FALCON OIL & GAS LTD.

FORM 51-102F1
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2008

The following management's discussion and analysis (the "**MD&A**") was prepared as at April 29, 2009 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 year ended December 31, 2008. This MD&A should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2008 and 2007.

The information provided herein in respect of Falcon includes information in respect of 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., a Hungarian limited liability company, JVX Energy S.R.L. ("**JVX**"), a Romanian limited liability company, and Falcon Oil & Gas Australia Pty. Ltd ("**Falcon Australia**") (collectively, the "**Company**").

Additional information related to the Company, including the Company's Annual Information Form ("**AIF**") for the year ended December 31, 2008 dated April 29, 2009, 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 therefrom; 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**"), Romania, the Commonwealth of Australia ("**Australia**"), 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. The financial information provided herein has been prepared in accordance with Canadian generally accepted accounting principles.

OVERVIEW OF BUSINESS AND OVERALL PERFORMANCE

About Falcon

The Company is an international energy company engaged in the exploration of petroleum and natural gas, with offices in Vancouver, British Columbia, Denver, Colorado and Budapest, Hungary. The Company's registered office is located at 810-675 Hastings Street West, 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 identification, exploration and development of conventional and unconventional petroleum and gas projects in Central Europe, specifically Hungary and Romania. In 2008, the Company's geographical focus was broadened to also include Australia with the Beetaloo Basin (as defined below) acquisition, as discussed below.

Hungary

The Company has achieved three critical milestones during 2008 and through the date hereof as follows:

- Through the Company's efforts to find a strategic partner (announced in June, 2007), on April 10, 2008 the Company and TXM entered into a Production and Development Agreement ("**PDA**") with ExxonMobil Corporation affiliate Esso Exploration International Limited ("**ExxonMobil**").

- Completion of the RPS Scotia Report (as defined below), which is an update to the previously filed (www.sedar.com) August 2006 resource evaluation of the Makó Trough prepared for Falcon by The Scotia Group, Inc. with an effective date of August 15, 2006 (the "**Scotia Report**").

- The repair of the Makó 6 well.

Strategic Partnership with ExxonMobil Corporation

As a result of the extensive technical data developed by Falcon, on May 22, 2007 the Hungarian Mining Authority granted to Falcon a production license (the "**Production License**"), which covers a significant part of the Makó Trough.

On April 10, 2008, Falcon and TXM entered into the PDA with ExxonMobil under which Falcon and ExxonMobil became joint owners in a specified portion (the "**Contract Area**") of Falcon's long-term production license granted on May 21, 2007 by the Hungarian Mining Authority (the "**Production License**") in the Makó Trough. Pursuant to a pre-existing agreement between ExxonMobil and MOL 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.

The PDA provided for an initial consideration of $25 million, which was paid to the Company, and for ExxonMobil and MOL to spend an aggregate of $50 million to conduct an initial work program to test one or more of the Company's existing well bores or drill one or more new wells for such tests (the "**Initial Work Program**"). After the Initial Work Program is completed (expected to be approximately one year after commencement), Falcon and ExxonMobil will evaluate the results over a period which could last up to four months, at which time ExxonMobil has the right to proceed to the next phase (the "**Appraisal Work Program**"). If ExxonMobil elects to proceed forward, ExxonMobil and MOL will pay the Company an aggregate of an additional $50 million and will be required to expend an aggregate of $100 million on the Appraisal Work Program. If ExxonMobil elects not to proceed beyond the Initial Work Program, ExxonMobil will relinquish and reassign all of its rights and ownership in the Contract Area to the Company.

After the Appraisal Work Program is completed, ExxonMobil has another election point – that is, to elect to proceed to full-scale development of the Contract Area (the "**Development Program**"). If ExxonMobil elects to proceed forward, ExxonMobil and MOL will pay the Company an aggregate of an additional $37.5 million. If ExxonMobil elects not to proceed to the Development Program, it will have the option to relinquish and reassign all of its rights and ownership in the Contract Area or retain a wellbore interest in the wells drilled during the Appraisal Work Program. In either circumstance Falcon will also resume operatorship of the Contract Area.

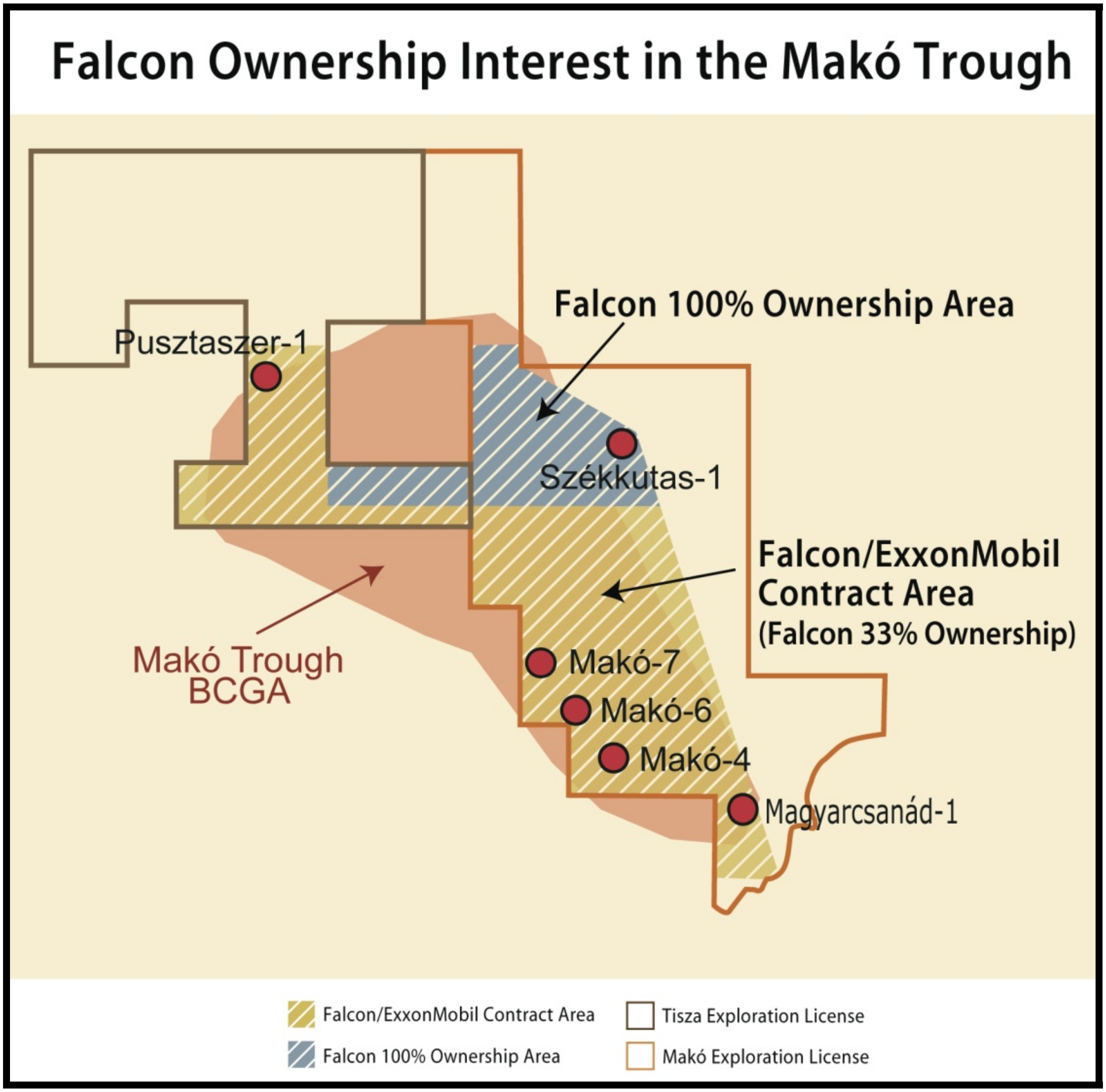
MOL has the right to retain and pay for its 33.5% working interest, including MOL's 50% share of the above-described payments to Falcon and work commitments, regardless of ExxonMobil's elections. Subject to the Company's pre-emptive right to acquire and assume ExxonMobil's participating interest upon relinquishment and reassignment by ExxonMobil at either the Appraisal Work Program election point or the Development Program election point, MOL has the option to acquire and assume all obligations related to ExxonMobil's 33.5% initial participating interest at the relevant election point.

The Company will incur no development costs within the Contract Area during the Initial Work Program or the Appraisal Work Program up to the amount stipulated in the PDA. Beginning with the Development Program, the Company, ExxonMobil and MOL will each receive revenues and be responsible for their proportionate share of expenses within the Contract Area (that is, 33% the Company, 33.5% ExxonMobil and 33.5% MOL), under the joint operating agreement ("**JOA**") which the parties entered into at the time of signing the PDA. The JOA will govern all operations during the Development Program, with ExxonMobil continuing as operator, but with all three parties participating in the formulation of the drilling and development plan and participating in the decision-making process. In addition to the Company's 33% undivided ownership in the ExxonMobil-operated Contract Area, the Company remains sole owner and operator of 391,445 acres outside the Contract Area boundaries, as well as shallow rights covering 184,336 acres within the Contract Area, as follows:

- **Falcon Lands:** The Company retains 100% ownership in the remaining 25% (61,445 acres) of the Production License that is not part of the Contract Area.
- **Exploration Licenses:** The Company retains 100% ownership in 330,000 acres which are outside the boundaries of the Production License, under the original Makó exploration license (the "**Makó License**") and original Tisza exploration license (the "**Tisza License**" and together with the Makó License, the "**Exploration Licenses**" and the Exploration Licenses together with the Production License, the "**Licenses**"). The Company also retains 100% ownership in the portions of the Exploration Licenses which are above 2,800 meters within the boundaries of the Production License. The 330,000-acre area outside the Production License and the shallower depths are not part of the Production License.

Amendment to Agreement with ExxonMobil

On December 8, 2008, the PDA was amended to provide that: (a) the parties shall use reasonable efforts to agree on unitizing their respective interests in all or a portion of the Makó Trough; (b) if ExxonMobil elects to proceed to the Appraisal Work Program, a portion of the work commitment may be applied to drill one or more wells based on the optimum location from a Makó Trough-wide standpoint; and (c) if ExxonMobil elects to proceed to the Development Program, $37.5 million (of the $75 million payment to Falcon) may be applied to operations on a Makó Trough-wide standpoint.



Resource Estimates

In May 2008, Falcon received a new, updated, independent report from RPS Scotia disclosing an updated resource estimate of the Makó Trough Pannonian Basin Gas Accumulation (the "**Makó Trough**") within the Production License (the "**RPS Scotia Report**"). The RPS Scotia Report has an effective date of March 31, 2008, and is an update to the Scotia Report. RPS Scotia is the parent company of the Scotia Group.

The RPS Scotia Report is compliant with National Instrument 51-101 "Standards of Disclosure for Oil and Gas Activities".

The RPS Scotia Report provides a probabilistic distribution of the potentially recoverable portion of "Contingent Resources" as defined by the Canadian Oil and Gas Exploration Handbook ("**COGEH**") and does not represent an estimate of reserves.

Based on all available data, RPS Scotia has assigned the following probabilistic estimation of potentially recoverable contingent resources to the Company's interests in the Szolnok formation, the Lower Endrod, the Basal Conglomerate and the Synrift Sequence. The RPS Scotia Report measures the Makó Trough in trillions of cubic feet of natural gas ("**Tcf**") and millions of barrels of oil ("**mmbo**"):

	Probability Greater Than		
	P90 (90%)	P50 (50%)	P10 (10%)
Probabilistic estimation of potentially recoverable contingent resources [(1) (2)]	**25.8 Tcf** **42.6 mmbo**	**43.9 Tcf** **97.8 mmbo**	**68.0 Tcf** **202.7 mmbo**

Notes:

(1) The resource estimate has been conducted using the definitions specified by the COGEH. The Makó Trough resource falls under the "Discovered Resources" classification. The values refer to the probabilistically estimated recoverable fraction of "Contingent Resources" within that classification. Contingent resources are those quantities of oil and gas estimated on a given date to be potentially recoverable from known accumulations but are not currently economic. The economic nature of this resource has not yet been assessed due to the early stage of data gathering for the Makó Trough resource. The recoverable portion of this "Contingent Resource" is contingent upon the demonstration of productive capability of the various zones of interest through well testing and longer term production testing which has not occurred as of the effective date of the report.

(2) Estimates are as of March 31, 2008, the effective date of the RPS Scotia Report.

A copy of the RPS Scotia Report is available on SEDAR at www.sedar.com and Falcon's website at www.falconoilandgas.com.

Operational Highlights for 2008

In June 2008, the Makó 6 well intervention was completed. The intervention included removal of the 3 ½ inch tubing down to 2,250 meters and the cementing of the well down to about 2,818 meters. A drillable plug was set above the cement in the 5 ½ inch casing, thereby concluding the Makó 6 well repair.

Operational activity for 2008 was limited to well site and well bore maintenance, and well intervention and repair of the Makó 6 well.

Future Operations

All future activity on wells within the Contract Area is subject to ExxonMobil and MOL's due diligence evaluation.

Evaluation Period

In 2008, Falcon substantially completed the work and studies undertaken in 2007 to evaluate the subsurface information, both geological and operational, with respect to the Company's existing Makó Trough well. This data has been shared with the ExxonMobil and MOL and is also of value to the Company in the Falcon Lands portion of the Production License.

ExxonMobil and MOL will continue to perform their own evaluation of the subsurface information, both geological and operational, as part of the Initial Work Program.

Australia

On August 25, 2008, the Company entered into a purchase and sale agreement with PetroHunter and one of its affiliates, which was amended by a first amendment to the Purchase and Sale Agreement between PetroHunter Energy Corporation ("**PetroHunter**"), a non-arm's length party for the purposes of the TSX Venture Exchange, and one of its affiliates, the Company and Falcon Australia dated October 31, 2008, (together, the "**Beetaloo PSA**"). Under the Beetaloo PSA, the Company to acquired an undivided 50% working interest in an aggregate 7,000,000 acre prospect in four exploration permits (the "**Permits**") in the Beetaloo Basin, Northern Territory, Australia (the "**Beetaloo Basin Project**"). The Company closed this acquisition on September 30, 2008.

The purchase price paid by the Company to PetroHunter was $25,000,000, $5,000,000 of which was paid in cash to PetroHunter as earnest money on August 25, 2008, and $20,000,000 of which was paid on September 30, 2008 in equity securities automatically convertible into common shares in the capital of Falcon (the "**Common Shares**") without payment of any additional consideration on a one-for-one basis (the "**Special Warrants**") based on the closing price of the Company's shares on August 22, 2008. In the event that Falcon's closing share price on the date that a receipt was issued for the (final) prospectus to qualify the distribution of the Common Shares underlying the Special Warrants was below the closing share price on August 22, 2008, the Special Warrants had an adjustment mechanism which provides PetroHunter with price protection of up to 20%.

PetroHunter serves as operator of the Beetaloo Basin Project, although the Beetaloo Basin Project joint operating agreement provides for a joint operating committee and for substantial direct involvement by the Company's managerial, technical and financial personnel in the identification, exploration and development of the Beetaloo Basin Project. The Company and PetroHunter are subject to certain drilling commitments on the Permits. These commitments require the drilling of seven wells during 2009, five wells during 2010 and three wells during 2011. In addition, the parties must complete seismic evaluations on certain Permits in order to keep such Permits in good standing. The cost of such work related to these commitments will be borne by the Company and PetroHunter in accordance with their respective percentage interests in the Beetaloo Basin Project.

Petrohunter had previously drilled one well in 2007, the Shanandoah-1 well, which was suspended prior to reaching its intended total depth. It is intended that this well will be re-entered in 2009 to drill to the planned total depth. As such, this well is untested and has no associated reserves.

See also "*Transactions with Non-Arm's Length Parties and Related Parties*".

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 Interests.

Romania

On June 1 2005, the Company entered into a farmout agreement (the "**Farmout Agreement**") with Pannonian International, Ltd. ("**Pannonian**"), a wholly owned subsidiary of Galaxy Energy Corporation ("**Galaxy**"), under which the Company agreed to pay 100% of the costs to drill two coalbed methane wells to earn a 75% undivided working interest in Pannonian's Jiu Valley Concession located in southwestern Romania, approximately 300 kilometers west of Bucharest. Through its wholly owned Romanian subsidiary, JVX, the Lupeni Sud-1 well was drilled. As of December 31, 2007, the Lupeni Sud-1 well was plugged and abandoned and 100% of the costs incurred were charged to the Company's operations. The Company has applied to have the Jiu Valley concession returned to the Romanian government.

In February 2008, the Company was notified that it has been contingently awarded a new concession, the "Anina Concession". The award is subject to negotiation and finalization of a concession agreement for the acreage. There is a minimal work program required under the Anina Concession, and the Company will have the option to withdraw from the concession agreement at the end of each contract year.

United States

On August 25, 2008, the Company entered into a binding purchase and sale agreement (the "**Buckskin PSA**") with PetroHunter and one of its affiliates to acquire an undivided 25% working interest in five wells, including the 40-acre tract surrounding each well (collectively, the "**Five Wells**") situated within PetroHunter's 20,000-acre Buckskin Mesa project ("**Buckskin Mesa Project**") located in the Piceance Basin, Colorado, and to undertake a testing and completion program in respect of the Five Wells. The Company closed this acquisition on October 31, 2008.

Under the terms of the Buckskin PSA, the Company agreed to pay 100% of the first $7,000,000 expended on testing and completion work 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 25% working interest in the Five Wells (for a total of 50%) and a 50% working interest in the remainder of the 20,000-acre Buckskin Mesa Project.

Under the terms of the Buckskin PSA, the Company agreed to pay 100% of the first $7,000,000 expended on testing and completion work 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 the Buckskin Mesa Option

Three of the five wells were tested in 2008 and 2009, and failed to identify sufficiently economic reserves for the Company to proceed with the exercise of the Buckskin Mesa Option. On February 24, 2009, the Company notified PetroHunter that it would not exercise the Buckskin Mesa Option.

See also "*Transactions with Non-Arm's Length Parties and Related Parties*".

SELECTED ANNUAL INFORMATION

	2008	2007	2006
For the year ended December 31:			
Revenues	$ 60,000	$ 207,000	$ 83,000
Net loss	(35,911,000)	(12,847,000)	(20,258,000)
Loss per share	(0.063)	(0.027)	(0.050)
Cash dividend per share	Nil	Nil	Nil
As of December 31:			
Total assets	304,471,000	308,865,000	286,383,000
Long-term liabilities	5,285,000	5,140,000	2,693,000

2008 compared with 2007

The Company reported net loss of $35,911,000 ($0.063 per share) for 2008 as compared to net loss of $12,847,000 ($0.027 per share) for 2007. Significant changes between the 2008 and 2007 year were as follows:

	Year Ended December 31,		Change	
	2008	2007	$	%
Stock based compensation	$ 8,481,000	$ 3,458,000	$ 5,023,000	145.3%
Impairment of petroleum and natural gas properties	6,970,000	847,000	6,123,000	722.9%
Foreign exchange	5,273,000	(7,987,000)	13,260,000	166.0%
Other	15,187,000	16,529,000	(1,342,000)	(8.1)%
Net loss	$ 35,911,000	$ 12,847,000	$ 23,064,000	179.5%

2007 compared with 2006

The Company reported net loss of $12,847,000 ($0.027 per share) for 2007 as compared to net loss of $20,258,000 ($0.050 per share) for 2006. Significant changes between the 2007 and 2006 year were as follows:

	Year Ended December 31,		Change	
	2007	2006	$	%
Stock based compensation	$ 3,458,000	$ 10,284,000	$(6,826,000)	(66.4)%
Writedown of inventory available for sale	3,594,000	-	3,594,000	
Foreign exchange	(7,987,000)	1,684,000	(9,671,000)	(574.3)%
Other	13,782,000	8,290,000	5,492,000	66.2%
Net loss	$ 12,847,000	$ 20,258,000	$ (7,411,000)	(36.6)%

See also *"Overview of Business and Overall Performance"* and *"Results of Operations"*.

RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations for the Year Ended December 31, 2008 as Compared to the Year Ended December 31, 2007

This review of the results of operations should be read in conjunction with the audited consolidated financial statements of the Company for the years ended December 31, 2008 and 2007. The following is a summary of those results:

	Year Ended December 31, 2008	2007	Change $	%
Petroleum revenue	$ 60,000	$ 207,000	$ (147,000)	(71.0)%
Direct costs				
Production costs	34,000	109,000	(75,000)	(68.8)%
Depreciation, depletion and accretion	378,000	237,000	141,000	59.5%
	412,000	346,000	66,000	19.1%
Costs and expenses				
Accounting	852,000	710,000	142,000	20.0%
Depreciation and amortization	450,000	340,000	110,000	32.4%
Consulting	1,659,000	2,429,000	(770,000)	(31.7)%
Director fees	258,000	176,000	82,000	46.6%
Investor relations	610,000	1,201,000	(591,000)	(49.2)%
Legal costs	1,353,000	2,064,000	(711,000)	(34.4)%
Office and administrative	2,544,000	2,864,000	(320,000)	(11.2)%
Payroll and related costs	2,908,000	2,908,000	-	0.0%
Stock-based compensation	8,481,000	3,458,000	5,023,000	145.3%
Travel and promotion	2,309,000	2,672,000	(363,000)	(13.6)%
Writedown of inventory available for sale	2,610,000	3,594,000	(984,000)	(27.4)%
	24,034,000	22,416,000	1,618,000	7.2%
Other income (expense)				
Interest income	1,548,000	2,568,000	(1,020,000)	(39.7)%
Impairment of petroleum and natural gas properties	(6,970,000)	(847,000)	(6,123,000)	722.9%
Gain (loss) on foreign exchange	(5,273,000)	7,987,000	(13,260,000)	(166.0)%
Other expense	(368,000)	-	(368,000)	
	(11,063,000)	9,708,000	(20,771,000)	(214.0)%
Loss before income taxes	(35,449,000)	(12,847,000)	(22,602,000)	175.9%
Provision for income taxes	(462,000)	-	(462,000)	
Net loss and comprehensive loss	$ (35,911,000)	$ (12,847,000)	$(23,064,000)	179.5%

Petroleum Revenue

Of the revenue from petroleum and natural gas sales, nil in 2008 and $137,000 in 2007 were from the initial test production of the Magyarcsanad-1 well in Hungary. The remainder of the revenue was derived from the sale of natural gas from the Hackett Interests. The Company has not yet realized revenue from its planned operations, and has incurred significant expenditures in connection with its exploration for petroleum and natural gas.

Costs and expenses

The overall decrease to general and administrative costs in 2008 was due to the Company's reduction and curtailment of its operations that commenced in the fourth quarter of 2007 as it changed its focus in Hungary from its initial resource delineation phase to a resource evaluation phase. The significant components of changes in general and administrative expenses in 2008, as compared to 2007, were as follows:

- Accounting – the increase was primarily a result of additional costs associated with quarterly review of the Company's financial statements by its auditors and the ExxonMobil joint venture in Hungary.

- Depreciation and amortization – the increase was primarily a result of the acquisition of office furniture and computer equipment in Budapest commencing with the relocation of the Budapest office in July 2007.

- Consulting – the decrease was primarily from the completion and termination of consulting agreements for gas marketing, financial and business advisory services, and technical services from 2007 to 2008.

- Investor relations – the decrease was attributable to the cost containment measures implemented in the fourth quarter of 2007, including the reduction in the use of outside public relations firms.

- Legal costs – the decrease for services from outside firms in Hungary and North America was attributable to the cost containment measures implemented in the fourth quarter of 2007, and reduction in activities as the Company changed its focus in Hungary from an initial resource delineation phase to a resource evaluation phase.

- Office and administrative – the decrease was attributable to the cost containment measures implemented in the fourth quarter of 2007 offset by additional office rent and associated costs in Denver that were previously absorbed by PetroHunter in connection with the office sharing arrangement.

- Stock based compensation (calculated utilizing the Black-Scholes option-pricing model) – the increase was primarily as a result of option grants during 2008. During the second quarter of 2008, the Company granted officers, directors, employees and consultants of the Company options to purchase 13,610,000 Common Shares at exercise prices ranging from $0.98 (CDN$1.00) to $1.10 (CDN$1.09). The options vest 20% at the date of grant, and 20% annually thereafter, and expire in May 2013.

- Travel and promotion – the decrease was attributable to the cost containment measures implemented in the fourth quarter of 2007, and reduction in activities as the Company changed its focus in Hungary from an initial resource delineation phase to a resource evaluation phase.

- Writedown of inventory available for sale – Inventory available for sale consists of drill pipe, casing and tubing. As of December 31, 2007, a portion of the Company's inventory aggregating $14,376,000 was reclassified from petroleum and natural gas properties to available for sale, and carried at the lower of cost or net realizable value. At December 31, 2007, the Company charged to operations $3,594,000 as a write down to the carrying cost of the inventory to estimated net realizable value of $10,782,000 (75% of the original cost basis).

During the year ended December 31, 2008, an additional $3,675,000 was reclassified from petroleum and natural gas properties to inventory available for sale, and the Company received $4,995,000 from the sale of inventory available for sale at approximately its carrying value. At December 31, 2008, the Company charged to operations $2,610,000 as a write down to the carrying cost of the inventory to estimated net realizable value of $6,852,000 (61% of the original cost basis).

Other income (expense)

- Interest income – the decrease was attributable to a reduction in the cash available for investment and the interest rate earned on the investments.

- Impairment of petroleum and natural gas properties – During 2008, the Company reflected impairment to the carrying value of its United States properties. The impairment resulted from an election not to exercise the Buckskin Mesa Option, the Company's sole petroleum and natural gas property located in the United States.

  During 2007, the Company reflected impairment to the carrying value of its Romanian properties. The impairment resulted from the drilling of a dry hole, and the decision not to pursue its interest in the Jiu Valley, the Company's sole petroleum and natural gas property located in Romania.

- Gain (loss) on foreign exchange – the change was primarily attributable to foreign exchange rate movements on Canadian denominated cash accounts. The Canadian dollar strengthened relative to the US dollar throughout 2007, and remained relatively static until mid-2008; thereafter, the US dollar strengthened relative to the Canadian dollar. The Hungarian forint strengthened relative to the US dollar throughout 2007 and until mid-2008; thereafter, the US dollar strengthened relative to the Hungarian forint.

  Substantially all of the Company's financings have been in Canadian dollars; commensurate with the strengthening of the US dollar, the Company has changed the composition of its cash balances to 86% in US dollars, 9% in Canadian dollars and 5% in Hungarian forints; a significant portion of the Company's operations are in Hungarian forints.

SUMMARY OF QUARTERLY RESULTS

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

As of:	**March 31, 2008**	**June 30, 2008**	**September 30, 2008**	**December 31, 2008**
Total assets	$293,967,511	$297,373,735	306,870,814	304,472,067
Petroleum and natural gas properties	231,956,676	211,927,213	240,329,003	237,020,325
Working capital	51,593,669	68,343,352	55,312,512	32,073,983
Total shareholders' equity	285,082,821	281,874,148	297,268,936	281,190,721
For the three months ended:	**March 31, 2008**	**June 30, 2008**	**September 30, 2008**	**December 31, 2008**
Revenue	18,420	25,165	22,671	(6,509)
Net income (loss)	(4,375,025)	(7,486,272)	(6,104,178)	(17,945,358)

Net income (loss) per share-basic and diluted	(0.008)	(0.013)	(0.011)	(0.031)

As of:	**March 31, 2007**	**June 30, 2007**	**September 30, 2007**	**December 31, 2007**
Total assets	$290,190,826	$288,263,412	$274,788,840	$308,864,891
Petroleum and natural gas properties	170,905,424	216,433,277	234,934,259	229,805,480
Working capital	85,233,651	40,586,242	18,293,328	56,746,001
Total shareholders' equity	258,580,626	259,789,896	256,068,735	288,076,167
For the three months ended:	**March 31, 2007**	**June 30, 2007**	**September 30, 2007**	**December 31, 2007**
Revenue	25,043	111,842	25,561	44,982
Net income (loss)	(3,101,064)	500,233	(4,595,798)	(5,650,292)
Net income (loss) per share-basic and diluted	(0.007)	0.001	(0.010)	(0.012)

The Company is a development stage company; it has limited revenue which is not material. As well, the Company's net income (loss) and net income (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, petroleum and natural gas properties, 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

Prior Offerings

In December 2007, the Company completed the sale of an aggregate of 100,000,000 Common Shares at a price of $0.39 (CDN$0.40) per common share pursuant to a short form prospectus (the "**December Offering**"). Gross proceeds from the December Offering were $39,304,314 (CDN$40,000,000). The underwriters received a cash commission of 6% of the gross proceeds $2,358,240 (CDN$2,400,000) and warrants (collectively, the "**December Underwriters' Warrants**") to purchase 6% of the number of Common Shares sold under the December Offering, at an exercise price of $0.39 (CDN$0.40) per share, for a period of 24 months from the date of the closing of the December Offering.

As was indicated in the (final) prospectus filed in connection with the December Offering dated December 10, 2007, the proceeds of the December Offering were to be used by the Company for the exploration and development of the Company's projects in Hungary, including the completion of three existing well bores, and for general corporate and working capital purposes, subject to the ability of the Company to reallocate the proceeds of the December Offering for sound business reasons. In light of the ExxonMobil transaction, the board of directors of the Company assessed the overall business strategy of the Company and determined that a reallocation of the remaining proceeds of the December Offering be made to the Beetaloo Basin Project and Buckskin Mesa Project acquisitions.

Working Capital

Cash and cash equivalents at December 31, 2008 were $25,547,000, a decrease of $30,445,000 from $55,992,000 at December 31, 2007. Working capital at December 31, 2008 decreased to $32,074,000 from $56,746,000 at December 31, 2007.

The decrease to cash and cash equivalents of $30,445,000 was attributable to cash used in operating activities and investing activities, and the effect of exchange rates on cash, of $8,432,000, $17,263,000 and $5,294,000, respectively, offset by cash provided by financing activities of $544,000.

In April 2008, the Company received $25,000,000 from ExxonMobil as the initial consideration under the PDA. At December 31, 2008, costs associated with the transaction were $3,684,000, resulting in net cash proceeds of $21,316,000. Capital expenditures, including payment of prior year's accounts payable incurred for petroleum and natural gas properties, and including costs associated with the acquisition of the working interests in Beetaloo Basin Project and Buckskin Mesa Project, aggregated $32,679,000.

Cash provided by financing activities of $544,000 resulted from $674,000 proceeds from the exercise of 1,711,250 December Underwriters' Warrants, net of Common Share issue costs of $130,000in connection with the conversion of the Special Warrants. Included in cash and cash equivalents at December 31, 2007 was $320,000 held as collateral for letters of credit issued by the Company, which were released in 2008.

Amounts Receivable and Prepaids

Amounts receivable at December 31, 2008 were $16,134,000, which includes $6,541,000 due from ExxonMobil ($6,000,000 for well intervention and repair on the Makó 6 well and $541,000 for amounts due under a services agreement between the Company and ExxonMobil), $5,769,000, 2,500,000 and $67,000 receivable from the Hungarian, Australian and Canadian governments as refunds of VAT, GST and GST, respectively, and $1,133,000 for amounts receivable from the sale of inventory available for sale; prepaids include $690,000 for advance payments to Hungarian suppliers.

Accounts Payables and Accrued Expenses

Accounts payable and accrued expenses at December 31, 2008 were $17,996,000, which includes $624,000 for capital expenditures related to the Company's Hungarian operations, as compared to accounts payable and accrued expenses of $14,649,000 at December 31, 2007, which includes $12,517,000 for capital expenditures related to the Company's Hungarian operations.

Capital Expenditures

For the year ended December 31, 2008, the Company incurred $39,410,000 for additions to its petroleum and natural gas properties, of which $25,890,000 and $748,000 were for the acquisition of working interests in the Beetaloo Basin and the Buckskin Mesa Project, respectively; and made cash payments on all petroleum and natural gas properties of $32,679,000 of which $12,517,000 and $1,000,000 represented amounts incurred and reflected in accounts payable and accrued expenses, and property contract payable, respectively, at December 31, 2007. Included in additions to petroleum and natural gas properties for the Beetaloo Basin were Special Warrants, valued at $20,000,000, that were converted into 28,888,888 Common Shares on December 29, 2008. During the comparable 2007 period, the Company incurred $118,040,000, of which $117,079,000 was for its properties in Hungary.

The significant costs for 2008 in Hungary were for repair work on the Makó 6 well in excess of amounts reimbursed by ExxonMobil, specialized processing and evaluation of the seismic and well data previously acquired in 2007 and well maintenance for the six existing well bores. The primary capital expenditures for 2007 were the location construction of the Foldeak well, the drilling of the Makó 4 well and the Magyarcsanad - 1 well, complete logging of the Makó 7 well, completion of Makó 6 well stimulations (fracturing) in the Synrift and lower Basil Conglomerate, completion of initial flow tests of the Szekkutas - 1 well, and completion of the Szekkutas - 1 well seismic survey.

As of December 31, 2008, the Company's net cumulative expenditures for exploration under the Licenses, including the acquisition cost of the Licenses, seismic testing, drilling of exploratory wells, and initial testing and completion of wells was approximately $210,926,000**,** including an asset retirement obligation of approximately $4,583,000 for the six wells drilled.

During 2007, a portion of the Company’s inventory (i.e. drill pipe, casing and tubing) aggregating $14,376,000 was reclassified from petroleum and natural gas properties to inventory available for sale. At December 31, 2007, the Company charged to operations $3,594,000 as a write down to the carrying cost of the inventory to estimated net realizable value of $10,782,000.

During 2008, an additional $3,675,000 of inventory was reclassified from petroleum and natural gas properties to inventory available for sale, and the Company received $4,995,000 from the sale of inventory available for sale at approximately its carrying value. At December 31, 2008, the Company charged to operations $2,610,000 as a write down to the carrying cost of the inventory to estimated net realizable value of $6,852,000.

Furniture and equipment at December 31, 2008 was $3,165,000 as compared to $2,381,000 at December 31, 2007. Included in the increase of $784,000 is $246,000 of furniture and office equipment in the Denver office acquired at the termination of the office sharing agreement with PetroHunter. See also “*Transactions with Non-Arm’s Length and Related Parties*”.

The Company’s activity in Hungary for 2008 has been focused on resource evaluation. With the completion of the strategic partnership initiative and ExxonMobil becoming operator of the Contract Area, the Company will be re-evaluating its operation plans and evaluation studies. ExxonMobil is evaluating the existing wellbores and determining its recommendations for the Initial Work Program. The Company’s activity in the United States for 2008 was focused on the testing and completion of the Five Wells. The Company’s activity in Australia for 2008 was focused on administrative matters prior to exploration activities that the Company believes should commence in 2009.

The Company’s future capital requirements will be dependent upon, among other things, the evaluation of the Hungarian properties, and the future testing and completion plan developed by the Company, ExxonMobil and MOL, including the Development Plan. The Company will continue to evaluate the potential for further activity in the Makó Trough in both the Falcon Lands and its exploration opportunities outside of the Production License. The Company’s requirements for additional capital are dependent upon its future operating plans, including the results of ExxonMobil’s evaluation of the Contract Area.

The Company’s future capital requirements will also be dependent upon the evaluation of the Beetaloo Basin Project described above, since the Company has already notified PetroHunter that the Company would not exercise the Buckstein Mesa Option.

The availability of debt and equity capital, and the price, at which additional capital could be issued, will be dependent upon the success of the Company’s exploration activities, and upon the state of the capital markets generally.

Transactions with Non-Arm’s Length Parties and Related Parties

The Company has entered into certain agreements and transactions with PetroHunter, a non-arm’s length party for the purposes of the TSX Venture Exchange, whose largest single shareholder is also the President and CEO of the Company. As discussed above, the Company acquired working interests from PetroHunter in the Beetaloo Basin Project and the Buckskin Mesa Project.

In June 2006, the Company entered into an office sharing agreement with PetroHunter for office space in Denver, Colorado, of which the Company is the lessee. Under the terms of the agreement, PetroHunter and the Company shared, on an equivalent employee basis, all costs related to the office space, including rent, office operating costs, furniture and equipment and any other expenses related to the operations of the corporate offices. Certain employees of PetroHunter had provided services to the Company, and in 2007 PetroHunter invoiced the Company $176,000 (2008- nil) for these services at cost. The above described office sharing arrangement was mutually terminated effective February 1, 2008. As at December 31, 2008 and 2007, PetroHunter owed the Company nil and $678,000, respectively, for its share of net costs incurred under this arrangement.

On October 1, 2008, the Company agreed to lend PetroHunter $5,000,000. Under the terms of the loan agreement, as amended on December 10, 2008, funds were advanced by the Company directly to certain creditors and vendors of PetroHunter who assigned leases in, provided goods to, or rendered services for the Beetaloo Basin Project and Buckskin Mesa Project. The loan bears interest at the rate of 10% per annum, and interest-only payments are due monthly. The maturity date is April 30, 2009. The collateral for the loan is as follows: (a) first mortgage on the Five Wells; (b) of the 28,888,888 Common Shares issued to PetroHunter in connection with the acquisition of the Beetaloo Basin: (1) 14,500,000 are held in escrow, with the proceeds from the sale to be irrevocably directed to the Company and applied on the account of the indebtedness; (2) 11,600,000 are available to PetroHunter as collateral for loans from third parties, and if PetroHunter obtains any such third party loans, the proceeds thereof shall be applied as follows: the first $4,000,000 shall be for PetroHunter’s use as working capital in the normal course of business, the next $2,000,000 shall be paid to the Company to reduce the outstanding principal balance of the loan, and thereafter the proceeds shall be distributed successively 50% to each party until the earlier of being fully applied or until all accrued and unpaid interest and principal under the loan is fully paid; and (3) the remaining 2,788,888 are held in escrow and may be sold by PetroHunter, in which case the proceeds of any such sale shall be distributed solely to PetroHunter (with none distributed to the Company). If the loan is not paid by April 30, 2009, in addition to all other remedies available to the Company, PetroHunter shall, upon the request of the Company, resign as operator under the joint operating agreement executed in connection with the Beetaloo Basin PSA and shall appoint (or if applicable, vote in favor of) the Company as operator under that joint operating agreement.

On April 27, 2009, Falcon issued a press release announcing that it has entered into a non-binding letter of intent (the “**LOI**”) with PetroHunter which stipulates that the Company will acquire an additional undivided 25% working interest in Beetaloo Basin Project. Under the terms of the LOI, the principal consideration being paid by the Company for this transaction is the forgiveness of the PetroHunter Loan. The LOI also stipulates that, on closing of this transaction, the Company will become operator of the Beetaloo Basin Project under the Beetaloo Basin Project joint operating agreement, and that PetroHunter and certain of its affiliates and the Company will enter into an escrow agreement which will govern the release of all remaining Common Shares previously issued to PetroHunter. The closing of this transaction is subject to the execution of definitive agreements, the fulfillment of certain closing conditions, as well as the receipt of all required regulatory approvals. Closing of this transaction is expected to occur on or about May 25, 2009.

During 2008, the Company incurred $180,000 (2007-$180,000) and $36,000 (2007-nil) to two current directors of the Company, Dr. György Szabó and Janos Csak, for advisory and consulting services rendered to TXM; and $156,000 (2007- $44,000) in consulting fees to a current director of the Company, Daryl Gilbert, for advisory and consulting services rendered to Falcon. David Brody, the Company's Corporate Secretary and General Counsel, is a partner of Patton Boggs LLP, a US law firm that provides US legal advice to the Company. The Company has not recorded any amounts paid to Patton Boggs LLP as transactions with a related party because Mr. Brody has not received any remuneration from Patton Boggs LLP since his appointment as Corporate Secretary and General Counsel of Falcon.

DISCLOSURE OF OUTSTANDING SHARE DATA

The following is a summary of the Company's outstanding share data as at December 31, 2008 and April 29, 2009:

Class Of Securities	December 31, 2008	April 29, 2009
Common Shares	595,799,301	595,799,301
Stock Options	46,950,000	46,950,000
December Underwriters' Warrants(1)	4,288,750	4,288,750

Notes:

(1) December Underwriters' Warrants to purchase 6,000,000 Common Shares at a price of $0.39 (CDN$0.40) per share were issued in December 2007 in connection with the December Offering and expire two years after the date of issuance.

OFF-BALANCE SHEET ARRANGEMENTS AND PROPOSED TRANSACTIONS

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

CRITICAL ACCOUNTING POLICIES

Management is often required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company. Following is a discussion of the accounting estimates that are critical in determining the Company's financial results.

Full cost accounting

The Company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs relating to the exploration and development of petroleum and natural gas reserves are capitalized on a country-by-country cost centre basis. Such costs include land acquisition costs, costs of drilling both productive and non-productive wells, well equipment, flow line and facility costs, geological and geophysical expenses and overhead expenses directly related to exploration and development activities. Gains or losses on sales of properties are recognized only when crediting the proceeds to the recorded costs would result in a change of 20% or more in the depletion and depreciation rate. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs are amortized using the unit-of-production method based on estimated proved reserves of petroleum and natural gas before royalties as determined by independent petroleum engineers. Changes in estimated proven reserves or future development costs have a direct impact on depletion and depreciation expense.

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly to determine if proved reserves should be assigned to them. If proved reserves are assigned to the properties, the costs are included in the depletion calculation. Similarly, if assets are determined to be impaired, any applicable write-downs are charges to depletion expense.

Petroleum and natural gas reserves

Estimates of petroleum and natural gas reserves are projections based on geological and engineering data. There are uncertainties inherent in these projections, including the interpretation of data and the projection of future rates of production and the timing of developmental expenditures. Reserve engineering is an analytical process of estimating below ground accumulations of petroleum and natural gas that are difficult to measure. The accuracy of any reserve estimate is a function of the quality of available data, engineering and geological interpretation and judgment. The Company's proved petroleum and natural gas reserves are evaluated and reported on annually by an independent petroleum-engineering consultant. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to a number of uncertainties and various interpretations. The Company expects that over time its reserve estimates will be revised upward or downward based on updated information such as the results of future drilling, testing and production levels. Reserve estimates can have a significant impact on net earnings, as they are a key component in the calculation of depletion. A revision to the reserves estimate could result in a higher or lower DD&A charge to net earnings. Downward revisions to reserve estimates could also result in a write-down of petroleum and natural gas property, plant and equipment under the ceiling test described below.

At December 31, 2008, the Company had proved reserves for the Hackett Interests.

Ceiling test

The carrying value of property, plant and equipment is reviewed each quarter for impairment. Impairment will occur when the carrying amount of the property, plant and equipment minus the sum of the undiscounted cash flows expected to result from the Company's proved reserves yields a negative result. The cash flows are calculated based on third party quoted forward prices and adjusted for the Company's contract and/or hedged prices as well as quality differentials. If there were impairment, the magnitude of it would be calculated by comparing the carrying amount of property, plant and equipment to the estimated net present value of future cash flows from proved plus risked probable reserves. A risk-free interest rate is used to arrive at the net present value of future cash flows. Any excess carrying value above the net present value of future cash flows would be recorded as a permanent impairment and charged as additional depletion expense in the Statement of Operations.

For the year ended December 31, 2008, no write-downs were required for the Company's petroleum and natural gas properties in Australia, Canada, Hungary and Romania, although the Company did require a write-down on the Buckskin Mesa Project.

Asset retirement obligations

The Company recognizes the fair value of asset retirement obligations ("**ARO**") in the period in which they are incurred and when a reasonable estimate of fair value can be made. The obligations recognized are estimates of statutory, contractual or legal obligations that the Company will reasonably be expected to incur and then discounted to its present value using the Company's credit adjusted risk-free interest rate. The fair value of the estimated ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on a unit-of-production basis over the life of the reserves. The liability amount is increased each reporting period due to the passage of time and the amount of this accretion is charged to earnings in the period through charges to accretion expense. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost would also result in an increase or decrease to the ARO. Any difference between the actual costs incurred upon settlement of the ARO and the recorded liability is recognized as a gain or loss in the Company's earnings in the period in which the settlement occurs. Determination of the original undiscounted costs is based on engineering estimates using current costs in accordance with existing legislation and industry practice. The estimation of these costs can be affected by factors such as the number of wells drilled, well depth, estimated future salvage values, location of the well and current environmental legislation.

At December 31, 2008, the Company has recorded an ARO for the Beetaloo Basin Project, the Hackett Interest, the six exploratory wells in Hungary and the Five Wells.

Future income tax

The Company follows the asset and liability method of accounting for income taxes. Under this method the Company records future income tax assets and liabilities based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities) and are measured using the currently enacted, or substantively enacted tax rates and laws expected to apply when these differences reverse. The effect of a change in substantively enacted income tax rates on future income tax assets and liabilities is recognized in income in the period that the change occurs.

Stock based compensation

The Company has a stock based compensation plan enabling officers, directors and employees to purchase common shares at exercise prices equal to the market price on the date the option is granted. The Company uses the fair value method for valuing stock option grants. Compensation costs attributable to share options granted are measured at their fair value at the grant date and expensed over the expected exercise time period with a corresponding increase to contributed surplus. Upon exercise of the stock options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is credited to share capital. The assumptions used in calculating its stock based compensation expense are: the volatility of the stock price, risk-free rates of return and the expected lives of the options given that some will be forfeited upon termination of employment.

Foreign currency

The United States dollar is our reporting currency in all of the Company's areas of operations: Australia, Canada, Hungary, Romania and United States. The Australian dollar, the Canadian dollar, the Hungarian forint, the Romanian lei, and the United States dollar are the functional currencies. The Company attempts to manage its operations in such a manner as to reduce its exposure to foreign exchange losses. However, there are many factors that affect foreign exchange rates and resulting exchange gains and losses, many of which are beyond the Company's influence. It is not possible to predict the extent to which the Company may be affected by future changes in exchange rates.

CHANGES IN ACCOUNTING POLICIES

(a) Capital Disclosures and Financial Instruments-Disclosures and Presentation

The Company adopted three new presentation and disclosure standards that were issued by the Canadian Institute of Chartered Accountants: Handbook Section 1535, "Capital Disclosures" ("**Section 1535**"), Handbook Section 3862, "Financial Instruments-Disclosures" ("**Section 3862**") and Handbook Section 3863, "Financial Instruments-Presentation" ("**Section 3863**").

Section 1535 requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital. Section 1535 specifies the disclosures of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, "Financial Instruments-Presentation and Disclosure", revising and enhancing its disclosure requirements and carrying forward unchanged its presentation requirements for financial instruments. Sections 3862 and 3863 place increased emphasis n disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

(b) Inventories

Handbook Section 3031, "Inventories" ("**Section 3031**"), which replaces Handbook Section 3030 "Inventories", requires inventory to be carried at the lower of cost and net realizable value using, in certain cases, the specific identification method or either of the first-in, first-out or average cost methods. Write downs to net realizable value may be reversed, to the extent of the original write down, if there is clear evidence of an increase in value due to a change in circumstances. Except for the new guidance on reversal of write downs, the Company's current practice for valuing inventories is substantially in accordance with the new standard, and therefore the adoption of Section 3031 did not result in a material impact on the Company's consolidated financial position and results of operations.

NEW CANADIAN ACCOUNTING STANDARDS

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

(a) Goodwill and intangible assets

Effective on January 1, 2009, the Company will adopt Handbook 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 is not anticipated to have a significant effect on the Company's consolidated financial statements.

(b) 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 and 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 to be differences between Canadian generally accepted accounting principles and IFRS, and is therefore monitoring this project with a view to understanding the possible future effects of the transition to IFRS.

No other new accounting policies were adopted by the Company during the year ended December 31, 2008, and the Company is not expected to adopt any new accounting policies in 2009.

Business Risks and Uncertainties

As stated above and as discussed in the Company's continuous disclosure documents, certain risks and uncertainties that could cause the Company's actual results to materially differ from our current expectations include, but are not limited to:

- The Company's business is at a similar stage to that of a recently formed company with no operating history, which makes it difficult to evaluate its business prospects;
- The Company cannot be certain that it will continuously meet all requirements to maintain the Production Licenses;
- The Company cannot be certain that current expected expenditures and completion/testing programs will be realized;
- The Company will have substantial capital requirements that, if not met, may hinder its growth and operations;
- The Company might not be able to determine reserve potential, identify liabilities associated with the properties or obtain protection from sellers against them, which could cause the Company to incur losses;
- The Company might incur debt in order to fund its exploration and development activities, which would continue to reduce its financial flexibility and could have a material adverse effect on the Company's business, financial condition or results of operation;
- Shortages of rigs, equipment, supplies and personnel could delay or otherwise adversely affect the Company's cost of operations or its ability to operate according to its business plans;
- Resource estimates depend on many assumptions that may turn out to be inconclusive, subject to varying interpretations, or inaccurate;
- The value of the common shares might be affected by matters not related to the Company's own operating performance for reasons that include the following:
    - general economic conditions in Australia, Canada, Hungary, Romania, the United States and globally;
    - industry conditions, including fluctuations in the price of petroleum and natural gas;
    - governmental regulation of the petroleum and natural gas industry, including environmental regulation;
    - fluctuation in foreign exchange or interest rates;
    - liabilities inherent in petroleum and natural gas operations;
    - geological, technical, drilling and processing problems;
    - unanticipated operating events which can reduce production or cause production to be shut-in or delayed;
    - failure to obtain third party consents and approvals, when required;
    - stock market volatility and market valuations;
    - competition for, among other things, capital, acquisition of reserves, undeveloped land and skilled personnel;

- the need to obtain required approvals from regulatory authorities;
- Hungarian and worldwide supplies and prices of and demand for petroleum and natural gas;
- political conditions and developments in Hungary;
- political conditions in petroleum and natural gas producing regions;
- revenue and operating results failing to meet expectations in any particular period;
- investor perception of the petroleum and natural gas industry;
- limited trading volume of Common Shares;
- change in environmental and other governmental regulations;
- announcements relating to the Company's business or the business of its competitors;
- the Company's liquidity; and
- the Company's ability to raise additional funds.

- The Company might not be able to obtain necessary approvals from one or more Hungarian government agencies, surface owners, or other third parties;
- Drilling for and producing petroleum and natural gas are high-risk activities with many uncertainties that could adversely affect the Company's business, financial condition or results of operations;
- Competition in the petroleum and natural gas industry is intense, and many of the Company's competitors have greater financial, technological and other resources than the Company does, which may adversely affect its ability to compete;
- Political instability or fundamental changes in the leadership or in the structure of the governments in the jurisdictions in which the Company operates could have a material negative impact on the Company;
- Market conditions or operation impediments may hinder the Company's access to petroleum and natural gas markets or delay its production;
- A substantial or extended decline in petroleum and natural gas prices may adversely affect the Company's ability to meet its capital expenditure obligations and financial commitments;
- The Company may enter into currency hedging agreements but may not be able to hedge against all such risks;
- The Company is subject to complex laws and regulations, including environmental regulations, which can have a material adverse effect on the cost, manner or feasibility of doing business;
- The loss of the Company's chief executive officer or other of the Company's key management and technical personnel or its inability to attract and retain experienced technical personnel could adversely affect the Company's ability to operate;
- The Company does not insure against all potential operating risks. It might incur substantial losses and be subject to substantial liability claims of its petroleum and natural gas operations; and

- To the extent that the Company establishes petroleum and natural gas reserves, it will be required to replace, maintain or expand its petroleum and natural gas reserves in order to prevent its reserves and production from declining, which would adversely affect cash flows and income.

Should one or more of these risks materialize, or should the Company's underlying assumptions prove incorrect, the Company's actual results may materially differ from the Company's current expectations. Therefore, in evaluating forward-looking statements, readers should specifically consider the various factors that could cause the Company's actual results to materially differ from such forward-looking statements.

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 reported to the Board of Directors. The Board of Directors has approved the MD&A as presented.