

MANAGEMENT'S DISCUSSION AND ANALYSIS

(Amounts in Canadian dollars unless otherwise indicated)

Fifteen months ended December 31, 2007 and twelve months ended September 30, 2006

Management's discussion and analysis ("MD&A") of Pearl Exploration and Production Ltd.'s (the "Company" or "Pearl") financial condition and results of operations should be read in conjunction with the audited consolidated financial statements for the fifteen months ended December 31, 2007 and related notes therein prepared in accordance with Canadian generally accepted accounting principles. The effective date of this MD&A is February 27th, 2008. Additional information relating to the Company is available on SEDAR at www.sedar.com and on the Company's web-site at www.pearleandp.com.

OVERVIEW

Pearl is a Canadian-based oil and gas company whose common shares are traded on the TSX Venture Exchange under the symbol "PXX". Pearl's main focus is large, heavy oil projects in Canada and the USA. The Company also holds interests in a number of natural gas properties.

Prior to September 30, 2005, Pearl was a Calgary based mining company known as Newmex Minerals Inc. and traded on the TSX Venture Exchange under the symbol "NMM". During the quarter ended December 31, 2005, the Company began its transition into an oil and gas company, and completed several significant acquisitions which are described more fully in the Company's Annual Report dated September 30, 2006 and filed on SEDAR. In February 2006, the Company changed its name to Pearl.

Pearl's core properties in Canada include:

- Onion Lake, Saskatchewan – heavy oil;
- Mooney, Alberta – heavy oil;
- Blackrod, Alberta – heavy oil; and
- Fishing Lake, Alberta – heavy oil.

The Company is also involved with several projects in the USA including:

- San Miguel, Texas – heavy oil;
- Palo Duro, Texas – gas; and
- Fiddler Creek, Montana – heavy oil.

CHANGE OF FINANCIAL YEAR END

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 will have a transitional 15-month financial year ending December 31, 2007.

SIGNIFICANT EVENTS

On October 20, 2006 the Company announced it had settled the land dispute surrounding the Onion Lake lands that were acquired from Pan-Global in April 2006.

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 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.

On December 22, 2006 the Company acquired all of the issued and outstanding shares of Atlas Energy Inc. ("Atlas") for total consideration, including transaction costs, of approximately \$267.0 million. The Company issued 55,670,226 common shares and paid approximately \$157,000 in cash to the Atlas shareholders.

On January 1, 2007 the Company amalgamated Nevarro and Pan-Global with Atlas and renamed the combined subsidiary Pearl E&P Canada Ltd.

On February 2, 2007 the Company announced the closing of a credit agreement with Alberta Treasury Branches for a \$65 million Revolving 364 Day Extendible Term Facility and a \$10 million Demand Revolving Operating Facility.

On March 1, 2007, the Company acquired all of the issued and outstanding shares of Cipher Exploration Inc. ("Cipher"), a privately-held oil and gas company with heavy oil assets in western Canada. The Company assumed Cipher's debt of approximately \$8.3 million and issued 2,047,502 common shares to the Cipher shareholders for a total deemed purchase price of \$20 million. Cipher's key heavy oil assets include Ear Lake, Reward and Eagle Creek, Saskatchewan. Production at the time of the acquisition was approximately 340 boe/d.

On May 8, 2007 the Company sold all of its Gulf of Mexico exploration assets to Bayou Bend Petroleum Ltd. ("Bayou Bend"; formerly Kit Resources Ltd.) in exchange for ten million shares of Bayou Bend having a deemed value of \$2.20 per share. The Gulf of Mexico assets comprised the Company's 100 percent working interest in five Gulf of Mexico offshore blocks (including Mustang Island), farm-in rights to acquire a 25 percent working interest in a sixth offshore block and all material contracts, physical data, work products and files and records associated with these blocks. The Company subsequently disposed of its Bayou Bend holdings in two transactions for cash proceeds of \$12 million. (\$10 million in the 3rd quarter and \$2 million in the 5th quarter).

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 4 percent finder's fee was paid on the gross proceeds of the private placement.

On August 2, 2007, the Company announced that it had closed the acquisition of a 24 percent working interest in the Mooney oil field from Ravenwood Energy Corp. ("Ravenwood"), a private oil and gas company for \$20.0 million net of standard industry adjustments. The acquisition increased Pearl's working interest in the Mooney field to over 98 percent and added approximately 625 boepd of production at the time of the acquisition.

On August 23, 2007 the Company acquired a 35 percent working interest in 2,816 contiguous hectares of oil sands leases (Blackrod) located south of Fort McMurray, in the Athabasca Oil Sands region of northern Alberta. The purchase price was \$5.0 million.

On October 17th, 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. The net proceeds of the private placement were used to fund the acquisition of heavy oil assets from PetroHunter and will be used in the Company's ongoing development programs as well as for general working capital purposes.

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 the Fishing Lake area of 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. 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 timing of when the ABCP will have a liquid market is uncertain.

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. 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.

SELECTED QUARTERLY INFORMATION

The following is a summary of selected financial information for the Company for the quarters indicated:

(\$000s, except where noted)	Dec. 31 2007	Sept. 30 2007	June 30 2007	March 31 2007	Dec. 31 2006	Sept. 30 2006	June 30 2006	March 31 2006
Oil and gas revenue	35,250	32,786	29,801	24,464	6,223	1,876	1,362	397
Production (boe/d)	9,507	9,093	7,910	6,966	1,674	454	270	121
Revenue per boe (\$)	40.30	39.17	41.40	38.98	40.40	44.89	55.40	36.59
Royalties	7,828	7,889	6,322	5,285	1,171	366	192	25
As a % of sales	22	24	21	22	19	19	14	6
Per boe (\$)	8.95	9.43	8.78	8.43	7.60	8.76	7.81	2.30
Interest income	551	19	40	243	266	413	252	54
Production costs	14,835	12,245	10,949	10,132	2,370	527	302	19
Per boe (\$)	16.96	14.64	15.21	16.16	15.38	12.60	12.27	1.72
Transportation costs	829	498	1,074	999	168	-	-	-
Per boe (\$)	0.95	0.59	1.49	1.59	1.09	-	-	-
General and administrative costs	6,356	4,268	3,953	2,559	2,006	2,280	1,176	394
Per boe (\$)	7.27	5.10	5.49	4.08	13.02	54.55	47.85	36.34
Depletion, depreciation and accretion	22,816	23,406	22,322	17,537	6,539	2,137	2,868	669
Per boe (\$)	26.09	27.98	31.01	27.97	42.45	51.13	116.66	61.65
Stock-based compensation	830	778	918	958	563	520	687	1,744
Interest expense	708	1,247	1,240	399	116	-	-	-
Change in fair market value of gas pricing contracts	-	-	-	488	48	-	-	-
Foreign currency exchange loss	61	119	97	172	54	22	133	85
Write-down	172,921	-	-	-	-	25	-	-
Loss (gain) on sale of assets	8,984	-	(13,270)	-	-	-	3	-
Income taxes	(16,959)	(3,961)	3,463	3,808	(1,283)	(1,596)	-	-
Net loss	(183,407)	(13,683)	(7,225)	(17,628)	(5,263)	(1,990)	(3,742)	(2,486)
Net loss per share basic and diluted	(1.01)	(0.09)	(0.05)	(0.13)	(0.08)	(0.04)	(0.09)	(0.07)
Total assets	575,865	654,543	620,792	586,276	640,195	129,067	97,982	26,068

The increase in revenue for the quarter ended December 31, 2007 is mainly due to an increase in oil production volumes compared to the prior quarter. Development drilling activities at Onion Lake and Mooney fields are the main reason for the increase in production volumes as well as the increase in production due to the acquisition of Mooney lands from Ravenwood. The increase in production costs during the quarter are due to wells being added from the Watch acquisition and new wells drilled in the quarter only adding limited production. General and administrative costs for the quarter were higher due to several specific items; year-end bonus, accruals relating to audit, tax and reserve report, fee paid to a marketing company and a \$0.7 million writedown of accounts receivable. During the quarter the Company assessed goodwill for impairment and determined that the fair value of the reporting unit had declined as a result of declining market factors, principally the market price of the Company's stock and thus, recorded a write-down of \$172.9 million. The remaining 5.0 million shares of Bayou Bend were sold for loss of \$8.9 million, which triggered a recovery of income taxes from the previously recorded gain resulting from the sale of the Gulf of Mexico assets in exchange for 10.0 million Bayou Bend shares. During the quarter there was a large future tax recovery as the Company continues to have a high depletion rate, which lowers the carrying value of the oil and gas assets at a faster rate than the utilization of tax pools to offset income.

The significant increase in revenue, production, royalties, production costs, transportation costs, depletion and total assets for the quarter ended December 31, 2006 is a result of the Company's acquisition of Atlas in December, 2006. The Atlas acquisition was completed on December 22, and although the Company only recorded nine days of production in December it was still significant to the Company's operations.

The significant increase in revenue, production, royalties, production costs, transportation costs and depletion for the quarter ended March 31, 2007 is a result of the Company reflecting a full quarter of operations from the Atlas assets which were acquired in December 2006. The Atlas acquisition added approximately 5,300 boepd to the Company's production for the quarter ended March 31, 2007. The decrease in total assets for the March quarter was due to a purchase price adjustment relating to the Atlas acquisition as a result of the Company receiving an updated reserve report in April, 2008.

OPERATIONS UPDATE

Onion Lake Heavy Oil Project – Saskatchewan

During 2007, the Company continued its successful multi-well development drilling program of the heavy oil trend at Onion Lake. A total of 70 new wells were drilled and placed on production. This increased net production at Onion Lake by over 6 times, raising it from approximately 350 boepd at the beginning of 2007 to approximately 2,300 boepd at year end. A 3-D seismic survey was completed in the third quarter and is currently being evaluated to assess the Company's southern acreage and prioritize further development drilling locations. The Company also completed the engineering design of centralized sand handling facilities and is presently completing the design of centralized emulsion treating facilities. Going forward, construction of these facilities, as well as construction of a fuel gas system, are expected to reduce overall operating costs at Onion Lake.

During 2007, planning and procurement for a thermal recovery pilot were completed and regulatory approvals received. The necessary wells were drilled in December and construction began on pilot facilities in late 2007. Commissioning of facilities will begin in the first quarter of 2008 in order that the pilot will be fully operational in the first half of 2008.

Mooney Heavy Oil Project – Alberta

The Company had continued success at its Mooney field with the drilling of 27 horizontal development wells and 12 vertical stratigraphic wells. Production at Mooney increased by over 300 percent during 2007 with the property exiting 2007 producing approximately 2,700 boepd net to the Company. Increased volumes and operational efficiencies also led to a reduction of overall operating costs at Mooney of approximately \$2.00 per boe over the year.

In 2008, the Company plans on drilling a total of 7 horizontal and 4 delineation wells at Mooney. The 7 horizontal wells will be brought on as producing oil wells and a number of previously drilled horizontal wells will be converted over to water injection in preparation of the water flood. Additionally the Company will also construct water handling and related facilities at Mooney in preparation of converting to a water flood.

The 4 delineation wells will also be drilled in 2008 to test the western extent of the reservoir.

The Company also plans to commission a study regarding the feasibility of introducing polymer flood techniques at Mooney in 2008.

Blackrod Heavy Oil Project – Alberta

During 2007 the Company acquired, in two separate Crown land sales, a 35 percent working interest in 15 contiguous Sections (8,960 acres) of oil sands leases located northcentral Alberta between Townships 76 – 77, Ranges 17 – 18, west of the 4th Meridian. The Company also has an additional indirect ownership of roughly 13 percent in this project through its ownership in Serrano Energy Ltd., who have a 35 percent working interest in the same acreage.

The Company has plans to drill one appraisal well this winter and is in the process of preparing an application for required governmental approvals of a thermal pilot project utilizing Steam-Assisted Gravity Drainage (SAGD) technology. Upon confirmation of positive results from this appraisal well, and receipt of the required regulatory approvals, a SAGD pilot comprised of single well pair and related facilities will be initiated.

San Miguel Heavy Oil Project – Maverick Basin, South Texas

During 2007 the Company continued with steam injection pilot operations at the San Miguel Heavy Oil Project to determine the technical and economic feasibility of cyclic steam injection to enhance oil recovery. The pilot has demonstrated that cyclic steam may not be the optimal development option. Based on these results and continuing reservoir simulation studies that incorporated the third cycle of injection and production, the existing pilot will now be converted to evaluate a Steam-Assisted Gravity Drainage (SAGD) process. This will involve doubling its current steam capacity and drilling two horizontal wells; both of which have been drilled in the first quarter of 2008. This will enable the pilot to continue operations in the first half of 2008.

Additionally in 2008 a new, larger production pilot is being initiated approximately eight miles north of the existing pilot. Planning and procurement of long-lead items necessary for facility modifications and construction were underway prior to the end of 2007. The production pilot will have four times the steam capacity of the original pilot and is projected to be operational in the second half of 2008. This production pilot will be capable of evaluating more than one recovery method (e.g., horizontal steam drive patterns, vertical well patterns and potentially a combination thereof) and will include the drilling of between 6 and 8 new horizontal and vertical wells.

Palo Duro Shale Gas Exploration Project – North Texas

The Company continued to participate in its non-operated Palo Duro Shale Gas Project in 2007. Following the drilling of the MacIntosh #1-76 appraisal well in the first quarter, no additional drilling occurred in 2007. Additional long-term testing of the five wells drilled will be required to establish the economic viability of the project. Discussions with our partners have focused on the building of a required pipeline and facilities to tie-in and test the long term performance of the two existing MacIntosh wells.

Fiddler Creek – Montana

During 2007, the Company acquired a 100 percent working interest in a large heavy oil opportunity with significant resource upside potential in the Fiddler Creek area of Montana. Pearl initiated the assessment and development of this area in December 2007 by drilling an appraisal well, Beartooth Federal 43-33, into the Fiddler Creek field of Stillwater County, in southern Montana. The well was drilled into the main structure of the property, the Fiddler Creek Dome, in order to extend the known limits of the southwestern portion of the field, and it will be further evaluated during the first half of 2008 to validate reservoir continuity and potential reserve additions. In addition to this well, an existing well, Mowell #1, was re-completed for evaluation. Both wells are connected to tank facilities to gather reservoir and production data that will be used to confirm and complete a field development study.

The Company expects to drill an additional appraisal well following regulatory approvals in the second half of 2008. This work is in preparation of future field development which, beginning in 2009, is anticipated to include horizontal development drilling in order to establish commercial production rates, installation of production facilities, acquisition and analysis of additional geophysical data, and examination of enhanced recovery methods.

Other Area Properties – Alberta, Saskatchewan

During 2007, drilling and other production enhancement projects continued on the Company's non-core heavy oil and natural gas producing properties in Alberta and Saskatchewan with a total of 54 wells drilled. This drilling activity increased production in the short term but was insufficient to cover the overall decline in production from these non-core properties in 2007. Production exited the year at approximately 5,500 boepd net to the Company. In order to dedicate more capital and intellectual resources to its core properties, the Company has initiated a sales process to divest certain non-core assets situated in Saskatchewan and Alberta. The outcome of this process is unknown at this time.

Other Area Properties – U.S.

The Company also holds interests in several other areas in the United States, including Texas City, West Rozel, Gunnison Wedge and Promised Land; however, there is limited or no production from these areas and there are no significant plans contemplated for these lands in 2008. However, the Company believes certain of these lands, namely Gunnison Wedge, West Rozel and Promised Land, contain large resource potential and may, based upon further evaluation, be developed in the future.

RESULTS OF OPERATIONS

(\$ Thousands, except where noted)

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Net loss	(227,506)	(8,953)
Per share (\$)	(1.73)	(0.23)

The Company incurred a net loss of approximately \$227.2 million or \$1.73 per share for the fifteen months ended December 31, 2007 compared to a loss of \$9.0 million or \$0.23 per share for the twelve months ended September 30, 2006. The net loss for the year is principally a result of the write-down of goodwill (\$172.9 million), the provision for depletion, depreciation and accretion (\$92.6 million) as well as high general and administrative costs and operating expenses, with an offsetting tax recovery (\$14.9 million). The Company believes that as reserves increase from the Company's development activities in 2008, depletion expense will decrease and profitability from oil and gas activities will increase.

Oil and Gas Sales and Production

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Oil and gas sales (\$)	128,524	3,635
Oil (net bopd)	5,295	96
Natural gas (net mcf/d)	10,309	626
NGLs (net bbls/d)	15	–
Total (net boe/d)*	7,029	201
Oil – average selling price per bbl (\$)	40.31	50.21
Gas – average selling price per mcf (\$)	6.39	5.97

* Gas production converted at 6:1.

The Company's oil and gas sales and production have increased substantially over the prior twelve-month period. In 2007, the Company grew its revenue significantly due to the many acquisitions and its drilling program with total revenue from oil and gas sales of \$128.5 million and average daily production of 7,029 boe per day.

Oil and gas sales and production were much lower in the prior twelve-month period. The Company acquired Pan-Global in late April 2006 and Nevarro Energy Ltd. ("Nevarro") in September, 2006; therefore, production from these properties is reflected only from the dates of acquisition.

Royalties

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Royalties	28,494	583
As a percent of sales	22%	16%

Royalties have increased significantly from \$0.6 million in the prior twelve-month period to \$28.5 million in the fifteen months ended December 31, 2007. This increase is consistent with the increase in production and revenues during the 15 month period due to acquisitions and the large drilling program that was completed in 2007.

Royalties as a percentage of revenue increased from 16 percent in the prior twelve-month period to 22 percent in the fifteen months ended December 31, 2007. The current 22 percent is consistent with industry averages and the 16 percent in the prior year periods was due to lower royalties on the production from Pearl's Texas Queen City wells which made up a much larger portion of production during that period.

Production Costs

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Production costs	50,531	847
Per boe (\$)	15.73	11.57

Operating costs on a per boe basis averaged \$15.73 for the fifteen months ended December 31, 2007 in comparison to \$11.57 per boe for the twelve months ended September 30, 2006. For the prior year periods, operating costs relate only to Onion Lake and the Texas Queen City gas wells. The Texas gas wells have a very low operating cost on a per boe basis and, due to the lower volumes in the prior year, had a more pronounced impact on reducing the total operating cost per boe. The significant increase in operating costs from the prior period is consistent with the large increases in production due to acquisitions and the significant amount of wells drilled in 2007. The Company is focused on increasing its efficiency and decreasing per barrel operating costs.

Transportation Costs

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Transportation costs	3,567	-
Per boe (\$)	1.11	-

Transportation costs are incurred to move marketable crude oil and natural gas to their selling points. Transportation costs are currently averaging \$1.11 per boe for the Company. For the prior twelve-month period ended September 30, 2006, the Company had minimal transportation costs that were netted against revenue by the operator.

Interest Income

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Interest income	1,120	746

Interest income represents bank interest earned on excess cash due to the large drilling program and the acquisitions that were completed during 2007 the Company had limited cash.

General and Administrative Expenses

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
General and administrative expenses	19,142	3,987
Per boe (\$)	5.96	54.45

General and administrative expenses have decreased on a per boe basis compared to the prior twelve-month period due to increased production. General and administrative expenses for the fifteen months ended December 31, 2007 include (i) \$6.2 million for wages and salaries and related benefits associated with the increased staffing level required for the Company's significant growth in 2007; (ii) \$5.5 million of consulting services, which includes engineering, geological, land and other consultants; (iii) \$3.2 million in bad debt expense resulting from uncollectible accounts acquired in corporate acquisitions; (iv) \$1.2 million in office rent; (v) \$1.2 million in costs associated with stock exchange fees and investor relations; and (vi) \$1.8 million in insurance, computer services and professional fees. The Company is focused on decreasing general and administrative costs on a per boe basis as efficiencies are realized. During 2007 the Company capitalized \$nil of general and administrative expenses.

Depletion, Depreciation and Accretion ("DD&A")

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Depletion, depreciation and accretion	92,620	5,674
Per boe (\$)	28.83	77.49

DD&A expense was \$92.6 million or \$28.83 per boe for the fifteen months ended December 31, 2007 in comparison to \$5.7 million or \$77.49 per boe for the twelve months ended September 30, 2006. The higher DD&A expense reflects the impact of the Company's 2007 capital spending, the impact of the numerous acquisitions that were completed during the period and significantly higher production.

The Company's independent reserve evaluation as of December 31, 2006 allocated a small amount of proved reserves, due to the minimal amount of capital activity in 2006. The low amount of proved reserves coupled with increased production contributed to the higher DD&A expense in 2007. The December 31, 2007 reserve report contains a significant increase in proved reserves reflecting the acquisitions and drilling program completed in 2007. As such, a lower depletion rate was utilized for the last quarter of 2007. As a result, the DD&A rate per boe is expected to decrease in 2008.

Stock-Based Compensation

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Stock-based compensation	4,047	3,412

The Company uses the fair value method of accounting for stock options granted to directors, officers, employees and consultants whereby the fair value of all stock options granted is recorded as a charge to operations. The fair value of common share options granted is estimated on the date of grant using the Black-Scholes option pricing model. For the fifteen months ended September 30, 2007, the Company issued 6.9 million options at prices ranging from \$2.25 to \$5.64.

Interest Expense

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Interest expense	3,709	114
Per boe (\$)	1.15	1.55

Included in interest expense is \$0.6 million of interest accrued on the Company's unspent flow-through share obligation. The remaining \$3.1 million of interest expense relates to the Company's bank debt. The Company had an average debt level of \$43.5 million and an effective interest rate of 5.71 percent for the fifteen months ended December 31, 2007.

Write-downs

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Write-downs	172,921	25

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).

Loss (Gain) on Sale of Assets

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Loss (gain) on sale of assets	(4,286)	–

On May 8, 2007 the Company sold its Gulf of Mexico assets to Bayou Bend in exchange for ten million common shares of Bayou Bend. 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 separate tranches resulting in net cash proceeds of \$12.0 million and a loss on sale of \$10.0 million.

Income Taxes (Recovery)

	Fifteen months ended December 31, 2007	Twelve months ended September 30, 2006
Income taxes (recovery)	(14,933)	(1,596)

During the fifteen months ended December 31, 2007 there was a large future tax recovery as the Company continues to have a high depletion rate, which lowers the carrying value of the oil and gas assets at a faster rate than the utilization of tax pools to offset income. In addition, the significantly higher reserves, and associated future cash flows, obtained in the new reserve report provided support for management to recognize the future income tax benefit on certain previously unrecognized tax pools.

FINANCIAL CONDITION

As at December 31, 2007, the Company had total assets of \$575.9 million compared to \$129.1 million at September 30, 2006.

Accounts receivable were \$25.1 million at December 31, 2007 compared to \$4.4 million at September 30, 2006. The December 31, 2007 accounts receivable balance includes approximately \$12.8 million relating to oil and gas revenue receivables and accruals for the period, and approximately \$6.9 million for joint interest receivables relating to capital and operating costs owed by partners and \$5.4 million relating to GST receivable from the Canada Revenue Agency.

Investments at December 31, 2007 were \$9.4 million compared to \$3.0 million at September 30, 2006. The Company holds \$5.5 million of common shares of Serrano Energy Ltd. ("Serrano"), a private oil and gas exploration and development company, which is in the initial stages of acquiring and drilling oil and gas exploration and development prospects. These shares represent an ownership interest in Serrano of approximately 37 percent. Initially, the Company subscribed for six million shares in Serrano in conjunction with the acquisition of Nevarro Energy Ltd. in September 2006. In June 2007, the Company subscribed for an additional 2,074,689 shares of Serrano. In July, 2007 Serrano consolidated the shares on a 2:1 basis. The remaining \$3.9 million in investments relates to ABCP as part of the Watch acquisition. The acquired ABCP is a \$5.0 million term deposit. 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.

Long-term accounts receivable were \$nil at December 31, 2007 compared to \$1.1 million at September 30, 2006. Prior to the Company's acquisition of Pan-Global in April 2006, Pan-Global had advanced \$3 million to the Onion Lake First Nation ("OLFN"). The total receivable amount was being set-off against the OLFN's share of net revenue from production from the pre-existing Onion Lake oil and gas producing wells. As a result of the new joint venture operating agreement entered into with OLFN in 2007, the Company assumed the remaining receivable balance and reclassified the capital and operating portions accordingly.

Prepaid expenses and deposits were \$3.2 million at December 31, 2007 compared to \$0.8 million at September 30, 2006. Approximately \$1.9 million of the balance relates to deposits for office space, equipment and Crown royalties. The remaining \$1.3 million includes lease rentals and other prepayments.

Accounts payable and accruals were \$69.9 million at December 31, 2007 compared to \$12.6 million at September 30, 2006. Included in the balance is \$19.7 million of trade payables (operating and capital), \$8.4 million for joint venture payables and cash call payables and \$41.8 million for operating and capital accruals.

The Company has a credit facility with a Canadian chartered bank in the amount of \$60 million which had no outstanding balance at December 31, 2007.

Share capital totaled \$723.1 million at December 31, 2007 compared to \$112.6 million at September 30, 2006. The increase from September 30, 2006 relates to funds raised through equity financings (\$273.9 million, net of issuance costs and not including the \$3.1 million tax effect from the flow thru shares) and shares issued for acquisitions (\$339.6 million).

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2007, the Company had \$60.0 million of remaining credit capacity available under its \$50.0 million extendible term credit facility and \$10.0 million demand revolving credit facility.

At December 31, 2007, the Company had a working capital deficit of \$34.2 million compared to a working capital deficit of \$3.8 million at September 30, 2006.

Funds from operations were \$21.6 million for the fifteen months ended December 31, 2007 compared to funds used in operations of \$1.2 million for the year ended September 30, 2006. The improvement in funds from operations is consistent with the growth of the Company in 2007.

Net cash from financing activities for the fifteen months ended December 31, 2007 was \$176.8 million compared to net cash from financing activities of \$55.7 million for the year ended September 30, 2006. Financing activities during the fifteen months ended December 31, 2007 included (i) receipt of \$270.8 million, net of issue costs, from equity financings that were used to fund the Company's acquisitions and its capital program and repay debt; (ii) net repayment of the Company's credit facility of \$94.7 million; and (iii) the exercise of \$0.7 million in stock options. Significant financing activities that occurred in the twelve months ended September 30, 2006 included (i) receipt of \$57.2 million, net of issue costs, from equity financings; (ii) net repayment of \$14.1 million of debt assumed in the Pan-Global acquisition; and (iii) receipt of \$12.3 million from early expiration of warrants issued in 2005.

Net cash used in investing activities was \$175.7 million for the fifteen months ended December 31, 2007 compared to \$47.6 million for the year ended September 30, 2006. The Company's investing activities included (i) exploration, development and lease acquisition expenditures of \$217.3 million (2006 – \$20.6 million); (ii) corporate acquisition costs of \$11.9 million (2006 – \$24.0 million); and (iii) proceeds from the sale of the 10.0 million Bayou Bend shares for \$12.0 million. The Company also used \$2.5 million of cash (2006 – \$3.0 million) to acquire additional shares in Serrano.

To date, the Company has not generated sufficient cash flow from its oil and gas operations to fund its entire oil and gas exploration, development and acquisition activities. The Company has relied upon the issuance of common shares and debt financing to provide additional funding. The 2008 capital program and budget of \$61.0 million has been established based on the Company's projected cash flow for the year. In 2008, the Company intends to focus its efforts chiefly on converting resources to reserves and increasing operational efficiencies in core areas. In addition, the Company is currently seeking to dispose of its non-core non-resource focused properties.

The Company may consider additional issuances of common shares or debt instruments to assist with financing its ongoing oil and gas exploration, development and acquisition activities to the extent that sufficient cash flow from operations is unavailable in the future. In addition, the Company may consider divesting of non-core oil and gas assets or farming out interests in oil and gas properties to finance its operations. Accordingly, the Company's consolidated financial statements are presented on a going-concern basis.

FINANCIAL INSTRUMENTS

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

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

OUTSTANDING SHARE DATA

As at February 27, 2008, the Company had 189,241,716 common shares outstanding and 6,673,473 stock options outstanding under its stock-based compensation plan.

RELATED PARTY TRANSACTIONS

Tanganyika Oil Company Ltd. ("Tanganyika") provides administrative and technical services to the Company from time to time based upon time and expenses incurred by Tanganyika. For the fifteen months ended December 31, 2007, Tanganyika charged the Company \$271,465 (2006 – \$141,800). Tanganyika and Pearl have certain directors and officers in common. In 2008, the Company expects these transactions to be minimal.

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.

Namdo Management Services Ltd. ("Namdo") provides executive and support services to the Company. For the fifteen months ended December 31, 2007, the Company paid Namdo \$117,000 (2006 – \$nil). Namdo is a private corporation owned by Lukas H. Lundin, a director of the Company.

Up to September 30, 2006, Proprietary Industries Inc. ("PPI") provided administrative and other services to the Company. PPI charged a fee to the Company based upon time and expenses incurred by PPI. For the year ended September 30, 2006, PPI charged the Company fees in the amount of \$105,000. PPI and Pearl had certain directors and officers in common. This arrangement is no longer in place.

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 18 in 2007 Consolidated Financial Statements). 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.

In May 2007 the Company closed the sale of its Gulf of Mexico assets to Bayou Bend. 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.

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.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's consolidated financial statements requires management to adopt accounting policies that involve the use of significant estimates and assumptions. These estimates and assumptions are developed based on the best available information and are believed by management to be reasonable under the circumstances. New events or additional information may result in the revision of these estimates over time.

Depletion, Depreciation and Accretion

Pearl follows Canadian Institute of Chartered Accountants ("CICA") accounting guideline AcG-16 on full cost accounting in the oil and natural gas industry to account for oil and natural gas properties. Under this method, all costs associated with the acquisition of, exploration for, and the development of crude oil and natural gas reserves are capitalized and costs associated with production are expensed. The capitalized costs are depleted using the unit-of-production method based on estimated proved reserves using management's best estimate of future prices. Reserves estimates can have a significant impact on earnings, as they are a key component in the calculation of depletion.

Asset Impairment

Producing properties and unproved properties are assessed for impairment annually or as economic events dictate. The cash flows used in the impairment assessment require management to make estimates and assumptions as to recoverable reserves, future commodity prices and operating costs. Changes in any of the estimates or assumptions could result in an impairment of the carrying value of producing properties and unproved properties.

Asset Retirement Obligations

Asset retirement obligations require that management make estimates and assumptions regarding future liabilities and cash flows involving environmental reclamation and remediation. Estimates of future liabilities and cash flows are subject to uncertainty associated with the method of reclamation and remediation, environmental legislation, the timing of reclamation and remediation activities and the cost of reclamation and remediation activities.

Purchase Price Allocation

Business acquisitions are accounted for by the purchase method of accounting. Under this method, the purchase price is allocated to the assets acquired and the liabilities assumed based on the fair value at the time of acquisition. The excess purchase price over the fair value of identifiable assets and liabilities acquired is goodwill. The determination of fair value often requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of petroleum and natural gas properties acquired generally require the most judgment and include estimates of reserves acquired, future commodity prices and discount rates. Future net earnings can be affected as a result of changes in future depletion and depreciation, asset impairment or goodwill impairment.

Goodwill Impairment

Goodwill is subject to impairment tests annually, or as economic events dictate, by comparing the fair value of the reporting entity to its carrying value, including goodwill. If the fair value of the reporting entity is less than its carrying value, a goodwill impairment loss is recognized as the excess of the carrying value of the goodwill over the implied value of the goodwill. The determination of fair value requires management to make assumptions and estimates about recoverable reserves, future commodity prices, operating costs, production profiles and discount rates. Changes in any of these assumptions, such as a downward revision in reserves, a decrease in future commodity prices, an increase in operating costs or an increase in discount rates could result in an impairment of all or a portion of the goodwill carrying values in future periods.

Accounting for Stock Options

The Company recognizes compensation expense on options granted pursuant to its stock option plan. Compensation expense is based on the theoretical fair value of each option at its grant date, the estimation of which requires management to make assumptions about the future volatility of the Company's stock price, future interest rates and the timing of optionee's decisions to exercise the options. The effects of a change in one or more of these variables could result in a materially different fair value.

RISKS AND UNCERTAINTIES

The Company is exposed to a number of risks and uncertainties inherent in exploring for, developing and producing crude oil and natural gas. These risks and uncertainties include, but are not limited to, the following:

- Risk of finding and producing reserves economically;
- Uncertainty associated with obtaining drilling licenses and other consents and approvals;
- Production risks associated with sour hydrocarbons;
- Marketing reserves at acceptable prices;
- Cost of capital risk associated with securing the needed capital to carry out the company's operations;
- Risk of fluctuating foreign currency exchange rates;
- Risk of governmental policies, social instability or other political, economic or diplomatic developments in its operations;
- Market risks associated with investing the company's cash reserves in interest bearing depository instruments; and
- Environmental risks related to its oil and gas properties.

Many of the previously mentioned risks are beyond the Company's control, and it is impossible to ensure that any exploration drilling program will result in commercial operations. The Company does not currently utilize derivative instruments to hedge its commodity price, foreign currency exchange or interest rate risks.

Pearl strives to minimize and manage these risks in a number of ways, including:

- Employing qualified professional and technical staff;
- Communicating openly with members of the public regarding its activities;
- Concentrating in a limited number of areas;
- Utilizing the latest technology for finding and developing reserves;
- Constructing high-quality, environmentally sensitive, safe production facilities; and
- Maximizing operational control of drilling and producing operations.

ENVIRONMENTAL RISKS

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. In 2002, the Government of Canada ratified the Kyoto Protocol (the "Protocol"), which calls for Canada to reduce its greenhouse gas emissions to specified levels. There has been much public debate with respect to Canada's ability to meet these targets and the government's strategy or alternative strategies with respect to climate change and the control of greenhouse gases. Implementation of strategies for reducing greenhouse gases, whether to meet the limits required by the Protocol or as otherwise determined, could have a material impact on the nature of oil and natural gas operations, including those of the Company. Given the evolving nature of the debate related to climate change and the control of greenhouse gases and resulting requirements, it is not possible to predict either the nature of those requirements or the impact on the Company and its operations and financial condition.

NEW ACCOUNTING PRONOUNCEMENTS

As disclosed in the September 30, 2006 annual audited consolidated financial statements, on October 1, 2006, the Company adopted the new CICA Handbook Sections 1530 "Comprehensive Income", 3855 "Financial Instruments – Recognition and Measurement", and 3865 "Hedges". The adoption of these standards has had no material impact on the Company's net income or cash flows. The other effects of the new standards are discussed below.

Comprehensive Income

The new standards introduce comprehensive income, which consists of net income and other comprehensive income ("OCI"). The Company's consolidated financial statements now include a Consolidated Statement of Comprehensive Loss, which includes the components of comprehensive income, and a Consolidated Statement of Accumulated Other Comprehensive Income, which provides the continuity of accumulated other comprehensive income ("AOCI"). The cumulative changes in OCI are included in AOCI, which is also presented as a new category within shareholders' equity on the Consolidated Balance Sheet. The adoption of comprehensive income has been made prospectively in accordance with its transitional provisions.

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 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. The methods used by the Company in determining fair value of financial instruments are unchanged as a result of implementing the new standard.

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:

Financial Instruments

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.

Capital Disclosures

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.

International Financial Reporting Standards

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 Generally Accepted Accounting Principles ("GAAP") and IFRS.

General Standards of Financial Statements Presentation

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 continually assesses the impact on its consolidated financial statements.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company has, under the supervision of its chief financial officer, designed a process for internal control over financial reporting, which process has been effected by the Company's board of directors and management. The process was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Company's GAAP and incorporates policies and procedures as described above.

The Company's operations have expanded significantly in the fifteen months ended December 31, 2007 and in the previous fiscal year ended September 30, 2006. This expansion necessitated the development and implementation of processes to ensure that the internal controls over financial reporting could meet the requirements of Multilateral Instrument (MI) 52-109. New policies have been implemented over the course of the last fiscal year and the initial evaluation indicates that the processes are effective in ensuring that the Company is able to provide reliable financial reporting and prepare satisfactory consolidated financial statements. There have been no changes to the Company's internal controls over financial reporting since the processes have been implemented, other than changes in scope and magnitude of the processes, required to adapt to the expansion of the Company's operations. None of these changes have materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

It should be noted that a control system, including the Company's disclosure and internal controls and procedures, no matter how well conceived can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

OUTLOOK

The Company plans to continue pursuing large resource North American heavy oil opportunities to add to its portfolio, to seek to rationalize non-core assets, and to focus on conversion of resources to reserves and development of its existing interests in the USA and Canada.

BOES

Throughout this MD&A, the calculation of barrels of oil equivalent (boe) is calculated at a conversion rate of six thousand cubic feet (mcf) of natural gas for one barrel of oil and is based on an energy equivalence conversion method. BOEs may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalence conversion method primarily applicable at the burner tip and does not represent a value equivalence at the wellhead.

FORWARD-LOOKING STATEMENTS

Certain information regarding the Company contained herein may constitute forward-looking statements. Forward-looking statements may include estimates, plans, expectations, opinions, forecasts, projections, guidance or other statements that are not statements of fact. By their nature, forward-looking statements and information involve assumptions, inherent risks and uncertainties, many of which are difficult to predict, and are usually beyond the control of management, that could cause actual results to be materially different from those expressed by these forward-looking statements and information. The Company does not undertake to update or re-issue the forward-looking statements and information that may be contained herein, whether as a result of new information, future events or otherwise. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement.

NON-GAAP MEASURES

Included in this report are references to terms commonly used in the oil and gas industry, such as, cash flow and funds from operations which represent cash flow from operating activities expressed before changes in non-cash working capital, long-term receivable and asset retirement costs incurred and are used by the Company to analyze operating performance, leverage and liquidity. These terms do not have standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other entities. Consequently, these are referred to as non-GAAP measures.

TRADING ON FIRST NORTH, STOCKHOLM

On June 20, 2007, the Company commenced trading Swedish depository receipts ("SDRs") on the First North list of the OMX Nordic Exchange.

Each SDR represents one issued common share of the Company on deposit with a designated depository and is exchangeable into common shares on a one-for-one basis subject to the payment of an exchange fee.