# FALCON OIL & GAS LTD.

# FORM 51-102F1
# MANAGEMENT'S DISCUSSION AND ANALYSIS
# FOR THE SIX MONTHS ENDED JUNE 30, 2009

The following management's discussion and analysis (the "**MD&A**") was prepared as at August 27, 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 for the six months ended June 30, 2009. This MD&A should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2008.

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. ("**FOG-TXM**"), a Hungarian limited liability company, JVX Energy S.R.L. ("**JVX**"), a Romanian limited liability company, and Falcon Oil & Gas Australia Pty. Ltd ("**Falcon Australia**"), an Australian company (collectively, the "**Company**").

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**"), 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 the Company

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 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 acquisition, exploration and development of conventional and unconventional petroleum and natural gas projects in Central Europe, specifically Hungary, and in Australia with the Beetaloo Basin project acquisitions in 2008 and 2009.

### Hungary

The Company holds a long-term Mining Plot (the "**Production License**") granted by the Hungarian Mining Authority. The lands within the Production License were formerly part of the Company's two petroleum and natural gas exploration licenses – the Tisza License and the Mako License (collectively, the "**Exploration Licenses**"). The Production License and the Exploration Licenses, covering approximately 575,700 acres, give the Company the exclusive right to explore for petroleum and natural gas on properties located in south central Hungary near the town of Szolnok. The Production License further gives the Company the exclusive right to commercially develop petroleum and natural gas within the area covered by that license. The Exploration Licenses expire on December 31, 2009, and are not eligible for extension. However, under the Hungarian laws applicable to oil and gas exploration licenses, the licensee has the first priority in obtaining a mining plot covering all or part of the area, but is not guaranteed that it will receive a mining plot. The process requires the filing of a "Closing Report" within six months from the expiration of the license, and filing an application for the mining plot within the second six-month period.

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

On April 10, 2008, Falcon and TXM entered into the Production and Development Agreement (the "**PDA**"), as amended, with ExxonMobil Corporation affiliate Esso Exploration International Limited ("**ExxonMobil**") under which Falcon and ExxonMobil became joint owners in a specified portion (the "**Contract Area**") of the Production License. Pursuant to a pre-existing agreement between ExxonMobil and MOL Hungarian Oil and Gas Plc. ("**MOL**") and ExxonMobil's rights under the PDA, ExxonMobil sold one-half of its interest in the Contract Area to MOL, effective April 10, 2008. ExxonMobil, MOL and TXM are also parties to a joint operating agreement (the "**JOA**"), dated April 10, 2008, which governs all operations of the Contract Area that are not expressly addressed in the PDA. ExxonMobil is the operator of the Contract Area under the JOA.

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

The PDA provides 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. 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. 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.

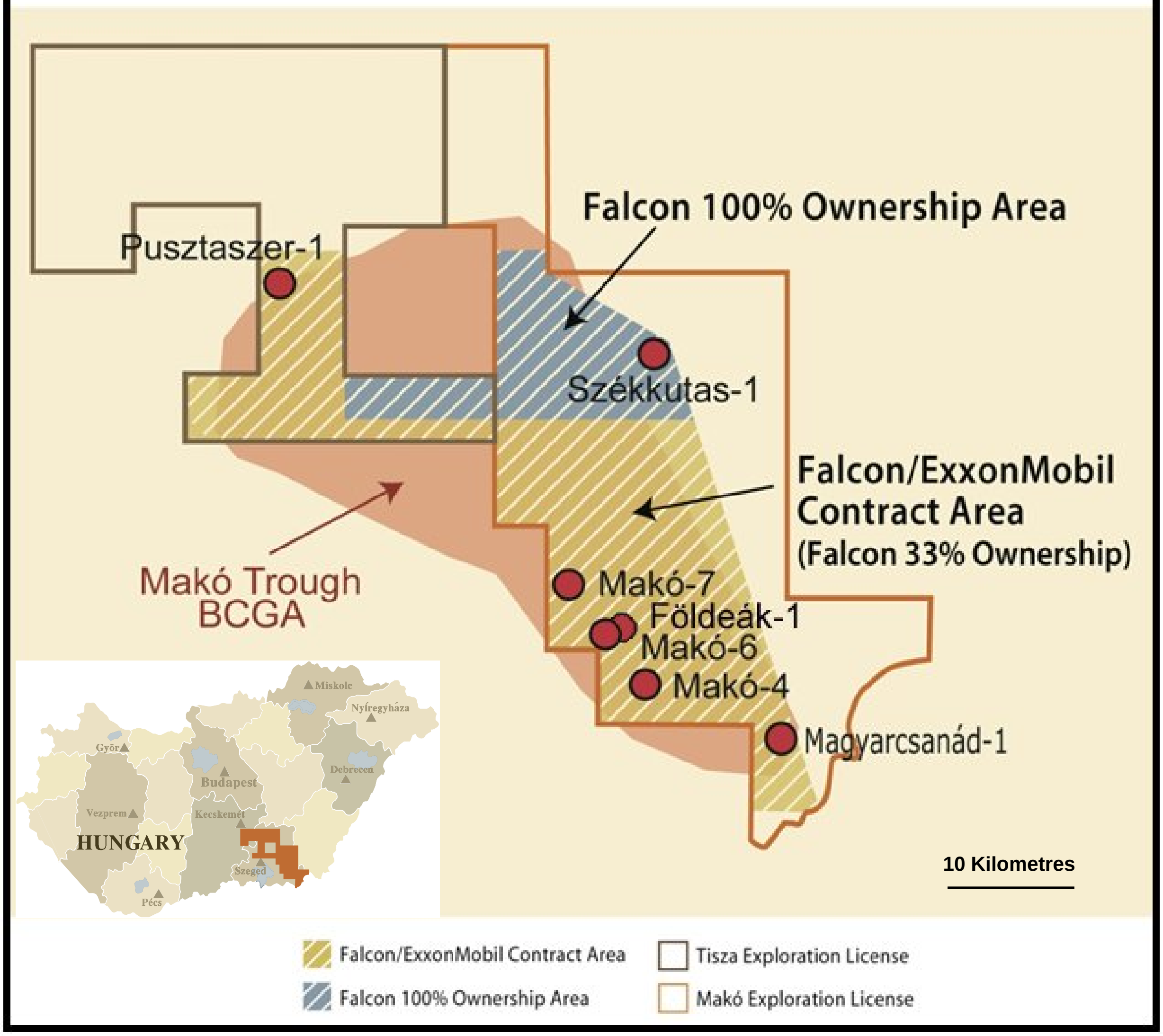
After the Appraisal Work Program is completed, ExxonMobil has another election point – that is, to elect to proceed to full-scale development of the Contract Area (the "**Development Program**"). If ExxonMobil elects to proceed forward, ExxonMobil and MOL will pay the Company an aggregate of an additional $37.5 million, and will expend $37.5 million in a manner consistent with the Appraisal Work Program. 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 Initial Work Program and the Appraisal Work Program. In either circumstance the Company 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 the Company 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 JOA. In addition to the Company's 33% undivided ownership in the ExxonMobil-operated Contract Area, the Company remains sole owner and operator of 391,400 acres outside the Contract Area boundaries, as well as shallow rights covering 184,300 acres within the Contract Area, as follows:

- **Falcon Lands:** The Company retains 100% ownership in the remaining 25% (61,400 acres) of the Production License that is not part of the Contract Area.
- **Exploration Licenses:** Under the original Exploration Licenses, the Company retains 100% ownership in 330,000 acres which are outside the boundaries of the Production License. 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 shallow depths are not part of the Production License.

Falcon Ownership Interest in the Makó Trough


Falcon 100% Ownership Area
Pusztaszer-1
Székkutas-1
Falcon/ExxonMobil Contract Area (Falcon 33% Ownership)
Makó Trough BCGA
Makó-7
Földeák-1
Makó-6
Makó-4
Magyarcsanád-1
10 Kilometres
Miskolc
Nyíregyháza
Győr
Debrecen
Budapest
Vezprem
Kecskemét
HUNGARY
Szeged
Pécs
▨ Falcon/ExxonMobil Contract Area
▨ Falcon 100% Ownership Area
□ Tisza Exploration License
□ Makó Exploration License

*Resource Estimates*

In May 2008, Falcon received a resource estimate from RPS Scotia, Inc. ("**RPS Scotia**") for the Makó Trough, Hungary effective March 31, 2008 (the "**RPS Scotia Report**"). The RPS Scotia Report is an update to the Company's previous resource estimate of the Makó Trough dated and effective in 2006 (the "**Scotia Report**").

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

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**<br>**42.6 mmbo** | **43.9 Tcf**<br>**97.8 mmbo** | **68.0 Tcf**<br>**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 2009*

In May 2009, ExxonMobil reached total depth of 14,500 feet (4,421 meters) on the drilling of the Földeák-1 well, which is currently being evaluated for testing. This well is part of the Initial Work Program under the PDA. The primary focus of the Initial Work Program and the Földeák-1 well is to test the Szolnok Formation.

*Future Operations*

Future operations within the Contract Area are subject to the terms of the PDA, as long as it remains in effect. Future operations within all of the Company's other Hungarian properties are being evaluated and will be determined based on a number of factors.

### Beetaloo Basin, Northern Territory, Australia

On September 30, 2008, Falcon and Falcon Australia consummated the acquisition of an undivided 50% working interest in an aggregate 7,000,000 acres in four exploration permits (the "**Permits**") in the Beetaloo Basin, Australia (the "**Beetaloo Basin Project**") pursuant to the terms of a Purchase and Sale Agreement, as amended on October 31, 2008, (together, the "**Beetaloo PSA**") with PetroHunter Energy Corporation and certain of its affiliates (collectively, "**PetroHunter**"), each of which is a non-arm's length party for the purposes of the TSX Venture Exchange (the "**TSXV**").

On June 11, 2009, pursuant to a second Purchase and Sale Agreement (the "**Second PSA**") with PetroHunter, the Company completed the acquisition of an additional undivided 25% working interest in the Beetaloo Basin Project. Under the terms of the Second PSA, the principal consideration being paid by the Company for this transaction was the exchange of the $5,000,000 note receivable from PetroHunter. In addition, the Company has agreed to pay certain vendors who had provided goods or services for the Beetaloo Basin Project, prior to the Company acquiring its 50% interest in September 2008, in exchange for inventory and operator bonds of approximately the same value, and has relinquished its right to the unexpended testing and completion funds of the Buckskin Mesa project as discussed below. Upon closing, the Company became operator of the Beetaloo Basin Project, and PetroHunter and the Company entered into an escrow agreement governing the release of all remaining common shares of Falcon previously issued to PetroHunter.

PetroHunter had previously drilled one well in 2007, the Shenandoah-1 well, which was suspended prior to reaching its intended total depth. The Company has commenced operations to re-enter the Shenandoah-1 well to be drilled to the planned total depth. As such, this well is untested and has no associated reserves.

In August 2009, the Company received a Resource Analysis Report from Ryder Scott Company - Canada (the "**Ryder Scott Report**") on the Beetaloo Basin Project, dated August 5, 2009 and effective as of July 1, 2009.

The Ryder Scott Report on the hydrocarbon resource potential of the Beetaloo Basin describes a possible distribution of the un-risked prospective (recoverable) portion of un-risked "Undiscovered in-place Resources," as defined by the COGEH, and does not represent an estimate of reserves or contingent resources. The Ryder Scott Report has been prepared in accordance with the Canadian standards set out in the COGEH and is compliant with NI 51-101.

Ryder Scott's resource evaluation of the Beetaloo Basin is as follows:

**Table 9: Total Undiscovered and Prospective (Recoverable) Oil Resources in the Beetaloo Basin, Australia**

| | Un-risked Undiscovered Oil-In-Place (Bstb) | | | Un-risked Prospective (Recoverable) Oil Resources (Bstb) | | |
|---|---|---|---|---|---|---|
| | **Low** | **Best** | **High** | **Low** | **Best** | **High** |
| Hayfield | 0.049 | 0.088 | 0.148 | 0.005 | 0.010 | 0.018 |
| Jamison | 8.220 | 11.920 | 16.402 | 0.800 | 1.337 | 2.153 |
| Conventional subtotal | 8.269 | 12.008 | 16.550 | 0.805 | 1.347 | 2.171 |
| Upper Kyalla shale oil | 127.4 | 180.9 | 256.0 | 11.3 | 17.8 | 27.4 |
| Shale oil subtotal | 127.4 | 180.9 | 256.0 | 11.3 | 17.8 | 27.4 |
| Total oil resource within the Beetaloo Basin | 135.67 | 192.91 | 272.55 | 12.11 | 19.15 | 29.57 |

**Table 10: Total Undiscovered and Prospective (Recoverable) Gas Resources in the Beetaloo Basin, Australia**

| | Un-risked Undiscovered Gas-In-Place (Tscf) | | | Un-risked Prospective (Recoverable) Gas Resources (Tscf) | | |
|---|---|---|---|---|---|---|
| | **Low** | **Best** | **High** | **Low** | **Best** | **High** |
| Hayfield (associated solution) | 0.013 | 0.025 | 0.046 | 0.002 | 0.004 | 0.009 |
| Jamison (associated solution) | 2.041 | 3.330 | 5.349 | 0.313 | 0.585 | 1.066 |
| Moroak | 0.800 | 1.437 | 2.346 | 0.607 | 1.048 | 1.731 |
| Conventional subtotal | 2.85 | 4.79 | 7.74 | 0.92 | 1.64 | 2.81 |
| Moroak BCGA | 21.00 | 29.61 | 40.85 | 3.18 | 4.85 | 7.23 |
| Bessie Creek BCGA | 159.4 | 210.0 | 275.0 | 23.8 | 34.4 | 49.4 |
| BCGA subtotal | 180.39 | 239.58 | 315.81 | 27.02 | 39.28 | 56.64 |
| Lower Kyalla shale gas | 12.70 | 15.80 | 19.20 | 1.90 | 2.60 | 3.50 |
| Middle Velkerrie shale gas | 94.6 | 125.1 | 160.4 | 14.2 | 20.4 | 29.0 |
| Shale gas subtotal | 107.3 | 140.9 | 179.6 | 16.1 | 23.0 | 32.5 |
| Total gas resource within the Beetaloo Basin | 290.54 | 385.27 | 503.16 | 44.05 | 63.91 | 91.94 |

Tables 9 and 10 are from the Ryder Scott Report. For a definition of “Low” “Best” and “High,” see Section 5 of the Ryder Scott Report titled “Definitions of Resources and Reserves,” item 5.3.5 titled “Uncertainty Category.” The total oil and gas resource is an arithmetic summation of the multiple estimates of the individual reservoir resources. Under Section 5.2 of COGEH: Undiscovered Petroleum Initially-In-Place (equivalent to undiscovered resources) is that quantity of petroleum that is estimated, on a given date, to be contained in accumulations yet to be discovered. Prospective Resources are those quantities of petroleum estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Prospective resources have both an associated chance of discovery and a chance of development. There is no certainty that any portion of the undiscovered resources will be discovered and that, if discovered, it may not be economically viable or technically feasible to produce any of the resources.

## 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.

## Romania

In February 2008, the Company was notified that it has been contingently awarded a new concession, the "Anina Concession". The award was subject to negotiation and finalization of a concession agreement for the acreage. A minimal work program is required under the Anina Concession, and the Company has the option to withdraw from the concession agreement at the end of each contract year. As of June 30, 2009, the Company has determined that it will not proceed with any work program on the Anina Concession, and has charged to operations its entire carrying cost in the project.

### Buckskin Mesa, Piceance Basin, US

On October 31, 2008, the Company consummated the acquisition of an undivided 25% working interest in five wells, including the 40-acre tract surrounding each well (collectively, the "**Five Wells**") from PetroHunter situated within PetroHunter's 20,000-acre Buckskin Mesa Project located in the Piceance Basin, Colorado, and to undertake a testing and completion program in respect of the Five Wells pursuant to the terms of the Purchase and Sale Agreement (the "**Buckskin PSA**"). Under the 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 undivided 25% interest in the Five Wells and acquire no greater interest, or it could exercise the Buckskin Option to acquire an additional undivided 25% working interest in the Five Wells (for a total of 50%) and a undivided 50% working interest in the remainder of the 20,000-acre Buckskin Mesa Project.

On February 24, 2009, the Company notified PetroHunter that it would not exercise the Buckskin Mesa Option. In accordance with the Second PSA, the Company reassigned the undivided 25% working interest in the Five Wells to PetroHunter, and the Company was relieved of all obligations related to the Five Wells, including reclamation and plugging and abandonment obligations.

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

### *Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three Months Ended June 30, 2009 as Compared to the Three Months Ended June 30, 2008*

This review of the results of operations should be read in conjunction with the unaudited interim consolidated financial statements for the six months ended June 30, 2009 and 2008, and the audited consolidated financial statements for the year ended December 31, 2008.

## RESULTS OF OPERATIONS

The Company reported a net loss of $3,694,000 ($0.006 per share) for 2009 as compared to net loss of $7,486,000 ($0.013 per share) for 2008. Significant changes between the 2009 and 2008 year were as follows:

| | **Three Months Ended June 30,** | | **Change** | |
|---|---|---|---|---|
| | **2009** | **2008** | **$** | **%** |
| Stock based compensation | $ (1,570,000) | $ (3,731,000) | $ 2,161,000 | 57.9% |
| Gain (loss) on foreign exchange | 1,487,000 | (868,000) | 2,355,000 | 271.3% |
| Other | (3,611,000) | (2,887,000) | (724,000) | (25.0)% |
| Net income (loss) and comprehensive income (loss) | $ (3,694,000) | $ (7,486,000) | $ 3,792,000 | 50.7% |

| | **Three Months Ended June 30,** | | **Change** | |
|---|---|---|---|---|
| | **2009** | **2008** | **$** | **%** |
| **Petroleum revenue** | $ 9,000 | $ 25,000 | $ (16,000) | (64.0)% |
| **Direct costs** | | | | |
| Production costs | 18,000 | 5,000 | (13,000) | (260.0)% |
| Depreciation, depletion and accretion | 91,000 | 94,000 | 3,000 | 3.2% |
| | 109,000 | 99,000 | (10,000) | (10.1)% |
| **Costs and expenses** | | | | |
| Accounting | 206,000 | 281,000 | 75,000 | 26.7% |
| Depreciation and amortization | 122,000 | 112,000 | (10,000) | (8.9)% |
| Consulting | 300,000 | 374,000 | 74,000 | 19.8% |
| Director fees | 66,000 | 67,000 | 1,000 | 1.5% |
| Investor relations | 243,000 | 181,000 | (62,000) | (34.3)% |
| Legal costs | 444,000 | 325,000 | (119,000) | (36.6)% |
| Office and administrative | 709,000 | 665,000 | (44,000) | (6.6)% |
| Payroll and related costs | 1,010,000 | 720,000 | (290,000) | (40.3)% |
| Stock based compensation | 1,570,000 | 3,731,000 | 2,161,000 | 57.9% |
| Travel and promotion | 578,000 | 539,000 | (39,000) | (7.2)% |
| | 5,248,000 | 6,995,000 | 1,747,000 | 25.0% |
| **Other income (expense)** | | | | |
| Interest income | 115,000 | 451,000 | (336,000) | (74.5)% |
| Impairment of petroleum and natural gas properties | (45,000) | - | (45,000) | |
| Gain (loss) on foreign exchange | 1,487,000 | (868,000) | 2,355,000 | 271.3% |
| Other income (expense) | 97,000 | - | 97,000 | |
| | 1,654,000 | (417,000) | 2,071,000 | 496.6% |
| **Net income (loss) and comprehensive income (loss)** | $ (3,694,000) | $ (7,486,000) | $ 3,792,000 | 50.7% |

*Petroleum Revenue*

Revenue from petroleum and natural gas sales 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*

General and administrative decreased $1,747,000, or 25.0% from 2008 to 2009. The significant components of changes in general and administrative expenses in 2009, as compared to 2008, were as follows:

- Consulting – the decrease resulted from the employment during 2009 of an individual who rendered services to the Company as a consultant during 2008.

- Legal costs – the increase resulted from greater operating activities in Australia during 2009, and additional corporate and administrative matters in Hungary.

- Investor relations – the increase was attributable to the Company’s financing activities resulting in the completion of the Offering (as defined below) in June 2009.

- Payroll and related costs – the increase was attributable to the retention of additional personnel to work on the Beetaloo Basin Project, and the employment of an individual who previously rendered services to the Company as a consultant.

- Stock based compensation – the decrease was attributable to the value of option granted during 2008 as compared to no options granted in 2009. During 2008, the Company granted officers, directors, employees and consultants options to purchase 13,610,000 common shares of Falcon 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.

*Other income (expense)*

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

- Gain (loss) on foreign exchange – during the second quarter of 2009, the gain on foreign exchange was primarily due to the payment of obligations for operating activities in Hungary during a period when the value of the Hungarian forint was declining relative to the US dollar. During the second quarter of 2008, the loss on foreign exchange was attributable to foreign exchange movements on Canadian denominated cash accounts.

  Compared to the US dollar, the value of the Canadian dollar remained relatively static throughout the first half of 2008; thereafter, the US dollar strengthened relative to the Canadian dollar through the first quarter of 2009 and, during the second quarter of 2009, weakened during the first two months and strengthened during the last month.

  Compared to the US dollar, the value of the Hungarian forint strengthened relative to the US dollar throughout the first half of 2008; thereafter, the US dollar strengthened relative to the Hungarian forint through the first quarter of 2009, and has weakened during the entire second quarter of 2009.

Substantially all of the Company's financings have been in Canadian dollars; commensurate with the strengthening of the US dollar, the Company changed the composition of its cash balances to 61% in US dollars, 35% in Canadian dollars, 3% in Hungarian forints, 1% in Euros and nil in Australian dollars at June 30, 2009; a significant portion of the Company's operations are in Hungarian forints. The increase in the Canadian dollar cash balance relative to the total cash balance resulted from the proceeds from the unit offering discussed below.

### *Management's Discussion and Analysis of Financial Condition and Results of Operations for the Six Months Ended June 30, 2009 as Compared to the Six Months Ended June 30, 2008*

The Company reported net loss of $7,482,000 ($0.012 per share) for 2009 as compared to net loss of $11,861,000 ($0.021 per share) for 2008. Significant changes between the 2009 and 2008 year were as follows:

| | **Six Months Ended June 30,** | | **Change** | |
|---|---|---|---|---|
| | **2009** | **2008** | **$** | **%** |
| Stock based compensation | $ (2,962,000) | $ (5,113,000) | $ 2,151,000 | 42.1% |
| Gain (loss) on foreign exchange | 1,983,000 | (1,280,000) | 3,263,000 | 254.9% |
| Other | (6,503,000) | (5,468,000) | (1,035,000) | (18.9)% |
| Net income (loss) and comprehensive income (loss) | $ (7,482,000) | $(11,861,000) | $ 4,379,000 | 36.9% |

| | Six Months Ended June 30, | | Change | |
|---|---|---|---|---|
| | 2009 | 2008 | $ | % |
| **Petroleum revenue** | $ 20,000 | $ 44,000 | $ (24,000) | (54.5)% |
| **Direct costs** | | | | |
| Production costs | 19,000 | 12,000 | (7,000) | (58.3)% |
| Depreciation, depletion and accretion | 183,000 | 188,000 | 5,000 | 2.7% |
| | 202,000 | 200,000 | (2,000) | (1.0)% |
| **Costs and expenses** | | | | |
| Accounting | 309,000 | 405,000 | 96,000 | 23.7% |
| Depreciation and amortization | 230,000 | 215,000 | (15,000) | (7.0)% |
| Consulting | 823,000 | 669,000 | (154,000) | (23.0)% |
| Director fees | 132,000 | 134,000 | 2,000 | 1.5% |
| Investor relations | 407,000 | 341,000 | (66,000) | (19.4)% |
| Legal costs | 756,000 | 808,000 | 52,000 | 6.4% |
| Office and administrative | 1,345,000 | 1,194,000 | (151,000) | (12.6)% |
| Payroll and related costs | 1,745,000 | 1,394,000 | (351,000) | (25.2)% |
| Stock based compensation | 2,962,000 | 5,113,000 | 2,151,000 | 42.1% |
| Travel and promotion | 906,000 | 1,004,000 | 98,000 | 9.8% |
| | 9,615,000 | 11,277,000 | 1,662,000 | 14.7% |
| **Other income (expense)** | | | | |
| Interest income | 267,000 | 852,000 | (585,000) | (68.7)% |
| Impairment of petroleum and natural gas properties | (45,000) | - | (45,000) | |
| Gain (loss) on foreign exchange | 1,983,000 | (1,280,000) | 3,263,000 | 254.9% |
| Other income (expense) | 110,000 | - | 110,000 | |
| | 2,315,000 | (428,000) | 2,743,000 | 640.9% |
| **Net income (loss) and comprehensive income (loss)** | $ (7,482,000) | $ (11,861,000) | $ 4,379,000 | 36.9% |

*Petroleum Revenue*

Revenue from petroleum and natural gas sales 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*

General and administrative decreased $1,662,000, or 14.7% from 2008 to 2009. The significant components of changes in general and administrative expenses in 2009, as compared to 2008, were as follows:

- Consulting – the increase was attributable to the Company's financing activities commencing in the first quarter of 2009 resulting in the completion of the Offering in June 2009. In addition, the Company incurred costs to investigate future potential petroleum and natural gas projects.

- Investor relations – the increase was attributable to the Company's financing activities commencing in the first quarter of 2009 resulting in the completion of the Offering in June 2009.

- Office and administrative – the increase was attributable to certain administrative matters associated with the Company's joint venture with ExxonMobil and MOL in Hungary.

- Payroll and related costs – the increase was attributable to the retention of a additional personnel to work on the Beetaloo Basin Project, and the employment of an individual who previously rendered services to the Company as a consultant.

- Stock based compensation – the decrease was attributable to the value of option granted during 2008 as compared to no options granted in 2009. During 2008, the Company granted officers, directors, employees and consultants 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.

*Other income (expense)*

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

- Gain (loss) on foreign exchange – during the first half of 2009, the gain on foreign exchange was primarily due to the payment of obligations for operating activities in Hungary during a period when the value of the Hungarian forint was declining relative to the US dollar. During the first half of 2008, the loss on foreign exchange was attributable to foreign exchange movements on Canadian denominated cash accounts.

  Compared to the US dollar, the value of the Canadian dollar remained relatively static throughout the first half of 2008; thereafter, the US dollar strengthened relative to the Canadian dollar through the first quarter of 2009 and, during the second quarter of 2009, weakened during the first two months and strengthened during the last month.

  Compared to the US dollar, the value of the Hungarian forint strengthened relative to the US dollar throughout the first half of 2008; thereafter, the US dollar strengthened relative to the Hungarian forint through the first quarter of 2009, and has weakened during the entire second quarter of 2009.

  Substantially all of the Company's financings have been in Canadian dollars; commensurate with the strengthening of the US dollar, the Company changed the composition of its cash balances to 61% in US dollars, 35% in Canadian dollars, 3% in Hungarian forints, 1% in Euros and nil in Australian dollars at June 30, 2009; a significant portion of the Company's operations are in Hungarian forints. The increase in the Canadian dollar cash balance relative to the total cash balance resulted from the proceeds from the unit offering discussed below.

## SUMMARY OF QUARTERLY RESULTS

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

| **As of:** | **September 30, 2008** | **December 31, 2008** | **March 31, 2009** | **June 30, 2009** |
|---|---|---|---|---|
| Total assets | $306,870,814 | $304,472,067 | $298,830,658 | $294,000,253 |
| Petroleum and natural gas properties | 240,329,003 | 237,020,325 | 237,757,364 | 245,704,299 |
| Working capital | 55,312,512 | 32,073,983 | 29,051,915 | 33,156,259 |
| Total shareholders' equity | 297,268,936 | 281,190,721 | 278,793,568 | 282,903,353 |
| **For the three months ended:** | **September 30, 2008** | **December 31, 2008** | **March 31, 2009** | **June 30, 2009** |
| Revenue | 22,671 | (6,509) | 11,091 | 9,157 |
| Net income (loss) | (6,104,178) | (17,945,358) | (3,788,342) | (3,693,105) |
| Net income (loss) per share-basic and diluted | (0.011) | (0.031) | (0.006) | (0.006) |

| **As of:** | **September 30, 2007** | **December 31, 2007** | **March 31, 2008** | **June 30, 2008** |
|---|---|---|---|---|
| Total assets | $274,788,840 | $308,864,891 | $293,967,511 | $297,373,735 |
| Petroleum and natural gas properties | 234,934,259 | 229,805,480 | 231,956,676 | 211,927,213 |
| Working capital | 18,293,328 | 56,746,001 | 51,593,669 | 68,343,352 |
| Total shareholders' equity | 256,068,735 | 288,076,167 | 285,082,821 | 281,874,148 |
| **For the three months ended:** | **September 30, 2007** | **December 31, 2007** | **March 31, 2008** | **June 30, 2008** |
| Revenue | 25,561 | 44,982 | 18,420 | 25,165 |
| Net income (loss) | (4,595,798) | (5,650,292) | (4,375,025) | (7,486,272) |
| Net income (loss) per share-basic and diluted | (0.010) | (0.012) | (0.008) | (0.013) |

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

On June 30, 2009, the Company completed an offering, on a best efforts basis, pursuant to a short form prospectus filed with the securities regulatory authorities in the provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Nova Scotia and New Brunswick, of 11,910 units at a price of $865 (CDN$1,000) per unit (the "**Offering**") for gross proceeds of $10,302,000 (CDN$11,910,000). Each unit consisted of one 11% convertible unsecured debenture in the principal amount of $779 (CDN$900) (each, a "**Debenture**") that matures on the fourth anniversary of its issuance, and 250 common shares in the capital of Falcon (the "**Unit Shares**") (collectively a "**Unit**"). The Debentures contain certain automatic and optional conversion features, as well as certain redemption features.

The Offering was conducted by Salman Partners Inc., as agent (the "**Agent**"). The Agent and members of any selling group were paid a cash commission of $644,000 (CDN$744,000), equal to 6.25% of the aggregate gross proceeds of the Offering, and received 1,250,550 non-transferrable warrants (the "**Agent Warrants**") to purchase Falcon common shares, based on an amount equal to 6% of the sum of the Unit Shares and the shares issuable upon conversion of the Debentures. Each Agent Warrant will entitle the holder thereof to acquire one Falcon common share for a period of two years following the closing of the Offering.

The Company expects to use the net proceeds from the Offering as determined and approved by Falcon's board of directors.

### *Working Capital*

Cash and cash equivalents at June 30, 2009 were $25,875,000, an increase of $328,000 from $25,547,000 at December 31, 2008. Working capital at June 30, 2009 was $33,155,000, an increase of $1,081,000 from $32,074,000 at December 31, 2008.

The increase to cash and cash equivalents of $328,000 was attributable to cash provided by financing activities and the effect of exchange rates on cash of $7,951,000 and $40,000, respectively, offset by cash used in operating activities of $4,715,000 and investing activities of $2,948,000 (primarily for capital expenditures, including payment of prior year's accounts payable incurred for petroleum and natural gas properties). Restricted cash of $1,020,000 at June 30, 2009 is for one year of escrowed debenture interest as required under the Offering.

### *Amounts Receivable and Prepaids*

Amounts receivable at June 30, 2009 were $2,045,000, which includes $230,000 due from ExxonMobil for amounts due under a services agreement, $1,074,000 due from the Hungarian, Australian and Canadian governments as refunds of VAT/GST, and a receivable of $469,000 for repayment from the Australian government for operator bonds assigned to the Company by PetroHunter in connection with the acquisition of an additional 25% working interest in the Beetaloo Basin Project; prepaids include $778,000 for deposits and advance payments to Hungarian vendors.

### *Accounts Payables and Accrued Expenses*

Accounts payable and accrued expenses at June 30, 2009 were $3,003,000, which includes $903,000 for capital expenditures related to the Company's Hungarian and Australian operations, as compared to accounts payable and accrued expenses of $12,227,000 at December 31, 2008, which includes $624,000 for capital expenditures related to the Company's Hungarian operations.

## Capital Expenditures

For the six months ended June 30, 2009, capitalized additions to petroleum and natural gas properties were $8,744,000, of which $5,696,000 was for the acquisition of an additional 25% interest in the Beetaloo Basin Project. During 2009, cash payments on all petroleum and natural gas properties were $2,557,000, of which $624,000 represented amounts incurred and reflected in accounts payable and accrued expenses at December 31, 2008. During the comparable 2008 period, the Company incurred $3,598,000 petroleum and natural gas properties, of which $3,557,000 was for its properties in Hungary.

The significant costs incurred during 2009 in Australia were for the acquisition of the additional 25% working interest in the Beetaloo Basin Project, and exploration costs, including tubular and drill pipe, related to the Company's planned re-entry into the Shenandoah-1 well. There were no exploration costs during 2008 in Australia.

The significant costs incurred during 2009 in Hungary were for well maintenance for the six existing well bores. The significant costs for 2008 were for specialized processing and evaluation of the seismic and well data previously acquired in 2007 and well maintenance for the six existing well bores.

As of June 30, 2009, the Company's net cumulative expenditures for the Production License and Exploration Licenses, including the acquisition, seismic testing, drilling of exploratory wells, and initial testing and completion of wells, was approximately $211,904,000**,** including an asset retirement obligation of approximately $4,583,000 for the six wells drilled.

The Company's activity in Hungary for 2009 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, MOL and the Company reached agreement on the Initial Work Program which ExxonMobil has been implementing as Operator of the Contract Area.

The Company's activity in Australia for 2009, prior to becoming operator on the Beetaloo Basin Project in June 2009, was focused on administrative matters. Exploration activities will be commencing in the second half of 2009 with the planned re-entry into the previously drilled Shenandoah-1 well.

The Company's future capital requirements for Hungary 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 the Initial Work Program.

The Company's future capital requirements for Australia will also be dependent upon the evaluation of the Beetaloo Basin Project.

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.

## 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 TSXV, whose largest single shareholder is also the President and CEO of the Company. The Company acquired working interests from PetroHunter in the Beetaloo Basin Project and the Buckskin Mesa Project.

*Beetaloo Basin Project*

On September 30, 2008, Falcon and Falcon Australia consummated the acquisition of an undivided 50% working interest in the Beetaloo Basin Project with PetroHunter. On June 11, 2009, pursuant to the Second PSA, the Company completed the acquisition of an additional undivided 25% working interest in the Beetaloo Basin Project. Under the terms of the Second PSA, the principal consideration paid by the Company for the acquisition was the exchange of the $5,000,000 note receivable from PetroHunter. In addition, the Company paid certain vendors who had provided goods or rendered services for the Beetaloo Basin Project, prior to the Company's acquisition of its 50% interest in September 2008, in exchange for inventory and operator bonds of approximately the same value, and has relinquished its rights to the unexpended testing and completion funds of approximately $874,000 as discussed below. On closing of this transaction, the Company became operator of the Beetaloo Basin Project, and PetroHunter and the Company entered into an escrow agreement governing the release of all remaining Falcon common shares previously issued to PetroHunter.

*Buckskin Mesa Project*

On October 31, 2008, the Company consummated the acquisition of an undivided 25% working interest in the Buckskin Mesa Project. Under the Buckskin PSA, the Company agreed to pay 100% of the first $7,000,000 of testing and completion work to be undertaken in connection with the Five Wells. After performance of the testing and completion work, the Company had up to 60 days to review and analyze the results, at which time it could either retain its 25% interest in the Five Wells and acquire no greater interest, or it could exercise the Buckskin Mesa Option to acquire an additional undivided 25% working interest in the Five Wells (for a total of 50%) and an undivided 50% working interest in the remainder of the 20,000-acre Buckskin Mesa Project. On February 24, 2009, the Company notified PetroHunter that it would not exercise the Buckskin Mesa Option. Of the $7,000,000 advanced to PetroHunter, approximately $874,000 had not been expended. On June 11, 2009, pursuant to the Second PSA, the Company relinquished its rights to the unexpended testing and completion funds, and reassigned the undivided 25% working interest in the Five Wells to PetroHunter. The Company was relieved of all obligations related to the Five Wells, including reclamation and plugging and abandonment obligations.

During 2009, the Company incurred $90,000 (2008-$90,000) to a current director of the Company, Dr. György Szabó, for advisory and consulting services rendered to TXM; and $91,000 (2008- $132,000) in consulting fees to a current director of the Company, Mr. Daryl Gilbert, for advisory and consulting services rendered to Falcon. Mr. David Brody, the Company's Corporate Secretary, 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 he has not received any remuneration from Patton Boggs LLP for its services to the Company since his appointment as Corporate Secretary of Falcon.

## DISCLOSURE OF OUTSTANDING SHARE DATA

The following is a summary of the Company's outstanding share data as at June 30, 2009 and August 27, 2009:

| Class Of Securities | June 30, 2009 | August 27, 2009 |
|---|---|---|
| Common Shares | 598,776,801 | 598,776,801 |
| Stock Options | 46,875,000 | 46,875,000 |
| December Underwriters' Warrants(1) | 4,288,750 | 4,288,750 |
| June Agents' Warrants(2) | 1,250,550 | 1,250,550 |

**Notes:**

(1) Warrants to purchase 6,000,000 Falcon common shares at a price of $0.39 (CDN$0.40) per share were issued to the underwriters in December 2007 in connection with the offering completed in December 2007, and expire two years after the date of issuance.

(2) Warrants to purchase 1,250,550 Falcon common shares at a price of $0.52 (CDN$0.60) per share were issued to the agents in June 2009 in connection with the 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

The critical accounting policies adopted by the Company have not changed from those described in the Management's Discussion and Analysis for the year ended December 31, 2008.

## CHANGES IN ACCOUNTING POLICIES

(a) Goodwill and intangible assets

Effective on January 1, 2009, the Company adopted Section 3064 "Goodwill and intangible assets" ("**Section 3064**"). Section 3064 replaces Sections 3062 "Goodwill and other intangible assets" and Section 3450 "Research and development costs". Section 3064 establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets including internally developed intangible assets. The adoption of Section 3064 did not have a significant effect on the Company's consolidated financial statements.

## NEW CANADIAN ACCOUNTING STANDARDS

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

(a) International Financial Reporting Standards

The AcSB has determined that Canadian accounting standards for publicly-listed companies will converge with International Financial Reporting Standards ("**IFRS**") effective for interim and annual periods beginning on 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.

(b) Business Combinations, Consolidated Financial Statements and Non-Controlling Interests

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

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

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

No other new significant accounting policies were adopted by the Company during the six months ended June 30, 2009, and the Company is not expected to adopt any new accounting policies during the remainder of 2009.

**Business Risks and Uncertainties**

The business risks and uncertainties affecting the Company have not changed from those described in the MD&A for the year ended December 31, 2008.

**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.