Falcon Oil & Gas Ltd.

Form 51-102F1
Management's Discussion & Analysis
For the Year Ended 31 December 2013

(Presented in U.S. Dollars)

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INTRODUCTION

The following management's discussion and analysis (the "**MD&A**") was prepared as at 29 April 2014 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 (as hereinafter defined) for the three months and year ended 31 December 2013. This MD&A should be read in conjunction with the audited consolidated financial statements for the year ended 31 December 2013 and 2012.

The information provided herein in respect of Falcon includes information in respect of its wholly-owned subsidiaries: Mako Energy Corporation, a Delaware company ("**Mako**"); TXM Oil and Gas Exploration Kft., a Hungarian limited liability company ("**TXM**"); TXM Marketing Trading & Service Kft., a Hungarian limited liability company ("**TXM Marketing**"); Falcon Oil & Gas Ireland Ltd., an Irish limited liability company ("**Falcon Ireland**"); Falcon Oil & Gas Holdings Ireland Ltd., an Irish limited liability company ("**Falcon Holdings Ireland**"); Falcon Oil & Gas USA Inc., a Colorado company ("**Falcon USA**"); Falcon Exploration and Production South Africa (Pty) Ltd., a South African limited liability company ("**Falcon South Africa**") and its 98.1% majority owned subsidiary, Falcon Oil & Gas Australia Limited, an Australian limited liability company ("**Falcon Australia**") (collectively, the "**Company**" or the "**Group**").

Additional information related to the Company, including the Company's Annual Information Form ("**AIF**") for the year ended 31 December 2013 dated 29 April 2014 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; Falcon's acquisition strategy; the criteria to be considered in connection therewith and the benefits to be derived therefrom; Falcon's goal to sustain or grow production and reserves through prudent management and acquisitions; the emergence of accretive growth opportunities; Falcon'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 Falcon's petroleum and natural gas properties; realisation of the anticipated benefits of acquisitions and dispositions; Falcon's ability to establish a broad institutional shareholder base in London, Dublin and Toronto and increase the volume of trading in common shares; expectations regarding the ability of Falcon to access additional sources of funding not currently available; and Falcon's ability to leverage its experience in the unconventional oil and gas industry to acquire interests in licenses.

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 Republic of Hungary, the Commonwealth of Australia, the Republic of South Africa and globally; supply and demand for petroleum and natural gas; industry conditions, including fluctuations in the price of petroleum and natural gas; governmental regulation of the petroleum and natural gas industry, including income tax, environmental and regulatory matters; fluctuation in foreign exchange or interest rates; risks and liabilities inherent in petroleum and natural gas operations, including exploration, development, exploitation, marketing and transportation risks; geological, technical, drilling and processing problems; unanticipated operating events which can reduce production or cause production to be shut-in or delayed; the ability of our industry partners to pay their proportionate share of joint interest billings; failure to obtain industry partner and other third party consents and approvals, when required; stock market volatility and market valuations; competition for, among other things, capital, acquisition of reserves, processing and transportation capacity, undeveloped land and skilled personnel; the need to obtain required approvals from regulatory authorities; and the other factors considered under "**Risk Factors**" in Falcon's AIF dated 31 December 2013. The forward-looking statements contained in this document are expressly qualified by this cautionary statement. Falcon disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulation.

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

The following table outlines certain forward looking statements contained in this MD&A and provides material assumptions used to develop such forward looking statements and material risk factors that could cause actual results to differ materially from the forward looking statements.

Page No.	Forward looking statements	Assumptions	Risk factors
7	*Overview of the business and overall performance - About the Group* "Falcon's strategy is to leverage the Group's expertise in the unconventional oil and gas industry to acquire interests in licences covering large acreages of land and to build on its internationally diversified portfolio of unconventional assets and interests, which are located in countries that the Board of Directors of Falcon (the "**Board**") believes support the exploitation of unconventional oil and gas."	The countries in which the Group operates support the exploitation of unconventional oil and gas.	The countries in which the Group operates may change their regulatory environment which might adversely impact the exploitation of unconventional oil and gas resources.
8	*Beetaloo basin, Northern Territory, Australia – overview – Discoveries and prospectivity* "The Board believes that the Beetaloo Basin is relatively under-explored and has shale oil, shale gas and basin centered gas accumulations ("**BCGA**") potential."	The Board believes that the Beetaloo Basin is relatively under-explored and has shale oil, shale gas and BCGA potential.	As the Beetaloo Basin is relatively under-explored it may not have shale oil, shale gas and BCGA potential.
9	*Beetaloo basin, Northern Territory, Australia – overview – current activity* "Falcon retained a 100% working interest in the Beetaloo exploration permits which puts Falcon in a stronger position going forward."	The Group views the permits as commercially attractive to potential farm-out partners.	Potential farm-out partners might not view the Beetaloo permits as commercially attractive for exploitation of oil and gas.
10	*Beetaloo basin, Northern Territory, Australia – overview – current activity - Farm-out discussions in Australia advancing* "Further to previous press releases, Falcon was approached by several oil and gas companies interested in farming into the Beetaloo Basin. Falcon is well advanced in its discussions with a number of those companies."	Falcon Australia will successfully farm-out its interest in the Beetaloo basin.	A farm-out deal cannot be successfully negotiated.
12	*Karoo basin, South Africa - overview* "The Department of Mineral Resources ("**DMR**") is in the process of formulating regulations, which are likely to limit the time and manner in which the Government will be entitled acquire further participating interests in petroleum operations. "	Falcon assumes that the regulations to be implemented will limit the time and manner in which the Government will be entitled acquire further participating interests in petroleum operations.	The regulations to be implemented will not limit the time and manner in which the Government will be entitled acquire further participating interests in petroleum operations.
12	*Karoo basin, South Africa - overview* "The Board expects that the exploration right over the acreage will be awarded in 2014."	The awarding of the exploration right over the acreage will occur in 2014.	The finalisation of legislation and regulation in South Africa may be delayed or Falcon may not be awarded the licence.
13	*Makó Trough, Hungary - The Deep Makó Trough* "The Company intends to re-enter the untested Makó-7 and Makó-4 wells and will seek a technically and financially capable partner to test and produce the shale gas and tight gas formations in the Deep Makó Trough."	The Group has assumed that it will secure a technically and financially capable partner to test and produce the shale gas and tight gas formations in the Deep Makó Trough.	The Group may not be able to secure a technically and financially capable partner.

Page No.	Forward looking statements	Assumptions	Risk factors
13	*Makó Trough, Hungary – current activity* "As announced by the Group on 3 March 2014, testing operations are anticipated to take 3 months"	The Group has assumed that the testing operations for Kútvölgy-1 will take 3 months.	Testing Kútvölgy-1 may take in excess of 3 months. This might delay the drilling of subsequent wells.
14	*Alberta, Canada* "Falcon does not anticipate any further exploration or development of these wells and no further material revenue is expected to be generated or material costs incurred."	The Group does not intend to do any further exploration or development of these wells.	The Group may be called upon to increase our cash commitment to these wells, given its interest.
17 & 20	*Managements' discussion and analysis of the results for the period – General and administrative expenses* "Investor relations: One of the main focuses of the Group's new management, who commenced in mid-2012, was and is to actively engage with its shareholders and investors. This has resulted in increased expense in this area in 2013. It is expected that the level of expenditure in this area will be maintained going forward."	The Group has assumed that increased levels of expenditure on investor relations will be maintained going forward.	N/a
17 & 20	*Managements' discussion and analysis of the results for the period – General and administrative expenses* "Travel and promotion decreased in the current period over the prior year due to the closure of the Denver office in Quarter 3, 2012 and increased focus by new management on cost containment. Certain levels of travel and promotion costs are and will be incurred due to the international geography of the Group's assets and investor base."	The Group has assumed that certain levels of expenditure on travel costs given the international geography of the Group's assets and investor base	N/a
24	*Liquidity & Capital resources – Going concern* "The Directors are confident that further funds can be raised and it is appropriate to prepare the financial statements on a going concern basis."	The Group is a going concern.	Due to unforeseen expenditures, the Group would not have available cash to meet its liabilities as they fall due in the foreseeable future.
25	*Liquidity & Capital resources – capital expenditures - Australia - Beetaloo Basin, Northern Territory, Australia* "Falcon Australia intends to meet this commitment either through a farm-out arrangement or through its own resources."	Falcon Australia will successfully farm-out its interest in the Beetaloo basin.	A farm-out deal cannot be successfully negotiated or Falcon does not have the available resources to meet the commitment.
25	*Liquidity & Capital resources – capital expenditures - Hungary - Makó Trough, Hungary* "The Group is not planning any independent technical operations in Hungary other than joint operations with NIS, and as such no material capital expenditures are expected."	The Group is not planning any independent technical operations in Hungary other than joint operations with NIS.	Unforeseen circumstances might require the Group to conduct independent technical operations in Hungary and incur material expense.
27	*Legal matters* "The Company is not currently involved in any claims, disputes, litigation or other actions with third parties which it believes could have a material adverse effect on its financial condition or results of operations."	The Company is not currently involved in any claims, disputes, litigation or other actions with third parties which it believes could have a material adverse effect on its financial condition or results of operations.	The Company is involved in claims, disputes, litigation or other actions with third parties which could have a material adverse effect on its financial condition or results of operations.

Dollar amounts

All dollar amounts in this document are in United States dollars (**"$"**), except as otherwise indicated. "**CDN$**" where referenced represents Canadian Dollars; "**£**" where referenced represents British Pounds sterling and "**HUF**" where referenced represents Hungarian Forints. "**A$**" where referenced represents Australian Dollars.

The financial information provided herein has been prepared in accordance with International Financial Reporting Standards ("**IFRS**").

OVERVIEW OF BUSINESS AND OVERALL PERFORMANCE

About the Group

Falcon is an international oil and gas company engaged in the acquisition, exploration and development of unconventional and conventional oil and gas assets. The Company's interests are located in internationally diversified countries that are characterised by a high regional demand for energy and are close to existing infrastructure allowing rapid delivery of oil and gas to market.

Falcon's strategy is to leverage the Group's expertise in the unconventional oil and gas industry to acquire interests in licences covering large acreages of land and to build on its internationally diversified portfolio of unconventional assets and interests, which are located in countries that the Board of Directors of Falcon (the "**Board**") believes support the exploitation of unconventional oil and gas. Falcon seeks to add value to its assets by entering into farm-out arrangements with major oil and gas companies that will fully or partially carry Falcon through seismic and drilling work programmes. The Group's principal interests are located in two major underexplored basins in Australia and South Africa; and in Hungary, covering approximately 14.75 million gross acres in total.

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

Summary of Operations

The following table summarises the principal oil and gas interests of the Company in Australia, South Africa and Hungary:

Assets (Country)	**Interest (%)**	**Operator**	**Status**	**Area (km^2)**
Exploration Permit EP-76 (Beetaloo Basin, Northern Territory, Australia)	98.1[(i)]	Falcon Australia	Exploration	4,976.3
Exploration Permit EP-98 (Beetaloo Basin, Northern Territory, Australia)	98.1[(i)]	Falcon Australia	Exploration	11,412.1
Exploration Permit EP-99 (Beetaloo Basin, Northern Territory, Australia)	98.1[(i)]	Falcon Australia	Exploration	2,587.2
Exploration Permit EP-117 (Beetaloo Basin, Northern Territory, Australia)	98.1[(i)]	Falcon Australia	Exploration	9,218.3
Technical Cooperation Permit, (Karoo Basin, South Africa) [(ii)]	100	Falcon	TCP	30,327.9
Makó Production Licence (Makó Trough, Hungary)	100	TXM	Production	994.6

Notes:
(i) Falcon owns 98.1% of Falcon Australia, which holds a 100% interest in the Beetaloo Exploration Permits. The remaining 1.9% interest is held by others.

(ii) In compliance with the terms of the Technical Cooperation Permit ("**TCP**"), the Company submitted its application for an exploration permit in August 2010 prior to the moratorium being introduced in April 2011. Local counsel has confirmed that despite the TCP expiry date of October 2010 having passed, the Company's interests remain valid and enforceable.

Beetaloo Basin, Northern Territory, Australia

Overview

Falcon Australia is the registered holder of four exploration permits, comprising approximately 7 million acres (approximately 28,000 km^2) in the Beetaloo Basin, Northern Territory, Australia. The Beetaloo Basin is located 600 kilometres south of Darwin close to infrastructure including a highway, two pipelines and a railway, offering transport options to the Australian market and beyond via the existing and proposed LNG capacity in Darwin.

The Beetaloo Basin is a Proterozoic and Cambrian tight oil and gas basin. In its entirety, the Beetaloo Basin covers approximately 8.7 million acres (approximately 35,260 km^2) and is a relatively underexplored onshore exploration basin with, as far as the Company is aware, 11 exploration wells drilled in the Beetaloo Basin to date. The area is remote and sparsely populated and the Board believes that it is well suited for oil and gas projects. Australia has a developed resources industry with a stable political, legal and regulatory system.

RPS Energy in its Competent Person Report ("**CPR**") titled "Evaluation of the Hydrocarbon Resource Potential Pertaining to Certain Acreage Interests in the Beetaloo Basin, Onshore Australia and Makó Trough, Onshore Hungary" (the "**RPS 2013 Report**") dated 1 January 2013 (filed on SEDAR at www.sedar.com and on Falcon's website at www.falconoilandgas.com), estimates gross unrisked recoverable prospective resource (play level) potential of 162 trillion cubic feet ("**Tcf**") of gas and 21,345 million barrels of oil ("**Mmbo**") (P50) for Falcon Australia's Beetaloo Exploration Permits.

Exploration Permits

A summary of Falcon Australia's Beetaloo Exploration Permits is contained in the table on page 7. The acreage interests covered by the Beetaloo Exploration Permits cover the majority of the Beetaloo Basin and are held 100% in the name of Falcon Australia. Falcon Australia is the operator of the exploration permits.

The work commitments for the Beetaloo Exploration Permits held by Falcon Australia have been met for previous years, with the exception of exploration permit EP-99, on which an original extension was granted to 31 December 2013.

In June 2013, the exploration permit for EP-99 was extended to 31 December 2014. The permits for EP-76, EP-98 and EP-117 were due to expire on 31 December 2013. Application to extend the permits was made prior to the application due date of 30 September 2013. Receipt of the application has been acknowledged by the Department of Mines and Energy, Northern Territory of Australia. During the first term of the three permits, a significant work program was completed and a major work program is proposed for the period of the renewal. Falcon Australia has met all the Northern Territory Government's requirements for renewal. The renewal process is ongoing.

In accordance with local law and regulations, all Falcon Australia's acreage interests are subject to royalties on production values of up to approximately 12% to government and native title holders/claimants and 12% to other parties. See "*current activity*" below, for an update concerning the agreements entered into by Falcon Australia to purchase up to 11% (eleventh twelfths) of the overriding royalty interest held by others. In addition, Falcon Australia is subject to Commonwealth Government corporation tax of 30%, and to the Commonwealth Government's Petroleum Resource Rent Tax ("**PRRT**") levied at the rate of 40% on the taxable profits derived from the petroleum projects. The PRRT is calculated on the individual projects, and royalties are deductible for PRRT purposes. The PRRT tax system is separate from the company income tax system and is based on cash flow. Both royalties and PRRT are deductible for corporate income tax purposes.

Discoveries and Prospectivity

The Board believes that the Beetaloo Basin is relatively under-explored and has shale oil, shale gas and basin centered gas accumulations ("**BCGA**") potential. As far as the Company is aware, 11 wells have been drilled in the Beetaloo Basin to date. This work was undertaken by a Rio Tinto Group subsidiary company exploring for conventional hydrocarbons and while not leading to a conventional development, the data from the cores demonstrated the presence of tight oil and gas and several horizons were shown to be prospective for unconventional oil and gas.

There are no existing fields but there are numerous mudlog oil and gas shows and oil indications on cores throughout the Beetaloo Basin in prospective formations. The Shenandoah-1 well was a vertical hole well drilled by Sweetpea Petroleum Pty Ltd. ("**Sweetpea**") in 2007. The well was deepened by Falcon Australia in 2009 to finish at 2,714 metres. It was re-entered in Quarter 3 2011 and five short tests were conducted including several fracking operations. Gas was recovered from three zones with some liquids. See "*current activity*" below, for the results of the 2011 / 2012 seismic program in the Beetaloo Basin.

Current activity

Falcon retains interest in Beetaloo permits / Hess request to defer drilling decision rejected by Falcon Board

In April 2011, Falcon Australia entered into a joint venture with Hess Australia (Beetaloo) Pty Ltd ("**Hess**") whereby Hess agreed to collect seismic data over an area made up of three of the four Beetaloo Exploration Permits, excluding exploration permit EP-99 and an area within exploration permit EP-98 (the Shenandoah-1 well and approximately 100,000 acres (approximately 405 km^2) of land around the well-bore), (the "**Hess Area of Interest**"). Falcon Australia was the operator of exploration permit EP-99 and Hess was the operator of exploration permits EP-76, EP-98 and EP-117. Falcon Australia also retained operatorship in the Shenandoah-1 well and approximately 100,000 acres (approximately 405 km^2) of land around the Shenandoah-1 well-bore within exploration permit EP-98.

Since the date of the agreement and during 2011 and 2012, Hess acquired 3,490 kilometres of 2D seismic data. This is further discussed below.

Hess had the option, valid until 30 June 2013, to acquire a 62.5% working interest in the Hess Area of Interest. However, Hess did not elect to commit to drilling the five wells required to earn their interest in the Beetaloo permits by the agreed deadline. Failure to elect on time meant that Hess forfeited their right to earn 62.5% in three of the Beetaloo permits. Hess had requested a one month extension to allow them sufficient time to conclude a farm - out deal with a third party. However, the late request by Hess to defer the election date again was unanimously rejected by Falcon's Board for reasons outlined below:

- Falcon retained a 100% working interest in the Beetaloo exploration permits which put Falcon in a stronger position going forward;
- Hess had transferred a perpetual, royalty-free and irrevocable licence to Falcon over the 3,490 kilometres of seismic acquired by them;
- The initial interpretation of 3,490 kilometres of new seismic data, acquired at no cost to Falcon, was extremely encouraging; (See results of the seismic program below for further details);
- Identification of a shale oil play in the northern part of the permits in addition to the shale gas and conventional plays throughout the acreage;
- Unsolicited interest from major oil and gas companies; and
- Falcon had already granted Hess an extension from August 2012 to June 2013.

Results of Seismic Program in Beetaloo Basin, Australia

As referred to above, under the terms of the joint venture with Hess, in 2011 and 2012 Hess acquired 3,490 kilometres of 2D seismic data investing approximately $80 million during that period at no cost to Falcon. The seismic database, along with existing well data, provides a very solid platform to extrapolate a detailed structural and stratigraphic model for the main parts of the Beetaloo Basin.

All the necessary elements of a productive unconventional and conventional petroleum system have been identified in multiple shales and sand reservoirs, and it is now clear that the Beetaloo Basin is an active petroleum system.

Three hydrocarbon plays have been identified:

- the shale gas potential in the basin centre;
- a shale oil play in the northern part of the permits; and
- conventional prospects throughout the acreage.

Recent interpretation of the seismic database mapped out several conventional drilling targets that are promising areas of hydrocarbons accumulation in the form of structural closures and traps.

Acquisition of additional 25.4% of share capital in Falcon Australia

In order to consolidate its interest in Australia, Falcon acquired Sweetpea's 50 million shares or 24.2% interest in Falcon Australia in July 2013 ("s**hare purchase**"). Following the completion of the share purchase, Falcon owned 96.9% of the issued share capital of Falcon Australia. The total value of the consideration was CDN$22.6 million consisting of $3 million in cash and the balance in Falcon common shares. Sweetpea, a wholly owned subsidiary of PetroHunter Energy Corporation, held 10.7% of the issued share capital of Falcon.

Falcon further consolidated its position in September 2013 when it completed the purchase of 2,462,686 shares from certain of the remaining shareholders in Falcon Australia. The consideration was 2.25 common shares in Falcon for every one Falcon Australia ordinary share held. The valuation used in this offer was the same as that used in the acquisition of the Sweetpea 24.2% holding. As a result of this transaction, 5,541,044 new Falcon common shares were issued.

Following the completion of the above transactions, Falcon holds 202,462,686 ordinary shares in Falcon Australia, representing 98.1% of its issued share capital.

Reducing the Overriding Royalty, Beetaloo Basin, Australia

On 1 November 2013, Falcon announced that Falcon Australia, had entered into an agreement ("**the CRIAG Agreement**") with CR Innovations AG ("**CRIAG**") to acquire its 4% Overriding Royalty Interest ("**ORRI**") relating to its exploration permits in the Beetaloo Basin. The transaction details were:

- Falcon Australia made an initial payment to CRIAG of $999,000 on signing the CRIAG Agreement;
- Falcon Australia to make a second payment to CRIAG of $999,000 to acquire the first 3% (three fourths) of the ORRI upon completion of a farm-out deal in Australia;
- CRIAG has granted Falcon Australia a five year call option to acquire the remaining 1% (one fourth) for $5 million; and
- All ORRI's acquired under the CRIAG Agreement will be immediately cancelled by Falcon Australia.

On 17 December 2013, Falcon announced that Falcon Australia, had entered into an agreement with Malcolm John Gerrard, Territory Oil & Gas LLC and Tom Dugan Family Partnership LLC ("**TOG Group**") to acquire up to 7% (seven eighths) of their 8% private ORRI over Falcon Australia's Exploration Permits in the Beetaloo Basin for the following consideration:

- Falcon Australia will make a payment to TOG Group of $5 million to acquire 5% (five eighths) of their ORRI only on completion of a Beetaloo farm-out transaction;
- TOG Group will grant Falcon Australia a five year call option to acquire a further 2% (two eights) of their ORRI for a payment of $15 million;
- All ORRIs acquired under the Agreement will be immediately cancelled by Falcon Australia; and
- TOG Group will retain a 1% ORRI.

The Group has now completed the two agreements to acquire 8% (eight twelfths) of the privately held ORRI at a total cost of just $7 million, of which $6 million is payable only upon completion of a farm–out. In addition, the Group has secured agreement to acquire a further 3% (three twelfths) based on two five year call options granted to Falcon at a future combined cost of $20 million leaving only a 1% Royalty in private hands.

Farm-out discussions in Australia advancing

Further to previous press releases, Falcon was approached by several oil and gas companies interested in farming into the Beetaloo Basin. Falcon is well advanced in its discussions with a number of those companies.

Karoo Basin, South Africa

Overview

The Company holds a Technical Co-operation permit ("**TCP**") covering an area of approximately 7.5 million acres (approximately 30,327 km^2), in the southwest Karoo Basin, South Africa, which grants the Company exclusive rights to apply for an exploration right over the underlying acreage. In August 2010, the Company submitted an application to the Petroleum Agency of South Africa for an exploration right over the acreage covered by the TCP and, as part of the application process, the Company submitted an environmental management plan in January 2011.

The Karoo Basin extending to approximately 173 million acres (approximately 700,000 km2) in size is located in central and southern South Africa. Until recently, the Karoo Basin was not considered prospective for commercial hydrocarbons resulting in very limited modern hydrocarbon exploration onshore in South Africa. In an independent report dated April 2011, the U.S. Energy Information Administration ("**EIA**") estimated that there are 485 Tcf technically recoverable resources in the Karoo Basin which would rank it fifth in the world after China, USA, Argentina and Mexico for shale gas potential.

On 1 February 2011, the Minister of Mineral Resources (the "**Minister**") published a notice in the Government Gazette declaring a moratorium on the processing of all new applications relating to the exploration and production of shale gas in the Karoo Basin. This moratorium did not extend to existing applications, such as Falcon's, that were submitted prior to 1 February 2011. In April 2011, the Minister announced a further moratorium, which was not officially declared by way of notice in the Government Gazette, prohibiting all new applications and suspending the processing of all pending applications whilst the South African Department of Mineral Resources conducted an environmental feasibility study on the effects of hydraulic stimulation and developed a system to regulate onshore exploration activities (the "**Undeclared Moratorium**"). Local counsel advises that the undeclared moratorium has no legal effect since it is a requirement of the South African petroleum legislation that all such moratoriums be published in the Government Gazette. In September 2012, the South African Government announced a decision to lift the undeclared moratorium on shale gas exploration. The Minister has indicated that although the Undeclared Moratorium has been lifted, pending exploration right applications will not be processed and awarded until the regulations regarding unconventional exploration are published. The proposed regulations titled "Mineral and Petroleum Resources Development Act (28/2002): Proposed technical regulations for petroleum exploration and exploitation" were published in the Republic of South Africa Government Gazette (Notice 1032 of 2013) for comment on 15 October 2013.

In February 2014, Minister of Mineral Resources published two notices with significant impacts on the petroleum industry.

The first notice (notice 71 of 2014) provides that the existing moratorium on applications for reconnaissance permits, technical co-operation permits, exploration rights and production rights relating to shale gas in the Karoo region has been extended. However the existing applications, such as Falcon's, received and accepted before 1 February 2011, are excluded from the moratorium. The notice provides that if, in the interim, the existing applications are granted, the applicants will not be entitled to conduct hydraulic fracturing until the technical regulations have been promulgated. A draft of these regulations was published for comment in Notice 1032 of 2013.

The second notice (notice 72 of 2014) states the Minister's intention to declare a moratorium on all new, onshore and offshore, applications for reconnaissance permits, technical co-operation permits, exploration rights and production rights for a period of two years and invites relevant stakeholders to comment on this proposal within 30 days from the date of publication.

The South African Government is entitled to a royalty on the sale of mineral resources of up to 7% of gross sales (in the case of unrefined resources) and 5% of gross sales (in the case of refined resources, such as oil and gas). The Liquid Fuels Charter provides that an oil and gas company must reserve not less than 9% (which in practice has been increased to 10%) of the interest in the operation for Historically Disadvantaged South Africans ("**HDSA**") to buy in to any offshore production right granted. Based on the advice of South African counsel, the Group believes that the HDSA buy-in will also apply to onshore production rights in South Africa, including any right granted pursuant to the TCP. The way in which HDSAs earn or pay for the 10% participating interest is not legislated, meaning that applicants are free to negotiate suitable terms with prospective HDSAs subject to the "unofficial approval" of the Petroleum Agency of South Africa ("**PASA**"). Similarly, the South African state currently has an option to acquire an interest of up to 10% in any production right granted. However, it is not required to pay any consideration for its 10% interest or contribute to past costs, but must contribute pro rata in accordance with its interest towards production costs going forward.

On 12 March 2014, South Africa's parliament passed "the Mineral and Petroleum Resources Development Amendment Bill" ("**MPRD Bill**") which amends the Mineral and Petroleum Resources Development Act (28 of 2002), South Africa's main petroleum law. This bill has been approved by the National Council of Provinces ("**NCOP**"). The Bill still needs to be sent to President's office for signing. Once it has been signed, a date for the commencement of the amendments will be published in the Government Gazette. Among the proposed changes, the law gives the state a free carried interest of 20% in new gas and oil exploration and production ventures. In addition to this 20% free carried interest, the government introduced a new clause entitling it to further participation in the form of an acquisition at an agreed price or production sharing agreements. No percentage limit on this entitlement has been stated in the amendments. The MPRD Bill stipulates that regulations must be promulgated to give effect to these provisions. The Department of Mineral Resources ("**DMR**") is in the process of formulating regulations, which are likely to limit the time and manner in which the Government will be entitled acquire further participating interests in petroleum operations.

The Board expects that the exploration right over the acreage will be awarded in 2014.

Corporation tax in South Africa is imposed at a rate of 28% of taxable income. Dividends tax is imposed on the shareholder at a rate of 15%, but it may be reduced to 5% in terms of a Double Tax Agreement (if applicable), or to 0% in respect of dividends paid by an oil and gas company out of amounts attributable to its oil and gas income.

Discoveries and Prospectivity
In its entirety, the Karoo Basin is approximately 173 million acres (approximately 700,000 km^2) in size located in central and southern South Africa and contains thick, organic rich shales such as the Permian Whitehill Formation. The Karoo describes a geological period lasting some 120 million years and the rocks laid down during that period of time, covering the late Paleozoic to early Mesozoic interval periods. These rocks were deposited in a large regional basin and resulted in the build-up of extensive deposits. Until recently, the Karoo Basin was not considered prospective for commercial hydrocarbons resulting in very limited modern hydrocarbon exploration onshore in South Africa. In an independent report dated April 2011, the U.S. Energy Information Administration ("**EIA**") estimated that there are 485 Tcf technically recoverable resources in the Karoo Basin which would rank it fifth in the world after China, USA, Argentina and Mexico for shale gas potential. In particular the Permian Ecca group contains three potential shales identified as having potential for shale gas. The shale in the Whitehall Formation, in particular, is ubiquitous, has a high organic content and is thermally mature for gas.

Current activity
In December 2012, Falcon entered into an exclusive cooperation agreement with Chevron to jointly seek unconventional exploration opportunities in the Karoo Basin. The Chevron agreement provides for Falcon to work exclusively with Chevron for a period of five years to jointly seek to obtain exploration rights in the Karoo Basin subject to the parties mutually agreeing participation terms applicable to each right. As part of the Chevron Agreement, Chevron made a cash payment to Falcon of $1 million in February 2013 as a contribution to past costs.

Makó Trough, Hungary

Overview
Falcon has been active in the Makó Trough since 2005 when it acquired two exploration licences, the Makó and the Tisza exploration licences. Between 2005 and 2007, Falcon pursued a work programme consisting of the acquisition of 1,100 km^2 of 3D seismic data and a six-well drilling programme. Each of the six wells encountered thick sequences of hydrocarbon bearing rocks, and tests flowed hydrocarbons from each tested horizon. In 2007, Falcon's subsidiary, TXM, was awarded the 35-year Makó Production Licence which covers some of the acreage originally covered by the Makó and the Tisza exploration licences.

Hungary is an established oil and gas producing country. The Makó Production Licence is in the vicinity of the largest producing field in Hungary, the MOL Group owned and operated Algyő field, which has produced approximately 2.5 Tcf and 220 Mmbo to date. The Makó Production Licence is located approximately ten kilometres to the east of the MOL Group owned and operated Algyő field and is transected by existing gas pipelines and infrastructure, including a 12 kilometre gas pipeline built by Falcon in 2007, together offering transport and potential access to local markets and larger distribution centres for international markets.

Makó Production Licence
The Makó Production Licence was granted by the Hungarian Mining Authority over a gas exploration project in the Makó Trough, located in south-eastern Hungary. The lands within the Makó Production Licence were formerly part of the Group's two hydrocarbon exploration licences – the Tisza exploration licence and the Makó exploration licence.

The Makó Production License covers approximately 245,775 acres (approximately 1,000 km^2) and is held 100% by TXM, a wholly owned subsidiary of the Group. Under the terms of the Makó Production Licence, the Group is obliged to pay a 12% royalty to the Hungarian Government on any unconventional production and has a further 5% royalty payable under an agreement with Prospect Resources Inc., the previous owners of the acreage covered by the Makó Production Licence. Corporate profits are taxed at 19%. In 2009, an additional profit based energy industry tax, levied on energy supplying companies, was introduced. The rate was originally set at 8% but, as part of Hungary's third package of austerity measures, the rate has increased to 31% from 2013, with deductions allowable for certain capital expenditures. TXM is the operator and there are no outstanding work commitments on the Makó Production Licence.

Discoveries and Prospectivity

The Makó Trough contains two plays:

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

The Algyő Play

The Algyő Play is a relatively shallow play of between 2,300 and 3,500 metres. A number of Falcon wells have been drilled through the Algyő Play in recent years, some of which encountered gas shows, but to date none of these wells tested the shallow play concept at an optimal location, as these wells targeted the Deep Makó Trough, at intervals of up to 6,000 metres. Multiple Algyő prospects have subsequently been identified by the Group through extensive AVO analysis, and 3D seismic data has shown the presence of possible gas zones above the Szolnok formation (part of the Deep Makó Trough). In total, ten prospects have been identified within the Algyő Play from which RPS Energy, in its independent RPS 2013 Report, estimates eight prospects contain gross unrisked recoverable prospective gas resources of 568 billion cubic feet ("**Bcf**") (P50).

In January 2013, Falcon agreed a three-well drilling exploration programme with Naftna industrija Srbije jsc ("**NIS**"), 56% owned by Gazprom Group, to target the Algyő Play, whereby NIS made a cash payment of $1.5 million to Falcon in February 2013, and agreed to drill three wells by July 2014. NIS will earn, after undertaking the three-well drilling obligation, 50% of the net production revenues from the three wells drilled. In addition, NIS will have an option to acquire a right of first negotiation for future drilling operations in the Algyő Play, sharing any potential future costs and revenue with the Group, on terms to be negotiated, after paying Falcon $2.75 million. Falcon will be fully carried on the drilling and testing of three wells and will retain 100% interest in the Deep Makó Trough.

The Deep Makó Trough

This is a deeper unconventional play targeting gas, and to a lesser extent oil, in the low permeability and low porosity rocks in the deeper horizons of the basin. RPS Energy in its independent RPS 2013 Report estimates gross recoverable contingent resources for the Deep Makó Trough of 35.3 Tcf of gas and 76.7 Mmbo of oil (P50).

Between 2005 and 2007, Falcon acquired 1,100 km^2 of 3D seismic data and executed a six-well drilling programme on the Deep Makó Trough. Early exploration efforts focused on proving hydrocarbon potential and delineation of the basin in order to secure the Makó Production Licence. Each of the six wells encountered thick sequences of hydrocarbon bearing rocks, and tests flowed hydrocarbons from each tested horizon. Several wells flowed gas on test and one well, Magyarcsanád-1, tested light oil. The deepest well was Makó-7 which, along with the Makó-4, is candidate for future testing. The Makó-7 results demonstrated the presence of a very large column of hydrocarbons in the well-bore. In 2007, Falcon constructed a 12 kilometre gas pipeline which connected the Makó-6 and Makó-7 wells with a MOL operated pipeline, offering potential access to local and international markets. The Company intends to re-enter the untested Makó-7 and Makó-4 wells and will seek a technically and financially capable partner to test and produce the shale gas and tight gas formations in the Deep Makó Trough.

Current Activity

Drilling operations on the first joint well between NIS and Falcon, Kútvölgy-1, were completed in July 2013, the well having reached total depth ("**TD**") of 3,305 metres. As anticipated, the top of the Algyő Formation was encountered at 2,985 metres, the well then penetrating an alternating sequence of sandstones, siltstones and shales over a gross interval of 320 metres to TD, with gas shows throughout. Two conventional cores were taken and extensive wireline logs were run. No operational problems or accidents occurred during drilling. Technical evaluation of the well results has been concluded. Testing operations on the well have started. The testing objectives are to determine reservoir quality and gas productivity from the target Algyő formation encountered in Kútvölgy-1. As announced by the Group on 3 March 2014, testing operations are anticipated to take 3 months.

Alberta, Canada

For the year ended 31 December 2013, Falcon had revenue of $17,000 (2012: $13,000) earned from its Alberta, Canada non-operating working interests. Falcon's Alberta interests are in three producing and one shut-in, natural gas wells. Falcon does not anticipate any further exploration or development of these wells and no further material revenue is expected to be generated or material costs incurred.

SELECTED ANNUAL INFORMATION

(In thousands of $ unless otherwise indicated)	**2013**	**2012**	**2011**
For the year ended 31 December:			
Revenues	17	21	33
Net loss	(3,570)	(17,715)	(34,827)
Basic & diluted - Loss per share - $	(0.004)	(0.03)	(0.05)
Cash dividend per share	Nil	Nil	Nil
At 31 December:			
Total assets	89,516	86,013	94,901
Non-current liabilities	11,586	16,247	17,937

The Group is an exploration company with limited revenue which is not material. The Group's net (loss) / income and net (loss) / income per share relate to the Group's operations during a particular period, and are not seasonal in nature.

The net loss has decreased since 2011. This is attributed to the focus by the Group's new management (who commenced mid 2012) to reducing costs.

In addition, the Group impaired its Hungarian exploration and evaluation assets in 2011, in the amount of $26 million. This was not repeated in 2012 or 2013.

Falcon's liabilities have decreased since 2011 as the Group repaid the full amount outstanding on its Convertible Loan Note of CDN$10.7 million. This repayment means that the Company is now completely debt free.

Generally, the Group's total assets, exploration and evaluation costs, working capital and total shareholders' equity fluctuate in proportion to one another until such time as the Group completes additional financing.

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RESULTS OF OPERATIONS

This review of the results of operations should be read in conjunction with the audited consolidated financial statements for the year ended 31 December 2013 and 2012.

Management's Discussion and Analysis of financial condition and results of operations for the three months ended 31 December 2013 as compared to the three months ended 31 December 2012

The Company reported a net income of $0.2 million for the three months ended 31 December 2013 as compared to a net loss of $1.1 million for the three months ended 31 December 2012. Changes between 2013 and 2012 were as follows:

	Three months ended 31 December		Changes	
	2013	2012		
	$'000	$'000	$'000	%
Revenue				
Oil and natural gas revenue	**6**	9	(3)	(33)
	6	9	(3)	(33)
Expenses				
Exploration and evaluation expenses	**(285)**	(93)	(192)	206
Production and operating expenses	**(10)**	(7)	(3)	43
Depreciation	**(46)**	(47)	1	(2)
General and administrative expenses	**(912)**	(1,289)	377	(29)
Share based compensation	**(206)**	(176)	(30)	17
Write-down of inventory	**-**	(552)	552	(100)
Restructuring expenses	**-**	(118)	118	(100)
Foreign exchange gain	**129**	-	129	100
Other income	**192**	78	114	146
	(1,138)	(2,204)	1,066	(48)
Results from operating activities	**(1,132)**	(2,195)	1,063	(48)
Fair value gain – outstanding warrants	**1,375**	1,937	(562)	(29)
Finance income / (expense)				
Interest income on bank deposits	**15**	13	2	15
Derivative gain	**-**	227	(227)	(100)
Effective interest on loans and borrowings	**-**	(1,032)	1,032	(100)
Accretion of decommission provisions	**(47)**	(39)	(8)	21
Net foreign exchange (loss) /gain	**(51)**	15	(66)	(440)
	(83)	(816)	733	(90)
Net income / (loss) and comprehensive income / (loss)	**160**	(1,074)	1,234	(115)
Net income / (loss) and comprehensive income / (loss) attributable to:				
Equity holders of the company	**166**	(988)	1,154	(117)
Non-controlling interest	**(6)**	(86)	80	(93)
Net income / (loss) and comprehensive income / (loss)	**160**	(1,074)	1,234	(115)

Oil and natural gas revenue
Oil and natural gas revenue of $6,000 (2012: $9,000) consists of the sale of natural gas from the Hackett Interests in Alberta, Canada. The Company has not yet realised significant revenue from its planned operations elsewhere.

Exploration and evaluation expenses
Exploration and evaluation expenses increased by $0.2 million to $0.3 million in 2013 from $0.1 million in 2012.

In December 2012, the Company entered into an exclusive cooperation agreement with Chevron to jointly seek unconventional exploration opportunities in the Karoo basin. The Chevron agreement provides for the Company to work exclusively with Chevron for a period of five years to jointly seek to obtain exploration rights in the Karoo Basin subject to the parties mutually agreeing participation terms applicable to each right. As part of the Chevron Agreement, Chevron made a cash payment to the Company of $1 million. This receivable has been included within exploration and evaluation expenses in Q4 2012. Excluding the remittance exploration and evaluation expenses decreased by $0.8 million to $0.3 million in the three months ended December 2013.

This movement is primarily attributable to function and integrity testing of the Makó 7 well in 2012 which was not repeated in 2013. 2013 expenses represent recurring maintenance to safeguard the Company's existing Hungarian wells.

Depreciation
2013 and 2012 depreciation expense consists of depreciating assets and equipment at the Group's Budapest and Dublin offices.

General and administrative expenses

	Three months ended 31 December		**Change**	
	2013	**2012**		
	$'000	**$'000**	**$'000**	**%**
Accounting and audit fees	**(83)**	(173)	90	(52)
Consulting fees	**(162)**	(401)	239	(60)
Legal fees	**(13)**	(108)	95	(88)
Investor relations	**(80)**	(35)	(45)	129
Office and Administrative costs	**(206)**	(116)	(90)	78
Payroll and related costs	**(278)**	(291)	13	(4)
Directors' fees	**(67)**	(81)	14	(17)
Travel and promotion	**(23)**	(84)	61	(73)
	(912)	(1,289)	377	(29)

General and administrative expenses decreased by $0.4 million to $0.9 million in 2013 from $1.3 million in 2012. The main changes were as follows:

- Accounting and audit fees: The decrease occurred due to the increased focus on managing the costs of accounting and audit fees incurred by the Group.
- Consulting and Legal fees: The overall decrease was attributable to a continued decrease in the use of outside consultants and counsel and increased focus on cost containment by management during the period. Legal fees were higher in 2012 as the Group addressed the closing of the Denver office and the related redundancies.
- Investor relations: One of the main focuses of the Group's new management, who commenced in mid-2012, was and is to actively engage with its shareholders and investors. This has resulted in increased expense in this area in 2013. It is expected that the level of expenditure in this area will be maintained going forward.
- Office and Administrative expenses are slightly higher over Q3, 2013 by approximately $40,000 due to local income taxes payment in the Group.
- Payroll and related cost: These costs are consistent quarter on quarter as the Group's Denver Office closed in Q3 2012.
- Travel and promotion decreased in the current period over the prior year due to the closure of the Denver office in Quarter 3, 2012 and increased focus by new management on cost containment. Certain levels of travel and promotion costs are and will be incurred due to the international geography of the Group's assets and investor base.

Share based compensation
Share based compensation increased marginally in the three months ended 31 December 2013 in comparison to the three months ended 31 December 2012. The 3 months to 31 December 2012 was primarily effected by the cost associated with the grant of 17 million share options in 2011. The 3 months to 31 December 2013, contains primarily the apportioned cost of the 6 million options granted in May 2012 and 9.9 million share options issued in April 2013.

Write-down of inventory
Inventory available for sale consisted of drill pipe, casing and tubing. The Group assessed the carrying value of its inventory as at 31 December 2012. It was determined, given the age and condition of the inventory, that it was appropriate to impair this to zero. No similar impairment occurred in 2013.

Restructuring expense
Restructuring expense of $0.1 million was recognised in 2012 as a result of the Company's decision to relocate its corporate headquarters from Denver, Colorado to Dublin, Ireland, which consisted primarily of severance and health benefits. The Denver office closed on 28 September 2012. This expense was not repeated in 2013.

Foreign exchange gain
Previously the Group attributed the majority of its foreign exchange gains and losses to the 11% debentures. Thus, exchange gains / (losses) were recorded in finance income / (expense). The Group repaid the debenture on 30 June 2013. All exchange gains and losses not related to financing are recorded in operating expenses.

Other Income
Other income has increased in the current period primarily due to work being carried out by TXM in providing geological and geophysical services to NIS as part of NIS's drilling of the three well programme.

Fair value gain / (loss) – outstanding warrants
Fair value gain / (loss) – outstanding warrants decreased from a gain of $1.9 million in 2012 to a gain of $1.4 million in 2013. The movement occurred due to the volatility changes in the fair value of the instruments. The primary variables are the movement in Falcon share price over the period and the time elapsed to maturity. As at 31 December 2012 Falcon's share price (as quoted on the TSX-V) was CDN$18 cents; 30 September 2012 – CDN$20 cents; 31 December 2013 – CDN$18 cents and 30 September 2013 – CDN$18.5 cents. Movements in exchange in the CDN$ and US$ also contributed to the variability.

Finance income / (expense)
Net Finance expense decreased from $0.8 million in 2012 to an expense of $0.1 million in 2013, a movement of $0.7 million. The decrease occurred primarily due to the repayment of the Group's debentures on 30 June 2013. The Group has no outstanding debt.

Net loss attributable to non-controlling interest
The amounts reflected in 2013 and 2012 represent Falcon Australia's losses attributable to shareholders other than Falcon.

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Management's Discussion and Analysis of financial condition and results of operations for the year ended 31 December 2013 as compared to the year ended 31 December 2012

The Company reported a net loss of $3.6 million for 2013 as compared to a net loss of $17.7 million for 2012. Changes between 2013 and 2012 were as follows:

	Year ended 31 December		Change	
	2013	2012		
	$'000	$'000	$'000	%
Revenue				
Oil and natural gas revenue	**17**	21	(4)	(19)
	17	21	(4)	(19)
Expenses				
Exploration and evaluation expenses	**(899)**	(1,654)	755	(46)
Production and operating expenses	**(27)**	(37)	10	(27)
Depreciation	**(307)**	(342)	35	(10)
General and administrative expenses	**(4,656)**	(6,206)	1,550	(25)
Write-down of inventory	**-**	(552)	552	(100)
Share based compensation	**(693)**	(2,380)	1,687	(71)
Restructuring expense	**-**	(792)	792	(100)
Foreign exchange gain	**326**	-	326	100
Other income	**683**	276	407	147
	(5,573)	(11,687)	6,114	(52)
Results from operating activities	**(5,556)**	(11,666)	6,110	(52)
Fair value gain / (loss) – outstanding warrants	**3,895**	(2,019)	5,914	(293)
Finance income / (expense)				
Interest income on bank deposits	**102**	66	36	55
Derivative gains	**26**	15	11	73
Effective interest on loans and borrowings	**(2,352)**	(3,721)	1,369	(37)
Accretion of decommission provisions	**(158)**	(209)	51	(24)
Net foreign exchange gain / (loss)	**473**	(181)	654	(361)
	(1,909)	(4,030)	2,121	(53)
Net loss and comprehensive loss	**(3,570)**	(17,715)	14,145	(80)
Net loss and comprehensive loss attributable to:				
Equity holders of the company	**(3,411)**	(17,441)	14,030	(80)
Non-controlling interest	**(159)**	(274)	115	(42)
Net loss and comprehensive loss	**(3,570)**	(17,715)	14,145	(80)

Oil and natural gas revenue
Oil and natural gas revenue of $17,000 (2012: $21,000) includes sale of natural gas from the Hackett Interests in Alberta, Canada of $17,000 in 2013 (2012: $13,000) and $8,000 in 2012 for production from the exploratory wells in Hungary. The Company has not yet realised revenue from its planned operations elsewhere.

Exploration and evaluation expenses
Exploration and evaluation expenses decreased by approximately $0.8 million to $0.9 million in 2013 from $1.7 million in 2012.

In December 2012, Falcon entered into an exclusive cooperation agreement with Chevron to jointly seek unconventional exploration opportunities in the Karoo Basin. The Chevron Agreement provides for Falcon to work exclusively with Chevron for a period of five years to jointly seek to obtain exploration rights in the Karoo Basin subject to the parties mutually agreeing participation terms applicable to each right. As part of the Chevron Agreement, Chevron made a cash payment to Falcon of $1 million in February 2013. This receivable has been included within exploration and evaluation expenses in 2012. Excluding this remittance, exploration and evaluation expenses decreased by $1.8 million to $0.9 million in 2013

This decrease is primarily attributable to function and integrity testing of the Makó 7 well in 2012 which was not repeated in 2013. 2013 expenses represent recurring maintenance to safeguard the company's existing Hungarian wells.

Depreciation
Depreciation expense consists of depreciating assets and equipment at the Group's Budapest, Dublin offices and previous Denver office (2012).

General and administrative expenses

	Year ended 31 December		Change	
	2013 $'000	**2012 $'000**	**$'000**	**%**
Accounting and audit fees	**(534)**	(703)	169	(24)
Consulting fees	**(617)**	(966)	349	(36)
Legal fees	**(250)**	(479)	229	(48)
Investor relations	**(349)**	(127)	(222)	175
Office and Administrative costs	**(870)**	(1,231)	361	(29)
Payroll and related costs	**(1,450)**	(1,873)	423	(23)
Directors' fees	**(281)**	(306)	25	(8)
Travel and promotion	**(305)**	(521)	216	(41)
	(4,656)	**(6,206)**	1,550	(25)

General and administrative expenses decreased $1.6 million to $4.7 million in 2013 from $6.2 million in 2012. The main changes were as follows:

- Accounting and audit fees: The decrease occurred due to increased focus on managing the costs of accounting and audit fees incurred by the Group.
- Consulting and Legal fees: The decrease was attributable to a continued decrease in the use of outside consultants and counsel and increased focus on cost containment by management during the period.
- Investor relations: One of the main focuses of the Group's new management, who commenced in mid-2012, was and is to actively engage with its shareholders and investors. This has resulted in increased expense in this area in 2013. It is expected that the level of expenditure in this area will be maintained going forward.
- Office and Administrative: The decrease was attributable to a decrease in occupancy costs associated with the Denver office due to its closure during Quarter 3, 2012 and an overall reduction in operating overhead costs.
- Payroll and related cost: The decrease was attributable to the closure of the Denver office in Quarter 3 of 2012 and the resulting reduction in the management team.
- Travel and promotion decreased in the current period over the prior year due to the closure of the Denver office in Quarter 3, 2012 and increased focus by new management on cost containment. Certain levels of travel and promotion costs are and will be incurred due to the international geography of the Group's assets and investor base.

Write-down of inventory available for sale
Inventory available for sale consisted of drill pipe, casing and tubing. The Group assessed the carrying value of its inventory as at 31 December 2012. It was determined, given the age and condition of the inventory, that it was appropriate to impair this to zero. This did not reoccur in 2013.

Share based compensation
Share based compensation decreased by $1.7 million to $0.7 million in 2013. The year ended 31 December 2012 was primarily effected by the cost associated with the grant of 17 million share options in 2011 and an additional $1.1 million due to the accounting modification relating to options held by employees and consultants who were terminated as a result of the decision to relocate the corporate headquarters. The year ended 31 December 2013, contains primarily the apportioned cost of the 6 million options granted in May 2012 and the 9.9 million share options issued in April 2013.

Restructuring expense
Restructuring expense of $0.8 million was recognised in 2012 as a result of the Company's decision to relocate its corporate headquarters from Denver, Colorado to Dublin, Ireland, and consisted of severance and health benefits – $0.5 million, rent expense, net of sublease – $0.2 million and other - $0.1 million. The Denver office closed on 28 September 2012. This expense was not repeated in 2013.

Other income
Other income has increased in the current period primarily due to the work being carried out by TXM in providing geological and geophysical services to NIS as part of NIS's drilling of the three well programme.

Foreign exchange gain
Previously the Group attributed the majority of its foreign exchange gains and losses to the 11% debentures. Thus, exchange gains / (losses) were recorded in finance income / (expense). The Group repaid the debenture on 30 June 2013. All exchange gains and losses not related to financing are recorded in operating expenses.

Fair value gain / (loss) – outstanding warrants
Fair value gain / (loss) – outstanding warrants decreased from a loss of $2.0 million in 2012 to a gain of $3.9 million in 2013. The movement occurred due to the volatility changes in the fair value of the instruments. The primary variables are the movement in Falcon share price over the period and the time elapsed to maturity. As at 31 December 2011 Falcon's share price (as quoted on the TSX-V) was CDN$11 cents; 31 December 2012 – CDN$18 cents and 31 December 2013 – CDN$18 cents. Movements in exchange in the Canadian and US$ also contributed to the variability.

Finance income / (expense)
Net Finance expense decreased from $4.0 million in 2012 to $1.9 million in 2013, a movement of $2.1 million. The decrease occurred primarily due to repayment of the issued debentures on 30 June 2013.

Net loss attributable to non-controlling interest
The amounts reflected in 2013 and 2012 represent Falcon Australia's losses attributable to shareholders other than Falcon.

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SUMMARY OF QUARTERLY RESULTS

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

(In thousands of $ unless otherwise stated)

As of:	**31 March 2013**	**30 June 2013**	**30 September 2013**	**31 December 2013**
Total assets	107,448	94,475	90,288	89,516
Exploration and evaluation assets	72,643	72,777	72,456	74,517
Working capital	12,342	7,662	7,095	6,422
Total shareholders' equity	65,851	64,186	74,330	74,711

For the three months ended:	**31 March 2013**	**30 June 2013**	**30 September 2013**	**31 December 2013**
Revenue	3	4	4	6
Net (loss) / income	(4,746)	(1,896)	2,912	160
Net (loss) / income attributable to common shareholders	(4,701)	(1,805)	2,929	166
Net (loss) / income per share-basic and diluted (cent)	(0.007)	(0.002)	0.003	0.000

As of:	**31 March 2012**	**30 June 2012**	**30 September 2012**	**31 December 2012**
Total assets	90,096	87,711	85,513	86,013
Exploration and evaluation assets	70,690	71,683	72,209	74,019
Working capital	11,270	637	(3,878)	(7,331)
Total shareholders' equity	60,590	55,701	47,665	46,913

For the three months ended:	**31 March 2012**	**30 June 2012**	**30 September 2012**	**31 December 2012**
Revenue	6	5	1	9
Net loss	(1,851)	(5,872)	(8,918)	(1,074)
Net loss attributable to common shareholders	(1,760)	(5,802)	(8,891)	(988)
Net loss per share-basic and diluted (cent)	(0.003)	(0.008)	(0.013)	(0.001)

The Group is an exploration company with limited revenue which is not material. The Group's net (loss) / income and net (loss) / income per share relate to the Group's operations during a particular period, and are not seasonal in nature.

Quarter 2 2012: On 1 May 2012, Philip O'Quigley assumed the role of Chief Executive Officer of the Group.

Quarter 3 2012: During the third quarter of 2012, the Company relocated its corporate headquarters from Denver, Colorado to Dublin, Ireland. The finance and executive function moved to Dublin while the primary technical function shifted to the company's Hungarian office in Budapest. In connection with that decision, all individuals and consultants in Denver were terminated. At 30 September 2012, the Company recorded an estimate of the expenses related to this restructuring, including severance and employee related benefits, certain expenses, acceleration of the recognition of certain future expenses and acceleration of the depreciation of certain assets. The Denver office closed on 28 September 2012.

Quarter 4 2012: In December 2012, Falcon entered into an exclusive cooperation agreement with Chevron to jointly seek unconventional exploration opportunities in the Karoo Basin. The Chevron agreement provides for Falcon to work exclusively with Chevron for a period of five years to jointly seek to obtain exploration rights in the Karoo Basin subject to the parties mutually agreeing upon participation terms applicable to each right. As part of the Chevron agreement, Chevron made a cash payment to Falcon of $1 million in February 2013 as a contribution to past costs.

Quarter 1 2013: In January 2013, Falcon agreed to a three-well drilling programme with NIS, 56% owned by Gazprom Group, to target the Algyő Play, whereby NIS made a cash payment of $1.5 million to Falcon in February 2013, and agreed to drill three wells by July 2014.

Quarter 1 2013: On 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange and the ESM market of the Irish Stock Exchange, of the Company's existing share capital and an additional 120,381,973 new common shares in the capital of the Company issued pursuant to the concurrent conditional brokered private placement at a price of £0.14 (CDN$0.215) per share, raising gross proceeds of $25.7 million (£16.9 million). Trading in these shares commenced on AIM and ESM on 28 March 2013.

Quarter 2 2013: On 30 April 2013, the Group announced that under the stock option plan approved at Falcon's annual shareholders meeting held on 25 September 2012, it had granted incentive stock options ("**options**") to purchase an aggregate of 9.9 million common shares of Falcon. A total of 3 million options were granted at an exercise price of CDN$0.215 to Eoin Grindley, Falcon's Chief Financial Officer pursuant to the terms of his employment contract. A further 5.5 million options were granted at an exercise price of CDN$0.24 to Falcon directors and 1.4 million options were granted to Falcon employees also at CDN$0.24. The options all have a vesting schedule allowing for 1/3 of the options to vest on the first anniversary of the grant with an additional 1/3 vesting each subsequent year until the options are fully vested on 30 April 2016, and an expiry date of the options of 29 April 2018. Immediately after this award, there were 42,737,000 options outstanding, representing 5.2% of the issued share capital of the company.

Quarter 2 2013: Falcon repaid the full amount outstanding on its convertible loan note of CDN$10.7 million. This repayment means that the Company is now completely debt free.

Quarter 3 2013: In order to consolidate its interest in Australia, Falcon acquired Sweetpea's 50 million shares or 24.2% interest in Falcon Australia in July 2013. Following the completion of the share purchase, Falcon owned 96.9% of the issued share capital of Falcon Australia. The total value of the consideration was CDN$22.6 million consisting of $3 million in cash and the balance in Falcon common shares. Sweetpea, a wholly owned subsidiary of PetroHunter Energy Corporation, held 10.7% of the issued share capital of Falcon. Falcon further consolidated its position in September 2013 when it has completed the purchase of 2,462,686 shares from certain of the remaining shareholders in Falcon Australia. The consideration was 2.25 common shares in Falcon for every one Falcon Australia ordinary share held. The valuation used in this offer was the same used in the acquisition of the Sweetpea 24.2% holding. As a result of this transaction, 5,541,044 new Falcon common shares were issued. Following the completion of the above transactions, Falcon holds 202,462,686 shares in Falcon Australia, representing 98.1% of its issued share capital.

Generally, the Group's total assets, exploration and evaluation costs, working capital and total shareholders' equity fluctuate in proportion to one another until such time as the Group completes additional financing.

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LIQUIDITY AND CAPITAL RESOURCES

Going Concern

The Group's consolidated financial statement have been prepared on a going concern basis which assumes that the Group will be able to meet its liabilities as they fall due for the foreseeable future. For the year ended 31 December 2013, the Group incurred a net loss of $3.6 million and operating cash outflows of $5.3 million and as at 31 December 2013, had a retained deficit of $350.6 million.

During the year the Group raised net funds of $23.5 million through a brokered private placement on the AIM and ESM markets. These funds have been used in the year to repay the Group's 11% debenture ($10.2 million), acquire the 25.4% minority interest in Falcon Australia, ongoing operations and to reduce Falcon Australia's Overriding Royalty Interest on the Beetaloo Permits in Australia. As at 31 December 2013 the Group had a cash balance of $8.4 million.

The Group has forward looking cash commitments regarding its exploration licences of $3.5 million and overheads which need to be met within the next 12 months. As a result, notwithstanding the Group's recent fundraising, the Group's ability to continue as a going concern is dependent upon its ability to raise additional capital through the sale of additional Common Shares, other debt or equity instruments, asset dispositions or entering into joint arrangement with third parties. The Directors are confident that further funds can be raised and it is appropriate to prepare the financial statements on a going concern basis. However, there can be no certainty that any of the aforementioned transactions will complete. This indicates the existence of a material uncertainty related to events or conditions that may cast significant doubt about the Group's ability to continue as a going concern and, therefore, that it may be unable to realise its assets and discharge its liabilities in the normal course of business. The 31 December 2013 financial statements do not include the adjustments that would be required if the Group could not continue as a going concern.

Working Capital

Cash and cash equivalents as at 31 December 2013 were $8.4 million, an increase of $5.5 million from $2.9 million as at 31 December 2012. Working capital as at 31 December 2013 increased to $6.4 million from negative working capital of $7.3 million as at 31 December 2012.

The increase to cash and cash equivalents was the result of net cash raised from financing activities amounting to $10.3 million, net cash used in investing activities of $0.3 million and net cash used in operating activities of $5.3 million.

Restricted cash amounts to $0.6 million at 31 December 2013.

Accounts Receivable

Current accounts receivable as at 31 December 2013 were $0.5 million, which includes $0.2 million receivable and prepayments of $0.3 million.

Accounts Payables and Accrued Expenses

Accounts payable and accrued expenses as at 31 December 2013 were $1.5 million which includes $0.5 million for accounts payable and $1.0 million accrued expenditure of which $0.1 million is for the restructuring provision associated with the closure of the Denver office.

Capital Expenditures

For the period ended 31 December 2013 no material capital expenditure commitments were incurred.

Australia - Beetaloo Basin, Northern Territory, Australia

During 2012, costs incurred in Australia were primarily for geological and geophysical analysis, engineering and analytical evaluations, and working with the Northern Land Council and Aboriginal Area Protection Agency for site reinstatement and necessary environmental studies.

Under the terms of Falcon Australia's exploration permit EP-99, Falcon Australia must spend a minimum of $1.5 million by 31 December 2014 in collecting 2D seismic data on acreage within exploration permit EP-99. Falcon Australia intends to meet this commitment either through a farm - out arrangement or through its own resources.

South Africa - Karoo Basin, South Africa
On granting of an approved exploration right in South Africa, the Group will be required to make a payment to the South African government of approximately $0.7 million.

Hungary - Makó Trough, Hungary
As at 31 December 2013, the Company's 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 $245 million.

The Group is not planning any independent technical operations in Hungary other than joint operations with NIS, and as such no material capital expenditures are expected.

Other commitments

(i) Lease commitments

The Group has entered into lease agreements for office space in:

- Denver, Colorado, expiring April 2015;
- Budapest, Hungary expiring 2 August 2015;
- Makó, Hungary expiring June 2014;
- Szeged, Hungary expiring June 2014;
- Dublin, Ireland, with a break clause exercisable in October 2017; and
- Sydney, Australia expiring October 2014.

The Group is obligated to pay the following minimum future rental commitments under non-cancelable operating leases at 31 December 2013 during the following periods:

	$'000
Year ending 31 December	
2014	**533**
2015	**284**
2016	**120**
2017	**100**
Thereafter	**-**
Total	**1,037**

As part of the Group's restructuring process in 2012, the Group sub-let its Denver premises. This sub lease rental income has not been included in the table above. A total amount of $0.2 million is expected to be received under the sublease ending April 2015.

(ii) Contractual commitments
Under existing agreements with two advisors, the Group is obligated to pay a success fee for services provided in relation to certain of the Group's assets. The success fees are based on the cash or cash equivalent value of the net amount received directly or indirectly by the Group. The agreements were terminated during 2011 and 2012 respectively, but payments will continue after termination until all relevant cash or cash equivalents amounts are settled.

Convertible debentures

On 30 June 2009, the Company completed an offering of 11,910 units at a price of $865 (CDN$1,000) per unit. Each unit consisted of one 11% convertible unsecured debenture in the principal amount of $779 (CDN$900) that matured on the fourth anniversary of its issuance (30 June 2013) pursuant to the terms of a trust indenture dated 30 June 2009, and 250 common shares in the capital of Falcon. The debentures accrued interest at an annual rate of 11% calculated and payable semi-annually in arrears on 1 January and 1 July in each year. The debentures were unsecured direct obligations of the Company. The debentures and all outstanding interest were repaid at maturity on 30 June 2013.

Debt and Equity Capital

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. As noted above on 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange and the ESM market of the Irish Stock Exchange, of the Company's existing share capital and an additional 120,381,973 new common shares in the capital of Falcon issued pursuant to the concurrent conditional brokered private placement at a price of £0.14 (CDN$0.215) per share, raising gross proceeds of $25.7 million (£16.9 million). Trading in these shares commenced on AIM and ESM on 28 March 2013.

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DISCLOSURE OF OUTSTANDING SHARE DATA

The following is a summary of the Company's outstanding share data as at 31 December 2013 and 29 April 2014:

Class of securities	31 December 2013	29 April 2014
Common shares	921,537,517	921,537,517
Stock options	34,952,000	34,952,000
Private placement warrants(i)	65,287,500	-
Hess warrants(ii)	10,000,000	10,000,000

(i) Warrants to purchase 65,287,500 Common Shares at a price of CDN$0.18 per Common Share were issued to shareholders in 2011 in connection with the Falcon private placement. The warrants expired in 2014. They were not exercised.

(ii) Warrants to purchase 10,000,000 Common Shares at a price of CDN$0.19 per Common share were issued to Hess on 13 July 2011 in connection with the Hess transaction. The Hess warrants expire on 13 January 2015.

LEGAL MATTERS

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

TRANSACTION WITH NON - ARMS LENGTH AND RELATED PARTY TRANSACTIONS

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

Dr. György Szabó Consulting Agreement
On 27 February 2009, Dr. György Szabó (Executive Director and Co-Managing Director of Falcon –TXM) entered into a consulting agreement (the "**GS Consulting Agreement**") with TXM, pursuant to which Dr. Szabó agreed to act as Managing Director of TXM, to perform certain oil and gas services for TXM and to not compete directly or indirectly with TXM during his employment with TXM. Dr. Szabó is paid a monthly fee of $5,000. The GS Consulting Agreement contains standard confidentiality provisions. TXM may terminate the GS Consulting Agreement at any time, with or without cause, for any lawful reason whatsoever, upon TXM providing Dr. Szabó with sixty days' prior written notice. The GS Consulting Agreement expired on 31 December 2009, however Dr. Szabó has continued to provide general managerial services to TXM and to receive the same monthly fee. Dr. Szabó was paid $60,000 pursuant to the GS Consulting Agreement in the year ending 31 December 2013.

P&S Consulting Agreement
On 4 May 2005, P&S Mérnöki Kereskedelmi-Tanácsadó Bt. ("**P&S**") entered into a consulting agreement (the "**P&S Agreement**") with TXM, pursuant to which P&S agreed to provide certain consulting services to TXM in connection with TXM's objectives of drilling wells on the Makó and Tisza licences. The P&S Agreement was amended on 28 November 2005 and further amended on 1 June 2006, 1 January 2008, 1 January 2009 and 1 April 2010. P&S is wholly-owned by a family member of Dr. György Szabó, a current Director of the Company. Under the terms of the P&S Agreement, TXM was obligated to pay P&S a monthly services fee of HUF 750,000. The P&S Agreement contains standard confidentiality provisions and provides that P&S shall not compete with TXM during the term of the P&S Agreement. TXM may terminate the P&S Agreement at any time, with or without cause, for any lawful reason whatsoever, upon TXM providing P&S with 30 days, prior written notice. TXM and P&S have further amended the terms of the P&S Agreement by oral agreement. Pursuant to the amended P&S Agreement, P&S is paid a monthly fee of $8,500 (effective 1 January 2013) (2012: $10,000) plus reasonable expenses incurred by Dr. Szabó as an employee of P&S, such amounts thereafter paid to Dr. Szabó from P&S. P&S was paid $102,000 pursuant to the agreement in the year ending 31 December 2013.

Dr. Gábor Bada
On 28 December 2012, Dr. Bada entered into an employment agreement (the "**Bada Employment Agreement**") with TXM pursuant to which Dr. Bada agreed, subject to certain conditions, to perform certain geological services for TXM. In addition, on 1 January 2013, Dr. Bada verbally agreed the terms on which he was to provide geological services to TXM as a consultant. Dr. Bada will be paid a consultancy fee of $20,000 in 2013 in relation to this work. Dr. Bada invoices TXM through his company Senzus Kft. The Bada Employment Agreement contains standard confidentiality provisions. Dr. Gábor Bada received a consultancy fee of $20,000 through his company in the year ended 31 December 2013.

Oakridge Financial Management Inc.
The Group has engaged Oakridge Financial Management Inc. to assist in submitting returns to the Canadian Revenue Agency. Mr. Greg Smith, a current director of Falcon, is the sole shareholder in Oakridge Financial Management Inc. The Group has incurred costs of approximately CDN$1,000 to Oakridge Financial Management Inc. during the year ended 31 December 2013.

Igor Akhmerov
Igor Akhmerov received €100,000 (US$137,000) for consulting services to the Group in 2013.

March 2013 Private placement
On 14 March 2013 the Group announced its application for admission to trading on the AIM market of the London Stock Exchange and the ESM market of the Irish Stock Exchange, of the Company's existing share capital and an additional 120,381,973 new common shares in the capital of Falcon issued pursuant to the concurrent conditional brokered private placement at a price of £0.14 (CDN$0.215) per share, raising gross proceeds of $25.7 million (£16.9 million) (the "**Placing**"). The following related parties participated in the Placing:

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

*immediately post-Placing.

April 2013 Stock Options
On 30 April 2013 a total of 3 million options were granted at an exercise price of CDN$0.215 to Eoin Grindley, Falcon's Chief Financial Officer pursuant to the terms of his employment contract. A further 5.5 million options were granted at an exercise price of CDN$0.24 (a 23% premium to the closing share price on 30 April 2013) to the following Falcon directors:

Directors	**Number of options granted**	**Total number of Options held after grant**
John Craven	2,000,000	3,100,000
Igor Akhmerov	2,500,000	2,900,000
Daryl Gilbert	200,000	2,900,000
Gregory Smith	200,000	1,000,000
Joachim Conrad	300,000	1,000,000
David Harris	300,000	300,000

A further 1.4 million options were granted to employees of Falcon at an exercise price of CDN$0.24 on 30 April 2013.

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 ESTIMATES

Preparation of financial statements pursuant to IFRS requires a significant number of judgemental assumptions and estimates to be made. This impacts the income and expenses recognised in the statement of operations and comprehensive loss together with the valuation of the assets and liabilities in the statement of financial position. Such estimates and judgements are based on historical experience and other factors, including expectation of future events that are believed to be reasonable under the circumstances and are subject to continual re-evaluation. It should be noted that the impact of valuation in some assumptions and estimates can have a material impact on the reported results.

The following are key sources of estimation uncertainty and critical accounting judgements in applying the Group's accounting policies:

Critical judgments

(i) Exploration and evaluation assets
The carrying value of exploration and evaluation assets was $74.5 million at 31 December 2013 (2012: $74.0 million). The Group has determined that there are no indicators of impairment present in accordance with IFRS 6 "Exploration for and evaluation of mineral interests" and thus impairment evaluations were not performed on these assets.

Management's conclusion that no facts or circumstances exist that suggested the exploration and evaluation assets may be impaired required judgment based on experience and the expected progress of current exploration and evaluation activities and the successful completion of farm-out projects.

The critical judgments were:

Falcon will secure participation by a new farm-in or joint venture partner for the development of the Beetaloo exploration permits in Australia. If Falcon is unable to secure participation by a new farm–in or joint venture partner, its ability to develop and realise its investment in the asset could be significantly curtailed.

Makó Trough, Hungary: Under the terms of the NIS Agreement, NIS will earn 50% of the net production revenues from the initial three wells being drilled in the Algyő Play, and will have an option to acquire a right of first negotiation for future drilling operations in the Algyő Play, sharing any potential future costs and revenue with the Group, on terms to be negotiated. In the event that NIS decide not participate in any further drilling operations in the Algyő Play, Falcon will become responsible for 100% of any exploration and development costs in the Algyő Play under the Makó Production Licence. If the Group were unable to secure participation by a new farm - out or joint venture partner for the development of the Algyő Play, its ability to develop and realise its investment in the asset could be significantly curtailed. This could have an adverse effect on the Group's business, prospects, financial condition and results of operations.

Critical estimates

(ii) Going concern
The consolidated financial statements have been prepared on the going concern basis. In considering the financial position of the Group, the Group has considered the forecasted operating and capital expenditures for the foreseeable future and cash flows relating to its financing. Forecasting those cash flows requires significant judgment when estimating expected operating expenditure, capital expenditure, expected monies to be received from potential farm-in partners and proceeds from share issuances.

(iii) Decommissioning Provision
The decommissioning provision represents the Group's best estimate of the costs involved in the various exploration and production licence areas to return them to their original condition in accordance with the licence terms. These estimates include certain management assumptions with regard to future costs, inflation rates and discount rates.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Derivative financial instruments

Derivatives (including embedded derivatives) are initially recognised at fair value of the date a derivative contract is entered into and subsequently re- measured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group has not designated any derivatives as hedges as at 31 December 2013 or 31 December 2012.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related. Changes in the fair value of separable embedded derivatives are recognised immediately in the statement of operations and comprehensive loss.

The Group has / had the following financial instruments – warrants and the conversion feature of the Group's debentures. The Group has not entered into contract for "other instruments" during 2013. The Group has no "Other instruments" as at 31 December 2012 and 31 December 2013.

Warrants

Warrants which do not meet the criteria to be classified as an equity instrument are classified at fair value through the statement of operations and comprehensive loss and are recorded on the statement of financial position at fair value. Transaction costs are recognised in the statement of operations and comprehensive loss as incurred.

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

The composition of the derivative liabilities as at 31 December 2013 and 2012, and the changes therein for the years then ended, are as follows:

	Convertible Debt Conversion Feature $'000	**Private Placement Warrants $'000**	**Hess Warrants $'000**	**Total $'000**
At 1 January 2012	41	2,652	621	3,314
Derivative gains - debt conversion feature	(15)	-	-	(15)
Derivative loss - unrealised – outstanding warrants	-	1,853	166	2,019
At 31 December 2012	26	4,505	787	5,318
Derivative gains – debt conversion feature	**(26)**	**-**	**-**	**(26)**
Derivative gains – unrealised – outstanding warrants	**-**	**(3,556)**	**(339)**	**(3,895)**
At 31 December 2013	**-**	**949**	**448**	**1,397**

The terms of the warrants are as follows:

Warrant issue	Date of issue	Number of common shares issuable under warrants	Exercise Price CDN$	Proceeds from warrants* CDN$'000	Expiry date
Private placement(i)	10 February 2011	33,400,000	0.18	-	10 February 2014
Private placement(i)	8 April 2011	31,887,500	0.18	-	8 April 2014
Hess(ii)	13 July 2011	10,000,000	0.19	1,900	13 January 2015
Total		**75,287,500**		**1,900**	

*Proceeds from warrants are subject to the warrant holders exercising their warrants. The warrants which expired on 10 February 2014 and 8 April 2014 were not exercised.

Compound financial instruments - debentures

Compound financial instruments issued by the Group where the exercise of the conversion feature does not result in a fixed number of shares being issued for a fixed amount in the functional currency of the Company, are separated into a host contract, the note, and embedded derivatives.

The Group had a 11% convertible redeemable debenture in issue at 31 December 2012. The debentures and all outstanding interest were repaid at maturity, on 30 June 2013.

The liability component of a compound financial instrument is recognised initially at the fair value of a similar liability that does not have an equity conversion option. Subsequent to initial recognition, the liability component of the compound financial instrument is measured at amortised cost using the effective interest method.

NEW ACCOUNTING PRONOUNCEMENTS

Several new standards and amendments to existing standards and interpretations, which have been issued by the IASB, and which are expected to apply to the Group are not yet effective and have not been applied in preparing these financial statements. The Group does not expect adoption of these new standards and interpretations, to have a material impact on the financial statements.

An amendment to IAS 32 'Offsetting financial assets and financial liabilities' was issued in December 2011 and will be implemented by the Group from 1 January 2014. The amendment provides additional guidance on when financial assets and financial liabilities may be offset.

IFRS 9 'Financial instruments' was first issued in November 2009 and has since been amended several times. The Standard will eventually replace IAS 39 and covers the classification, measurement and derecognition of financial assets and financial liabilities together with a new hedge accounting model. The IASB intends to expand IFRS 9 to add new requirements for impairment and for it to become a complete replacement of IAS 39 in due course, although no date for its mandatory implementation has been set.

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. The Board has approved the MD&A as presented.

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