

MANAGEMENT'S REPORT

The accompanying Consolidated Financial Statements of Pearl Exploration and Production Ltd. and related financial information presented in this annual report are the responsibility of Management and have been approved by the Board of Directors. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles. The Consolidated Financial Statements and related financial information reflect amounts which must, of necessity, be based upon informed estimates and judgments of Management with appropriate consideration to materiality. All financial information contained in the annual report is consistent, where appropriate, with that contained in the Consolidated Financial Statements.

The Company has developed and maintains systems of internal controls, policies and procedures in order to provide reasonable assurance as to the reliability of the financial records and the safeguard of assets.

PricewaterhouseCoopers, LLP, independent external auditors appointed by the shareholders of the Company, review Pearl Exploration and Production Ltd.'s systems of internal controls and conduct their work to the extent they deem appropriate. They have examined the Consolidated Financial Statements and they have expressed an opinion on the statements. Their report is included in the Consolidated Financial Statements.

The Board of Directors has established an Audit Committee. The Audit Committee reviews with Management and the external auditors any significant financial reporting issues, the financial statements, and any other matters of relevance to the parties. The Audit Committee meets quarterly to review and approve the interim financial statements prior to their release, as well as annually to review the Company's annual financial statements and Management's discussion and analysis, and to recommend their approval to the Board of Directors. The external auditors have unrestricted access to the Company, the Audit Committee and the Board of Directors.



Keith C. Hill
*President and
Chief Executive Officer*



Randy Neely
Chief Financial Officer

March 14, 2008

AUDITORS' REPORT

March 12, 2008

TO THE SHAREHOLDERS OF PEARL EXPLORATION AND PRODUCTION LTD.

We have audited the consolidated balance sheets of Pearl Exploration and Production Ltd. as at December 31, 2007 and September 30, 2006 and the consolidated statements of operations and deficit, comprehensive loss and accumulated other comprehensive income, and cash flows for the periods then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining,

on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2007 and September 30, 2006 and the results of its operations and its cash flows for the periods then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

PricewaterhouseCoopers refers to the Canadian firm of PricewaterhouseCoopers LLP and the other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

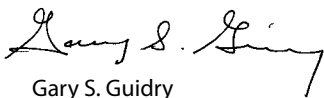
CONSOLIDATED BALANCE SHEET

(audited)	December 31, 2007	September 30, 2006
ASSETS		
Current assets		
Cash	\$ 4,799,186	\$ 8,717,568
Accounts receivable	25,134,435	4,417,816
Income taxes and capital taxes receivable	2,618,015	-
Prepaid expenses and deposits	3,195,770	788,394
	35,747,406	13,923,778
Investments (note 8)	9,362,895	3,000,000
Long-term accounts receivable (note 9)	-	1,144,136
Petroleum and natural gas properties (note 10)	528,352,540	92,069,058
Future income tax (note 16)	2,402,532	-
Goodwill (note 7)	-	18,930,509
	\$ 575,865,373	\$ 129,067,481
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 69,899,310	\$ 12,559,545
Bank loan (note 11)	-	4,976,200
Income taxes and capital taxes payable	-	145,372
	69,899,310	17,681,117
Long-term liabilities		
Asset retirement obligation (note 12)	16,586,030	3,772,479
Future income tax (note 16)	-	5,523,339
	16,586,030	9,295,818
SHAREHOLDERS' EQUITY		
Share capital (note 14)	723,121,821	112,613,584
Contributed surplus (note 15)	8,778,124	4,791,060
Accumulated other comprehensive income	-	-
Deficit	(242,519,912)	(15,314,097)
	489,380,033	102,090,546
	\$ 575,865,373	\$ 129,067,481

Commitments (note 17)

Contingencies (note 20)

See accompanying notes to consolidated financial statements.



Gary S. Guidry
Chairman and Director



Brian D. Edger
Director

CONSOLIDATED STATEMENT OF OPERATIONS AND DEFICIT

(audited)	For the fifteen months ended December 31, 2007	For the year ended September 30, 2006
Revenue		
Oil and gas sales	\$ 128,523,931	\$ 3,634,821
Interest income	1,119,701	746,240
Royalties	(28,494,293)	(582,550)
	101,149,339	3,798,511
Expenses		
Production costs	50,531,155	846,946
Transportation costs	3,567,211	-
General and administrative	19,142,176	3,987,234
Depletion, depreciation and accretion	92,619,784	5,673,989
Stock-based compensation	4,046,779	3,411,784
Interest	3,708,831	113,817
Change in unrealized loss of gas pricing contracts	536,000	-
Foreign currency exchange loss	501,463	292,201
	174,653,399	14,325,971
Other items		
Write-downs (note 7)	172,921,210	21,626
Loss (gain) on sale of assets	(4,286,369)	-
	168,634,841	21,626
Loss before income taxes	(242,138,901)	(10,549,086)
Income taxes		
Future income taxes (recovery)	(19,518,014)	(1,693,611)
Income taxes and capital taxes	4,584,928	97,398
	(14,933,086)	(1,596,213)
Net and comprehensive loss for the period	(227,205,815)	(8,952,873)
Deficit, beginning of period	(15,314,097)	(6,361,224)
Deficit, end of period	\$ (242,519,912)	\$ (15,314,097)
Basic and diluted loss per share	\$ (1.73)	\$ (0.23)
Weighted average number of common shares used in computing earnings per share:		
basic	131,223,521	38,648,736
diluted	132,525,404	38,992,416

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(audited)	For the fifteen months ended December 31, 2007	For the year ended September 30, 2006
Operating activities		
Net and comprehensive loss	\$ (227,205,815)	\$ (8,952,873)
Items not involving cash:		
Depletion, depreciation and accretion	92,619,784	5,673,989
Write-down of accounts receivable	3,195,817	-
Loss (gain) on sale of assets	(4,286,369)	-
Write-downs	172,921,210	21,626
Stock-based compensation	4,046,779	3,411,784
Future income tax (recovery)	(19,518,014)	(1,693,611)
Change in unrealized loss of gas pricing contracts	536,000	-
Foreign exchange loss	501,463	292,201
Abandonment costs	(1,164,821)	-
	21,646,034	(1,246,884)
Changes in non-cash working capital balances related to operations	(27,774,336)	1,428,573
Long term accounts receivable	1,144,136	(1,144,136)
	(4,984,166)	(962,447)
Financing activities		
Advances of bank loan	66,532,316	2,037,566
Advance of bridge loan	10,000,000	-
Repayments of bank loan	(171,214,951)	(16,160,999)
Proceeds from equity financings, net of issue costs	270,787,465	57,173,576
Exercise of stock options	707,623	337,251
Exercise of warrants	-	12,316,008
	176,812,453	55,703,402
Investing activities		
Acquisition of Watch Resources Ltd.	(191,800)	-
Acquisition of Atlas Energy Ltd.	(2,926,017)	-
Acquisition of Cipher Exploration Inc.	(8,809,049)	-
Acquisition of Pan-Global Energy Ltd.	-	238,929
Acquisition of Nevarro Energy Ltd.	-	(24,251,745)
Acquisition of Serrano shares	(2,500,000)	(3,000,000)
Proceeds from sale of investments	12,016,325	-
Additions to petroleum and natural gas properties	(217,319,693)	(20,618,883)
Changes in non-cash working capital from investing	43,983,566	-
	(175,746,668)	(47,631,699)
Net increase (decrease) in cash	(3,918,382)	7,109,256
Cash, beginning of period	8,717,568	1,608,312
Cash, end of period	\$ 4,799,186	\$ 8,717,568
Supplementary information		
Interest paid	\$ 3,653,631	\$ 2,945,714
Capital taxes paid	\$ 368,597	\$ 80,460

See accompanying notes to consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

Pearl Exploration and Production Ltd. (collectively with its subsidiaries, the “Company” or “Pearl”) is listed and traded on the TSX Venture Exchange under the trading symbol “PXX”. The Company is engaged in the business of oil and gas exploration and development in North America.

2. BASIS OF PRESENTATION AND CHANGE OF FINANCIAL YEAR-END

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries: Pearl E&P Canada Ltd., Pearl Exploration and Production USA Ltd., Pearl Exploration and Production Montana Ltd., Newmex Energy (USA) Inc., Valkyries Texas Corp., Valkyries Texas Gas Ltd., Cipher Exploration Inc. and Watch Resources Ltd.

The Company changed its financial year end from September 30 to December 31 effective October 1, 2006. The Company made this change in order that its financial results would be more comparable to its peers in the oil and gas industry. As a result of this change, the Company has a transitional 15-month financial year ended December 31, 2007.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada (“Canadian GAAP”). The significant accounting policies used in these consolidated financial statements are as follows:

(a) Measurement Uncertainty

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and the disclosure of contingencies. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

Significant estimates used in the preparation of the consolidated financial statements include asset retirement obligations, future income taxes, stock-based compensation, the estimate of oil and gas reserves and the related depletion, depreciation and accretion, asset impairment and the valuation of goodwill.

(b) Foreign Currency Translation

The Company's reporting currency is Canadian dollars.

The Company's U.S. operations are considered integrated. Accordingly, the Company uses the temporal method of accounting for the foreign currency transactions of its U.S. subsidiaries. Under the temporal method, monetary assets and liabilities are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the historical exchange rates. Revenues and expenses are translated at the average rate for the period, except for charges related to non-monetary assets which are translated at the historical rate for the assets to which the charge relates, and material items where a specific date can be identified for the transaction which is translated at the rate on that specific date. Exchange gains or losses are included in the determination of net income.

(c) Joint Interests

A substantial portion of all of the Company's activities are conducted jointly with others through joint ventures. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

(d) Petroleum & Natural Gas Properties

The Company follows the full cost method of accounting for its petroleum and natural gas properties. In accordance with Accounting Guideline 16 (AcG 16) issued by the CICA, all costs relating to the exploration for and development of oil and gas reserves are capitalized in country-by-country cost centres and charged against income as set out below. Capitalized costs include lease acquisition costs, geological and geophysical expenditures, costs of drilling exploration and development wells, gathering and production facilities and other development expenditures. Gains and losses are not recognized upon disposition of petroleum and natural gas properties unless such a disposition would alter the rate of depletion by 20 percent or more.

Depreciation, Depletion and Amortization

Capitalized costs, along with estimated future costs to develop proved reserves, are depleted on a unit-of-production basis using estimated proved oil and gas reserves before royalties, as determined by independent engineers. Natural gas reserves and production are converted to equivalent barrels of oil based upon the relevant energy content (6:1). Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion until it is determined whether proved reserves are attributable to the properties or impairment occurs. Unproved properties are evaluated for impairment on at least an annual basis. If an unproved property is considered to be impaired, the amount of the impairment is added to costs subject to depletion.

Office furniture and equipment is depreciated on the declining balance basis at rates ranging from 10 to 30 percent per year.

Ceiling Test

The net amount at which petroleum and natural gas properties are carried is subject to a cost recovery test (the "ceiling test"). The ceiling test is an impairment test whereby the carrying amount of petroleum and natural gas properties, excluding the cost of unproved properties, is compared to the undiscounted cash flows from proved reserves using management's best estimate of future prices, adjusted for the Company's contract prices and quality differentials. If the carrying value exceeds the undiscounted cash flows, an impairment loss would be recorded against income. The impairment is measured as the amount by which the carrying amount of petroleum and natural gas properties exceeds the discounted cash flows from proved and probable reserves. The Company's risk-free interest rate is used to arrive at the net present value of future cash flows.

(e) Revenue Recognition

Revenue from the sale of petroleum and natural gas is recorded when title passes to an external party.

(f) Investments

Long-term investments are accounted for using the cost method.

(g) Stock-based Compensation

The Company has a stock option plan as described in note 15. Stock options granted are accounted for using the fair value method. Fair values are determined, at the grant date, using the Black-Scholes option-pricing model. The compensation expense associated with these options is charged to earnings over the vesting period with a corresponding increase in contributed surplus. On the exercise of stock options, consideration paid and the associated contributed surplus is credited to common shares.

(h) Asset Retirement Obligations

The fair values of estimated asset retirement obligations are recorded as liabilities when incurred and the associated cost is capitalized as part of the cost of the related asset. Over time, the liabilities are accreted for the change in their present value and the initial capitalized costs are depleted on a unit-of-production basis over the life of the reserves. The associated accretion is charged to earnings in the period. Actual expenditures incurred are charged against the accumulated obligation. Revisions to the estimated timing of cash flows or the original estimated undiscounted cost would also result in an increase or decrease to the obligation and related asset.

(i) Earnings per Share

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated based upon the treasury stock method which assumes that any proceeds from the exercise of in-the-money stock options or warrants would be used to purchase the Company's common shares at the average market price during the year (or period if applicable). Diluted earnings per share do not include any anti-dilutive conversions, nor is diluted earnings per share presented where the total effect would be anti-dilutive.

(j) Flow-through Shares

The resource expenditure deductions for income tax purposes related to exploratory activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. A future tax liability is recognized upon the filing of the renunciation with the tax authorities and share capital is reduced by the estimated costs of the renounced tax deductions.

(k) Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future tax liabilities and assets are measured using enacted or substantially enacted tax rates. The effect on future tax liabilities and assets of a change in tax rates is recognized in income in the period that the change occurs.

(l) Goodwill

Goodwill represents the excess purchase price over the fair value of identifiable assets and liabilities acquired in business combinations. Goodwill is not amortized but is assessed for impairment annually at year-end or more frequently if economic events dictate. The test for impairment is conducted by the comparing the book value of the entity to the fair value. If the fair value is less than the book value, impairment is deemed to have occurred. The extent of the impairment is measured by allocation of the fair value of the entity to the identifiable assets and liabilities at their fair values. Any remainder of this allocation is the implied value of goodwill. Any excess of the book value of goodwill over this implied value is the impairment amount. Impairment is charged to earnings in the period in which it occurs.

(m) Financial Instruments

All financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the standard.

Financial assets and financial liabilities “held-for-trading” are measured at fair value with changes in those fair values recognized in net income. Financial assets “available-for-sale” are measured at fair value, with changes in those fair values recognized in OCI. Financial assets “held-to-maturity”, “loans and receivables” and “other financial liabilities” are measured at amortized cost using the effective interest method of amortization.

4. CHANGES IN ACCOUNTING POLICIES

As disclosed in the September 30, 2006 annual audited Consolidated Financial Statements, on October 1, 2006, the Company adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1530 “Comprehensive Income”, Section 3251 “Equity”, Section 3855 “Financial Instruments – Recognition and Measurement”, and Section 3865 “Hedges”. As required by the new standards, prior periods have not been restated.

The adoption of these standards has had no material impact on the Company’s net earnings or cash flows. The other effects of the implementation of the new standards are discussed below.

Comprehensive Income

The new standards introduce comprehensive income, which consists of net loss and other comprehensive income (“OCI”). The Company’s Consolidated Financial Statements now include a Statement of Comprehensive Loss, which includes the components of comprehensive income. For Pearl, OCI is currently comprised of the mark-to-market on available-for-sale financial assets.

The cumulative changes in OCI are included in accumulated other comprehensive income (“AOCI”), which is presented as a new category within shareholders’ equity on the Consolidated Balance Sheet. The Company’s Consolidated Financial Statements now include a Statement of Accumulated Other Comprehensive Income, which provides the continuity of the AOCI balance.

The adoption of comprehensive income has been made in accordance with the applicable transitional provisions. Accordingly, the change in the mark-to-market loss on available-for-sale financial assets is now included in OCI in the Statement of Comprehensive Loss (2006 – \$nil).

Financial Instruments

The financial instruments standard establishes the recognition and measurement criteria for financial assets, financial liabilities and derivatives. All financial instruments are required to be measured at fair value on initial recognition of the instrument, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as “held-for-trading”, “available-for-sale”, “held-to-maturity”, “loans and receivables”, or “other financial liabilities” as defined by the standard.

Financial assets and financial liabilities “held-for-trading” are measured at fair value with changes in those fair values recognized in net earnings. Financial assets “available-for-sale” are measured at fair value, with changes in those fair values recognized in OCI. Financial assets “held-to-maturity”, “loans and receivables” and “other financial liabilities” are measured at amortized cost using the effective interest method of amortization. The methods used by the Company in determining fair value of financial instruments are unchanged as a result of implementing the new standard.

Cash and cash equivalents are designated as “held-for-trading” and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. Accounts receivable are designated as “loans and receivables”. Accounts payable and accrued liabilities, income and capital taxes payable and bank loan are designated as “other financial liabilities”.

The adoption of the financial instruments standard has been made in accordance with its transitional provisions. The adoption of this policy has no effect on opening retained earnings.

5. RECENT ACCOUNTING PRONOUNCEMENTS

The Company has assessed new and revised accounting pronouncements that have been issued and are not yet effective and determined that the following may have a significant impact on the Company:

As of January 1, 2008, Pearl will be required to adopt two new CICA standards, Section 3862 “Financial Instruments – Disclosures” and Section 3863 “Financial Instruments – Presentation,” which will replace Section 3861 “Financial Instruments – Disclosure and Presentation.” The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006 and the Company is assessing the impact on its consolidated financial statements.

As of January 1, 2008, Pearl will be required to adopt Section 1535 “Capital Disclosures,” which will require companies to disclose their objectives, policies and processes for managing capital. In addition, disclosures are to include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006 and the Company is assessing the impact on its consolidated financial statements.

In January 2006, the CICA Accounting Standards Board (“AcSB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (“IFRS”) for fiscal periods commencing on or after January 1, 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

In June 2007, the CICA amended Section 1400, “General Standards of Financial Statement Presentation,” to require an assessment and potential disclosure of an entity’s ability to continue as a going concern. The new requirements are effective for interim and annual periods beginning on or after January 1, 2008. The Company is assessing the impact on its consolidated financial statements.

6. ACQUISITIONS

(i) Atlas Acquisition

On December 22, 2006 the Company acquired all of the issued and outstanding shares of Atlas Energy Ltd. (“Atlas”), a publicly traded junior oil and gas company with producing and development assets in western Canada, on the basis of 0.82 of a Pearl share for each Atlas share. The Company issued 55,670,226 common shares at a deemed price of \$4.74 per common share, determined based on the weighted average trading price of the Company’s common shares shortly before and after the announcement of the acquisition. On January 1, 2007 Atlas was amalgamated with Pearl E&P Canada Ltd.

The deemed consideration, including transaction costs, for the Atlas acquisition totaled \$267.0 million. The allocation of the purchase price is as follows:

Net assets acquired

Petroleum and natural gas properties	\$ 243,001,173
Working capital deficiency	(92,046,077)
Asset retirement obligation	(9,389,295)
Future income tax	(12,745,082)
Goodwill	138,190,453
Total net assets acquired	\$ 267,011,172

Consideration

Shares	264,085,155
Acquisition costs, net of interest earned on escrowed funds	2,926,017
Total purchase price	\$ 267,011,172

(ii) Cipher Acquisition

On March 1, 2007, the Company acquired all the issued and outstanding shares of Cipher Exploration Inc. ("Cipher"), a privately-held oil and gas company with heavy oil assets in Western Canada, for a gross purchase price of \$18.6 million, including an amount equal to the aggregate of all outstanding long and short term debt of Cipher. At closing, the Company issued 2,047,502 common shares to the Cipher shareholders at a deemed price of approximately \$4.78 per share, based on the weighted average trading price of Pearl's shares shortly before and after the announcement of the acquisition, and assumed \$8.3 million of debt.

The deemed consideration, including transaction costs, for the Cipher acquisition totaled \$18.6 million. The allocation of the purchase price is as follows:

Net assets acquired

Petroleum and natural gas properties	\$	20,000,000
Working capital deficiency		(2,381,820)
Asset retirement obligation		(1,578,543)
Future income tax		(181,030)
Goodwill		2,742,616
Total net assets acquired	\$	18,601,223

Consideration

Shares		9,792,174
Repayment of Cipher debt		8,293,904
Acquisition costs		515,145
Total purchase price	\$	18,601,223

(iii) Watch Acquisition

On October 19th, 2007, the Company acquired all of the issued and outstanding shares of Watch Resources Ltd. ("Watch"), a junior oil and gas company with conventional heavy oil interests in north-central Alberta, in an all-share transaction at an exchange ratio of 0.23 common shares of Pearl for each common share of Watch. At closing, the Company issued 10,542,927 common shares of Pearl to former Watch shareholders at a deemed price of \$4.76 per share, based on the weighted average trading price of Pearl's shares shortly before and after the announcement of the acquisition.

The deemed consideration, including transaction costs, for the Watch acquisition totaled \$51.0 million. The allocation of the purchase price is as follows:

Net assets acquired

Petroleum and natural gas properties	\$	34,919,135
Investment		3,862,895
Working capital deficiency		(1,393,517)
Asset retirement obligation		(759,588)
Future income tax		1,265,023
Goodwill		13,057,632
Total net assets acquired	\$	50,951,580

Consideration

Shares		50,184,333
Stock options		575,447
Transaction costs		191,800
Total purchase price	\$	50,951,580

Included in the assets of Watch is a \$5.0 million term deposit which is part of the non-bank-sponsored Asset Backed Commercial Paper ("ABCP"). The liquidity and settlement of the ABCP has been suspended pending the restructuring of the notes as determined by the Montreal Accord. At this time the plan for such restructuring and eventual liquidity of the ABCP are unknown. As a result the Company has classified its ABCP as long-term investments. The valuation technique used by the Company to estimate the fair value of its investments in ABCP incorporates probability – weighted discounted cash flows considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. This evaluation resulted in a reduction of \$1.1 million to the estimated fair value of the ABCP upon the Company's acquisition of Watch. Continuing uncertainties regarding the value of the assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a further change in the value of the Company's investment in ABCP which would impact the Company's earnings.

(iv) Property Acquisitions and Dispositions

On August 2, 2007, the Company purchased a 24 percent working interest in the Mooney oil field from Ravenwood Energy Corp. ("Ravenwood") for \$20 million. After standard industry adjustments, the net purchase price was paid \$7.5 million in cash and \$7.5 million by the issuance of 1,475,108 Pearl common shares at a price of \$5.12 per share. The remaining \$5.0 million in consideration was by way of settlement of certain accounts receivables. The price per share was determined based on the weighted average trading price of the shares shortly before and after the announcement of the acquisition.

On November 6th, 2007, the Company acquired heavy oil assets in the states of Montana and Utah from PetroHunter Energy Corporation ("PetroHunter"). The purchase price is a maximum of US \$30 million, payable as follows: (a) US \$7.5 million in cash at closing; (b) the issuance of up to 2.5 million common shares of Pearl, the equivalent of up to US \$10 million based on US \$4.00 per share; and (c) a performance payment of US \$12.5 million in cash at such time as either: (i) production from the assets reaches 5,000 bopd; or (ii) proven reserves from the assets is greater than 50 million barrels of oil. Of the 2.5 million common shares potentially issuable, 947,153 of these shares were issued on closing, 592,822 shares, are held in escrow, and are to be issued upon settlement of certain closing conditions related to title, and 960,025 of these shares are contingently issuable based on the outcome of negotiations with a third party (see note 20). In addition, 294,117 common shares were issued to a third party as a finder's fee. The outcome of the contingent shares and the performance payment could not be determined beyond a reasonable doubt and therefore no value was assigned to them.

In May 2007, the Company sold its Gulf of Mexico leases to Bayou Bend Petroleum Ltd. ("Bayou Bend") in exchange for ten million shares of Bayou Bend having a deemed value of \$2.20 per share for total consideration of \$22.0 million. The share price was determined based on the trading price of the Bayou Bend shares shortly before and after the acquisition was announced. The disposition of the Gulf of Mexico assets resulted in a gain of \$14.3 million, the realization of which was required as the depletion rate changed by more than 20 percent upon disposition. The Bayou Bend shares were subsequently sold in two transactions for cash proceeds of \$12.0 million, resulting in a loss on sale of \$10.0 million.

(v) Pan-Global Acquisition

On April 28, 2006 the Company acquired all of the issued and outstanding shares of Pan-Global Energy Ltd. ("Pan-Global") in exchange for the issuance of one-sixth of a Pearl common share for each Pan-Global share. Pan-Global engaged in the business of exploration and development of oil and gas properties with operations in the Onion Lake area. The Company issued 6,277,232 common shares to the Pan-Global shareholders upon closing at a price of \$3.30 per share, based on the weighted-average trading price of Pearl's shares shortly before and after the announcement of the acquisition.

In addition to the common shares issued to the existing Pan-Global shareholders, the Company also (i) forgave a \$1.2 million loan that was advanced to Pan-Global prior to the closing of the Pan-Global Arrangement; (ii) issued 150,000 common shares as part of a negotiated early repayment of Pan-Global's outstanding convertible debenture; and (iii) issued Pearl stock options to Pan-Global stock option holders at the time of closing at a ratio of one Pearl stock option for six Pan-Global stock options.

The deemed consideration for the Pan-Global acquisition totaled \$23.2 million. The allocation of the purchase price was as follows:

Net assets acquired	
Petroleum and natural gas properties	\$ 39,116,407
Working capital deficiency ^(a)	(13,839,162)
Asset retirement obligation	(744,905)
Future income tax	(1,321,517)
Total net assets acquired	\$ 23,210,823
Consideration	
Common shares	21,209,866
Forgiveness of debt	1,200,000
Stock options	800,957
Total purchase price	\$ 23,210,823

(a) Included in the working capital deficiency was a cash balance of \$238,929.

(vi) Nevarro Acquisition and Serrano Investment

On September 19, 2006 the Company acquired all of the issued and outstanding shares of Nevarro Energy Ltd. ("Nevarro"), a junior oil and gas company focused on exploration in western Canada, for total consideration of \$33.5 million. The purchase was paid for with \$23.7 million in cash and the issuance of 1,637,126 common shares at a price of \$5.12 per share. The deemed share price was determined based on the weighted-average trading price of the Company's shares shortly before and after the announcement of the acquisition. In addition, the Company also subscribed for 6.0 million shares of Serrano Energy Ltd. ("Serrano"), a privately-owned oil and gas company whose management is the former management of Nevarro, at a price of \$0.50 per share and entered into a joint venture agreement with Serrano that committed the Company to spend up to \$10.0 million in each calendar year, ending on December 31, 2011. This joint venture agreement was terminated effective December 31, 2007 for no additional consideration.

The net assets acquired and consideration was as follows:

Net assets acquired	
Petroleum and natural gas properties	\$ 33,114,082
Working capital deficiency ^(a)	(9,869,624)
Asset retirement obligation	(2,745,319)
Future income tax	(5,895,433)
Goodwill	18,930,509
Total net assets acquired	\$ 33,534,215
Consideration	
Cash	23,764,556
Common shares	8,382,085
Acquisition costs	1,387,574
Total purchase price	\$ 33,534,215

(a) Included in the working capital deficiency was a cash balance of \$900,385.

(vii) Property Acquisitions in 2006

The Company completed three acquisitions of working interests in certain petroleum leases and related facilities in 2006:

In the first transaction, the San Miguel transaction, the Company paid an aggregate of \$0.5 million cash and \$3.7 million through the issuance of 4,000,000 common shares valued at \$0.92 per share. The share price was determined based on the trading price of the Company's shares shortly before and after the acquisition was announced. Included in the consideration were 4,000,000 warrants which entitled the holder thereof to purchase an additional common share of the Company at a price of \$1.00 exercisable from the date that the San Miguel project achieves an average daily producing rate of 5,000 barrels of oil per day, averaged 30 consecutive days until November 18, 2008. As these share purchase warrants were contingent upon certain production targets being attained within a specified time period they were considered contingent consideration. Given that at the time of the transaction there was no production in San Miguel the outcome of the contingency could not be determined beyond a reasonable doubt. Therefore, no value was assigned to the warrants.

In the second transaction, the Palo Duro transaction, the Company paid an aggregate of \$2.3 million cash and \$0.7 million through the issuance of 270,000 common shares valued at \$2.76 per share. The share price was determined based on the trading price of the Company's shares shortly before and after the acquisition was announced. Included in the consideration were 270,000 warrants which entitled the holder to receive an additional 270,000 common shares of the Company, within 75 days of the third anniversary of the memorandum of understanding, which is September 15, 2008 for no additional consideration if the average production rate per well drilled in the Palo Duro project is at least 1.5 million cubic feet equivalent per day on the initial 60 days of production. The number of warrants issued will be reduced pro rata to the actual average production rate if the actual average production rate per well drilled by September 15, 2008 is less than 1.5 million cubic feet equivalent per day. As these share purchase warrants were contingent upon certain production targets being attained within a specified time period they were considered contingent consideration. Given that at the time of the transaction there was no production in Palo Duro the outcome of the contingency could not be determined beyond a reasonable doubt. Therefore, no value was assigned to the warrants.

In the third transaction, the Valkyries transaction, the Company paid an aggregate of \$6.7 million cash. The fair value of these assets was determined based on a third party reserve evaluation (note 20).

7. GOODWILL

The Company assessed goodwill for impairment at December 31, 2007 and determined that the fair value of the reporting unit had declined as a result of declining market factors, principally the market value of the Company's stock and, thus, recorded a write-down of \$172.9 million (2006 – \$nil). The following table details the changes in goodwill for the fifteen months ended December 31, 2007:

Goodwill continuity

Balance, October 1, 2005	\$	–
Nevarro acquisition		18,930,509
Balance, September 30, 2006		18,930,509
Atlas acquisition		138,190,453
Cipher acquisition		2,742,616
Watch acquisition		13,057,632
Write-down of goodwill		(172,921,210)
Balance, December 31, 2007	\$	–

8. INVESTMENTS

	December 31, 2007	September 30, 2006
Investment in Serrano Energy Ltd.	\$ 5,500,000	\$ 3,000,000
Asset-backed commercial paper	3,862,895	–
	\$ 9,362,895	\$ 3,000,000

In connection with the Nevarro acquisition in September 2006, the Company acquired 6.0 million shares of Serrano at a price of \$0.50 per share (see note 6(vi) on page 29). On June 13, 2007 the Company acquired an additional 2,074,689 shares of Serrano at a price of \$1.205 per share. In July, 2007 Serrano consolidated its shares on a 2:1 basis. These shares represent an ownership interest of approximately 37 percent in Serrano.

The Company holds an investment in asset-backed commercial paper as part of the Watch acquisition (note 6 (iii)).

9. LONG-TERM ACCOUNTS RECEIVABLES

In 2006, the Company had a long-term receivable from an industry partner for the costs of drilling and completions as well as recovery of the pre-advance of royalties. The amounts were unsecured and non-interest bearing. This amount was settled in 2007.

10. PETROLEUM AND NATURAL GAS PROPERTIES

December 31, 2007	Cost	Accumulated depreciation and depletion	Net book value
Petroleum and natural gas properties	\$ 623,916,051	\$ 96,763,951	\$ 527,152,100
Office equipment	1,520,287	319,847	1,200,440
	\$ 625,436,338	\$ 97,083,798	\$ 528,352,540

September 30, 2006	Cost	Accumulated depreciation and depletion	Net book value
Petroleum and natural gas properties	\$ 97,669,414	\$ 5,626,440	\$ 92,042,974
Office equipment	31,840	5,756	26,084
	\$ 97,701,254	\$ 5,632,196	\$ 92,069,058

The depletion and ceiling test calculations have excluded the cost of unproved properties of \$61.0 million (September 30, 2006 – \$6.9 million) and included the cost of future development costs of \$145.0 million (September 30, 2006 – \$1.6 million).

The Company performed the ceiling test calculations at December 31, 2007 and 2006 to assess whether the carrying value of petroleum and natural gas properties is recoverable. The following represent the prices that were used in the December 31, 2007 ceiling test:

	2008	2009	Average price forecast ⁽¹⁾			
			2010	2011	2012	2013+ ⁽²⁾
WTI (\$Cdn/bbl)	90.00	86.52	84.87	83.32	82.78	2%
AECO (\$Cdn/mcf)	6.69	7.29	7.18	7.13	7.19	2%

(1) The benchmark prices listed above are adjusted for quality differentials, heat content, distance to market and other factors in performing our ceiling test.

(2) Percentage change represents the change in each year after 2012 to the end of the reserve life.

11. BANK CREDIT FACILITY

The Company has a credit facility with a Canadian chartered bank which is comprised of a \$50 million revolving 364-day extendible term facility, and a \$10 million demand revolving operating facility. The Company may borrow, repay and re-borrow advances with the aggregated outstanding not to exceed the total credit facility. The facility bears interest at the bank prime rate payable monthly and is secured by a general security agreement.

The facility is subject to semi-annual reviews. The next scheduled review will take place on May 30, 2008.

During the fifteen months ended December 31, 2007 the Company repaid and cancelled two credit facilities that were acquired through the Nevarro and the Atlas acquisitions. In addition, on September 25, 2007 the Company received a \$10.0 million bridge loan which was repaid on October 17, 2007.

12. ASSET RETIREMENT OBLIGATION

The total future asset retirement obligation was estimated based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total undiscounted amount of the estimated cash flows required to settle the asset retirement obligations is approximately \$32.4 million which will be incurred over the next 48 years with the majority of costs incurred between 2008 and 2025. A credit adjusted risk-free rate of 8 percent and an inflation factor of 1.5 percent was used to calculate the fair value of the asset retirement obligation.

Changes to asset retirement obligation were as follows:

Balance October 1, 2005	\$	–
Liabilities acquired through acquisitions, net of dispositions		3,490,224
Liabilities incurred during the period		240,462
Actual remediation expenses		–
Accretion		41,793
Balance September 30, 2006		3,772,479
Liabilities acquired through acquisitions, net of dispositions		9,822,642
Liabilities incurred during the period		2,987,539
Actual remediation expenses		(1,164,822)
Accretion		1,168,192
Balance December 31, 2007	\$	16,586,030

13. RELATED PARTY TRANSACTIONS

The Company entered into the following transactions with related parties in the normal course of business, which are recorded at the exchange amount established and agreed to by the related parties:

- The Company paid \$271,465 (2006 – \$141,800) to Tanganyika Oil Company Ltd. ("Tanganyika") for administrative and other services. The Company and Tanganyika have certain officers and directors in common.
- The Company borrowed \$3,000,000 on October 27, 2006 from Tanganyika which was repayable on or before November 30, 2006. Interest was charged at a rate equal to prime plus 2 percent per annum. The Company repaid the loan in full on November 22, 2006 plus accrued interest of \$18,195.
- The Company paid \$117,000 (2006 – \$nil) to Namdo Management Services Ltd. ("Namdo") for executive and support services pursuant to a services agreement. Namdo is a private corporation owned by Lukas H. Lundin, a director of the Company.
- During the year ended September 30, 2006, the Company paid \$105,100 to Proprietary Industries Inc. ("Proprietary") for administrative and other services. The Company and Proprietary had certain directors and officers in common. The Company had no dealings with Proprietary in the fifteen months ended December 31, 2007.

(e) In January 2006 the Company acquired oil and gas assets from Valkyries Petroleum Corp. (“Valkyries”) for cash consideration of \$6.7 million and a potential deferred bonus payment (see note 20). A director appointed to Pearl’s Board of Directors in January 2006 was also a Valkyries director and officer. In addition, Pearl’s largest individual shareholder was also a director, a shareholder and a previous officer of Valkyries. The acquisition of assets from Valkyries was transacted at fair market value, had commercial substance and was consistent with the Company’s normal course of operations.

(f) In May 2007 the Company closed the sale of its Gulf of Mexico assets to Bayou Bend (note 6 (iv)). An officer and director of the Company is also a Bayou Bend director. In addition, Pearl’s largest individual shareholder is a director and shareholder of Bayou Bend. The disposal of assets in exchange for common shares of Bayou Bend was transacted at fair market value, had commercial substance and was consistent with the Company’s normal course of operations.

(g) In June 2007 the Company closed the sale of 5.0 million shares of Bayou Bend to a company that is controlled by a shareholder and an officer of Pearl. The loss was recorded on the sale of the shares due to a decline in the market price of the Bayou Bend shares. The share price was valued at \$2.00 which was the weighted-average trading price of the Bayou Bend shares shortly before and after the date of the sale. The disposal of the shares of Bayou Bend was transacted at fair market value, had commercial substance and was consistent with the Company’s normal course of operations.

14. SHARE CAPITAL

(a) Authorized:

The Company is authorized to issue an unlimited number of common shares.

(b) Common Shares Issued:

	Number of shares	Attributed value (\$)
Balance at September 30, 2005	23,745,822	8,530,798
Shares issued for property acquisitions	4,270,000	4,425,875
Shares issued through private placements	12,158,000	58,763,445
Shares issued for Pan-Global acquisition (note 6(v))	6,277,232	20,714,866
Shares issued upon exercise of options	95,834	575,377
Shares issued upon exercise of warrants	3,579,002	12,316,008
Shares issued upon repayment of debt	150,000	495,000
Shares issued for the Nevarro acquisition (note 6(vi))	1,637,126	8,382,085
Share issue costs	–	(1,589,870)
Balance as at September 30, 2006	51,913,016	112,613,584
Shares issued through equity financings (note 14 (b)(i))	65,553,845	281,849,994
Shares issued for Atlas acquisition (note 6(i))	55,670,226	264,085,155
Shares issued for Cipher acquisition (note 6(ii))	2,047,502	9,792,174
Shares issued for Watch acquisition (note 6(iii))	10,542,927	50,184,333
Shares issued for property acquisitions (note 6(iv))	3,309,200	14,247,378
Shares issued upon exercise of options	205,000	1,342,788
Tax effect of flow-through (note 14 (b)(i))	–	(3,106,000)
Share issue costs, net of tax of \$3,174,946	–	(7,887,585)
Balance as at December 31, 2007	189,241,716	723,121,821

(i) On November 15, 2006, the Company completed an equity financing of common shares and flow-through shares for gross proceeds of \$111 million. 22,444,444 common shares were issued at a price of \$4.50 each and 1,709,401 of flow-through common shares were issued at a price of \$5.85 each. A 3.9 percent underwriter's fee was paid to qualified persons in respect of a portion of the equity financing. Effective December 31, 2006 the Company renounced \$10.0 million of qualifying oil and natural gas expenditures and is required to incur those qualifying exploration expenditures before December 31, 2007. The Company has incurred the \$10.0 million of qualifying expenditures as of December 31, 2007. The future income tax effect and reduction to share capital are disclosed above.

On July 10, 2007 the Company sold on a non-brokered, private placement basis an aggregate of 12 million common shares at a price of \$5.05 per share for gross proceeds of \$60.6 million. A four percent finder's fee was paid on the gross proceeds of the private placement.

On October 17, 2007, the Company sold, on a bought-deal, private placement basis, an aggregate of 29.4 million common shares at a price of \$3.75 per share for gross proceeds of \$110.3 million. An underwriting fee of four percent was paid on the gross proceeds of the financing.

(c) Warrants Outstanding:

	Number of whole warrants	Weighted average exercise price per share (\$)
Balance as at December 31, 2007 and September 30, 2006	4,091,800	0.98

(i) Four million warrants were issued pursuant to the San Miguel property acquisition in November 2005. Each warrant entitles the holder thereof to purchase an additional common share of the Company at a price of \$1.00, exercisable from the date the San Miguel heavy oil project achieves an average daily producing rate of 5,000 barrels of oil per day, averaged over 30 consecutive days, until November 18, 2008.

(ii) In connection with the December, 2005 Palo Duro property acquisition, the Company issued 270,000 warrants. This number was subsequently reduced by 66 percent to 91,800 when the vendor exercised a back-in right on March 3, 2006. Each remaining warrant provides the warrant holder with the right to receive an additional common share of the Company, within 75 days of September 15, 2008, for no additional consideration, if the average production rate per well drilled in the Palo Duro shale gas project is at least 1.5 million cubic feet equivalent per day, based on the initial 60 days of production. The number of warrants ultimately issued will be reduced pro rata to the actual average production rate if the actual average production rate per well drilled by September 15, 2008 is less than 1.5 million cubic feet equivalent per day.

15. STOCK-BASED COMPENSATION

The Company has a stock option plan (the "plan") for directors, officers, consultants and employees of the Company and its subsidiaries. A total of 18,924,172 stock options are authorized to be issued under the plan. Stock options have terms of two to five years, vest over periods of up to three years and are exercisable at the market prices of the shares on the dates that the options were granted. All of the options are subject to a four-month "hold" period.

The continuity of stock options issued and outstanding is as follows:

	Number of options	Weighted average exercise price (\$)
Outstanding October 1, 2005	–	–
Granted	1,848,334	4.08
Exercised	(95,834)	3.52
Outstanding September 30, 2006	1,752,500	4.11
Granted	6,902,690	4.04
Exercised	(205,000)	3.45
Cancelled	(723,833)	5.04
Outstanding at December 31, 2007	7,726,357	3.98

The following stock options were outstanding at December 31, 2007:

Range of exercise prices (\$)	Options outstanding			Options exercisable	
	Number	Weighted average exercise price (\$)	Weighted average life (years)	Number	Weighted average exercise price (\$)
2.25 – 4.00	3,842,333	2.95	3.77	928,333	3.41
4.01 – 5.00	1,249,190	4.48	2.90	901,190	4.39
5.01 – 6.00	2,583,167	5.20	3.28	1,874,500	5.21
6.01 – 8.94	51,667	7.02	0.33	51,667	7.02
2.25 – 8.94	7,726,357	3.98	3.44	3,755,690	4.59

Compensation expense for the fifteen-month period ended December 31, 2007 of \$4,046,779 (2006 – \$3,411,784) net of recovery of \$590,137 (2006 – \$nil) for cancelled stock options, has been recorded in the Consolidated Statements of Operations and Deficit. The fair value of common share options granted is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average fair value of options granted during 2007 and the assumptions used in their determination are as noted below:

Weighted average fair value of stock options granted (per option)	\$	1.652
Expected life of stock options (years)		3.44
Volatility (weighted average)		62%
Risk free rate of return (weighted average)		4.00%
Expected dividend yield		0%

Contributed surplus continuity

Balance October 1, 2005	816,444
Stock-based compensation	3,411,784
Stock-based compensation allocated to contributed surplus as part of Pan-Global acquisition	800,957
Transfer to share capital on exercise of options	(238,125)
Balance September 30, 2006	4,791,060
Stock-based compensation	4,636,916
Stock-based compensation allocated to contributed surplus as part of Watch acquisition	575,448
Recovery of expense on cancelled stock options	(590,137)
Transfer to share capital on exercise of options	(635,163)
Balance December 31, 2007	8,778,124

16. INCOME TAXES

(a) Future Income Tax Expense:

The provision for income taxes reflects an effective income tax rate which differs from Federal and Provincial statutory tax rates.

The main differences are as follows:

	December 31, 2007	September 30, 2006
Income (loss) before income taxes	(242,138,901)	(10,549,086)
Corporate income tax rate	34.03%	35.72%
Computed income tax recovery	(82,399,868)	(3,768,134)
Increase (decrease) resulting from:		
Change in valuation allowance	(1,398,439)	13,115
Goodwill write-off	58,845,088	-
Gain on sale of USA properties	1,654,273	-
Non-deductible Crown charges	94,908	71,654
Non-deductible compensation expense	1,377,119	1,218,689
Resource allowance	(119,574)	(65,719)
Foreign exchange	170,398	104,374
Change in enacted tax rates	3,009,074	520,018
Capital tax and Saskatchewan Resource Surcharge	1,837,500	97,398
Other	1,996,435	212,392
Income tax expense (recovery)	(14,933,086)	(1,596,213)

(b) The components of the future income tax liability are as follows:

	December 31, 2007	September 30, 2006
Future income tax assets:		
Mineral properties and deferred costs	-	-
Non-capital losses	12,818,396	5,195,757
Capital loss	-	-
Share issue costs	3,561,591	1,046,549
Asset retirement obligation	4,342,626	1,105,251
Other	290,343	-
Valuation allowance	(1,240,556)	(2,575,621)
	19,772,400	4,771,936
Future income tax liabilities:		
Property, plant and equipment	(17,369,868)	(10,295,275)
Net future tax liability	2,402,532	(5,523,339)

The Company has \$48.0 million of non-capital losses that expire each year from 2008 to 2017.

17. COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The Company enters into commitments and contractual obligations in the normal course of business, including the purchase of services, farm-in agreements, royalty agreements, operating agreements, transportation agreements, processing agreements, right of way agreements and lease agreements for vehicles.

The Company has a 10-year operating lease for office space which it renegotiated with the provision that the terms could be cancelled with a 30 day notice. This back-out provision allowed the Company to enter into a nine-year operating lease for a new larger office space.

	2008	2009	2010	2011	2012	Subsequent to 2012
Office rent	\$ 1,039,394	\$ 1,084,760	\$ 1,084,760	\$ 1,152,557	\$ 1,220,355	\$ 4,576,331

18. FINANCIAL INSTRUMENTS

The Company does not utilize derivative instruments to manage risks. The Company is exposed to the following risks related to financial assets and liabilities:

(a) Commodity Price Risk

The Company is exposed to risks associated with fluctuating commodity prices. At this time, the Company does not use derivative financial instruments to manage its exposure to this risk.

(b) Foreign Currency Exchange Risk

The Company is exposed to risks arising from fluctuations in foreign currency exchange rates and the volatility of those rates. This exposure primarily relates to: (i) certain expenditure commitments, deposits, accounts receivable, and accounts payable which are denominated in US dollars, and (ii) its operations in the United States.

(c) Fair Values

The carrying amounts of financial instruments comprising cash, accounts receivable and accounts payable approximate their fair value due to the immediate or short-term nature of these financial instruments.

(d) Credit Risk

The Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas business and are subject to normal credit risks. Management believes that there is no unusual exposure associated with the collection of the receivables due to the size and reputation of the companies and to the continuing joint venture relationship.

(e) Interest Rate Risk

The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility.

19. SEGMENTED INFORMATION

The Company presently has one reportable business segment, that being oil and gas exploration and development. The Company's operations are carried on in the following geographic locations:

Fifteen months ended December 31, 2007	Canada	USA	Consolidated
Total revenues, net of royalties	\$ 99,306,665	\$ 1,842,674	\$ 101,149,339
Expenses	171,522,370	2,629,565	174,151,935
Foreign currency loss	586,417	(84,954)	501,463
Gain on sale of assets	–	(4,286,369)	(4,286,369)
Write-downs	172,921,210	–	172,921,210
Net income (loss) before income taxes	(245,723,332)	3,584,432	(242,138,901)
Income taxes (recovery)	(17,789,988)	2,856,902	(14,933,086)
Net income (loss)	(227,933,344)	727,530	(227,205,815)
Segment assets	522,074,972	53,790,403	575,865,375
Segment petroleum and natural gas properties	482,505,954	45,846,586	528,352,540
Capital additions	502,604,530	25,130,554	527,735,084
Twelve months ended September 30, 2006	Canada	USA	Consolidated
Total revenues, net of royalties	2,269,625	1,528,886	3,798,511
Expenses	11,627,053	2,406,717	14,033,770
Foreign currency loss	292,201	–	292,201
Write-downs	21,626	–	21,626
Loss before income taxes	(9,671,255)	(877,831)	(10,549,086)
Income taxes (recovery)	(1,592,288)	(3,925)	(1,596,213)
Net loss	(8,078,967)	(873,906)	(8,952,873)
Segment assets	106,150,258	22,917,223	129,067,481
Goodwill	18,930,509	–	18,930,509
Segment petroleum and natural gas properties	70,177,774	21,891,284	92,069,058
Capital additions	72,877,549	23,795,716	96,673,265

20. CONTINGENCIES

(a) In connection with the property acquisition from PetroHunter (see note 6(iv)), the Company may be required to pay a performance payment of US \$12.5 million in cash at such time as either: (i) production from the assets reaches 5,000 bopd; or (ii) proven reserves from the assets is greater than 50 million barrels of oil, if either condition is met prior to November 6, 2010. In addition, additional consideration of 960,025 Pearl common shares will be payable if the Company and certain third party owners agree to terms acceptable to Pearl for the acquisition of leases included in the deal. In the event that the Company fails to reach an agreement with the third party by May, 2008 the performance payment will be reduced to \$9.8 million and the contingent shares will remain unissued.

(b) Four million warrants were issued pursuant to the San Miguel property acquisition in November 2005. Each warrant entitles the holder thereof to purchase an additional common share of the Company at a price of \$1.00, exercisable from the date the San Miguel heavy oil project achieves an average daily producing rate of 5,000 barrels of oil per day, averaged over 30 consecutive days, until November 18, 2008.

(c) In connection with the December, 2005 Palo Duro property acquisition, the Company has 91,800 warrants outstanding, entitling the holder to receive an additional Pearl common share within 75 days of September 15, 2008, for no additional consideration, if the average production rate per well drilled in the Palo Duro shale gas project is at least 1.5 million cubic feet equivalent per day, based on the initial 60 days of production. The number of warrants ultimately issued will be reduced pro rata to the actual average production rate if the actual average production rate per well drilled by September 15, 2008 is less than 1.5 million cubic feet equivalent per day.

(d) Pursuant to the January, 2006 property acquisition agreement between the Company and Valkyries, the Company may be required to pay additional consideration to Valkyries if specified properties have additional net proved reserves within two years of the closing of the transaction. The additional consideration would be calculated as US \$1.00 per barrel of additional reserves. The only remaining contingency for the Company is related to the Topanga prospect.

21. SUBSEQUENT EVENTS

(a) On January 8, 2008 the Company announced that it would seek to dispose of certain non-core properties, principally located in west central Saskatchewan (heavy oil assets) and in southern Alberta (natural gas assets). These assets were selected for disposal due to their lack of resource and production scale. The outcome of this process is uncertain.

(b) On February 4, 2008 Canadian Phoenix Resources Corp, formerly Arapahoe Energy Corporation, announced it had executed a term sheet dated February 1, 2008 with Serrano Energy which would provide Canadian Phoenix with a 50.1 percent controlling interest in Serrano for total consideration of \$55 million. This financing announcement may have a significant effect on the Company's ownership in Serrano Energy.

22. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in 2007.