# FALCON OIL & GAS LTD.

## FORM 51-102F1
## MANAGEMENT'S DISCUSSION AND ANALYSIS
## FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2011

The following Management's Discussion and Analysis (the "**MD&A**") was prepared as at August 26, 2011 and is management's assessment of Falcon Oil & Gas Ltd's ("**Falcon**") financial and operating results and provides a summary of the financial information of the Company for the three and six months ended June 30, 2011. This MD&A should be read in conjunction with the unaudited condensed consolidated financial statements for the three and six months ended June 30, 2011 and 2010, and the audited consolidated financial statements and MD&A for the year ended December 31, 2010. The June 30, 2011 and 2010 unaudited condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("**IFRS**").

The information provided herein in respect of Falcon includes information in respect of its wholly-owned operating 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, and its majority owned subsidiary, Falcon Oil & Gas Australia Limited ("**Falcon Australia**") (collectively, the "**Company**").

Additional information related to the Company, including the Company's Annual Information Form ("**AIF**") for the year ended December 31, 2010 dated May 2, 2011, can be found on the System for Electronic Document Analysis and Retrieval (**"SEDAR"**) at www.sedar.com and Falcon's website at www.falconoilandgas.com.

**Forward-looking Statements**

Forward-looking statements include, but are not limited to, statements with respect to: the focus of capital expenditures; the sale, farming in, farming out or development of certain exploration properties using third party resources; the impact of changes in petroleum and natural gas prices on cash flow; drilling plans; processing capacity; operating and other costs; the existence, operation and strategy of the commodity price risk management program; the approximate and maximum amount of forward sales; the Company's acquisition strategy, the criteria to be considered in connection therewith and the benefits to be derived there from; the Company's goal to sustain or grow production and reserves through prudent management and acquisitions; the emergence of accretive growth opportunities; the Company's ability to benefit from the combination of growth opportunities and the ability to grow through the capital markets; development costs and the source of funding thereof; the quantity of petroleum and natural gas resources or reserves; treatment under governmental regulatory regimes and tax laws; liquidity and financial capital; the impact of potential acquisitions and the timing for achieving such impact; expectations regarding the ability to raise capital and continually add to reserves through acquisition and development; the performance characteristics of the Company's petroleum and natural gas properties; and realization of the anticipated benefits of acquisitions and dispositions.

Some of the risks and other factors, which could cause results to differ materially from those expressed in the forward-looking statements include, but are not limited to: general economic conditions in Canada, the United States of America (the "**United States**"), the Republic of Hungary ("**Hungary**"), the Commonwealth of Australia ("**Australia**"), the Republic of South Africa ("**South Africa**") and globally; supply and demand for petroleum and natural gas; industry conditions, including fluctuations in the price of petroleum and natural gas; governmental regulation of the petroleum and natural gas industry, including income tax, environmental and regulatory matters; fluctuation in foreign exchange or interest rates; risks and liabilities inherent in petroleum and natural gas operations, including exploration, development, exploitation, marketing and transportation risks; geological, technical, drilling and processing problems; unanticipated operating events which can reduce production or cause production to be shut-in or delayed; the ability of our industry partners to pay their proportionate share of joint interest billings; failure to obtain industry partner and other third party consents and approvals, when required; stock market volatility and market valuations; competition for, among other things, capital, acquisition of reserves, processing and transportation capacity, undeveloped land and skilled personnel; the need to obtain required approvals from regulatory authorities; and the other factors considered under "Risk Factors" in the AIF.

In addition, other factors not currently viewed as material could cause actual results to differ materially from those described in the forward-looking statements.

**Dollar Amounts**

All dollar amounts below are in United States dollars, except as otherwise indicated. **Adoption of International Financial Reporting Standards**

Falcon adopted International Financial Reporting Standards as the Company's GAAP, effective January 1, 2011. The impact of adopting IFRS is disclosed in Note 14 of the unaudited condensed consolidated financial statements for the three and six months ended June 30, 2011. The Company's 2010 comparative financial information has been restated accordingly with details provided in Note 14 of the unaudited condensed consolidated financial statements as at and for the three and six months ended June 30, 2010.

## OVERVIEW OF BUSINESS AND OVERALL PERFORMANCE

**About Falcon**

The Company is an international energy company engaged in the business of acquiring, exploring and developing petroleum and natural gas properties, with offices in Vancouver, British Columbia, Denver, Colorado, Budapest, Hungary and Sydney, Australia. The Company's registered office is located at 810-675 West Hastings Street, Vancouver, British Columbia, Canada V6B 1N2 and the Company's head office is located at 1875 Lawrence Street, Suite 1400, Denver, Colorado, U.S.A. 80202.

The Company's primary focus is the acquisition, exploration and development of conventional and unconventional petroleum and natural gas projects in Central Europe (specifically Hungary), Australia and South Africa.

**Beetaloo Basin, Northern Territory, Australia**

Falcon Australia is the registered owner of four exploration permits ("the **Permits**"), comprising 7,000,000 acres in the Beetaloo Basin, Northern Territory, Australia

The Permits are subject to a government royalty of 10% and non-government royalties of 13%-14%.

*Hess Participation Agreement*

On June 28, 2011, all conditions precedent to closing of the Evaluation and Participation Agreement (the "**E&P Agreement**") entered into on April 28, 2011 between Falcon Australia and Hess Australia

(Beetaloo) Pty Ltd. (“**Hess**”) were satisfied. By the terms of the E&P Agreement, in July 2011 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 three of the four Permits, and excluding an area comprising 100,000 acres surrounding the Shenandoah-1 well (the “**Area of Interest**”) and (ii) as consideration for warrants to acquire 10,000,000 common shares in the capital of Falcon at an exercise price of CDN$0.19 per share. The warrants are exercisable commencing on November 14, 2011, and expire on January 13, 2015.

Hess shall acquire seismic data, at its sole cost of at least $40.0 million, over the Area of Interest within 18 months of the execution of the E&P Agreement. After acquiring the seismic data, Hess shall have the right to acquire a 62.5% working interest in the Area of Interest. If Hess acquires the working interest, they commit to drill and evaluate five exploration wells at their 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.

Under existing agreements with two advisors, the Company is obligated to pay a “success fee” in the aggregate amount of 5% for services provided in conjunction with the E&P Agreement with Hess. The success fee is based on the cash or cash-equivalent value of any net amount received directly or indirectly by the Company, including the participation fee, cost of seismic data commitment and cost of drilling commitment.

The transaction received all governmental and regulatory consents, including the TSX Venture Exchange (“**TSX-V**”).

Under a revised work program approved by the Northern Territory of Australia Government, Department of Resources on July 6, 2011 for Permits EP 76, EP 98, and EP 117, the Company’s required minimum work program obligations, in order to continue to hold the underlying Permits (including EP 99) in the Beetaloo Basin, are to expend $27,100,000 and $13,600,000 during the years ending December 31, 2011 and 2012, respectively, of which $16,000,000 (2012 - $9,900,000) is for the acquisition of seismic which will be borne by Hess under the E&P Agreement.

Additionally, by December 31, 2011, Falcon Australia must test and complete the Shenandoah-1 well at their sole cost, and in accordance with the work program. After testing and completion, Falcon Australia must provide Hess copies of the data obtained from such activities, and Hess must pay Falcon Australia $2.0 million for the data.

*Operational Highlights*

In February 2010, the Company commenced service tendering exercises for the 2010 work program, with the intentions of commencing drilling and completion activities in July/August 2010. Abnormal rains and flooding throughout the Australian states of Northern Territory, Queensland and New South Wales had a significant impact on work progress and affected service companies’ ability to honor their commitment to perform the contracted services and provide the equipment required for the 2010 drilling and completion activities. As a result, the Company requested, and received in June 2010, notice from the Northern Territory Government Department of Resources that its 2010 work commitment obligation for EP 98 has been extended to December 31, 2011.

In July 2011, the Company commenced access and well site preparation for the 2011 completion and testing program for the Shenandoah 1 well. The program was delayed until July due to extraordinary rainfall in the Northern Territories at the beginning of the year. It is anticipated that the 2011 testing program will be completed in the fourth quarter.

**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 Makó License (collectively, the "**Exploration Licenses**"). The Production License, covering approximately 245,700 acres, gives the Company 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 the Company the exclusive right to commercially develop petroleum and natural gas within the area covered by that license. The Production License incorporates depths beginning at 7,546 feet (2,300 meters) from the surface, and extends to the basement of the Makó Trough, Pannonian hydrocarbon accumulation.

*Makó Production License Letter of Intent*

On June 9, 2011, the Company's wholly owned Hungarian subsidiary, TXM, entered into a Letter of Intent with Naftna Industrija Srbije, j.s.c. Novi Sad ("**NIS**") for the earning by NIS of an interest in producing the Algyö play within the Makó Production License in Hungary in an area of approximately 995 square kilometers, from a depth of 2,300m down to the base of the Algyö Formation (the "**Agreement Area**"). TXM will retain all rights within the entire Production License deeper than the base of the Algyö Formation such as the Szolnok and Endröd formations. Under the terms of the Letter of Intent, NIS is required to make a $1,500,000 payment to TXM upon signing of a participation agreement. NIS shall then, at its sole cost, drill, test and complete three wells in the Agreement Area. These wells, to be drilled and tested before December 31, 2012, shall be located such that each well tests an independent Algyö prospect. NIS will earn a 50% interest in production from each prospect if the discovery well is tied in and placed on production at the sole cost of NIS. After the drilling of the three wells is completed, NIS has the right to acquire a 50% interest in production from the entire Agreement Area by paying TXM an additional $2,750,000 (the "**NIS earn-in**"). If NIS does not fulfill their drilling obligations under the participation agreement, TXM will retain 100 percent 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.

The transaction as a whole is subject to receipt of all governmental and regulatory consents.

**Karoo Basin, South Africa**

On October 27, 2009, the Company secured a Technical Cooperation Permit (the "TCP") to evaluate the Karoo Basin in central South Africa. The Company had 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. Falcon's application for an exploration permit covering the TCP was accepted on September 7, 2010. Falcon has not yet been awarded the exploration permit due to a moratorium in South Africa while the government reviews its policy and regulations regarding fracture stimulated wells. Falcon's exploration application does not include any well drilling or fracture stimulation in the first 3 year exploration period and is limited to geophysical data acquisition and the study of drilling opportunities and environmental impact. Upon receipt of an approved exploration permit, the Company will be required to make a payment of one South African Rand per hectare (approximately $400,000), and obtain an approved work program. An additional payment will be required as a contribution to a South African government sponsored training program in the same amount required to obtain the exploration license. The TCP covers approximately 7.5 million acres and is located approximately 120 miles northeast of Cape Town, South Africa.

**Canada**

Falcon owns non-operating working interests in four producing natural gas wells in Alberta, Canada which do not comprise a material portion of Falcon's assets (the "**Hackett Interest**"). The Company does not anticipate any further exploration or development of the Hackett Interest.

## RESULTS OF OPERATIONS

This review of the results of operations should be read in conjunction with the unaudited interim consolidated financial statements for the three and six months ended June 30, 2011 and 2010, and the audited consolidated financial statements for the year ended December 31, 2010.

***Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three Months Ended June 30, 2011 as Compared to the Three Months Ended June 30, 2010***

The Company reported a net loss of $1,708,000 ($0.002 per share) for 2011 as compared to a net loss of $5,682,000 ($0.009 per share) for 2010. Significant changes between the 2011 and 2010 periods were as follows:

| | Three Months Ended June 30, | | Change | |
|---|---|---|---|---|
| | 2011 | 2010 | $ | % |
| **Revenue** | $ 144,000 | $ (155,000) | $ 299,000 | 192.9% |
| **Expenses** | | | | |
| Exploration and evaluation expenses | 398,000 | 289,000 | (109,000) | (37.7)% |
| Production and operating expenses | 9,000 | 5,000 | (4,000) | (80.0)% |
| Depreciation, depletion and amortization | 84,000 | 92,000 | 8,000 | 8.7% |
| General and administrative | 1,812,000 | 3,806,000 | 1,994,000 | 52.4% |
| Share based compensation | 1,129,000 | 1,118,000 | (11,000) | (1.0)% |
| Reversal of litigation expense | (1,654,000) | - | 1,654,000 | |
| Finance income | (863,000) | (188,000) | 675,000 | 359.0% |
| Finance expenses | 978,000 | 779,000 | (199,000) | (25.5)% |
| | 1,893,000 | 5,901,000 | 4,008,000 | 67.9% |
| **Net loss and comprehensive loss** | $ (1,749,000) | $ (6,056,000) | $ 4,307,000 | 71.1% |
| **Net loss and comprehensive loss attributable to:** | | | | |
| Common shareholders | $ (1,708,000) | $ (5,682,000) | $ 3,974,000 | 69.9% |
| Non-controlling interest | (41,000) | (374,000) | 333,000 | 89.0% |
| **Net loss and comprehensive loss** | $ (1,749,000) | $ (6,056,000) | $ 4,307,000 | 71.1% |

*Exploration and evaluation expenses*

Exploration and evaluation expenses increased by $109,000 from $289,000 in 2010 to $398,000 in 2011. Expenses related to Hungarian properties increased to $304,000 in 2011 ($247,000 - 2010) as minimal maintenance was performed to safeguard the wells as the Company pursued a joint venture partner. South Africa expenses of $94,000 in 2011 ($42,000 - 2010) were legal, environmental and application expenses incurred for the Company's filing for the application for an exploration permit in the Karoo Basin.

*General and administrative expenses*

General and administrative expenses decreased by $1,994,000 from $3,806,000 in 2010 to $1,812,000 in 2011. Overall expenses decreased due to the implementation by the company of cost containment measures in 2010 for which the total impact was reflected in 2011. Significant cost decreases are as follows: joint venture marketing - $1,647,000; travel - $354,000; office and administrative costs - $149,000; and accounting – $106,000. Legal increased by $218,000 as a result of certain litigation (see *Legal Matters* below).

*Reversal of litigation expense*

On July 29, 2011, the Company entered into a settlement agreement regarding certain legal matters. Included in accounts payable and accrued expenses in the consolidated statement of financial position as at June 30, 2011 and December 31, 2010 is a liability related to the settlement of this matter of $2,046,000 and $3,700,000, respectively, including an estimate of all fees and costs related to this claim. The reduction to the liability of $1,654,000 is included in operations for the three months ended June 30, 2011.

*Finance income*

During the three months ended June 30, 2011, finance income included the changes in fair value of the embedded derivative of the private placement warrants of $833,000 and interest income of $30,000. During the corresponding three months of 2010, finance income included the change in the fair value of the embedded derivative of the convertible debenture and agents warrants of $175,000, and interest income of $13,000.

*Finance expenses*

During the three months ended June 30, 2011, finance expense included the effective interest on convertible debentures of $588,000, loss from foreign currency exchange of $321,000 and accretion of decommissioning liability of $69,000. During the corresponding three months of 2010, the effective interest, loss from foreign currency exchange and accretion of decommissioning liability were $475,000, 231,000 and $73,000, respectively.

*Net loss attributable to non-controlling interest*

Net loss attributable to non-controlling interest – the amount reflected in 2011 represents the share of Falcon Australia losses attributable to shareholders other than Falcon.

***Management's Discussion and Analysis of Financial Condition and Results of Operations for the Six Months Ended June 30, 2011 as Compared to the Six Months Ended June 30, 2010***

The Company reported a net loss of $4,608,000 ($0.007 per share) for 2011 as compared to a net loss of $11,422,000 ($0.019 per share) for 2010. Significant changes between the 2011 and 2010 periods were as follows:

| | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2010 | Change $ | Change % |
|---|---|---|---|---|
| **Revenue** | $ 297,000 | $ (100,000) | $ 397,000 | 397.0% |
| **Expenses** | | | | |
| Exploration and evaluation expenses | 698,000 | 1,011,000 | 313,000 | 31.0% |
| Production and operating expenses | 19,000 | 9,000 | (10,000) | (111.1)% |
| Depreciation, depletion and amortization | 178,000 | 220,000 | 42,000 | 19.1% |
| General and administrative | 3,580,000 | 6,602,000 | 3,022,000 | 45.8% |
| Share based compensation | 1,564,000 | 2,568,000 | 1,004,000 | 39.1% |
| Reversal of litigation expense | (1,654,000) | - | 1,654,000 | |
| Finance income | (1,077,000) | (30,000) | 1,047,000 | 3,490.0% |
| Finance expenses | 1,696,000 | 1,316,000 | (380,000) | 28.9% |
| | 5,004,000 | 11,696,000 | 6,692,000 | 57.2% |
| **Net loss and comprehensive loss** | $ (4,707,000) | $ (11,796,000) | $ 7,089,000 | 60.0% |
| **Net loss and comprehensive loss attributable to:** | | | | |
| Common shareholders | $ (4,608,000) | $ (11,422,000) | $ 6,814,000 | 59.7% |
| Non-controlling interest | (99,000) | (374,000) | 275,000 | 73.5% |
| **Net loss and comprehensive loss** | $ (4,707,000) | $ (11,796,000) | $ 7,089,000 | 60.0% |

*Exploration and evaluation expenses*

Exploration and evaluation expenses decreased by $313,000 from $1,011,000 in 2010 to $698,000 in 2011. Expenses related to Hungarian properties decreased to $549,000 in 2011 ($882,000 - 2010) as only minimal maintenance was performed to safeguard the wells as the Company pursued a joint venture partner. South Africa expenses of $149,000 in 2011 ($129,000-2010) were legal, environmental and application expenses incurred for the Company's filing for the application for an exploration permit in the Karoo Basin.

*Share based compensation*

Share based compensation decreased by $1,004,000 from 2010 to 2011 primarily due to a reduction in the grant date fair value of 2011 grants relative to the fair value of prior grants.

*General and administrative expenses*

General and administrative expenses decreased by $3,022,000 from $6,602,000 in 2010 to $3,580,000 in 2011. Overall expenses decreased due to the implementation by the company of cost containment measures in 2010 for which the total impact was reflected in 2011. Significant cost decreases are as follows: joint venture marketing - $1,647,000; travel - $644,000; payroll and related costs - $412,000; office and administrative costs - $350,000; investor relations - $110,000; and accounting – $102,000. Legal increased by $264,000 as a result of certain litigation (see *Legal Matters* below).

*Reversal of litigation expense*

On July 29, 2011, the Company entered into a settlement agreement regarding certain legal matters. Included in accounts payable and accrued expenses in the consolidated statement of financial position as at June 30, 2011 and December 31, 2010 is a liability related to the settlement of this matter of $2,046,000 and $3,700,000, respectively, including an estimate of all fees and costs related to this claim. The reduction to the liability of $1,654,000 is included in operations for the six months ended June 30, 2011.

*Finance income*

During the six months ended June 30, 2011, finance income included the changes in fair value of the embedded derivative of the private placement warrants and the convertible debenture conversion feature of $435,000 and $605,000, respectively, and interest income of $37,000. During the corresponding six months of 2010, the changes in fair value of the convertible debenture conversion feature and agents' warrants were reflected as finance expense, and finance income for 2010 was only comprised of interest income.

*Finance expenses*

During the six months ended June 30, 2011, finance expense included the effective interest on convertible debentures of $1,095,000, loss from foreign currency exchange of $464,000 and accretion of decommissioning liability of $137,000. During the corresponding six months of 2010, the effective interest, loss from foreign currency exchange, accretion of decommissioning liability and the change in the fair value of the convertible debenture conversion feature and agent warrants were $941,000, 158,000, $135,000 and $82,000, respectively.

*Net loss attributable to non-controlling interest*

Net loss attributable to non-controlling interest – the amount reflected in 2011 represents the share of Falcon Australia losses attributable to shareholders other than Falcon.

## SUMMARY OF QUARTERLY RESULTS

The following is a summary of the eight most recently completed quarters:

| As of: | September 30, 2010(1) | December 31, 2010(1) | March 31, 2011 | June 30, 2011 |
|---|---|---|---|---|
| Total assets | $194,402,000 | $115,409,000 | $114,227,000 | $126,256,000 |
| Evaluation and exploration costs | 175,121,000 | 98,755,000 | 99,755,000 | 82,665,000 |
| Working capital | 5,711,000 | 4,848,000 | 2,260,000 | 33,167,000 |
| Total shareholders' equity | 165,432,000 | 86,812,000 | 84,355,000 | 90,700,000 |
| **For the three months ended:** | **September 30, 2010** | **December 31, 2010** | **March 31, 2011** | **June 30, 2011** |
| Revenue | 12,000 | 4,000 | 8,000 | 9,000 |
| Net loss-common shareholders | (58,966,000) | (80,022,000) | (2,900,000) | (1,708,000) |
| Net loss per share-basic and diluted | (0.100) | (0.133) | (.005) | (.002) |

| As of: | September 30, 2009(2) | December 31, 2009(2) | March 31, 2010 (1) | June 30, 2010(1) |
|---|---|---|---|---|
| Total assets | $292,435,000 | $242,999,000 | $239,384,000 | $248,149,000 |
| Evaluation and exploration costs | 250,348,000 | 207,889,000 | 208,071,000 | 220,135,000 |
| Working capital | 27,514,000 | 18,176,000 | 13,715,000 | 14,125,000 |
| Total shareholders' equity | 280,973,000 | 230,179,000 | 225,569,000 | 223,957,000 |
| **For the three months ended:** | **September 30, 2009** | **December 31, 2009** | **March 31, 2010** | **June 30, 2010** |
| Revenue | 7,000 | 41,000 | 12,000 | nil |
| Net loss-common shareholders | (4,770,000) | (51,677,000) | (5,740,000) | (6,056,000) |
| Net loss per share-basic and diluted | (0.009) | (0.086) | (0.010) | (0.009) |

(1) Represented under IFRS.

(2) As previously reported under Canadian GAAP. Evaluation and exploration costs were previously classified as petroleum and natural gas properties.

The Company is a development stage company, and has limited revenue which is not material. The Company's net loss and net loss per share relate to the Company's operations during a particular period, and are not seasonal in nature. Generally, the Company's total assets, exploration and evaluation costs, working capital and total shareholders' equity fluctuate in proportion to one another until such time as the Company completes additional financing.

## LIQUIDITY AND CAPITAL RESOURCES

### *Falcon Private Placement*

On April 11, 2011, Falcon issued 87,050,000 units (each a "**Private Placement Unit**") at $0.16 (CDN$0.15) per Private Placement Unit by way of a non-brokered private placement for aggregate gross proceeds of $13,674,000 (CDN$13,058,000). Each Private Placement Unit consists of one common share in the capital of Falcon and three-quarters of one common share purchase warrant (each a "**Private Placement Warrant**"), each whole warrant being exercisable into a common share for a period of 36 months from the date of its issuance at an exercise price of $0.19 (CDN$0.18) per share.

### *Going Concern*

For the six months ended June 30, 2011, the Company incurred a net loss of $4,608,000 and, as at June 30, 2011, had a deficit of $286,885,000 and working capital of $33,167,000. As a result, the Company's ability to continue as a going concern is dependent upon its ability to raise additional capital and to secure an industry partner for its operations in Hungary and South Africa. Additional capital may also be sought from the sale of additional common shares or other debt or equity instruments. There is no assurance that additional capital will be available to the Company on acceptable terms or at all.

In recent months, the Company has been focused on securing equity financing and joint venture funding for both its operations in the Beetaloo Basin located in the Northern Territory, Australia, and for its operations in the Makó Trough located in Hungary. On June 28, 2011, the conditions precedent in the E&P Agreement with Hess for the Beetaloo Basin project were satisfied, and in July 2011 the Company received $20,000,000 from Hess; and, on June 9, 2011, the Company entered into a Letter of Intent with NIS for the earning of an interest by NIS in producing the Algyö play within Falcon's Makó production license in Hungary, as described under *Operational Highlights* – Hungary above.

In the longer term, the recoverability of the carrying value of the Company's exploration and evaluation 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.

### *Working Capital*

Cash and cash equivalents as at June 30, 2011 were $14,604,000, an increase of $7,330,000 from $7,274,000 at December 31, 2010. Working capital at June 30, 2011 increased $28,319,000 to $33,167,000 at June 30, 2011 from $4,848,000 at December 31, 2010.

The increase to cash and cash equivalents of $7,330,000 was attributable to cash used in operating activities and investing activities, and the effect of exchange rates on cash and cash equivalents, of $3,813,000, 2,225,000 and $105,000, respectively, offset by cash provided by financing activities of $13,473,000.

***Accounts Receivable***

Accounts receivable as at June 30, 2011 were $20,984,000, which includes $20,000,000 receivable from Hess, $223,000 receivable from a former joint interest owner for Australian GST, $162,000 for refund of operator bonds due from the Australian government, $357,000 receivable from the Hungarian, Australian and Canadian governments as refunds of VAT, GST and GST, respectively, and other of $242,000.

***Accounts Payable and Accrued Expenses***

Accounts payable and accrued expenses as at June 30, 2011 were $4,494,000, which include $2,046,000 for settlement of legal matters (see *Legal Matters* below) and $1,402,000 for Australian exploration and evaluation costs, as compared to $1,871,000 as at December 31, 2010, which includes $99,000 for Australian exploration and evaluation costs.

***Capital Expenditures***

For the six months ended June 30, 2011, additions to exploration and evaluation costs of $1,619,000 were solely related to the Company's Australian operations, and consist of a $717,000 increase to the decommissioning provision and $902,000 for Beetaloo project costs.

***Legal Matters***

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. 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, as amended on March 16, 2011, the Company was served with a Complaint by a former vendor (**the "Vendor"**) of TXM arising out of a dispute related to TXM's alleged failure to pay for certain oilfield equipment.

On July 29, 2011, TXM and the Vendor entered into a settlement agreement. Accordingly, included in accounts payable and accrued expenses in the consolidated statement of financial position at June 30, 2011 is a liability related to the settlement of this matter of $2,046,000, including an estimate of all fees and costs related to this claim.

**Transactions with Non-Arm's Length Parties and Related Parties**

*Services – Directors and Officers*

During 2011, the Company incurred expenses in the amount of $48,000 (2010 - $70,000) to a current director of the Company, Dr. György Szabó, for advisory and consulting services rendered to TXM.

## DISCLOSURE OF OUTSTANDING SHARE DATA

The following is a summary of the Company's outstanding share data as at June 30, 2011 and August 26, 2011:

| Class Of Securities | June 30, 2011 | August 26, 2011 |
|---|---|---|
| Common Shares | 694,316,800 | 694,316,800 |
| Stock Options | 31,645,500 | 31,645,500 |
| Private Placement Warrants(1) | 65,287,500 | 65,287,500 |
| Hess Warrants(2) | 10,000,000 | 10,000,000 |

**Notes:**
(1) Warrants to purchase 65,287,500 Common Shares at a price of $0.19 (CDN$0.19) per Common Share were issued to shareholders on April 11, 2011 in connection with the Falcon Private Placement discussed above, and expire on April 11, 2014.
(2) Warrants to purchase 10,000,000 Common Shares at a price of $0.19 (CDN$0.19) per Common Share were issued to Hess on July 13, 2011 in connection with the Hess transaction discussed above. The Hess Warrants are exercisable commencing on November 14, 2011, and expire on January 13, 2015.

## OFF-BALANCE SHEET ARRANGEMENTS AND PROPOSED TRANSACTIONS

The Company does not have any off-balance sheet arrangements or proposed transactions, other than operating leases.

## NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS

There were no new financial reporting standards since the quarter ended March 31, 2011.

## BUSINESS RISKS AND UNCERTAINTIES

Risks and uncertainties that could cause the Company's actual results to materially differ from current expectations have not changed from those disclosed in the Company's MD&A of December 31, 2010.

## MANAGEMENT'S RESPONSIBILITY FOR MD&A

The information provided in this MD&A is the responsibility of management. In the preparation of this MD&A, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected in this MD&A.

The audit committee has reviewed the MD&A with management, and has approved the MD&A as presented.