

**PEARL EXPLORATION AND PRODUCTION LTD.
MANAGEMENT'S DISCUSSION AND ANALYSIS
Three months ended June 30, 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 and six months ended June 30, 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 August 13th, 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 include:

- Onion Lake, Saskatchewan – heavy oil;
- Mooney, Alberta – heavy oil;
- Blackrod, Alberta – heavy oil;
- San Miguel, Texas – heavy oil

OPERATIONS UPDATE

Onion Lake Heavy Oil Project – Saskatchewan

In Onion Lake the Cyclic Steam Stimulation (CSS) thermal pilot commenced steam injection on May 15th, over a month ahead of schedule. The first steam cycle on the first well was completed on June 19th and the well is currently producing approximately 140 barrels of oil per day which is above expected modeling predictions. Steam injection on the second well began on June 20th and first production commenced on August 11, 2008.

Mooney Heavy Oil Project – Alberta

During the first half of 2008 Pearl drilled four net horizontal wells in our Mooney area. Three of the new wells will form the basis of a polymer pilot which has been accelerated to be initiated in Q4 2008. Preliminary results from the pilot are expected by Q1 2009. Plans for a field wide polymer flood implementation are expected to be finalized by Q2 2009 with implementation targeted as early as the end of 2009. Permits have now been obtained for the implementation of the waterflood with its initiation expected in Q4 2008 and continuing into the first half of 2009. In addition, plans are underway to commence a development drilling program by year end to extend the productive area to the west with the goals of increasing production and proven and probable reserves

Blackrod Heavy Oil Project – Alberta

At Blackrod, as previously announced, the Company has entered into an agreement to acquire an additional 30% working interest in 3,886 contiguous hectares of oil sands leases in the project area. In addition, Pearl is continuing with its plans to drill a 10 to 15 stratigraphic core well program in the 2008/2009 winter to further delineate this deposit and gather additional petrophysical data. Pearl remains on track to initiate steaming at its Steam-Assisted Gravity Drainage (“SAGD”) pilot, comprised of single well pair pilot and related facilities, during the first half of 2009. The application for the required governmental approvals of the thermal SAGD pilot project was submitted in May of 2008.

San Miguel Heavy Oil Project – Maverick Basin, South Texas

At San Miguel, Pearl and its 50% partner TXCO have finished construction of its SAGD pilot located within the Chittim “B” field. Steam injection commenced on June 1, 2008 with preliminary results expected by Q1 2009. Temperature monitoring of the well pair indicates that the steam chamber is building as anticipated. At the Saner Ranch portion of the field, construction is continuing on the second production pilot. The Saner Ranch pilot includes both a vertical inverted five spot well pattern and a horizontal three well pattern utilizing a modified Fracture Assisted Steamflood Technology (FAST) process. The three horizontal wells were drilled and completed successfully in Q2 2008. All major long lead time items for the pilot are on site with assembly of facilities and infrastructure installation proceeding on schedule. The pilot is expected to be operational in the third quarter of 2008 and allow preliminary results to be analyzed during the first half of 2009. By the end of the second quarter of 2009, Pearl expects to select which of the three recovery techniques will be used to form the basis of a commercial development project.

Other Properties – Alberta, Saskatchewan

During the current quarter, the Company sold certain non-core heavy oil producing assets for \$75 million. These assets were located in the Lloydminster, Celtic, Pikes Peak and Thunderchild areas of Saskatchewan and were part of the non-core asset package that the Company announced its intention to rationalize on January 8, 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 in Utah, Promised Land in Montana and Queen City gas fields in Texas, 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 June 30		Six months ended June 30	
	2008	2007	2008	2007
Daily production / sales volumes ⁽¹⁾				
Oil (bbl/d)	6,660	5,934	7,679	5,282
Natural gas (mcf/d)	9,402	11,757	10,080	12,834
Combined ⁽¹⁾ (boe/d)	8,246	7,910	9,375	7,441
Product pricing (\$)				
Crude oil - per bbl	84.57	41.29	72.41	39.13
Natural gas - per mcf	9.80	6.81	8.73	7.10
Combined - per boe	79.74	41.40	68.97	40.29
Revenue (000's)				
PNG revenue - gross	59,839	29,801	117,669	54,265
Royalties	(14,956)	(6,322)	(28,887)	(11,607)
PNG revenue - net	44,883	23,479	88,782	42,658

* gas production converted at 6:1

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

For the three months ended June 30, 2008 production is relatively consistent with the prior year three-months ended June 30, 2007 due to the company disposing of non-core properties during the quarter representing approximately thirty percent of daily production.

Significant increase in revenue for both the three and six months ended June 30, 2008 is primarily due to the higher market pricing for heavy oil and natural gas in 2008.

Royalties

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Royalties	14,956	6,322	28,887	11,607
as a percentage of PNG revenue	25%	21%	25%	21%

Royalties represent charges against production or revenue by governments and landowners. Royalties for the three and six months ended June 30, 2008 increased over the comparable periods of 2007. This increase is consistent with the increase in revenues during the period.

Royalties as a percentage of revenue increased from 21% during the three and six months ended June 30, 2007 to 25% in the three and six months ended June 30, 2008 principally due to higher market pricing. These percentages are consistent with the expectations given the nature of the royalty calculations.

PNG Operating Expenses and Netbacks

	Three months ended June 30				Six months ended June 30			
	2008		2007		2008		2007	
	Total	Per boe	Total	Per boe	Total	Per boe	Total	Per boe
Average daily production	8,246		7,910		9,375		7,441	
Gross PNG revenue	59,839	79.74	29,801	41.40	117,669	68.97	54,265	40.29
Royalties	(14,956)	(19.93)	(6,322)	(8.78)	(28,887)	(16.93)	(11,607)	(8.62)
Net PNG revenue	44,883	59.81	23,479	32.62	88,782	52.04	42,658	31.67
Operating costs	(11,453)	(15.26)	(10,949)	(15.21)	(30,337)	(17.78)	(21,081)	(15.65)
Transportation	(1,003)	(1.34)	(1,074)	(1.49)	(2,201)	(1.29)	(2,073)	(1.54)
PNG netback	32,427	43.21	11,456	15.92	56,244	32.97	19,504	14.48

Operating Expenses

Second quarter operating costs on a per boe basis were fairly consistent when compared to the same period in 2007, averaging \$15.26 for the three months ended June 30, 2008 in comparison to \$15.21 per boe in 2007. For the six months ended June 30, 2008 operating costs were \$17.78 per boe as compared to \$15.65 for the six months ended June 30, 2007. The increase in per unit operating costs for the six month period is principally due to several factors, that occurred in the first quarter, including (i) high cost of propane; (ii) timing of focusing resources on developing efficiencies with regards to operating costs; and (iii) \$2.2 million or \$2.28 per boe of underestimated 3rd party costs that related to prior periods that was recognized in the first quarter. Installation of a fuel gas system has helped to alleviate the high cost of propane in the second quarter.

PNG netbacks are significantly higher in both the three and six months ended June 30, 2008 when compared to 2007 results. The increase is largely due to the higher price of oil and gas in 2008.

General and Administrative Expenses ("G&A")

General and administrative expenses were \$3.4 million in the second quarter of 2008 compared to \$4.0 million in 2007. On a per unit basis, G&A was \$4.51 per boe compared to \$5.49 per boe in 2007. General and administrative costs have decreased by \$0.98 per boe from the same period in 2007 due to an increase in production and a corporate focus on decreasing administrative costs and an overall decrease in corporate acquisition activities.

G&A for the six months ended June 30, 2008 was \$6.4 million or \$3.76 per boe compared to \$6.5 million or \$4.83 per boe in 2007. The decrease of \$1.07 per boe from 2007 is again principally due to an 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 \$19.0 million or \$24.49 per boe for the three months ended June 30, 2008 in comparison to \$22.3 million or \$31.01 per boe for the three months ended June 30, 2007. For the six months ended June 30, DD&A expense was \$44.0 million or \$25.17 per boe in comparison to \$39.9 million or \$29.60 for the same period of 2007. The lower rate in 2008 is due to increased proved reserves as a result of the significant drilling and acquisition activity in 2007.

Interest Expense

Interest expense for the three months ended June 30, 2008 was \$0.4 million in comparison to \$1.2 million for the three months ended June 30, 2007. Interest expense relates to the Company's bank debt. The Company had an average debt level of \$27.6 million and an effective interest rate of 5.77% for the three months ended June 30, 2008. Lower interest expense is due to a lower dependence on debt financing during the period.

For the six months ended June 30, 2008 interest expense was \$0.8 million in comparison to \$1.6 million for the same period in 2007. The Company's average debt balance was \$22.2 million with an effective interest rate of 6.11% for the six months ended June 30, 2008. Lower interest expense is due to a lower dependence on debt financing during the period.

Change in unrealized loss of gas pricing contracts

The change in unrealized loss of gas pricing contracts for the six months ended June 30, 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 June 30, 2008 was \$2.3 million compared to a recovery of \$3.1 million for the three months ended June 30, 2007. As at June 30, 2008, the Company has recognized a future tax asset of \$2.4 million as the Company believes, based on estimated cash flows from existing reserves, that it is more likely than not to realize these assets

For the six months ended June 30, 2008, future income taxes were \$0.01 million in comparison to \$0.4 million for the comparable period in 2007.

Current tax of \$0.7 million for the three months ended June 30, 2008 is comprised of Saskatchewan capital tax and resource surcharge. The \$6.6 million for the same period of 2007 is taxes payable as a result of the sale of certain assets in the United States.

Net Income (Loss)

Net income for the quarter ended June 30, 2008 was \$6.7 million in comparison to a net loss of \$7.2 million for the quarter ended June 30, 2007. Earnings for the six months ended June 30, 2008 were \$2.9 million, a \$27.8 million improvement over the six months ended June 30, 2007 reported net loss of \$24.9 million. The significant increase in 2008 net income is mainly due to increased revenues caused by the high market price for heavy oil and natural gas in the first half of 2008.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2008, the Company had \$42.0 million of remaining credit capacity available under its \$37.0 million extendible term credit facility and \$10.0 million demand revolving credit facility.

At June 30, 2008, the Company had working capital of \$57.4 million compared to a working capital deficit of \$34.2 million at December 31, 2007.

Funds from operations were \$28.0 million for the three months ended June 30, 2008 compared to funds from operations of \$0.2 million for the three months ended June 30, 2007. For the six months ended June 30, 2008 funds

from operations were \$47.5 million as compared to \$5.2 million for the six months ended June 30, 2007. The improvement in funds from operations is principally due to higher commodity prices and to a lesser extent lower G&A expenses.

Net cash used in financing activities for the quarter ended June 30, 2008 was \$20.0 million compared to net cash from financing activities of \$35.5 million for the quarter ended June 30, 2007. During the current quarter the Company repaid \$20.0 million on its credit facility. Significant financing activities from the quarter ended June 30, 2007 included (i) an advance of \$35.4 million of debt, and (ii) the exercise of \$0.1 million in stock options.

Net cash from financing activities was \$5.0 million for the six months ended June 30, 2008 in comparison to net cash used in financing activities of \$20.1 million for the six months ended June 30, 2007. An advance of \$5.0 million on the Company's bank loan was the only financing activity for the current period. Significant financing activities from the six months ended June 30, 2007 included a net repayment of \$20.7 million of the Company's debt.

Net cash from investing activities was \$44.1 million for the three months ended June 30, 2008 compared to net cash used in investing activities of \$35.2 million for the three months ended June 30, 2007. During the current quarter, the Company sold certain non-core heavy oil producing assets for \$75 million and spent \$17.6 million on exploration, development and lease acquisition activities. Investing activities during the quarter ended June 30, 2007 included: (i) \$51.3 million spent on exploration, development and lease acquisition activities; (ii) \$2.5 million used to acquire additional shares in Serrano, and (iii) \$10.0 million from the sale of Bayou Bend shares.

Net cash from investing activities for the six months ended June 30, 2008 was \$8.0 million compared to net cash used in investing activities of \$70.6 million in the same period of 2007. In addition to the \$75 million from the sale of assets, the Company spent \$35.1 million on exploration, development and lease acquisition activities during the first six months of 2008. During the six months ended June 30, 2007 the Company's exploration, development and lease acquisition activities totaled \$93.3 million, corporate acquisition costs totaled \$11.7 million and the sale of Bayou Bend shares generated \$10.0 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.

In the future 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 addition, the Company may consider divesting additional 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 and six months ended June 30, 2008 and 2007 are as follows:

	2008	2007	2008	2007
Land	172,341	202,102	863,993	804,703
Seismic	202,845	250,971	561,214	1,009,467
Drilling and completion	8,945,931	35,020,604	13,505,511	68,203,944
Equipment	6,767,716	11,551,858	19,187,757	17,700,630
Other	439,289	180,725	561,003	1,266,994
Total exploration and development	16,528,122	47,206,260	34,679,478	88,985,738
Corporate acquisition	-	-	-	8,809,049
Property acquisitions	1,133,391	5,450,595	1,279,712	5,702,996
Property dispositions	(75,392,870)	(8,847,317)	(76,178,194)	(8,847,317)
Total capital expenditures	(57,731,357)	43,809,538	(40,219,005)	94,650,466

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 six months ended June 30, 2008, Tanganyika charged the Company \$56,099 (2007 - \$89,902). 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 six months ended June 30, 2008, the Company paid Namdo \$90,000 (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 North American heavy oil resource 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.