

**PEARL EXPLORATION AND PRODUCTION LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS
Three months ended March 31, 2008 and 2007**

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 unaudited consolidated financial statements for the three months ended March 31, 2008 and 2007 as contained in this interim report and the MD&A and audited financial statements for the fifteen months ended December 31, 2007 and twelve months ended September 30, 2006 contained in the Company's 2007 Financial Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in Canadian dollars unless otherwise indicated. The effective date of this MD&A is May 13, 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.

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.

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.

Pearl's core properties in Canada include:

- Onion Lake, Saskatchewan – heavy oil;
- Mooney, Alberta – heavy oil;
- Blackrod, Alberta – Heavy oil;

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

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

OPERATIONS UPDATE

Onion Lake Heavy Oil Project – Saskatchewan

Activity at Onion Lake during the first quarter focused on the installation of facilities to reduce operating costs and optimization of well operations. A fuel gas system was installed to collect solution gas from the field and provide dry fuel gas to the generators powering the wells. Beginning in the second quarter, the fuel gas system will allow a majority of the field to convert to this lower cost solution gas rather than using propane.

Engineering design continued on the sand handling and salt water disposal facilities. It is anticipated that both facilities will become operational during late Q3 2008. This will further reduce operating costs at Onion Lake by reducing the amount of trucking required in the field.

Construction commenced on the Onion Lake Thermal Pilot with the facilities at 90% complete by the end of Q1 2008. First steam is anticipated by mid May 2008 with first production expected during July 2008.

Mooney Heavy Oil Project – Alberta

During the first quarter, Pearl drilled one Bluesky horizontal development well at Mooney. The well production tested at 230 Boed and was shut-in due to infrastructure constraints. The well will be brought on production later in 2008 once tie-in is complete. This well, along with the vertical stratigraphic wells drilled in Q4 2007 were successful in identifying multiple additional development drilling locations.

Also during the first quarter, a second booster compressor was installed to allow for the recovery and sales of all the produced solution gas from the field.

Pearl is continuing work on its polymer flood enhanced oil recovery pilot. Planning is currently focused on selection and procurement of the polymer additive, location of the polymer plant, design and procurement of the treating facilities and identification and distribution of source water. Pearl has identified horizontal wells that will be converted to polymer injection and regulatory approval is pending. Polymer flooding is expected to begin in early Q4 2008. In addition to the polymer pilot, the water flood will be expanded from the current single water injection well to 14 water injection wells by year end.

Blackrod Heavy Oil Project – Alberta

During 2007 the Company acquired, in two separate Crown land sales, a 35% working interest in 15 contiguous Sections (8,960 acres) of oil sands leases located north-central Alberta between Townships 76 – 77, Ranges 17 – 18, west of the 4th Meridian. This project consists of a large scale heavy oil resource in the Athabasca region with over 100 million barrels of possible net reserves according to the Company's most recent third party reserve report. The Company also has an additional indirect interest of approximately 8% in this project through its approximate 18% ownership in Serrano Energy Ltd., who have a 35% working interest in the same acreage.

The Company has plans to drill one stratigraphic core 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 pilot and related facilities will be initiated. The Company is also investigating the possibility of executing a shallow corehole program to further delineate this deposit in the 2008/2009 winter season.

San Miguel Heavy Oil Project – Maverick Basin, South Texas

The San Miguel heavy oil deposit is located in South Texas near the Mexican border and contains an estimated 2 to 3 billion barrels of oil in place in the Area of Mutual Interest ("AMI") jointly held by the Company and its 50% partner TXCO.

During the quarter, the Company continued with plans to convert the initial steam injection pilot located within the Chittim "B" Area to a Steam-Assisted Gravity Drainage (SAGD) process. Pearl participated in the successful drilling of a horizontal producer/injector pair placed between the existing cyclic steam wells, which will be converted to temperature monitoring wells. Pearl is currently leading the facilities expansion project of the existing operations and took delivery of a second 25 MMBTU steam generator at site in March that will double steam generation capacity at the pilot. The remaining facilities modifications will be made to integrate this equipment into the existing process and

tie-in the additional new wells to the gathering system to enable the pilot to commence SAGD operations in the second quarter of 2008.

Field operations were initiated on the second larger production pilot (Saner Ranch Field) approximately eight miles north of the existing pilot and will utilize the Fracture-Assisted Steamflood Technology (FAST) technique previously proven by Conoco. Drilling the inverted five spot well pattern was completed in Q1 2008 and will be augmented by further drilling of a horizontal line drive pattern to complement the inverted five well pattern. Detailed facilities engineering continued with a contracted engineering firm to finalize facilities layout, process, and operation with initial field construction expected to commence in the second quarter. The production pilot will have four times the steam capacity of the original pilot, be capable of evaluating both recovery methods, and is projected to be operational by the second quarter of 2008.

Fiddler Creek – Montana

During 2007, the Company acquired a 100% 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 Properties – Alberta, Saskatchewan

On April 24, 2008 the Company announced that it had entered into a binding agreement with a large integrated energy company to sell certain non-core heavy oil producing assets for \$75 million. These assets, principally located in the Lloydminster, Celtic, Pikes Peak and Thunderchild areas of Saskatchewan, currently produce approximately 3,200 boe/d and are part of the non-core asset package that the Company intended to sell as announced on January 8, 2008. This deal is expected to close during the quarter ending June 30, 2008.

Other Properties – U.S.

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

RESULTS OF OPERATIONS

Oil and Gas Production, Pricing and Revenue

	Three months ended March 31	
	2008	2007
Daily production / sales volumes ⁽¹⁾		
Oil (bbl/d)	8,698	4,622
Natural gas (mcf/d)	10,757	13,923
Combined ⁽¹⁾ (boe/d)	10,503	6,966
Product pricing (\$)		
Crude oil - per bbl	63.11	35.89
Natural gas - per mcf	7.79	7.32
Combined - per boe	60.50	39.02
Revenue (000's)		
PNG revenue - gross	57,830	24,464
Royalties	(13,931)	(5,285)
PNG revenue - net	43,899	19,179

* gas production converted at 6:1

(1) Includes small amounts of NGLs not separately identified in the table

For the three months ended March 31, 2008 production increased significantly over the prior year three-months ended March 31, 2007 which reflects the Company's 2007 initiative to grow production through drilling and acquisitions.

Increased revenue is consistent with the increase in production and the significantly higher market pricing for heavy oil and higher prices for natural gas in the first quarter of 2008.

Royalties

	Three months ended March 31	
	2008	2007
Royalties	13,931	5,285
as a percentage of PNG revenue	24%	22%

Royalties represent charges against production or revenue by governments and landowners. Royalties for the three months ended March 31, 2008 were \$13.9 million in comparison to \$5.3 million for the three months ended March 31, 2007. This increase is consistent with the increase in production and revenues during the quarter.

Royalties as a percentage of revenue increased from 22% in the quarter ended March 31, 2007 to 24% in the quarter ended March 31, 2008 principally due to higher prices and higher production in the Mooney property which has higher average well rates and higher royalty rates than our production in Saskatchewan. These percentages are consistent with industry averages.

PNG Operating Expenses and Netbacks

Three months ended March 31	2008		2007	
	Total	Per boe	Total	Per boe
(000's)				
Average daily production (Boe/d)	10,503		6,966	
Gross PNG revenue	57,830	60.50	24,464	39.02
Royalties	(13,931)	(14.58)	(5,285)	(8.43)
Net PNG revenue	43,899	45.92	19,179	30.59
Operating costs	(18,884)	(19.76)	(10,132)	(16.16)
Transportation	(1,197)	(1.25)	(999)	(1.59)
PNG netback	23,818	24.91	8,048	12.84

Operating costs on a per boe basis averaged \$19.76 for the three months ended March 31, 2008 in comparison to \$16.16 per boe for the same period in 2007. The increase in operating costs is consistent with increased operations as compared to prior year. Although the Company did see increased production, the per unit cost increased more than expected due to several factors including (i) high cost of propane; (ii) delays in focusing resources on developing efficiencies with regards to operating costs; and (iii) \$2.2 million or \$2.28 per boe of 3rd party costs that related to prior periods. Current quarter operating costs, net of this prior period amount, totaled \$17.48 per boe.

General and Administrative Expenses (“G&A”)

General and administrative expenses were \$3.0 million in the first quarter of 2008 compared to \$2.6 million in 2007. On a per unit basis, G&A was \$3.17 per boe compared to \$4.08 per boe in 2007. General and administrative costs are consistent on a dollar basis but have decreased by \$0.91 per boe from the same period in 2007 due to the substantial increase in production and a corporate focus on decreasing administrative costs and an overall decrease in corporate acquisition activities.

Depletion, Depreciation and Accretion (“DD&A”)

DD&A expense was \$25.0 million or \$26.20 per boe for the three months ended March 31, 2008 in comparison to \$17.5 million or \$27.97 per boe for the three months ended March 31, 2007.

Interest Expense

Interest expense for the three months ended March 31, 2008 was \$0.3 million in comparison to \$0.4 million for the three months ended March 31, 2007. Interest expense relates to the Company's bank debt. The Company had an average debt level of \$16.9 million and an effective interest rate of 6.66% for the three months ended March 31, 2008.

Change in unrealized loss of gas pricing contracts

The change in unrealized loss of gas pricing contracts for the three months ended March 31, 2007 relates to gas contracts acquired as part of the Atlas acquisition in December, 2006.

Income Taxes

The provision for future income taxes for the quarter ended March 31, 2008 was a recovery of \$2.3 million compared to an expense of \$3.5 million for the three months ended March 31, 2007. As at March 31, 2008, the Company has recognized a future tax asset of \$4.6 million as the Company believes, based on estimated cash flows from existing reserves, that it is more likely than not to realize these assets.

Current tax of \$0.7 million for the three months ended March 31, 2008 and \$0.3 million for the same period of 2007 and is comprised primarily of Saskatchewan capital tax and resource surcharge. The increase is consistent with higher revenues in the current quarter.

Net Loss

The net loss for the quarter ended March 31, 2008 was \$3.8 million in comparison to a net loss of \$17.6 million for the quarter ended March 31, 2007. The \$13.8 million improvement in earnings is a result of the increased production and revenues derived from numerous acquisitions in 2007 combined with a recovery of future income taxes.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2008, the Company had \$35.0 million of remaining credit capacity available under its \$50.0 million extendible term credit facility and \$10.0 million demand revolving credit facility.

At March 31, 2008, the Company had a working capital deficiency of \$7.2 million compared to a working capital deficit of \$34.2 million at December 31, 2007.

Funds from operations were \$19.5 million for the three months ended March 31, 2008 compared to funds from operations of \$5.0 million for the three months ended March 31, 2007. The improvement in funds from operations is principally due to higher production rates, higher commodity prices and lower general and administrative expenses offset by higher operating expenses and royalties.

Net cash from financing activities for the quarter ended March 31, 2008 was \$25.0 million compared to net cash used in financing activities of \$55.6 million for the quarter ended March 31, 2007. During the current quarter the only financing activity was an advance of \$25.0 million from the Company's credit facility. Significant financing activities from the quarter ended March 31, 2007 included (i) net repayment of \$56.1 million of debt, and (iv) the exercise of \$0.5 million in stock options.

Net cash used in investing activities was \$36.0 million for the three months ended March 31, 2008 compared to \$35.4 million for the three months ended March 31, 2007. The Company's investing activities included exploration, development and lease acquisition expenditures of \$17.5 million (2007 - \$42.0 million).

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.

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 additional dispositions 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.

CAPITAL EXPENDITURES

Capital expenditures for the three months ended March 31, 2008 and 2007 are as follows:

Three months ended March 31	2008	2007
Land	391,694	602,601
Seismic	358,369	758,496
Drilling and completion	4,859,539	33,183,340
Equipment	12,420,040	6,148,772
Other	121,713	1,086,269
Total exploration and development	18,151,355	41,779,478
Corporate acquisition	-	8,809,049
Property acquisitions	146,321	252,401
Property dispositions	(785,324)	-
Total capital expenditures	17,512,352	50,840,928

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 three months ended March 31, 2008, Tanganyika charged the Company \$40,054 (2007 - \$59,111). Tanganyika and Pearl have certain directors and officers in common.

Namdo Management Services Ltd. ("Namdo") provides executive and support services to the Company. For the three months ended March 31, 2008, the Company paid Namdo \$45,000 (2007 - \$nil). Namdo is a private corporation owned by Lukas H. Lundin, a director of the Company.

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;
- Maximizing operational control of drilling and producing operations; and

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 STANDARDS ADOPTED

As disclosed in the December 31, 2007 annual audited consolidated financial statements, on January 1, 2008, the Company adopted the new CICA Handbook Sections 3862 "Financial Instruments – Disclosures", 3863 "Financial Instruments – Presentation", and 1535 "Capital Disclosures". The adoption of these standards has had no material

impact on the Company's net income or cash flows. Additional information on the implementation of these new standards can be found in Note 3 to the Interim Consolidated Financial Statements.

RECENT ACCOUNTING PRONOUNCEMENTS

Goodwill and Intangible Assets

As of January 1, 2009, Pearl will be required to adopt Section 3064 "Goodwill and Intangible Assets," which revises the requirement for recognition, measurement, presentation and disclosure of intangible assets and replaces the existing Goodwill and Intangible Asset standard. The adoption of this standard should not have a material impact on the Company's 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, the Accounting Standards Board confirmed in February, 2008 that International Reporting Standards ("IFRS") will replace Canadian GAAP for profit-oriented Canadian publicly accountable enterprises in 2011. Pearl is assessing the potential impact of this change and developing a plan accordingly.

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. There have been no changes in the Company's systems of internal control over financial reporting that would materially affect, or is reasonably likely to materially affect, the Company's internal controls 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.

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 Generally Accepted Accounting Principles and therefore may not be comparable with the calculations of similar measures for other entities. Consequently, these are referred to as non-GAAP measures.

PEARL EXPLORATION AND PRODUCTION LTD.

**Consolidated Balance Sheet
(unaudited)**

	March 31, 2008	December 31, 2007
Assets		
Current assets		
Cash	\$ -	\$ 4,799,186
Accounts receivable	43,485,113	25,134,435
Income taxes and capital taxes receivable	2,493,212	2,618,015
Prepaid expenses and deposits	2,908,659	3,195,770
	48,886,984	35,747,406
Investments (note 5)	9,362,895	9,362,895
Petroleum and natural gas properties (note 6)	521,334,919	528,352,540
Future income tax	4,652,051	2,402,532
	\$ 584,236,849	\$ 575,865,373
Liabilities		
Current liabilities		
Bank indebtedness	\$ 506,700	\$ -
Accounts payable and accrued liabilities	55,556,996	69,899,310
	56,063,696	69,899,310
Long-term liabilities		
Asset retirement obligation (note 8)	16,682,028	16,586,030
Bank loan (note 7)	25,000,000	-
	97,745,724	86,485,340
Shareholders' equity		
Share capital (note 10)	723,121,821	723,121,821
Contributed surplus (note 11)	9,679,244	8,778,124
Deficit	(246,309,940)	(242,519,912)
	486,491,125	489,380,033
	\$ 584,236,849	\$ 575,865,373
Commitments (note 13)		
Contingencies (note 16)		

See accompanying notes to consolidated financial statements

PEARL EXPLORATION AND PRODUCTION LTD.

**Consolidated Statement of Operations and Deficit
(unaudited)**

	For the three months ended March 31	
	2008	2007
Revenue		
Oil and gas sales	\$ 57,829,970	\$ 24,463,816
Interest income	116,516	243,483
Royalties	(13,931,457)	(5,284,815)
	<u>44,015,029</u>	<u>19,422,484</u>
Expenses		
Production costs	18,883,835	10,132,434
Transportation costs	1,197,331	999,118
General and administrative	3,026,793	2,558,530
Depletion, depreciation and accretion	25,043,131	17,537,007
Stock-based compensation	901,120	957,775
Interest	338,783	398,665
Change in unrealized loss of gas pricing contracts	-	487,760
Foreign currency exchange loss (gain)	(35,685)	171,549
	<u>49,355,308</u>	<u>33,242,838</u>
Loss before income taxes	<u>(5,340,279)</u>	<u>(13,820,354)</u>
Income taxes		
Future income taxes (recovery)	(2,249,519)	3,513,013
Income taxes and capital taxes	699,268	294,692
	<u>(1,550,251)</u>	<u>3,807,705</u>
Net and comprehensive loss for the period	<u>(3,790,028)</u>	<u>(17,628,059)</u>
Deficit, beginning of period	<u>(242,519,912)</u>	<u>(20,577,168)</u>
Deficit, end of period	<u>\$ (246,309,940)</u>	<u>\$ (38,205,227)</u>
Basic and diluted loss per share	\$ (0.02)	\$ (0.13)
Weighted average number of common shares used in computing earnings per share:		
basic	189,241,716	132,472,088
diluted	189,241,716	132,720,698
<i>See accompanying notes to consolidated financial statements</i>		

PEARL EXPLORATION AND PRODUCTION LTD.

Consolidated Statements of Cash Flows
(unaudited)

	For the three months ended March 31	
	2008	2007
Operating activities		
Comprehensive loss	\$ (3,790,028)	\$ (17,628,059)
Items not involving cash:		
Depletion, depreciation and accretion	25,043,131	17,537,007
Stock-based compensation	901,120	957,775
Future income tax (recovery)	(2,249,519)	3,513,013
Change in unrealized loss of gas pricing contracts	-	487,760
Foreign exchange loss (gain)	(35,685)	171,549
Abandonment costs	(417,160)	-
	<u>19,451,859</u>	<u>5,039,045</u>
Changes in non-cash working capital balances related to operations	(13,724,782)	(862,868)
Long term accounts receivable	-	1,066,758
	<u>5,727,077</u>	<u>5,242,935</u>
Financing activities		
Advances of bank loan	25,000,000	38,600,000
Repayments of bank loan	-	(94,670,719)
Exercise of stock options	-	452,125
	<u>25,000,000</u>	<u>(55,618,594)</u>
Investing activities		
Acquisition of Cipher Exploration Inc.	-	(8,809,049)
Additions to petroleum and natural gas properties	(17,512,352)	(42,031,879)
Changes in non-cash working capital from investing	(18,520,611)	15,469,794
	<u>(36,032,963)</u>	<u>(35,371,134)</u>
Net increase (decrease) in cash	(5,305,886)	(85,746,793)
Cash, beginning of period	4,799,186	91,058,203
Cash, end of period	\$ (506,700)	\$ 5,311,410
Supplementary Information		
Interest paid	\$ 338,783	\$ 416,641
Capital taxes paid	\$ 358,403	\$ -

See accompanying notes to consolidated financial statements

PEARL EXPLORATION AND PRODUCTION LTD.
Notes to the Consolidated Financial Statements
(unaudited)

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

The interim 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., and Valkyries Texas Gas Ltd. Both Cipher Exploration Inc. and Watch Resources Ltd. were amalgamated with Pearl E & P Canada Ltd. on January 1, 2008.

The interim consolidated financial statements for the Company have been prepared in accordance with accounting principles generally accepted in Canada, using the same accounting policies and methods of computation as set out in note 3 to the audited consolidated financial statements in the Company’s Financial Report for the fifteen months ended December 31, 2007. The disclosures provided herein are incremental to those included with the audited consolidated financial statements. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the fifteen months ended December 31, 2007.

3. CHANGES IN ACCOUNTING POLICIES

As disclosed in the December 31, 2007 annual audited Consolidated Financial Statements, on January 1, 2008, the Company adopted the following Canadian Institute of Chartered Accountants (“CICA”) Handbook Sections:

- Section 3862 “Financial Instruments – Disclosures” and Section 3863 “Financial Instruments – Presentation,” which replace Section 3861 “Financial Instruments – Disclosure and Presentation.” The new disclosure standard increases the emphasis on the risks associated with financial instruments and how those risks are managed (See Note 14). The new presentation standard carries forward the former presentation requirements.
- Section 1535 “Capital Disclosures,” The new standard requires the Company to disclose its objectives, policies and processes for managing its capital structure (See Note 12).

4. RECENT ACCOUNTING PRONOUNCEMENTS

As of January 1, 2009, the Company will be required to adopt the CICA Handbook Section 3064, “Goodwill and Intangible Assets”, which will replace the existing Goodwill and Intangible Assets standard. The new standard revises the requirement for recognition, measurement, presentation and disclosure of intangible assets. The adoption of this standard should not have a material impact on the Company’s 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 is assessing the potential impacts of this changeover and developing its plan accordingly.

5. INVESTMENTS

	March 31, 2008	December 31, 2007
Investment in Serrano Energy Ltd. (“Serrano”)	\$5,500,000	\$5,500,000
Asset-backed commercial paper (“ABCP”)	3,862,895	3,862,895
	\$9,362,895	\$9,362,895

The Company owns approximately 4.0 million shares of Serrano. On April 29, 2008 Serrano entered into a transaction to acquire assets for the issuance of shares and executed a subscription agreement to sell 2.0 million

shares of Serrano for \$10.0 million, as a result, Pearl's ownership will decrease in Serrano from approximately 37 percent to approximately 18 percent.

6. PETROLEUM AND NATURAL GAS PROPERTIES

March 31, 2008			
	Cost	Accumulated depreciation and depletion	Net book value
Petroleum and natural gas properties	\$641,526,430	\$121,411,501	\$520,114,929
Office equipment	1,642,002	422,012	1,219,990
	<u>\$643,168,432</u>	<u>\$121,833,513</u>	<u>\$521,334,919</u>
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
	<u>\$625,436,338</u>	<u>\$97,083,798</u>	<u>\$528,352,540</u>

The depletion and ceiling test calculations have excluded the cost of unproved properties of \$61.7 million (December 31, 2007 – \$61.0 million) and included the cost of future development costs of \$125.0 million (December 31, 2007 – \$145.0 million).

7. 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 with a one year term out, 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 securities agreement.

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

8. 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:

	March 31, 2008	December 31, 2007
Asset retirement obligation at beginning of period	\$ 16,586,030	\$ 3,772,479
Liabilities acquired through acquisitions, net of dispositions	-	9,822,642
Liabilities incurred during the period	219,742	2,987,539
Actual remediation expenses	(417,160)	(1,164,822)
Accretion	293,416	1,168,192
Asset retirement obligation at end of period	\$ 16,682,028	\$ 16,586,030

9. RELATED PARTY TRANSACTIONS

During the three months ended March 31, 2008 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:

(a) The Company paid \$40,054 (2007 – \$59,111) to Tanganyika Oil Company Ltd. (“Tanganyika”) for administrative and other services. The Company and Tanganyika have certain officers and directors in common.

(b) The Company paid \$45,000 (2007 – \$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.

10. 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 as at March 31, 2008 and December 31, 2007	189,241,716	\$ 723,121,821

(c) Warrants Outstanding:

	Number of whole warrants	Weighted average exercise price per share
Balance as at March 31, 2008 and December 31, 2007	4,091,800	\$ 0.98

(i) Four million warrants were issued pursuant to the San Miguel 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 acquisition, the Company issued 270,000 warrants. This number was subsequently reduced by 66% 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.

11. 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 December 31, 2007	7,726,357	3.98
Granted	72,000	2.37
Cancelled	(393,886)	4.24
Expired	(1,060,000)	3.81
Outstanding at March 31, 2008	<u>6,344,471</u>	<u>3.97</u>

The following stock options were outstanding at March 31, 2008:

Options Outstanding				Options Exercisable			
Range of Exercise Prices (\$)	Number	Weighted-Average Exercise Price (\$)	Weighted-Average Life (Years)	Number	Weighted-Average Exercise Price (\$)	Weighted-Average Life (Years)	
1.59 - 4.00	2,949,333	2.81	4.58	83,333	3.39	1.53	
4.01 - 5.00	1,105,804	4.48	2.67	797,804	4.40	2.05	
5.01 - 6.00	2,237,667	5.17	3.32	942,333	5.20	2.77	
6.01 - 8.94	51,667	7.02	0.08	51,667	7.02	0.08	
	<u>6,344,471</u>	<u>3.97</u>	<u>3.77</u>	<u>1,875,137</u>	<u>4.83</u>	<u>2.33</u>	

Compensation expense for the three month period of \$901,120, net of recovery of \$15,575 for cancelled stock options, has been recorded in the Consolidated Statements of Operations and Deficit for the quarter ended March 31, 2008 (2007 – \$1,521,122). 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 2008 and the assumptions used in their determination are as noted below:

	Three Months Ended March 31, 2008
Weighted average fair value of stock options granted (per option)	\$1.00
Expected life of stock options (years)	3.00
Volatility (weighted average)	59%
Risk free rate of return (weighted average)	3.18%
Expected dividend yield	0%

Contributed surplus continuity	March 31, 2008	December 31, 2007
Balance, beginning of the period	\$ 8,778,124	\$ 4,791,060
Stock-based compensation	916,695	4,636,916
Stock-based compensation allocated to contributed surplus as part of Watch acquisition	-	575,448
Recovery of expense on cancelled stock options	(15,575)	(590,137)
Transfer to share capital on exercise of options	-	(635,163)
Balance, end of period	<u>\$ 9,679,244</u>	<u>\$ 8,778,124</u>

12. CAPITAL MANAGEMENT

The Company's capital management strategy is designed to minimize the use of long term debt and maintaining positive working capital. This strategy should provide the financial flexibility to fund the Company's capital program and profitable growth opportunities.

Financial covenants associated with the Company's credit facility are reviewed regularly and controls are in place to maintain compliance with these covenants. The Company complied with all covenants for the three months ended March 31, 2008.

13. 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 nine-year operating lease for office space.

	2008	2009	2010	2011	2012	Subsequent to 2012
Office rent	\$813,570	\$1,084,760	\$1,084,760	\$1,152,557	\$1,220,355	\$4,576,331

The Company has contracted drilling rig services over the next two years. In the event that the Company does not utilize the minimum contracted days, the Company would be obligated to pay the rig operators a variable rate based on days not utilized under the contracts. The maximum commitment at March 31, 2008 related to these contracts is approximately \$11.9 million, which can be reduced by farm-outs to other operators.

14. 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.

15. 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:

	Three Months Ended March 31, 2008		
	Canada	USA	Consolidated
Total revenues, net of royalties	43,636,265	378,764	44,015,029
Expenses	49,136,834	254,159	49,390,993
Foreign currency gain	(4,346)	(31,339)	(35,685)
Net income (loss) before income taxes	(5,496,223)	155,944	(5,340,279)
Income taxes (recovery)	(1,558,889)	8,638	(1,550,251)
Net income (loss)	(3,937,334)	147,306	(3,790,028)
Segment assets	529,678,611	54,558,238	584,236,849
Segment petroleum and natural gas properties	471,533,653	49,801,266	521,334,919
Capital additions	13,395,156	4,117,196	17,512,352

	Three Months Ended March 31, 2007		
	Canada	USA	Consolidated
Total revenues, net of royalties	19,089,051	333,433	19,422,484
Expenses	32,354,459	716,830	33,071,289
Foreign currency loss	171,549	-	171,549
Loss before income taxes	(13,436,957)	(383,397)	(13,820,354)
Income taxes (recovery)	3,807,705	-	3,807,705
Net loss	(17,244,662)	(383,397)	(17,628,059)
Segment assets	552,465,267	33,810,777	586,276,044
Goodwill	159,863,578	-	159,863,578
Segment petroleum and natural gas properties	356,947,547	32,303,208	389,250,755
Capital additions	47,001,871	3,839,057	50,840,928

16. CONTINGENCIES

(a) In connection with the November, 2007 property acquisition from PetroHunter, 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 6th, 2010. In addition, 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 31, 2008 the performance payment will be reduced to \$9.8 million and the contingent shares will remain unissued. At this time the Company does not anticipate that the additional leases will be acquired and as such it is unlikely that the additional payment will be made.

(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 is 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. As at March 31, 2008 the Company owes consideration of \$21,000 to Valkyries.

17. SUBSEQUENT EVENTS

On April 24, 2008 the Company announced that it had entered into a binding agreement with a large integrated energy company to sell certain non-core heavy oil producing assets for \$75 million. These assets, principally located in the Lloydminster, Celtic, Pikes Peak and Thunderchild areas of Saskatchewan, currently produce approximately 3,200 boe/d and are part of the non-core asset package that the Company intended to sell as announced on January 8, 2008. This deal is expected to close during the quarter ending June 30, 2008.

18. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in 2008.