Falcon Oil & Gas Ltd.

Form 51-102F1
Management's Discussion & Analysis
For the Three Months Ended 31 March 2014

(Presented in U.S. Dollars)

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INTRODUCTION

The following management's discussion and analysis (the "**MD&A**") was prepared as at 27 May 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 ended 31 March 2014. This MD&A should be read in conjunction with the unaudited Interim Financial statements for the three months ended 31 March 2014 and 2013 and the audited consolidated financial statements and MD&A for the year ended 31 December 2013.

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 29 April 2014. 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
6	*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.
7	*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.
8 & 9	*Beetaloo basin, Northern Territory, Australia – overview – current activity - Transformational Farm out of Beetaloo unconventional acreage* This section in the document contains forward-looking statements pertaining to the completion of the Farm-out agreement, the intended work programme and bringing the project toward commerciality.	Falcon will successfully complete the Farm-out Agreement, the work programme will occur as expected and the project will be brought towards commerciality.	The risks are (1) Falcon does not complete the Farm-out agreement and / or (2) required approvals are not obtained to complete the Farm-out agreement and / or (3) the work programme does not proceed as planned and /or (4) the project is not brought to commerciality.
10	*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.
10	*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.
11	*Makó Trough, Hungary - 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."	The Group assumed that the Group's partner will fulfill its obligations in the 3 well drilling programme.	NIS (as defined on page 11) may not be in a position to fulfill its commitment to Falcon within the agreed timeframe.
11	*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
12	*Makó Trough, Hungary – current activity* "Falcon and NIS have discontinued testing Kútvölgy-1; the well is to be plugged and abandoned."	Kútvölgy-1 well is to be plugged and abandoned.	Circumstances beyond the Group or NIS's control might prevent the successful plugging and abandonment of the well.
12	*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 its cash commitment to these wells, given its interest.
18	*Liquidity & Capital resources – Going concern* "….the Directors are confident further funds can be raised through the sale of additional Common Shares, other debt or equity instruments or asset dispositions 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.
18	*Liquidity and capital resources – capital expenditures* "The Group is planning a 9 well drilling programme with our farm-out partners as announced on 2 May 2014."	Falcon will successfully complete the Farm-out Agreement, the work programme will occur as expected and the project will be brought towards commerciality.	The risks are (1) Falcon does not complete the Farm-out agreement and / or (2) required approvals are not obtained to complete the Farm-out agreement and / or (3) the work programme does not proceed as planned and /or (4) the project is not brought to commerciality.
19	*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.
20	*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 becomes 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.

Liquidity & Capital resources – capital expenditures - Australia - Beetaloo Basin, Northern Territory, Australia
(In the MD&A for the year ended 31 December 2013, it was referenced regarding capital expenditure for EP-99 "Falcon Australia intends to meet this commitment either through a farm-out arrangement or through its own resources." – As part of the renewal process for the Beetaloo permits, this expenditure is no longer necessary)

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 for 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 12.3 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 (iii)	Exploration	1,891.3
Exploration Permit EP-98 (Beetaloo Basin, Northern Territory, Australia)	98.1 (i)	Falcon Australia (iii)	Exploration	10,316.0
Exploration Permit EP-117 (Beetaloo Basin, Northern Territory, Australia)	98.1 (i)	Falcon Australia (iii)	Exploration	6,412.0
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.

(iii) On completion of the Farm-out with Origin Energy Resources Limited, a subsidiary of Origin Energy Limited ("**Origin**") and Sasol Petroleum Australia Limited, a subsidiary of Sasol Limited ("**Saso**l"), collectively referred to herein as (the **"Farminees**"), Origin will be appointed as operator of the exploration permits.

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

Overview
Falcon Australia is the registered holder of approximately 4.6 million acres (approximately 18,600 km^2) within three exploration permits 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 Liquified Natural Gas ("**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.

Exploration Permits
A summary of Falcon Australia's Beetaloo Exploration Permits is contained in the table above.

Three (EP-76, EP-98 and EP-117) of Falcon Australia's four Beetaloo Permits were due for renewal at 31 December 2013. As part of the renewal process, Falcon agreed to relinquish approximately 26% of the three Permits which was not considered to be core to the unconventional play in the Beetaloo Basin by Falcon, Origin and Sasol. The renewal of the three Permits was completed on 30 April 2014. Falcon Australia's fourth permit, EP-99, which was due for renewal at 31 December 2014 was surrendered as it too was not considered to be core to the unconventional play**.**

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.

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 "*Overriding Royalty Beetaloo Basin exploration permits*", 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.

Overriding Royalty Beetaloo Basin exploration permits
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 call options will be funded by Falcon and each of the Farminees in proportion to their interest in the permits.

Discoveries and Prospectivity
The Board believes that the Beetaloo Basin is relatively underexplored 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.

Falcon Australia's previous joint venture partner, Hess Australia (Beetaloo) Pty. Ltd ("**Hess**"), during 2011 and 2012 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, provided 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.

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.

Current activity

Transformational Farm out of Beetaloo unconventional acreage

On 2 May 2014, the Group announced that Falcon Australia, had executed definitive agreements including a Farm-Out Agreement and Joint Operating Agreements (collectively the **"Agreements**") with Origin and Sasol, to each farm into 35% of Falcon's Exploration Permits in the Beetaloo Basin, Australia (the **"Permits**"). The Agreements are subject to conditions inter alia, Government, statutory authority consents and relevant Stock Exchange approvals.

The transaction details are:

- Farminees to carry Falcon in a nine well exploration and appraisal program over five years, detailed as follows:
    - 3 vertical exploration/stratigraphic wells and core studies;
    - 1 hydraulic fracture stimulated vertical exploration well and core study;
    - 1 hydraulic fracture stimulated horizontal exploration well, commercial study and 3C resource assessment; and
    - 4 hydraulic fracture stimulated horizontal exploration/appraisal wells, micro-seismic and 90 day production tests.
- Drilling to commence as soon as possible following completion of the Agreements - targeting 2014 subject to the normal regulatory requirements and rig availability.
- Drilling/testing specifically planned to take the project towards commerciality.
- Farminees to pay Falcon A$20 million cash on completion of the Agreements.
- Origin and Sasol to each earn 35% interest in the Permits.
- Falcon to retain a 30% interest in the Permits.
- Origin to be the Operator.
- Farminees will pay for the full cost of completing the first five wells estimated at A$64 million, and will fund any cost overruns. This work is expected to be completed within the first three years.
- Farminees to pay the full cost of the following two horizontally fracture stimulated wells, 90 day production tests and micro seismic with a capped expenditure of A$53 million, any cost overrun funded by each Party in proportion to their working interest. This work programme is expected to be undertaken in year 4.
- Farminees to pay the full cost of the final two horizontally fracture stimulated wells and 90 day production tests capped at A$48 million, any cost overrun funded by each party in proportion to their working interest. This work programme is expected to be undertaken in year 5.
- As part of the agreements to reduce the overriding royalties from what was originally 12% to 1%, Farminees will pay their pro-rata share (US$14 million) of the two five year call options entered into by Falcon as part of agreements announced on 1 November 2013 with CR Innovations AG and 17 December 2013 with the TOG Group, should Farminees and Falcon decide to exercise the call options.

- Farminees may reduce or surrender their interests back to Falcon only after:
  - the drilling of the first five wells or
  - the drilling and testing of the next two horizontally fracture stimulated wells.

<u>Karoo Basin, South Africa</u>

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 invited 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 the 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 Licence 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 amplitude versus offset ("**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 to 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 a 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. As announced on 16 May 2014, the second joint well "Besa-D-1" has been spudded. In addition, it was announced that the Kútvölgy-1 well testing

operations were completed. The testing indicated that the well experienced improved recovery from certain intervals however well production did not meet commercial rates. Falcon and NIS have discontinued testing Kútvölgy-1; the well is to be plugged and abandoned. Falcon and NIS are now focused on Besa-D-1.

Alberta, Canada

For the three months ended 31 March 2014, Falcon had revenue of $10,000 (2013: $3,000) earned from its Alberta, Canada non-operating working interests (the "**Hackett Interest**"). 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.

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RESULTS OF OPERATIONS

This review of the results of operations should be read in conjunction with the unaudited interim condensed consolidated financial statements for the three months ended 31 March 2014 and 2013, and the audited consolidated financial statements for the year ended 31 December 2013.

Management's Discussion and Analysis of financial condition and results of operations for the three months ended 31 March 2014 as compared to the three months ended 31 March 2013

The Company reported a net loss of $0.3 million for the three months ended 31 March 2014 as compared to a net loss of $4.7 million for the three months ended 31 March 2013. Changes between 2014 and 2013 were as follows:

	Three months ended 31 March		Changes	
	2014	2013		
	$'000	$'000	$'000	%
Revenue				
Oil and natural gas revenue	**10**	3	7	233
	10	3	7	233
Expenses				
Exploration and evaluation expenses	**(198)**	(198)	-	-
Production and operating expenses	**(7)**	(5)	(2)	40
Depreciation	**(43)**	(145)	102	(70)
General and administrative expenses	**(1,019)**	(1,185)	166	(14)
Share based compensation	**(195)**	(95)	(100)	105
Foreign exchange loss	**(33)**	-	(33)	-
Other income	**137**	237	(100)	(42)
	(1,358)	(1,391)	33	(2)
Results from operating activities	**(1,348)**	(1,388)	40	(3)
Fair value gain / (loss) – outstanding warrants	**991**	(1,881)	2,872	(153)
Finance income / (expense)				
Interest income on bank deposits	**17**	6	11	183
Derivative gain	**-**	2	(2)	-
Effective interest on loans and borrowings	**-**	(1,435)	1,435	-
Accretion of decommission provisions	**(35)**	(36)	1	(3)
Net foreign exchange gain / (loss)	**42**	(14)	56	400
	24	(1,477)	1,501	(102)
Loss and comprehensive loss	**(333)**	(4,746)	4,413	(93)
Loss and comprehensive loss attributable to:				
Equity holders of the company	**(329)**	(4,701)	4,372	(93)
Non-controlling interest	**(4)**	(45)	41	(91)
Loss and comprehensive loss	**(333)**	(4,746)	4,413	(93)

Oil and natural gas revenue
Oil and natural gas revenue of $10,000 (2013: $3,000) consists of the sale of natural gas from the Hackett Interest in Alberta, Canada. The Company has not yet realised significant revenue from its planned operations elsewhere.

Exploration and evaluation expenses
Exploration and evaluation expenses are consistent year on year. 2014 & 2013 expenses represent recurring maintenance and landowners costs in maintaining and safeguarding the Company's existing Hungarian wells.

Depreciation
2014 and 2013 depreciation expense consists of depreciating assets and equipment at the Group's Budapest and Dublin offices.

General and administrative expenses

	Three months ended 31 March		Change	
	2014	2013		
	$'000	$'000	$'000	%
Accounting and audit fees	**(86)**	(144)	58	(40)
Consulting fees	**(179)**	(183)	4	(2)
Legal fees	**(24)**	(45)	21	(47)
Investor relations	**(73)**	(33)	(40)	121
Office and Administrative costs	**(185)**	(252)	67	(27)
Payroll and related costs	**(331)**	(403)	72	(18)
Directors' fees	**(71)**	(80)	9	(11)
Travel and promotion	**(70)**	(45)	(25)	56
	(1,019)	(1,185)	166	(14)

General and administrative expenses decreased by $0.2 million to $1.0 million in 2014 from $1.2 million in 2013. 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 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 management is to actively engage with its shareholders and investors. This has resulted in increased expense in this area in 2014.
- Office and Administrative expenses have decreased due to focus on managing the costs of office and administrative expenses incurred by the Group.
- Travel and promotion increased marginally in the current period over the prior period due to increased travel in managing the Group's overseas assets. 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 in the three months ended 31 March 2014 in comparison to the three months ended 31 March 2013. The 3 months to 31 March 2013, contains primarily the apportioned cost of the 6 million options granted in May 2012; the 3 months ended 31 March 2014 contains the apportioned cost of the options granted in May 2012 and the 9.9 million share options issued in April 2013.

Foreign exchange loss
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 decreased in the current period primarily due to reduced 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 loss of $1.9 million in 2013 to a gain of $1.0 million in 2014. The movement occurred due to the volatility changes in the fair value of the instruments. The primary variables are the movement in Falcon's share price over the period and the time elapsed to maturity. As at 31 December 2013 Falcon's share price (as quoted on the TSX-V) was CDN$18 cents; 31 March 2014 – CDN$18 cents; 31 December 2012 – CDN$18 cents and 31 March 2013 – CDN$21.5 cents. Movements in exchange in the CDN$ and US$ also contributed to the variability. The 65.3 million private placement warrants outstanding at 31 December 2013 which expired in February 2014 and April 2014 were not exercised.

Finance income / (expense)
Net Finance income / (expense) decreased from $1.5 million in 2013 to an expense of $0.0 million in 2014, a movement of $1.5 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 2014 and 2013 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:	**30 June 2013**	**30 September 2013**	**31 December 2013**	**31 March 2014**
Total assets	94,475	90,288	89,516	88,389
Exploration and evaluation assets	72,777	72,456	74,517	74,720
Working capital	7,662	7,095	6,422	5,697
Total shareholders' equity	64,186	74,330	74,711	74,577

For the three months ended:	**30 June 2013**	**30 September 2013**	**31 December 2013**	**31 March 2014**
Revenue	4	4	6	10
Net (loss) / income	(1,896)	2,912	160	(333)
Net (loss) / income attributable to common shareholders	(1,805)	2,929	166	(329)
Net (loss) / income per share-basic and diluted (cent)	(0.002)	0.003	0.000	0.000

As of:	**30 June 2012**	**30 September 2012**	**31 December 2012**	**31 March 2013**
Total assets	87,711	85,513	86,013	107,448
Exploration and evaluation assets	71,683	72,209	74,019	72,643
Working capital	637	(3,878)	(7,331)	12,342
Total shareholders' equity	55,701	47,665	46,913	65,851

For the three months ended:	**30 June 2012**	**30 September 2012**	**31 December 2012**	**31 March 2013**
Revenue	5	1	9	3
Net loss	(5,872)	(8,918)	(1,074)	(4,746)
Net loss attributable to common shareholders	(5,802)	(8,891)	(988)	(4,701)
Net loss per share-basic and diluted (cent)	(0.008)	(0.013)	(0.001)	(0.007)

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.

Quarter 4 2013: On 1 November 2013, Falcon announced that Falcon Australia, had entered into an agreement with CR Innovations AG ("**CRIAG**") to acquire its 4% Overriding Royalty Interest ("**ORRI**") relating to its exploration permits in the Beetaloo Basin. 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. The Group has now completed the two agreements to acquire 8% 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% 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.

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

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 three months ended 31 March 2014, the Group incurred additional losses of $0.3 million.

During 2013 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 March 2014 the Group had a cash balance of $6.9 million.

On 2 May 2014, Falcon executed definitive agreements including a Farm-Out Agreement and Joint Operating Agreements (collectively "**the Agreements**") with Origin and Sasol, to each farm into 35% of Falcon's Exploration Permits in the Beetaloo Basin, Australia ("**the Permits**"). The Agreements are subject to conditions inter alia Government, statutory authority consents and relevant Stock Exchange approvals. Falcon Australia will receive A$20 million cash when the Farm-out completes.

The Group has forward looking cash commitments regarding its exploration licences and overheads which need to be met within the next 12 months. These are expected to be funded from existing cash reserves and the upfront cash payment received on completion of the Farm-out. Completion of the Farm-out is subject conditions precedent being Government, including statutory authority consents, and relevant Stock Exchange approvals. Should the conditions precedent not be met, or there is a significant delay, the Directors are confident further funds can be raised through the sale of additional Common Shares, other debt or equity instruments or asset dispositions and it is appropriate to prepare the Interim 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. These Interim 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 March 2014 were $6.9 million, a decrease of $1.5 million from $8.4 million as at 31 December 2013. Working capital as at 31 March 2014 decreased to $5.7 million from working capital of $6.4 million as at 31 December 2013.

The decrease to cash and cash equivalents was the result of net cash used in investing activities of $0.4 million and net cash used in operating activities of $1.2 million.

Restricted cash amounts to $0.6 million at 31 March 2014.

Accounts Receivable

Current accounts receivable as at 31 March 2014 were $0.7 million, which includes $0.3 million receivable and prepayments of $0.4 million.

Accounts Payables and Accrued Expenses

Accounts payable and accrued expenses as at 31 March 2014 were $1.5 million which includes $0.6 million for accounts payable and $0.9 million accrued expenditure.

Capital Expenditures

For the period ended 31 March 2014 the following expenditure commitments were incurred.

Australia - Beetaloo Basin, Northern Territory, Australia

Expenditures were incurred in negotiating the Farm-out Agreement, as announced on 2 May 2014. The Group is planning a 9 well drilling programme with our farm-out partners as announced on 2 May 2014.

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 March 2014, 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.

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.

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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 27 May 2014:

Class of securities	31 March 2014	27 May 2014
Common shares	921,537,517	921,537,517
Stock options	34,952,000	34,952,000
Private placement warrants(i)	31,887,500	-
Hess warrants(ii)	10,000,000	10,000,000

Notes:
(i) Warrants to purchase 31,887,500 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. 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 $15,000 pursuant to the GS Consulting Agreement in the 3 month period ending 31 March 2014.

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 $6,057 (effective 1 February 2014) (2013: $8,500) 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 $20,614 pursuant to the agreement in the period ending 31 March 2014.

Senzus Kft
On 1 January 2013, Dr. Gábor Bada (Head of Technical) verbally agreed terms on which he will provide geological services to TXM as a consultant. Dr. Bada will be paid a consultancy fee of $20,000 in 2014 in relation to this work. Dr. Bada invoices TXM through his company Senzus Kft. Dr. Bada received a consultancy fee of $5,000 through Senzus Kft in the 3 month period ended 31 March 2014.

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$700 to Oakridge Financial Management Inc.

OFF-BALANCE SHEET ARRANGEMENTS AND PROPOSED TRANSACTIONS

The Company does not have any off-balance sheet arrangements, other than operating leases. The following proposed transaction is in progress:

On 2 May 2014, Falcon executed definitive agreements including a Farm-Out Agreement and Joint Operating Agreements (collectively "**the Agreements**") with Origin and Sasol, to each farm into 35% of Falcon's Exploration Permits in the Beetaloo Basin, Australia ("**the Permits**"). The Agreements are subject to conditions inter alia Government, statutory authority consents and relevant Stock Exchange approvals. On completion of the agreement Falcon will receive A$20 million. The transaction details are on pages 8 and 9 of this document.

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 March 2014 or 31 December 2013.

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 2014. The Group has no "Other instruments" as at 31 March 2014 or 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 March 2014 and 31 December 2013, and the changes therein for the periods then ended, are as follows:

	Convertible Debt Conversion Feature $'000	**Private Placement Warrants $'000**	**Hess Warrants $'000**	**Total $'000**
At 1 January 2013	26	4,505	787	5,318
Derivative gains - debt conversion feature	(26)	-	-	(26)
Derivative gains - outstanding warrants	-	(3,556)	(339)	(3,895)
At 31 December 2013	-	949	448	1,397
Derivative gains – outstanding warrants	**-**	**(836)**	**(155)**	**(991)**
At 31 March 2014	**-**	**113**	**293**	**406**

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	8 April 2011	31,887,500	0.18	-	8 April 2014
Hess	13 July 2011	10,000,000	0.19	1,900	13 January 2015
Total		**41,887,500**		**1,900**	

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

NEW ACCOUNTING PRONOUNCEMENTS

These Interim Condensed Consolidated Financial Statements ("**Interim Statements**") of the Group have been prepared in accordance with IAS 34 'Interim Financial Reporting' and, except as described below, on the basis of the same accounting principles as, and should be read in conjunction with, the Consolidated Financial Statements for the year ended 31 December 2013 (pages 9 to 18) as filed on the Canadian Securities Administrator's System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

The following amended standard is mandatory for the first time for the financial year beginning 1 January 2014. The amended Standard does not have any significant impact on the condensed Interim Statements:

- Amendments to IAS 32, 'Offsetting financial assets and financial liabilities'

BUSINESS RISKS AND UNCERTAINTIES

Risks and uncertainties that could cause the Company's actual results to materially differ from current expectations have not changed from those disclosed in the Company's MD&A as at 31 December 2013.

CRITICAL ACCOUNTING ESTIMATES

Critical accounting estimates that could cause the Company's actual results to materially differ from current expectations have not changed from those disclosed in the Company's MD&A and Consolidated Financial Statements for the year ended 31 December 2013.

MANAGEMENT'S RESPONSIBILITY FOR MD&A

The information provided in this MD&A is the responsibility of management. In the preparation of this MD&A, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities.

Management believes such estimates have been based on careful judgments and have been properly reflected in this MD&A.

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

[End of document]