements.

The Interim Statements are presented in United States dollars, the functional currency of all group entities. All amounts, except as otherwise indicated, are presented in thousands of dollars. CDN$ where referenced in the interim statements represents Canadian Dollars. £ / Stg where referenced in the interim statements represents British Pounds Sterling.

On 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange and the ESM market of the Irish Stock Exchange of the Company's existing share capital and the additional 120,381,973 new common shares in the capital of the Company issued pursuant to the concurrent conditional brokered private placement of new common shares at a price of Stg14 pence (CDN$0.215) per share raising gross proceeds of $25.7 million (£16.9 million) (note 9). Trading in these shares commenced on AIM and ESM on 28 March 2013.

Having given due consideration to the cash requirements of the Group and having raised capital in the gross amount of $25.7 million (note 9), the Board of Directors ("the Board") has a reasonable expectation that the Group will have adequate resources to continue in operational existence for the foreseeable future. For this reason, the Board continues to adopt the going concern basis in preparing this financial information which assumes the Group will be able to meet its liabilities as they fall due for the foreseeable future.

2. Accounting policies (continued)

Notwithstanding the Group's recent fundraising, the Group's ability to continue as a going concern is dependent upon either its ability to raise additional capital from the sale of additional common shares or other debt or equity instruments, asset dispositions, having producing assets and/ or entering into joint arrangement with third parties.

3. Segment information

Based on internal reporting information, it was determined that there is one reportable segment. 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 unproven petroleum and natural gas properties and interests in Australia, South Africa and Hungary.

The key performance measures reviewed for the segment which management believe is the most relevant information when evaluating the results of the Group are:

- the progress and extent to which farm out agreements have been executed over the Group's acreage; and
- cash flow, capital expenditure and operating expenses.

An analysis of the geographic areas is as follows:

	Australia $'000	**South Africa $'000**	**Hungary $'000**	**Ireland $'000**	**Canada $'000**	**United States $'000**	**Total $'000**
Three months ended 31 March 2013							
Revenue	**-**	**-**	**-**	**-**	**3**	**-**	**3**
Net loss (i)	**(118)**	**(5)**	**(524)**	**-**	**(3,987)**	**(67)**	**(4,701)**
At 31 March 2013							
Capital assets (ii)	**49,860**	**-**	**28,120**	**174**	**-**	**-**	**78,154**

	Australia $'000	South Africa $'000	Hungary $'000	Ireland $'000	Canada $'000	United States $'000	Total $'000
Three months ended 31 March 2012							
Revenue	-	-	3	-	3	-	6
Net (loss) / income (i)	(242)	(84)	(1,055)	-	241	(620)	(1,760)
At 31 March 2012							
Capital assets (ii)	48,527	-	27,188	-	-	150	75,865

(i) Net (loss) /income attributable to equity holders of the company.
(ii) Capital assets consist of exploration & evaluation assets and property, plant and equipment.

4. Finance income and expense

	Notes	Three months ended 31 March **2013** **$'000**	2012 $'000
Finance income			
Interest income on bank deposits		**6**	20
Derivative gains – unrealised[(i)]	14	**2**	27
		8	47
Finance expense			
Effective interest on loans and borrowings		**(1,435)**	(808)
Accretion of decommissioning provisions	15	**(36)**	(56)
Net foreign exchange loss		**(14)**	(77)
		(1,485)	(941)
Net finance expense		**(1,477)**	(894)

[(i)] Derivative gains – unrealised gains arising on the convertible debt conversion feature

5. Net loss per share

Basic and diluted loss per share is calculated as follows:

	Three months ended 31 March **2013** **$'000**	2012 $'000
Loss attributable to equity holders of the company	**(4,701)**	(1,760)
Weighted average number of common shares in issue - (thousands)	702,304	695,655
Loss per share	**(0.007 cents)**	**(0.003 cents)**

All outstanding convertible securities, options and warrants are excluded from the calculation of net loss per share as the effect of these assumed conversions and exercises is anti-dilutive.

6. Supplemental cash flow information

Changes in non-cash working capital is comprised of:

	Three months ended 31 March **2013** **$'000**	2012 $'000
Trade and other receivables	**277**	1,186
Inventories	**-**	51
Accounts payable and accrued expenses	**(445)**	(202)
	(168)	1,035

7. Exploration and evaluation assets

	Australia $'000	**South Africa $'000**	**Hungary $'000**	**Total $'000**
At 1 January 2013	**49,873**	**-**	**24,146**	**74,019**
Farm out: net of costs	**-**	**-**	**(1,011)**	**(1,011)**
Disposals	**(13)**	**-**	**(16)**	**(29)**
Reclassification	**-**	**-**	**32**	**32**
Decommissioning provision	**-**	**-**	**(368)**	**(368)**
At 31 March 2013	**49,860**	**-**	**22,783**	**72,643**

	Australia $'000	South Africa $'000	Hungary $'000	Total $'000
At 1 January 2012	48,221	-	22,756	70,977
Additions	1,652	-	-	1,652
Disposals	-	-	(140)	(140)
Decommissioning provision	-	-	1,530	1,530
At 31 December 2012	49,873	-	24,146	74,019

Exploration and evaluation ("E&E") assets consist of the Company's exploration projects which are pending the determination of proven or probable reserves. Additions represent the Company's costs incurred on E&E assets during the period.

<u>Beetaloo Basin, Northern Territory, Australia</u>

Falcon Australia, Falcon's 72.7% owned subsidiary, is the registered holder of four exploration permits covering approximately 7 million acres (approximately 28,000 km^2) in the Beetaloo Basin, a sparsely populated area of the Northern Territory.

In April 2011, Falcon Australia entered into a joint venture with Hess Australia (Beetaloo) Pty. Ltd, whereby Hess agreed to collect seismic data over an area covering three of the four Beetaloo Exploration Permits, excluding an area covering approximately 100,000 acres (approximately 405 km^2) surrounding the Shenandoah-1 well-bore (the "Area of Interest").

Under the terms of the E&P Agreement, Hess paid $20.0 million to the Company (i) as a participation fee for the exclusive right to conduct operations for the exploration, drilling, development and production of hydrocarbons from the Area of Interest and (ii) as consideration for warrants to acquire 10,000,000 common shares in the capital of Falcon exercisable from 14 November 2011 through 13 January 2015 at an exercise price of CDN$0.19 per share (the "Hess Warrants"). The $20.0 million of gross proceeds received from Hess in 2011 were reduced by closing costs of $1.3 million resulting in net proceeds of $18.7 million which were allocated $17.7 million to the farm-out transaction and $0.9 million to the warrants.

In November 2011, Falcon Australia, in accordance with the work program for Permit EP 98, completed the testing and stimulation of the Shenandoah-1 well at its sole cost, and the well has been plugged and abandoned. Falcon Australia provided Hess with the data obtained from these activities, and Hess paid Falcon Australia $2.0 million.

Since the date of this agreement, Hess has spent in excess of $55 million acquiring 3,490 kilometres of 2D seismic data which is currently being interpreted. Hess has the option, exercisable until 30 June 2013, to acquire a 62.5% working interest in the Area of Interest by committing to drill and evaluate five exploration wells at Hess' sole cost, one of which must be a horizontal well. All costs to plug and abandon the five exploration wells will also be borne solely by Hess. The drilling and evaluation of the five exploration wells must meet the minimum work requirements of the work program. Costs to drill wells after the five exploration wells will be borne 62.5% by Hess and 37.5% by Falcon Australia.

7. Exploration and evaluation assets (continued)

Karoo Basin, South Africa

Falcon holds a Technical Cooperation Permit ("TCP") covering an area of approximately 7.5 million acres (approximately 30,327 km^2) onshore Karoo Basin, South Africa.

The TCP grants Falcon an exclusive right to apply for an exploration right over the underlying acreage. In February 2011, a moratorium on the processing of all new applications relating to the exploration and production of shale gas in the Karoo Basin was put in place, and in April 2011 the processing of all existing applications was suspended whilst the South African Department of Mineral Resources conducted an environmental study on the effects of hydraulic stimulation and developed a system to regulate onshore exploration activities. In September 2012, the South African Government announced a decision to lift the moratorium on the processing of existing shale gas exploration permit applications following the publication of legislation, and consequently the company is awaiting exploration rights to be awarded.

In December 2012, Falcon entered into a cooperation agreement with Chevron Business Development South Africa Ltd. ("Chevron") to jointly seek unconventional exploration opportunities in the Karoo Basin. The Chevron Agreement provides for Falcon to work exclusively with Chevron for a period of five years to jointly seek to obtain exploration rights in the Karoo Basin subject to the parties mutually agreeing participation terms applicable to each right.

All expenditures and recoveries of costs associated with the TCP and with the application for the exploration permit are charged/ credited to operations as exploration and evaluation expenses.

Makó Trough, Hungary

Falcon began operations in Hungary in 2005 and it is the most progressed asset in the Group's portfolio. Falcon's subsidiary, TXM, holds the 35-year Makó Production Licence covering an area of approximately 245,775 acres (approximately 1,000 km^2) located in the Makó Trough, part of the greater Pannonian Basin of central Europe. The Makó Licence is located approximately ten kilometres from the MOL Group owned and operated Algyö field. The Makó Licence area is transected by existing gas pipelines, including a 12 kilometre gas pipeline built by Falcon in 2007, which together offer potential access to local and international markets.

The Makó Trough contains two distinct plays:

- a play targeting gas prospects in the shallower Algyö Play at depths between 2,300 metres and 3,500 metres; and
- a deeper unconventional play targeting significant contingent resources in the Deep Makó Trough.

In January 2013, Falcon agreed a three-well drilling exploration programme with Naftna industrija Srbije jsc ("NIS"), owned 56% by Gazprom Group, to target the Algyö Play ("the agreement area"). NIS has made a cash payment of $1.5 million to Falcon in 2013, which was recorded net of costs of $0.5 million against the carrying amount of the E&E asset in Hungary; and agreed to drill three exploration wells by July 2014. NIS will earn 50% of net production from the first three wells, and has the option to participate in any future drilling on terms to be negotiated, after paying Falcon $2.75 million. Falcon is to be fully carried on the drilling and testing of the initial three exploration wells.

If NIS does not fulfill their drilling obligations under the participation agreement, TXM will retain 100% interest in the Agreement Area.

If the NIS earn-in is completed, NIS and TXM will share future exploration, appraisal and development costs and production in the Agreement Area in accordance with their participating interests held under a joint operating agreement. TXM shall be the Operator under both the participation agreement and the joint operating agreement.

8. Property, plant and equipment

	Canadian natural gas interests $'000	**Pipeline and facilities $'000**	**Furniture and equipment $'000**	**Total $'000**
Cost:				
At 1 January 2013	**466**	**4,284**	**2,647**	**7,397**
Decommissioning provision	**-**	**(15)**	**-**	**(15)**
Reclassification	**-**	**(57)**	**25**	**(32)**
At 31 March 2013	**466**	**4,212**	**2,672**	**7,350**
Depletion, depreciation and amortisation:				
At 1 January 2013	**(466)**	**-**	**(1,228)**	**(1,694)**
Depletion and depreciation	**-**	**-**	**(145)**	**(145)**
At 31 March 2013	**(466)**	**-**	**(1,373)**	**(1,839)**
Net book value:				
At 31 March 2013	**-**	**4,212**	**1,299**	**5,511**

	Canadian natural gas interests $'000	Pipeline and facilities $'000	Furniture and equipment $'000	Total $'000
Cost:				
At 1 January 2012	466	3,831	3,385	7,682
Additions	-	-	375	375
Decommissioning provision	-	453	-	453
Disposals	-	-	(1,113)	(1,113)
At 31 December 2012	466	4,284	2,647	7,397
Depletion, depreciation and amortisation:				
At 1 January 2012	(466)	-	(1,992)	(2,458)
Depletion and depreciation	-	-	(342)	(342)
Disposals	-	-	1,106	1,106
At 31 December 2012	(466)	-	(1,228)	(1,694)
Net book value:				
At 31 December 2012	-	4,284	1,419	5,703

9. Share capital

At 31 March 2013 and 31 December 2012, the Company was authorised to issue an unlimited number of common shares, without par value.

The following is a reconciliation of issued and outstanding common shares:

	Number of shares	**Share capital $'000**
At 1 January 2012	695,654,500	339,006
Options exercised	1,000,000	274
Issuance of shares to a former officer	300,000	54
At 31 December 2012	**696,954,500**	**339,334**
Private Placement – March 2013	**120,381,973**	**25,668**
Transaction costs associated with placing – March 2013	**-**	**(2,124)**
At 31 March 2013	**817,336,473**	**362,878**

On 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange and the ESM market of the Irish Stock Exchange of the Company's existing share capital and the additional 120,381,973 new common shares in the capital of the Company issued pursuant to the concurrent conditional brokered private placement of new common shares at a price of Stg14 pence (CDN$0.215) per share raising gross proceeds of $25.7 million (£16.9 million). Trading in these shares commenced on AIM and ESM on 28 March 2013.

10. Share based compensation

The Group, 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 discounted 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 at the grant date of the options granted. These amounts are recorded as contributed surplus. Any consideration paid on the exercise of these options together with the related contributed surplus associated with the exercised options is recorded as share capital. The Group incurred share based expense of $0.1 million during the three months ended 31 March 2013 (three months ended 31 March 2012: $0.6 million).

A summary of the Group's stock option plan as of 31 March 2013 and 31 December 2012 and changes during the periods then ended, is presented below:

	2013		2012	
	Number of options	**Weighted average exercise price CDN$**	Number of options	Weighted average exercise price CDN$
Outstanding as at beginning of period	**32,837,000**	**0.35**	29,764,500	0.41
Granted	**-**	**-**	6,000,000	0.10
Expired	**-**	**-**	(978,333)	0.73
Forfeited	**-**	**-**	(949,167)	1.10
Exercised	**-**	**-**	(1,000,000)	0.15
Outstanding as at end of period	**32,837,000**	**0.35**	32,837,000	0.35
Exercisable as at end of period	**21,323,667**	**0.48**	21,323,667	0.48

10. Share based compensation (continued)

During the year ended 31 December 2012, the Company granted 6 million options at an exercise price of CDN$0.10 per share. These options vest 1/3 ratably at the anniversary date over three years, and have an expiry date of 1 May 2017.

11. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

(i) *Cash & cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses*
The fair value of cash & cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. As at 31 March 2013 and 31 December 2012, the fair value of accounts receivable, accounts payable and accrued expenses approximated their carrying value due to their short term to maturity.

(ii) *Derivatives*
The fair value of the conversion feature embedded in the convertible note, the private placement and Hess warrants and the incentive stock options granted to employees is calculated using a Black Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends, and the risk-free interest rate (based on government bonds). A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of incentive stock options that vest.

(iii) *Convertible debentures*
The fair value of host contract of the convertible debentures is determined for disclosure purposes by calculating the present value of the expected future cash flow using the market rate of interest at the reporting date.

12. Financial Instruments and risk management

The following tables provide fair value measurement information for financial assets and liabilities as at 31 March 2013 and 31 December 2012. The carrying value of cash & cash equivalents, restricted cash, accounts receivable, accounts payable and accrued expenses included in the consolidated statement of financial position approximate fair value due to the short term nature of those instruments.

		31 March 2013		31 December 2012
	Carrying value $'000	**Fair value $'000**	Carrying value $'000	Fair value $'000
Financial assets:				
Cash and cash equivalents including restricted cash	**27,469**	**27,469**	3,270	3,270
Loans and receivables:				
Accounts receivable	**1,825**	**1,825**	3,021	3,021
Financial Liabilities:				
Other financial liabilities				
Accounts payable and accrued expenses	**3,130**	**3,130**	3,122	3,122
Convertible debentures	**9,775**	**11,014**	8,773	11,014

12. Financial Instruments and risk management (continued)

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1 Fair Value Measurements
- Level 1 fair value measurements are based on unadjusted quoted market prices.

Level 2 Fair Value Measurements
- Level 2 fair value measurements are based on valuation models and techniques where the significant inputs are derived from quoted indices.

Level 3 Fair Value Measurements
- Level 3 fair value measurements are based on unobservable information. No financial assets or liabilities have been valued using the Level 3 fair value measurements.

	Carrying amount $'000	**Fair value $'000**
31 March 2013		
Financial liabilities:		
Conversion feature – convertible debt	**24**	**24**
Private placement warrants	**6,090**	**6,090**
Hess warrants	**1,083**	**1,083**
31 December 2012		
Financial liabilities:		
Conversion feature – convertible debt	26	26
Private placement warrants	4,505	4,505
Hess warrants	787	787

All instruments in the table are Level 2 instruments.

13. Convertible debentures

On 30 June 2009, the Company completed an offering 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 (30 June 2013) pursuant to the terms of a trust indenture dated 30 June 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 1 January and 1 July in each year commencing 1 January 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 may be converted 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.

13. Convertible debentures (continued)

No fractional shares will be issued. Notwithstanding the foregoing, no Debentures may be converted during the 10 business days preceding and including 1 January and 1 July in each year, commencing 1 January 2010 as the registers of the Indenture Trustee (as defined in the Trust Indenture) will be closed during such periods. The optional conversion privilege is an embedded derivative for accounting purposes and recorded as a liability at fair value.

As at 31 March 2013, the face value of the convertible debentures, due on maturity at 30 June 2013, is CDN$10.7 million.

As at 31 March 2013, the convertible debentures are recorded at $9.8 million.

14. Derivative liabilities

Derivative liabilities consist of the fair value of the convertible debt conversion feature, the fair value of the private placement warrants and the fair value of the Hess warrants. Changes in the fair value of the derivative liabilities are recorded in the Consolidated Statements of Operations and Comprehensive loss. The composition of the derivative liabilities as at 31 March 2013 and 31 December 2012, and the changes therein for the periods then ended, are as follows:

	Convertible Debt Conversion Feature $'000	Private Placement Warrants $'000	Hess Warrants $'000	Total $'000
At 1 January 2012	41	2,652	621	3,314
Derivative gains - unrealised – Debt conversion feature	(15)	-	-	(15)
Derivative loss - unrealised – outstanding warrants	-	1,853	166	2,019
At 31 December 2012	26	4,505	787	5,318
Derivative gains – unrealised - Debt conversion feature	**(2)**	**-**	**-**	**(2)**
Derivative loss – unrealised – outstanding warrants	**-**	**1,585**	**296**	**1,881**
At 31 March 2013	**24**	**6,090**	**1,083**	**7,197**

The fair value of the derivative liabilities is analysed between non-current and current below:

	Convertible Debt Conversion Feature $'000	Private Placement Warrants $'000	Hess Warrants $'000	Total $'000
Non-current	-	3,043	1,083	4,126
Current	24	3,047	-	3,071
At 31 March 2013	**24**	**6,090**	**1,083**	**7,197**

33,400,000 of the private placement warrants expire on 10 February 2014 and the remaining 31,887,500 warrants expire on 8 April 2014. The Hess warrants expire on 13 January 2015.

15. Provisions

(i) *Decommissioning provision*
A reconciliation of the decommissioning provision for the period ended 31 March 2013 and the year ended 31 December 2012 is provided below:

	2013 $'000	2012 $'000
Balance as at beginning of period	**11,005**	8,813
Revision to provisions	**(383)**	1,983
Accretion	**36**	209
Balance as at end of period	**10,658**	11,005
Non-current	**10,608**	10,955
Current	**50**	50
Balance as at end of period	**10,658**	11,005

The Group's decommissioning provision results from its ownership interest in oil and natural gas assets. The total decommissioning provision is estimated based on the Group's net ownership interest in the wells, estimated costs to reclaim and abandon these wells and the estimated timing of the costs to be incurred in future years. The Group's has estimated the net present value of the decommissioning provision to be $10.7 million as at 31 March 2013 (31 December 2012: $11.0 million) based on an undiscounted total future liability of $13.3 million. These payments are expected to be made over approximately the next 20 years with the majority of costs to be incurred between 2027 and 2031. The discount factor, being the risk free rate related to the liability, was 1.35% as at 31 March 2013 (31 December 2012: 1.3%).

(ii) *Restructuring provision*
During 2012 the Group relocated its corporate headquarters from Denver, Colorado to Dublin, Ireland. The finance and executive function moved to Dublin while the primary technical function shifted to the company's well established Hungarian office in Budapest where the company operates exploration and producing interests. In connection with that decision, all individuals and consultants in Denver were terminated. The Denver office closed on 28 September 2012.

The movement in the provision to 31 December 2012 and 31 March 2013 is as follows.

	Severance & health benefits $'000	**Rent expense net of sublease $'000**	**Other $'000**	**Total $'000**
At 1 January 2012	-	-	-	-
Charged during the year	567	176	49	792
Utilised	(375)	(36)	(15)	(426)
At 31 December 2012	192	140	34	366
Utilised during the period	**(190)**	**(12)**	**(5)**	**(207)**
At 31 March 2013	**2**	**128**	**29**	**159**

16. Related party transactions

The following are the related party transactions which occurred during the period:

Dr. György Szabó Consulting Agreement
On 27 February 2009, Dr. György Szabó entered into a consulting agreement (the "GS Consulting Agreement") with Falcon TXM ("TXM"), pursuant to which Dr. Szabó agreed to act as Managing Director of TXM, to perform certain oil and gas services for TXM and to not compete directly or indirectly with TXM during his employment with TXM. Dr. Szabó is paid a monthly fee of $5,000. The GS Consulting Agreement contains standard confidentiality provisions. TXM may terminate the GS Consulting Agreement at any time, with or without cause, for any lawful reason whatsoever, upon TXM providing Dr. Szabó with sixty days' prior written notice.

The GS Consulting Agreement expired on 31 December 2009, however Dr. Szabó has continued to provide general managerial services to TXM and to receive the same monthly fee. Dr. Szabó was paid $15,000 pursuant to the GS Consulting Agreement in Quarter 1, 2013.

P&S Consulting Agreement
On 4 May 2005, P&S Mérnöki Kereskedelmi-Tanácsadó Bt. ("P&S") entered into a consulting agreement (the "P&S Agreement") with TXM, pursuant to which P&S agreed to provide certain consulting services to TXM in connection with TXM's objectives of drilling wells on the Makó and Tisza licences. The P&S Agreement was amended on 28 November 2005 and further amended on 1 June 2006, 1 January 2008, 1 January 2009 and 1 April 2010. P&S is wholly-owned by a family member of Dr. Szabó, a current Director of the Company.

Under the terms of the P&S Agreement, TXM was obligated to pay P&S a monthly services fee of HUF 750,000. The P&S Agreement contains standard confidentiality provisions and provides that P&S shall not compete with TXM during the term of the P&S Agreement.

TXM may terminate the P&S Agreement at any time, with or without cause, for any lawful reason whatsoever, upon TXM providing P&S with 30 days prior written notice. TXM and P&S have further amended the terms of the P&S Agreement by oral agreement. Pursuant to the amended P&S Agreement, P&S is paid a monthly fee of $8,500 (effective 1 January 2013) (2012: $10,000) plus reasonable expenses incurred by Dr. Szabó as an employee of P&S, such amounts thereafter paid to Dr. Szabó from P&S. P&S was paid $25,500 pursuant to the agreement in Quarter 1, 2013.

Dr. Gábor Bada
On 28 December 2012, Dr. Bada entered into an employment agreement (the "Bada Employment Agreement") with TXM pursuant to which Dr. Bada agreed, subject to certain conditions, to perform certain geological services for TXM. In addition, on 1 January 2013, Dr. Bada verbally agreed the terms on which he was to provide geological services to TXM as a consultant. Dr. Bada will be paid a consultancy fee of $20,000 in 2013 in relation to this work. The Bada Employment Agreement contains standard confidentiality provisions. Dr. Gábor Bada received a consultancy fee of $5,000 through his company in Quarter 1, 2013.

March 2013 Private placement
As noted above on 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange and the ESM market of the Irish Stock Exchange of the Company's existing share capital and the additional 120,381,973 new common shares in the capital of Falcon issued pursuant to the concurrent conditional brokered private placement of new common shares at a price of Stg14 pence (CDN$0.215) per share to raising gross proceeds of $25.7 million (£16.9 million). The following deemed related parties, have participated in the Placing:

Directors	**Previous shareholding**	**March 2013 placing participation**	**Enlarged shareholding**	**% of enlarged share capital**
John Craven	500,000	2,357,143	2,857,143	0.35%
Philip O'Quigley	1,000,000	513,696	1,513,696	0.19%
Gregory Smith	420,000	50,000	470,000	0.06%
David Harris	-	150,000	150,000	0.02%

17. Subsequent events

On 30 April 2013, the Group announced that under the stock option plan approved at Falcon's annual shareholders meeting held on 25 September 2012, it has granted incentive stock options ("options") to purchase an aggregate of 9.9 million common shares of Falcon. A total of 3 million options were granted at an exercise price of CDN$0.215 to Eoin Grindley, Falcon's Chief Financial Officer pursuant to the terms of his employment contract. A further 5.5 million options were granted at an exercise price of CDN$0.24 to Falcon directors and 1.4 million options were granted to Falcon employees also at CDN$0.24. The options all have a vesting schedule allowing for 1/3 of the options to vest on the first anniversary of the grant with an additional 1/3 vesting each subsequent year until the options are fully vested on 30 April 2016, and an expiry date of the options of 29 April 2018. After this award, there were 42,737,000 options outstanding, representing 5.2% of the issued share capital of the company.

On 24 May 2013, the Group announced that it has executed a conditional agreement with Sweetpea Petroleum Pty Ltd, a wholly-owned subsidiary of PetroHunter Energy Corporation ("Sweetpea") (the "Agreement"), to acquire its 50 million shares or 24.22% interest in Falcon Oil & Gas Australia Limited ("FOGA") (the "Share Purchase"). FOGA is a subsidiary of Falcon and is the registered holder of four exploration permits in the Beetaloo Basin, Northern Territory, Australia. Falcon currently owns 150 million shares in FOGA representing 72.68% of the issued share capital of FOGA. Upon completion of the Agreement, Falcon's shareholding in FOGA will increase to 200 million shares representing 96.90% of the issued share capital of FOGA. The terms of the Agreement include a cash consideration of US$3 million together with the issue of 97.86 million Falcon shares ("New Falcon Shares") to Sweetpea. Based on Falcon's share price, at the time the Share Purchase was agreed between the parties of CAD 0.20, the total value of the consideration is CAD 22.6 million. Upon completion of the Agreement, Sweetpea's shareholding in the enlarged share capital of Falcon will be 10.7%. The New Falcon Shares will be held in an Escrow account with the New Falcon Shares locked up for three years, and Sweetpea, commencing on the date of closing, being permitted to sell 15% each year during the lock up period. The Agreement is conditional on, *inter alia*, approval by a requisite majority of FOGA shareholders entitled to vote. A Notice of Meeting will be sent to the shareholders of FOGA once regulatory approval of the deal has been received from the Australian Securities & Investments Commission and it is hoped that the Share Purchase can then be completed by the end of June 2013. The Share Purchase is also subject to TSX Venture Exchange approval.

18. Approval of Interim Statements

These Interim Statements were approved by the Audit Committee as delegated by the Board of Directors and authorised for issue on 29 May 2013.

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