

## **PEARL EXPLORATION AND PRODUCTION LTD.**

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### **FIRST QUARTER 2009 FINANCIAL AND OPERATING RESULTS**

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#### Highlights:

- Hired a new heavy oil management team;
- Acquired an additional 15% interest in the SAGD project at Blackrod, to bring the Company's ownership to 80%;
- Achieved positive results from the polymer pilot flood at Mooney;
- Undertook a 10 well delineation program at Blackrod to confirm the aerial extent and quality of the resource;
- Maintained a strong balance sheet with \$8.6 million in working capital and no debt;
- Production, cash flow and net earnings impacted by low commodity prices;
- Subsequent to the quarter end, added to our working capital with a \$46 million equity financing.

John Festival, new President of Pearl, commenting on the results, indicated that, "the first quarter of 2009 was a challenging economic environment for Pearl, as well as for most oil and gas producers. The global economic conditions during the quarter have impacted oil and gas prices and this is reflected in Pearl's financial and operating performance. We are fortunate to have a strong balance sheet with positive working capital and no debt, which will allow us to weather the global economic downturn. With the current weak economic conditions we elected to conserve our cash and minimize capital spending, including workover capital, which resulted in production slipping about 10% from fourth quarter levels. As prices improve we will allocate funds to restore some of this production. While the current market is providing its challenges, we are generally bullish on oil prices going forward and we are positioning the Company to capitalize on its opportunities when conditions improve.

The new management team has had about three months to review and evaluate Pearl's operations, and while this review will continue, at this point, we are very optimistic about the development potential of our core properties of Mooney, Onion Lake and Blackrod. Development of these properties will take time and capital. Development will require extensive regulatory and other approvals because we will be utilizing secondary and tertiary recovery methods. Typically, with these recovery methods there is a relatively long lag time between capital spent and seeing response in terms of incremental production and cash flow. Nevertheless, we believe development of these projects over the medium term will ultimately add production, reserves and value to our shareholders".

## **Operations Review**

### **Mooney**

At Mooney, we continue to monitor the results of the water and polymer pilot floods. The current pilot polymer flood consists of two horizontal injectors and one horizontal producer. The results of the pilot have been positive to date. The initial production rate of a typical Mooney well is in excess of 100 barrels of oil per day and then drops off by 50 – 70% after 6-12 months. With the introduction of polymer, production from the producing pilot well has been restored to its initial production rate.

In addition to continuing to monitor the pilot results, over the next six months we will undertake studies to refine the type and quantity of polymer to use, as well as evaluate the suitability of adding a surfactant/alkali with the polymer flood, which has the potential of increasing overall oil recovery rates. The Company will also be working with the Alberta Department of Energy to establish an EOR royalty scheme for Mooney when commercial development of the polymer flood is established.

### **Onion Lake**

At Onion Lake, during the first quarter of 2009, Pearl completed testing a Cyclic Steam Stimulation (CSS) pilot which was initiated in the second half of 2008. Positive results were achieved from the pilot, with each of the two test wells reaching peak production in excess of 200 barrels of oil per day. Over the next six months we will continue to evaluate the results of the CSS pilot, as well as study the applicability of a modified SAGD recovery process to develop Onion Lake. However, due to the incremental capital and operating costs, thermal development at Onion Lake will be deferred until oil prices improve. We will likely focus on continued conventional primary development, with the potential of 50-75 additional drilling locations.

### **Blackrod**

At Blackrod, in early 2009 we acquired an additional 15% working interest from our joint interest partner, bringing our working interest to 80% in the main project area planned for development. In addition, Pearl was named operator at Blackrod.

During the first quarter of 2009, 10 additional wells were drilled to evaluate and understand the areal extent and quality of the resource. We are currently evaluating the results of these wells.

Going forward, our plan is to proceed with an application for regulatory approval to conduct a 1-3 well pair SAGD pilot at Blackrod to obtain better information on reservoir performance, refine operating and capital cost estimates and other relevant information for full field development. We are currently gathering data that will allow us to file the application in the summer, and it is expected it will take 6-12 months to receive the required approvals.

### **Production Volumes**

Pearl's crude oil and natural gas production volumes decreased to 5,510 boe per day during the first quarter of 2009 compared with 10,503 boe per day during the first quarter of 2008. The decrease from the prior year is a result of Pearl selling approximately 3,200 boe per day of production mid last year. First quarter production was also 11% lower than fourth quarter 2008 of 6,198 boe per day. The principle reason production is lower is due to the Company's decision to defer maintenance capital while oil prices are low. As oil prices have improved somewhat in the second quarter, maintenance work will be undertaken to restore some of the lost production.

	Three months ended March 31, 2009		Three months ended March 31, 2008	
	Oil(bbls/d)	Gas(mcf/d)	Oil(bbls/d)	Gas(mcf/d)
Onion Lake	2,131	167	2,027	669
Mooney	1,343	2,146	2,408	2,737
Salt Lake	288	523	504	689
Celtic – Pike’s Peak	-	-	1,503	516
Ear Lake	433	1	414	284
Long Coulee/McGregor/Pageant	25	1,599	14	2,555
Other	203	2,091	1,840	3,307
	4,423	6,527	8,710	10,757

## Management’s Discussion and Analysis

The following is Management’s Discussion and Analysis (“MD&A) of the operating and financial results of Pearl Exploration and Production Ltd (“Pearl” or the “Company”) for the quarter ended March 31, 2009. These results are being compared with the 3 month period ended March 31, 2008. The MD&A should be read in conjunction with the Company’s unaudited consolidated financial statements for the three months ended March 31, 2009, together with the accompanying notes.

All dollar amounts are referenced in thousands of Canadian dollars, except where otherwise noted. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

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.

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, and cash flow per share, 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. Management uses these non-GAAP measurements to evaluate the Company’s performance and to provide shareholders and investors with additional information to measure the Company’s performance and efficiency and its ability to fund a portion of its future activities.

Additional information relating to the Company, including its Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com)

This MD&A contains forward looking information and statements. At the end of this MD&A is an advisory on forward looking information and statements.

The effective date of this MD&A is May 5, 2009.

## OVERVIEW

Pearl is a Canadian-based oil and gas company whose common shares are traded on the TSX Exchange under the symbol “PXX” and on the First North (OMX Nordic Exchange) under the symbol “PXXS”. Pearl’s main focus is heavy oil projects in western 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

These core areas provide the Company with a combination of short term cash flow generation, medium term EOR (Enhanced Oil Recovery) development and longer term thermal growth opportunities.

## 2009 SIGNIFICANT EVENTS

- The deterioration in the financial markets, which began in 2008 as a result of a credit crisis and global recession, continued during the first quarter of 2009. The worldwide financial crisis has directly impacted the demand for crude oil and natural gas and resulted in dramatically lower commodity prices. Pearl has not been immune from these circumstances and this has resulted in significantly lower revenues.
- On January 1, 2009 the Company amalgamated CODA Holdings (acquired in 2008) with Pearl E & P Canada Ltd.
- On January 8, 2009, the Company acquired all of the issued and outstanding shares of BlackCore Resources Inc. in exchange for 17,600,000 common shares of the Company, as well as 5,000,160 Class A and 5,000,160 Class B share purchase warrants. The Class A and B warrants will allow the holder to acquire one Pearl share for a price of \$0.60 when the Pearl share price reaches a volume weighted average price for 30 consecutive days of \$1.50 and \$2.00, respectively. In addition, 2,500,000 common shares of the Company were issued to extinguish the potential contingency payments related to the purchase of lands in the Blackrod area. In conjunction with the acquisition, the Company has hired a new management team who were formerly with BlackRock Ventures Inc. The new Pearl management team were also the principal shareholders of BlackCore.
- On January 28, 2009, the Company closed an agreement with Serrano Energy Ltd. (“Serrano”) to exchange the Company’s equity interest in Serrano for an additional 15% increased interest in the Blackrod area lands (increasing the Company’s working interest to 80% within the main project area) and a carried work commitment of \$5 million. The Company has become the operator of the Blackrod project.
- Due to low commodity prices, the Company curtailed its capital program during the first quarter of 2009, with total expenditures of \$3.1 million.
- On April 20, 2009, the Company issued 52,334,000 special warrants of Pearl at a price of \$0.88 per special warrant for aggregate net proceeds of approximately \$43.9 million. Each special warrant is convertible into one common share of the Company.

## RESULTS OF OPERATIONS

\$ 000s, except where noted

	Three months ended March 31, 2009	Three months ended March 31, 2008
Net loss	(20,516)	(3,790)
Per share (\$)	(0.10)	(0.02)

The Company incurred a net loss of \$20.5 million or \$0.10 per share for the quarter ended March 31, 2009 compared to a loss of \$3.8 million or \$0.02 per share for the three months ended March 31, 2008. The net loss for the year is principally a result of low commodity prices and high depletion costs.

### Commodity Prices

In Canada and the US, crude oil prices are generally based on WTI benchmark prices. In the first quarter 2009, WTI prices were significantly lower averaging US\$43.08/bbl compared with US\$97.90/bbl in 2008. The decrease is attributable to the decreased demand for oil as a result of the global recession and financial crisis. The WTI forward strip price for the remainder of 2009 is approximately US\$53 per barrel, suggesting continued reduced demand. Pearl predominately produces heavy oil, which sells for less than light oil, due to increased processing required for a heavy barrel. One of the benchmark prices for heavy oil in Canada is the Western Canadian Select (“WCS”) stream price. During the first quarter of 2009, the WCS reference price averaged 79% of the WTI price, which is consistent with the 78% experienced in Q1 2008. However, more recently heavy oil differentials have narrowed and WCS is selling for 91% of WTI.

Oil prices in Canada are also impacted by the Canada/US exchange rate, since oil is generally priced in US dollars. During the first quarter of 2009, the Canadian dollar was relatively weak against the US dollar with an exchange rate of \$1.2453. This is a significant decrease from the first quarter 2008 where the Canadian dollar was, on average, even with the US dollar.

In the first quarter 2009, natural gas prices decreased 38% compared to the same period in 2008, reflecting lower demand. The AECO-C gas price averaged \$4.66 per GJ in Q1 2009 compared to \$7.49 per GJ in 2008. Similar to oil prices, natural gas prices decreased as a result of lower demand caused by slowing economies and warm weather which resulted in higher gas storage levels. Lower natural gas prices have continued during the second quarter of 2009.

## ***Oil and Gas Production, Pricing and Revenue***

	Three months ended March 31, 2009	Three months ended March 31, 2008
Daily production / sales volumes <sup>(1)</sup>		
Oil (bbl/d)	4,423	8,710
Natural gas (mcf/d)	6,527	10,757
Combined (boe/d)	5,510	10,503
Product pricing (\$)		
Crude oil - per bbl	31.99	63.28
Natural gas - per mcf	5.08	7.79
Combined - per boe	31.77	60.50
Revenue (\$000s)		
Oil and gas revenue – gross	15,755	57,830
Royalties	(2,874)	(13,931)
Oil and gas revenue – net	12,881	43,899

*(1) gas production converted at 6:1*

Oil and gas revenues decreased 73% in the first quarter 2009 to \$15.8 million compared with \$57.8 million in 2008. The decrease is attributable to:

- a) a 49% decrease in oil production
- b) a 49% decrease in the average oil price
- c) a 39% decrease in natural gas production
- d) a 35% decrease in the average gas price

Overall, production, on a boe basis, decreased 48% to 5,510 boe/d in the first quarter 2009 compared with 10,503 boe/d in the same period 2008. 2009 production was impacted by the sale of oil and gas properties in May 2008. The properties that were sold were producing approximately 3,200 boe per day at the time of sale. The remaining decrease is due to natural decline during 2008 and the shutting in of some wells in 2009 due to lower prices. Until commodity prices improve, the Company will limit its capital expenditures, including maintenance capital. As a result, production for the remainder of 2009 will likely decrease from first quarter levels. With minimal maintenance capital, the Company anticipates that production will average between 4,500 and 5,000 boe per day for the remainder of the year.

During the first quarter of 2009, Pearl's average realized oil price was 60% of the WTI reference price, compared to 64% for the corresponding period in the previous year.

The Company did not enter into any hedging arrangements in the first quarter, and, at the present time, does not anticipate hedging any of its production in 2009.

### ***Royalties***

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Royalties	2,874	13,931
as a percentage of revenue	18%	24%

Royalties have decreased significantly from \$13.9 million in the first quarter 2008 to \$2.9 million in 2009. The decrease is consistent with the lower revenues and production during the current period. Royalty rates are generally dependent on well productivity and commodity prices. The decreased royalty rates in the first quarter reflect the significantly lower oil prices during the first three months of 2009. Effective January 1, 2009, the New Royalty Framework adopted by the Alberta government was implemented. The new royalty formulas would result in sliding scale royalties of up to 50%. The new royalty structure did not have a significant impact on our operations this quarter due to dramatically lower commodity prices, which kept royalty rates low.

### ***Production Costs***

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Production costs	10,165	18,884
Per boe (\$)	20.50	19.76

The decrease in production costs from the first quarter of 2008 reflects the lower production levels in 2009.

Production costs on a per BOE basis averaged \$20.50 for the current quarter which is an increase over the corresponding three month period average of \$19.76 in 2008. The increase in per unit operating costs for the period is principally due to a number of wells producing for partial months. A number of wells were shut-in for economic reasons and other wells were shut-in requiring maintenance. Fixed costs continue on these wells even though they are not on production.

### ***Transportation Costs***

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Transportation costs	1,304	1,197
Per boe (\$)	2.63	1.25

Transportation costs are incurred to move marketable crude oil and natural gas to their selling points. Average transportation costs in the first quarter 2009 were \$2.63 per BOE which is a \$1.38 per boe increase over 2008. The increase is a result of one time adjustments being processed pertaining to prior months that were settled in the first quarter of 2009.

### ***Operating Netback***

	Three months ended March 31, 2009	Three months ended March 31, 2008
Revenues	\$31.77	\$60.50
Royalties	(5.80)	(14.58)
Transportation costs	(2.63)	(1.25)
Operating costs	(20.50)	(19.76)
Netback per boe (\$)	2.84	24.91

The 2008 netback of \$2.84 per boe has decreased significantly from the \$24.91 per boe reported in the same quarter of 2008. This decrease is consistent with the significant decrease in oil revenue due to low market prices for oil in the first quarter 2009.

### **General and Administrative Expenses (“G&A”)**

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
General and administrative expenses	2,885	3,027
Per boe (\$)	5.82	3.17

General and administrative costs of \$2.9 million in the first quarter of 2009 are consistent with the \$3 million in costs in 2008. The first quarter 2009 expenses include approximately \$0.4 million in severance costs. As a result of these staff reductions and other cost reduction measures we anticipate lower general and administrative costs in future quarters.

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

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Depletion, depreciation and accretion	22,104	25,043
Per boe (\$)	44.57	26.20

DD&A expense was \$22.1 million or \$44.57 per boe for the current year in comparison to \$25.0 million or \$26.20 per boe for the prior three month period. The higher rate in 2009 is a result of a reduction in proved reserves as detailed in the Company’s 2008 reserve report. Due to the reduction in reserves, the Company anticipates that the depletion rate per boe will remain high for the remainder of 2009. If oil prices remain low, the Company may potentially be required to take a “ceiling test” write-down in future periods.

### **Stock-Based Compensation**

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Stock-based compensation (recovery)	(13)	901

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 options pricing model. For the first quarter 2009, the Company issued 2.1 million options at \$0.63 per option.

The expense recovery in the first quarter 2009 is a result of a large number of options being forfeited by former employees during the period. Any previous expense recorded that related to vesting options would be reversed in the current period. During the three month period, the value of forfeited options exceeded the value of those vesting.

### **Interest Expense**

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Interest expense	20	339
Per boe (\$)	0.04	0.35

The reduction in interest expense is a result of the Company repaying its bank debt in full with funding provided from asset dispositions in the second quarter of 2008. The \$0.02 million of interest expense in 2009 relates to standby fees on the Company's credit facility and a small amount of interest on taxes.

## Income Taxes

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Future income tax (recovery)	(2,752)	(2,249)
Income taxes (recovery)	202	699
	(2,550)	(1,550)

The provision for future income taxes in the first quarter 2009 is a recovery of \$2.8 million compared to a recovery of \$2.2 million in 2008. Net losses in both periods triggered the recovery. As a percentage of net losses, the recovery in 2009 is less than in 2008. This is due to an increase in the valuation allowance taken on the Company's tax assets during 2009. In 2009, the Company has a current tax expense of \$0.2 million for Saskatchewan capital tax and resource surcharge compared with \$0.7 million recorded in 2008. The decrease in tax is consistent with the decrease in oil prices in 2009.

## LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2009, the Company had \$47.0 million of remaining credit capacity available under its \$37.0 million extendible term credit facility and \$10.0 million demand revolving credit facility. The amount available under the credit facility is based on the value of oil and gas reserves. The Company's credit facility is scheduled for review on May 31, 2009. Based on discussions with the bank, we were provided with an indicative proposal to renew the existing credit facilities with a borrowing base of \$45 million. However, consistent with credit markets around the world, the cost of obtaining credit has increased. With the Company's recent equity placement, the Company does not believe it will require a \$45 million facility and, as a result, to reduce standby fees and other charges, the Company is considering reducing its credit facility to \$25 million.

In addition, at March 31, 2009, the Company had a working capital surplus of \$8.6 million compared to a working capital surplus of \$6.5 million at December 31, 2008. Subsequent to March 31, 2009, the Company entered into an agreement to issue 52,334,000 common shares for net proceeds of approximately \$43.9 million. These funds will initially be used for working capital purposes, but will ultimately be used to fund our capital expenditure programs.

Funds used for operations were (\$1.8) million for the period ended March 31, 2009 compared to funds from operations of \$19.5 million for the prior three month period. The decrease is a direct result of lower commodity pricing in 2009. Our objective in a low price environment is to remain cash flow neutral. We have addressed the negative cash flow in the first quarter by implementing several cost reduction strategies, including a significant reduction in staff levels. Based on current production levels we have estimated that our cash flow from operations break-even point is in range of US\$40-45 (WTI) per barrel.

During the first quarter of 2009, the Company issued 20,100,000 shares at a price of \$0.60 per share as consideration for the acquisition of BlackCore Resources Inc. and to complete a property acquisition in the Blackrod area.

The Company remains dedicated to a capital budget philosophy which is to fund capital budgets based on available cash flow from operations, non-core asset sales, equity financings, and to limit the timing of our capital expenditures to minimize the amount of debt used. Our original capital budget for 2009 was

approximately \$8 million. This budget reflected the difficult commodity price environment, as well as the Company's desire to maintain financial flexibility given the limited availability for additional capital. As a result of the Company's recent equity financing, this budget will be expanded but the Company has not finalized its plans for this capital. However, the Company's intention is to continue development of its core areas of Onion Lake, Mooney and Blackrod as well as selectively work on new exploration opportunities.

## CAPITAL EXPENDITURES

Pearl's capital program is focused on heavy oil opportunities. For the first quarter ended 2009, Pearl incurred \$3.1 million in capital expenditures, a significant decrease from the \$17.5 million spent in the first quarter of 2008. First quarter 2009 costs included facility costs and the drilling of one well in the Mooney area.

\$000s, except where noted	Three months ended March 31, 2009	Three months ended March 31, 2008
Land	308	392
Seismic	-	358
Drilling and completion	1,474	4,859
Equipment	1,352	12,420
Other	-	122
Total exploration and development	3,134	18,151
Property acquisitions	13	146
Total capital expenditures	3,147	18,297
Property dispositions	-	(785)
Net capital expenditures	3,147	17,512

## SEGMENTED INFORMATION

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

\$000s	Three Months Ended March 31, 2009		
	Canada	USA	Consolidated
Total revenues, net of royalties	\$ 12,802	\$ 144	\$ 12,946
Net loss	(19,227)	(1,289)	(20,516)
Segment assets	440,272	10,564	450,836
Capital additions	\$ 1,659	\$ 1,488	\$ 3,147

\$000s	Three Months Ended March 31, 2008		
	Canada	USA	Consolidated
Total revenues, net of royalties	\$ 43,636	\$ 379	\$ 44,015
Net income (loss)	(3,937)	147	(3,790)
Segment assets	529,679	54,558	584,237
Capital additions	\$ 13,395	\$ 4,117	\$ 17,512

## SELECTED QUARTERLY INFORMATION

	31-Mar	31-Dec	30-Sep	30-Jun	31-Mar	31-Dec	30-Sep	30-Jun
\$000s, except where noted	2009	2008	2008	2008	2008	2007	2007	2007
Production (boe/d)	5,510	6,198	5,776	8,246	10,503	9,507	9,093	7,910
Revenue per boe(\$)	31.77	36.28	85.02	79.74	60.50	40.30	39.17	41.40
Oil & gas revenue	15,755	20,687	45,180	59,839	57,830	35,250	32,786	29,801
Production costs	10,165	10,299	9,272	11,453	18,883	14,835	12,245	10,949
Net earnings (loss) (1)	(20,516)	(83,686)	1,926	6,688	(3,790)	(183,407)	(13,683)	(7,225)
Per share, basic and diluted	(0.10)	(0.44)	0.01	0.04	(0.02)	(1.04)	(0.09)	(0.05)
Cash flow from operations	(1,804)	3,623	21,021	28,023	19,452	9,609	6,268	973
Per share, basic and diluted	(0.01)	0.02	0.11	0.15	0.10	0.05	0.04	0.01
Total assets	450,836	472,143	554,956	543,123	584,237	575,865	654,543	620,792
Weighted average shares outstanding (000s)	207,555	189,242	189,242	189,242	189,242	181,212	145,616	133,935

(1) The loss in the first quarter 2009 is a result of low commodity prices and high depletion costs.

## CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The Company has a number of financial obligations in the ordinary course of business. The following table summarizes the outstanding contractual obligations and commitments of the Company as at March 31, 2009:

\$000s	2009	2010	2011	2012	2013	Thereafter
Long-term debt	-	-	-	-	-	-
Operating leases <sup>(1)</sup>	1,093	1,457	1,525	1,593	1,593	4,474
Drilling rig commitment <sup>(2)</sup>	319	616	935	1,211	319	-
	1,412	2,073	2,460	2,804	1,912	4,474

(1) Relates to a lease for office premises, including estimated operating costs.

(2) Relates to a commitment to utilize a drilling rig for a minimum number of days per year.

These obligations are expected to be funded through operating cash flow.

The Company also has ongoing obligations related to the abandonment and reclamation of well sites and facilities which have reached the end of their economic lives. Programs to abandon and reclaim them are undertaken regularly in accordance with applicable legislative requirements.

## FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The following table outlines the classification, carrying value and fair value of the Company's financial instruments. All of these instruments are used in the normal course of business. The Company has not entered into any derivative financial instruments or any other hedging activities.

\$000s	Classification		As at March 31, 2009		As at December 31, 2008	
			Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	Held for Trading	(i)	\$13,471	\$13,471	\$24,059	\$24,059
Accounts receivable	Loans and receivable	(i)	9,664	9,664	9,536	9,536
Investment in MAV Notes	Held for Trading	(ii)	1,288	1,288	1,288	1,288
Other investments	Available for sale	(iii)	-	-	7,768	7,768
Accounts payable and accrued liabilities	Other Financial liabilities	(iv)	(16,654)	(16,654)	(34,409)	(34,409)

The fair values of financial assets and financial liabilities are calculated on the basis of information available at the balance sheet date using the following methods:

- (i) The fair value of cash and cash equivalents and accounts receivable approximates their carrying amounts due to the short-term nature of the instruments.
- (ii) The fair value of the Company's investment in MAV Notes is determined by a probability-weighted discounted cash flows considering the best available public information regarding market conditions and other factors (maturity dates, interest rates etc) that a market participant would consider for such investments.
- (iii) Investment in shares of a private company are valued at fair market value based on some comparable transactions involving the issuance of additional shares of the private company.
- (iv) The fair value of accounts payable and accrued liabilities approximates their carrying amounts due to the short-term nature of the instruments.

The risks associated with these financial instruments include price risk, foreign currency exchange risk, credit risk, interest rate risk and liquidity risk which are more fully discussed in note 13 of the Interim Financial Statements.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

The Company has no off-balance sheet arrangements.

#### **OUTSTANDING SHARE DATA**

As at May 5, 2009, the Company had 209,341,716 common shares outstanding, 10,000,320 warrants outstanding and 11,354,667 stock options outstanding under its stock-based compensation plan and 52,334,000 special warrants which are exercisable into 52,334,000 common shares of the Company.

#### **RELATED PARTY TRANSACTIONS**

Namdo Management Services Ltd. ("Namdo") provides executive and support services to the Company. For the three months ended March 31, 2009, the Company paid Namdo \$45,000 (2008 - \$45,000). Namdo is a private corporation owned by Lukas H. Lundin, a director of the Company.

#### **PROPOSED TRANSACTIONS**

As of the date of this MD&A, the Company does not have any pending transactions.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements requires management to make estimates and assumptions that affect reported assets and liabilities, disclosure of contingencies and revenues and expenses. Management is also required to adopt accounting policies that require the use of significant estimates. Actual results could differ materially from those estimates. A comprehensive discussion of the Company's significant accounting policies is contained in the MD&A and audited consolidated financial statements for the year ended December 31, 2008. There have been no significant changes in critical accounting estimates since December 31, 2008.

## **NEW ACCOUNTING STANDARDS ADOPTED**

January 1, 2009, the Company adopted the new CICA Handbook Sections 3064 "Goodwill and Intangible Assets"; 1582 "Business Combinations"; 1601 "Consolidated Financial Statements" and 1602 "Non-controlling Interests". 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 2 to the Company's first quarter unaudited Consolidated Financial Statements.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

### *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 interim and annual reporting purposes. The required changeover date is for fiscal years beginning on or after January 1, 2011.

The Company has commenced the process to transition from current Canadian GAAP to IFRS. There are three phases in the process: diagnostic, detailed assessment and design and implementation. The Company has completed a high level review of the major differences between current Canadian GAAP and IFRS. During the second quarter of 2009 the Company will commence the detailed assessment and design phase of the project. The detailed assessment and design phase involves establishing work teams to complete a comprehensive analysis of the impact of the IFRS differences identified in the initial diagnostic assessment. In addition, an initial evaluation of IFRS transition exemptions and an analysis of financial systems will be performed.

During the implementation phase, the Company will execute the required changes to business processes, financial systems, accounting policies, disclosure controls and internal controls over financial reporting. At this time, the impact on financial statements is not reasonably determinable.

## **CONTROL CERTIFICATION**

### *Disclosure Controls and Procedures and Internal Controls over Financial Reporting*

Management reported on its disclosure controls and procedures and the design of its internal controls over financial reporting in the year end 2008 MD&A. There has been no material change to the Company's disclosure controls or procedures or to the design of internal controls over financial reporting since that time. It should be noted that the Chief Executive Officer and Chief Financial Officer believe the internal controls, including compensating controls to overcome the lack of certain segregation of duties and the utilization of outside advice to assist with complex taxation, accounting and reporting issues to overcome limited in-house expertise on these matters, are designed appropriately given the nature and size of the Company's operations. Because of their inherent limitations, internal controls over financial reporting may not prevent or detect misstatements, errors or fraud. Control systems, no matter how well conceived or operated, can provide only

reasonable, not absolute assurance that objectives of the control systems are met.

## **OUTLOOK**

Late in 2008 economies worldwide slowed considerably, particularly in the US. This has caused a reduction in demand for oil and gas, resulting in a significant deterioration in commodity prices from levels experienced for most of 2008. The WTI forward strip price for 2009 is presently approximately US\$53 per barrel. As a result of these forecast low prices, the Company has significantly reduced its planned capital spending for 2009. However, in light of equity financing in April, the Company will expand its capital expenditure program going forward in order to advance development of projects in our core areas. Some of these projects, such as EOR at Mooney and development of a thermal pilot at Blackrod will require extensive regulatory approval and have a relatively long lead time before we will see a response in terms of increase production and reserves.

The low price environment has resulted in the Company selectively shutting-in some of its high cost production that is not profitable at these price levels. This will likely continue into the second quarter. In addition, Pearl will likely see a further drop in daily oil production throughout Q2 2009 as maintenance capital is deferred until prices improve. Heavy oil production tends to have higher costs to produce than light oil and, therefore, low prices have a more dramatic effect on a heavy oil producer. We believe it is prudent to remain fiscally conservative during these challenging times and plan to focus spending on promising projects that have yet to be developed. This will help ensure the Company better positions itself to maximize profits upon the recovery of oil prices. In addition to capital spending restrictions, we have also implemented several cost reduction initiatives in the field and in head office to maintain our cash and working capital.

The equity and credit markets are expected to continue to remain tight in 2009. As a result of the recent equity financing, we have no specific plans to access additional capital in 2009; however, this will be reviewed internally on a regular basis. Pearl currently has not used its \$47 million bank credit facility.

In summary, the remainder of 2009 will continue to be a challenging year; however, we believe that we have a good suite of assets and our strong balance sheet will help us weather the current low price environment.

### **Forward-Looking Statements**

This MD&A contains certain forward-looking statements and forward looking information (collectively referred to as "forward-looking statements"). All statements other than statements of historic fact are forward-looking statements. Forward-looking statements are typically identified by such words as "seek", "anticipate", "plan", "continue", "estimate", "expect", "may", "will", "project", "potential", "targeting", "intend", "could", "might", "should", "believe" or similar words suggesting future events or future performance. In addition, statements relating to "reserves" or "resources" are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions, that the reserves and resources described exist in the quantities predicted or estimated and can be profitably produced in the future. In particular, this document contains forward-looking statements pertaining to, without limitation, the following:

- Future crude oil and natural gas prices
- The timing and amount of future oil and gas production
- Expected operating costs, general and administrative and other costs
- Impact of new government legislation regarding royalties
- Use of funds from Pearl's recent equity offering
- Expectations regarding the ability to raise capital to fund the Company's capital program
- Renewal of the Company's credit facilities in May 2009
- Future earnings

- Future drilling plans and capital expenditure programs
- The Company's business plans and strategies
- Supply and demand for oil and natural gas
- The Company's ability to add reserves through acquisitions, exploration and development
- The impact of federal and provincial governmental regulation

The forward-looking statements are subject to known and unknown risks and uncertainties and other factors which may cause actual results to differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this MD&A which include but are not limited to:

- operational risk of finding and producing reserves economically;
- uncertainties associated with estimating the quantity of reserves;
- changes in global economic conditions; particularly in Canada and the US
- competition for, among other things, capital, undeveloped land, skilled labor and equipment
- risk of fluctuating oil and natural gas prices;
- risk of changes to interest rates;
- risk of fluctuating foreign currency exchange rates;
- credit or counterparty risk with respect to non-performance by counterparties to financial instruments;
- marketing reserves at acceptable prices;
- cost of capital risk associated with securing the needed capital to carry out the Company's operations;
- uncertainty associated with obtaining drilling licenses and other regulatory consents and approvals;
- production risks associated with sour hydrocarbons;
- risk of changes in governmental policies, especially related to royalty legislation, income tax laws, incentive programs, operating practices and environmental protection, social instability or other political, economic or diplomatic developments in its operations; and
- environmental and safety risks related to its oil and gas properties.
- Ability, expertise, judgment and financial capability of joint interest partners

Many of the previously mentioned risks are beyond the Company's control, and it is impossible to ensure that any exploration drilling program or piloting program will ultimately 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;
- Maintaining a healthy balance sheet that minimizes the use of debt;
- Carrying insurance to provide reasonable amount of protection from risk of loss;
- Communicating openly with members of the public regarding its activities;
- Concentrating in areas with long life reserves to reduce the risk associated with commodity price cycles;
- Monitoring price trends and establishing relationships with credit worthy counterparties;
- 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.

Undue reliance should not be placed on forward-looking statements, which are inherently uncertain, are based on estimates and assumptions, and are subject to known and unknown risks and uncertainties (both general and specific) that contribute to the possibility that the future events or circumstances contemplated by the

forward-looking statements will not occur. There can be no assurance that the plans, intentions or expectations upon which forward-looking statements are based will in fact be realized. Actual results will differ, and the difference may be material and adverse to the Corporation and its shareholders.

Readers are also cautioned that the foregoing list of factors is not exhaustive.

## PEARL EXPLORATION AND PRODUCTION LTD.

### Consolidated Balance Sheets

(unaudited)

(Cdn\$ in thousands)

March 31, 2009

December 31, 2008

#### Assets

##### Current assets

Cash	\$	13,471	\$	24,059
Accounts receivable		9,664		9,536
Income taxes and capital taxes receivable		607		5,607
Prepaid expenses and deposits		1,482		1,658
		25,224		40,860

Investments (note 5)

1,851

9,619

Petroleum and natural gas properties (note 6)

423,761

421,664

\$	450,836	\$	472,143
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#### Liabilities

##### Current liabilities

Accounts payable and accrued liabilities	\$	16,654	\$	34,409
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Future income tax

3,560

4,036

Asset retirement obligation (note 8)

23,257

20,064

43,471		58,510
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#### Shareholders' equity

Share capital (note 10)	735,182		723,122
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Contributed surplus (note 10)	14,081		11,895
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Deficit	(341,898)		(321,382)
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407,365		413,635
\$ 450,836	\$	472,143

Commitments and contingencies (note 11)

*See accompanying notes to consolidated financial statements*

## PEARL EXPLORATION AND PRODUCTION LTD.

### Consolidated Statement of Operations, Comprehensive Loss and Deficit

(unaudited)

(Cdn\$ in thousands, except for per share amounts)

	Three months ended March 31	
	2009	2008
<b>Revenue</b>		
Oil and gas sales	\$ 15,755	\$ 57,830
Interest income	65	116
Royalties	(2,874)	(13,931)
	12,946	44,015
<b>Expenses</b>		
Production	10,165	18,884
Transportation	1,304	1,197
General and administrative	2,885	3,027
Depletion, depreciation and accretion	22,104	25,043
Stock-based compensation (recovery)	(13)	901
Interest	20	339
Foreign currency exchange gain	(453)	(36)
	36,012	49,355
Loss before income taxes	(23,066)	(5,340)
<b>Income taxes</b>		
Future income tax (recovery)	(2,752)	(2,249)
Income taxes and capital taxes expense	202	699
	(2,550)	(1,550)
<b>Loss and comprehensive loss for the period</b>	(20,516)	(3,790)
<b>Deficit, beginning of period</b>	(321,382)	(242,520)
<b>Deficit, end of period</b>	\$ (341,898)	\$ (246,310)
Basic and diluted loss per share	\$ (0.10)	\$ (0.02)
Weighted average number of common shares used in computing loss per share:		
basic and diluted	207,555,049	189,241,716

See accompanying notes to consolidated financial statements

## PEARL EXPLORATION AND PRODUCTION LTD.

### Consolidated Statements of Cash Flows

(unaudited)

(Cdn\$ in thousands, except for per share amounts)

	Three months ended March 31	
	2009	2008
<b>Operating activities</b>		
Net Loss	\$ (20,516)	\$ (3,790)
Items not involving cash:		
Depletion, depreciation and accretion	22,104	25,043
Stock-based compensation (recovery)	(13)	901
Future income tax (recovery)	(2,752)	(2,249)
Foreign exchange gain	(453)	(36)
Abandonment costs	(174)	(417)
	(1,804)	19,452
Changes in non-cash working capital balances related to operations	(26,030)	(13,725)
	(27,834)	5,727
<b>Financing activities</b>		
Advances of bank loan	-	25,000
	-	25,000
<b>Investing activities</b>		
Additions to petroleum and natural gas properties	(3,147)	(17,512)
Cash received on acquisition of BlackCore Resources Inc.	5,589	-
Changes in non-cash working capital from investing	14,804	(18,521)
	17,246	(36,033)
<b>Net increase (decrease) in cash</b>	<b>(10,588)</b>	<b>(5,306)</b>
<b>Cash, beginning of period</b>	<b>24,059</b>	<b>4,799</b>
<b>Cash, end of period</b>	<b>\$ 13,471</b>	<b>\$ (507)</b>
Supplementary Information		
Cash interest paid	\$ 9	\$ 339
Cash capital taxes paid	\$ 5	\$ 358

*See accompanying notes to consolidated financial statements*

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

(tabular amounts in thousands of Cdn\$, except as noted)

## **1. NATURE OF OPERATIONS**

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

These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”), and follow the same accounting policies as the financial statements for the year ended December, 31 2008, except as noted in note 2 below. These notes do not include all disclosures required in annual financial statements and are incremental to, and should be read in conjunction with the audited financial statements for the year ended December 31, 2008.

## **2. CHANGES IN ACCOUNTING POLICIES**

On January 1, 2009, the Company adopted the following CICA Handbook Sections:

- Section 3064 “Goodwill and Intangible Assets,” which replaces Section 3062 “Goodwill and other Intangible Assets.” The new standard revises the requirement for recognition, measurement, presentation and disclosure of intangible assets.
- Section 1582 “Business Combinations”, which replaces Section 1581 “Business Combinations”. The new standard establishes principles and requirements of the acquisition method for business combinations and related disclosures.
- Section 1601 “Consolidated Financial Statements” and Section 1602 “Non-controlling Interests”, both of which replace Section 1600 “Consolidated Financial Statements”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination.

## **3. RECENT ACCOUNTING PRONOUNCEMENTS**

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 a plan for the conversion.

## **4. ACQUISITIONS**

*BlackCore Acquisition* - On January 8, 2009, the Company acquired all of the issued and outstanding shares of BlackCore Resources Inc. in exchange for 17,600,000 common shares of the Company, as well as 5,000,160 Class A and 5,000,160 Class B share purchase warrants. The Class A & B warrants will allow the holder to acquire one Pearl share for a price of \$0.60 when the Pearl share price reaches a volume weighted average price for 30 consecutive days of \$1.50 and \$2.00, respectively. The warrant price was calculated by using the weighted average share price for the five days before and after the date the agreement was entered into.

The consideration, including transaction costs, for the BlackCore acquisition totaled \$12.9 million. The allocation of the purchase price is as follows:

<b>Net assets acquired</b>	
Petroleum and natural gas properties	\$12,691
Working capital	5,468
Asset retirement obligation	(3,023)
Future income tax	(2,274)
<b>Total net assets acquired</b>	<b>\$12,862</b>
<b>Consideration</b>	
Shares	10,560
Warrants	2,200
Acquisition costs	102
<b>Total purchase price</b>	<b>\$12,862</b>

## 5. INVESTMENTS

	March 31, 2009	December 31, 2008
Investment in Serrano Energy Ltd. ("Serrano")	\$ -	\$7,768
MAV Notes (formerly Asset-backed commercial paper)	1,288	1,288
Investment in Tyner Resources Ltd. ("Tyner")	563	563
	<u>\$1,851</u>	<u>\$9,619</u>

- (a) On January 28, 2009, the Company closed an agreement with Serrano Energy Ltd. ("Serrano") to exchange the Company's equity interest in Serrano for a 15% increased interest in the Blackrod area lands and a carried work commitment of \$5 million. The Company was also appointed the operator of the Blackrod project.
- (b) The Company acquired an interest in third party asset-backed commercial paper ("ABCP") with a face value of \$5 million on October 19, 2007 as part of a corporate acquisition. As a result of liquidity issues in the ABCP market, these investments did not settle on maturity. On January 21, 2009, a restructuring plan was implemented which resulted in the Company receiving longer-term replacement notes for its investment in short-term ABCP.

The Company received the following replacement notes:

Notes	Maturity Date (1)	Interest Rate (2)	Face Amount
MAV II Class A-1	July 15, 2056	BA - 0.5%	\$1,537
MAV II Class A-2	July 15, 2056	BA - 0.5%	2,804
MAV II Class B	July 15, 2056	BA - 0.5%	509
MAV II Class C	July 15, 2056	BA +20%	150
			<u>\$5,000</u>

1) Maturity date reflects legal maturity date. The latest maturity date of the underlying assets is December 31, 2016.

2) BA represents Bankers Acceptance interest rates with a maturity of 90 days.

The replacement notes have been classified as held-for-trading which will require them to be measured at fair value at each period end with changes in fair value included in the consolidated statement of operations in the period in which they arise. Currently there is not an active market for the replacement notes. Until a market develops for these notes, the fair value will be determined using a probability weighted discounted cash flow considering the best available public information regarding market conditions and other factors that a market participant would consider for such investments. As at March 31, 2009 and December 31, 2008, the Company has estimated the fair value of the notes at \$1,288,000.

No gain or loss was recorded on the exchange of ABCP for the replacement notes.

- (c) On December 30, 2008 the Company sold all of its interests in certain lands, wells, pipelines and other associated equipment located in the Palo Duro Basin area of Texas. In exchange, Pearl received 18,756,414 common shares of Tyner Resources Ltd. These shares are valued at a price of \$0.03. The share price was calculated by using the weighted average share price for the five days before and after the transaction date. This investment represents 26.4% of the outstanding shares of Tyner and is subject to equity accounting as significant influence exists.

## 6. PETROLEUM AND NATURAL GAS PROPERTIES

	<b>March 31, 2009</b>		
	<b>Cost</b>	<b>Accumulated depreciation and depletion</b>	<b>Net book value</b>
Petroleum and natural gas properties	\$622,798	\$201,141	\$421,657
Office equipment	2,953	849	2,104
	<u>\$625,751</u>	<u>\$201,990</u>	<u>\$423,761</u>
	<b>December 31, 2008</b>		
	<b>Cost</b>	<b>Accumulated depreciation and depletion</b>	<b>Net book value</b>
Petroleum and natural gas properties	\$600,297	\$180,581	\$419,716
Office equipment	2,739	791	1,948
	<u>\$603,036</u>	<u>\$181,372</u>	<u>\$421,664</u>

The depletion and ceiling test calculations have excluded the cost of unproved properties of \$38.9 million (December 31, 2008 – \$31.1 million) and included future development costs of \$34.6 million (December 31, 2008 – \$34.7 million).

The Company performed the ceiling test calculations at March 31, 2009 to assess whether the carrying value of the petroleum and natural gas properties were recoverable. A writedown in the amount of \$1.1 million of the US assets has been included in depletion, depreciation and accretion in the Company's March 31, 2009 financial statements.

## 7. BANK CREDIT FACILITY

The Company has a credit facility with a Canadian chartered bank which is comprised of a \$37 million revolving 364-day extendible term facility, and a \$10 million demand revolving operating facility. The Company may borrow, repay and re-borrow advances with the aggregated outstanding not to exceed the total credit facility. The facility bears interest at the bank prime rate, banker's acceptance or LIBOR loan rates plus applicable margins and is secured by a general securities agreement. At March 31, 2009, there were no advances outstanding under this facility.

The facility is subject to annual reviews. The next scheduled review will take place on May 31, 2009.

## 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 \$37.1 million which will be incurred over the next 28 years with the majority of costs incurred between 2010 and 2024.

A credit adjusted risk-free rate of 6.5 percent and an inflation factor of 2 percent was used to calculate the fair value of the asset retirement obligation.

Changes to the asset retirement obligation were as follows:

	<u>2009</u>	<u>2008</u>
<b>Asset retirement obligation at beginning of period</b>	<b>\$ 20,064</b>	<b>\$ 16,586</b>
Liabilities acquired through acquisitions, net of dispositions	<b>3,023</b>	(6,464)
Liabilities incurred during the period	-	896
Adjustment for change in reserve life, abandonment costs, inflation and discount rates	-	8,545
Actual remediation costs	<b>(174)</b>	(668)
Accretion	<b>344</b>	1,169
<b>Asset retirement obligation at end of period</b>	<b>\$ 23,257</b>	<b>\$ 20,064</b>

## 9. RELATED PARTY TRANSACTIONS

During the three months ended March 31, 2009 the Company entered into the following transactions with related parties in the normal course of business, which are recorded at the exchange amount established and agreed to by the related parties:

The Company paid \$45,000 (2008 – \$45,000) 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:

	<b>Number of Shares</b>	<b>Attributed Value</b>
Balance as at December 31, 2008 and December 31, 2007	189,241,716	\$723,122
Shares issued for BlackCore acquisition (note 4)	17,600,000	10,560
Shares issued for property acquisitions	2,500,000	1,500
Balance as at March 31, 2009	209,341,716	\$735,182

**(c) Warrants Outstanding:**

	Number of warrants	Weighted average exercise price per share
Outstanding at December 31, 2008	0	\$ 0.00
Issued Class A on BlackCore Acquisition (note 4)	5,000,160	0.60
Issued Class B on BlackCore Acquisition (note 4)	5,000,160	0.60
Outstanding at March 31, 2009	10,000,320	\$ 0.60

Each warrant allows the holder to acquire, on or before January 13, 2013, one Pearl share for a price of \$0.60 when the Company's share price reaches a volume weighted average price for 30 consecutive days of \$1.50 (Class A warrants) and \$2.00 (Class B warrants).

**(d) Stock Options Outstanding**

The Company has a stock option plan (the "Plan") available to directors, officers, consultants and employees of the Company and its subsidiaries. Under the Plan, the number of common shares to be reserved and authorized for issuance pursuant to options granted under the Plan cannot exceed ten percent of the total number of issued and outstanding shares in the Company. All issued stock options have terms of two to five years, vest over periods of up to three years and both the term and the vesting period are determined at the discretion of the board of directors. The stock options are exercisable at the market prices of the shares on the dates that the options were granted.

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

	Number of Options	Weighted Average Exercise Price (\$)
Outstanding at December 31, 2008	11,138,436	2.16
Granted	2,110,500	0.63
Forfeit	(1,249,667)	\$3.00
Balance, end of the period	11,999,269	\$1.81

The following stock options were outstanding at March 31, 2009:

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)
0.40 – 1.50	7,140,500	0.69	4.78	1,194,509	0.69	4.84
1.51 – 3.00	2,326,166	2.23	3.95	593,333	2.53	3.73
3.01 – 4.50	1,113,603	3.88	2.45	750,936	4.03	1.96
4.51 – 5.28	1,419,000	5.11	2.78	1,086,000	5.12	2.76
	11,999,269	1.81	4.16	3,624,778	3.01	3.44

### (e) Stock Based Compensation

Stock based compensation recoveries of \$13,000, net of expenditures of \$586,000, has been recorded in the Consolidated Statements of Operations and Deficit for the quarter ended March 31, 2009 (2008 – expense of \$901,000). 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 2009 and the assumptions used in their determination are noted below:

	<b>Three Months Ended March 31, 2009</b>	<b>Year Ended December 31, 2008</b>
Weighted average fair value of stock options granted (per option)	\$0.32	\$0.73
Expected life of stock options (years)	2.00	5.00
Volatility (weighted average)	94%	117%
Risk free rate of return (weighted average)	0.97%	1.69%
Expected dividend yield	0%	0%

### (f) Contributed Surplus Continuity

	<b>March 31, 2009</b>	<b>December 31, 2008</b>
Balance, beginning of the period	\$ 11,895	\$ 8,778
Stock-based compensation	586	3,749
Recovery of expense on forfeited stock options	(600)	(633)
Warrants issued on BlackCore acquisition	2,200	-
Balance, end of period	<u>\$ 14,081</u>	<u>\$ 11,895</u>

## 11. COMMITMENTS AND CONTINGENCIES

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.

- (a) The Company has an eight-year operating lease for office space as at March 31, 2009, the payments (net of sublease proceeds) due under this lease agreement (including an estimate for operating costs) are as follows:

	2009	2010	2011	2012	2013	Subsequent to 2013
Office rent	\$1,093	\$1,457	\$1,525	\$1,593	\$1,593	\$4,474

- (b) The Company has contracted drilling rig services over the next four years. In the event that the Company does not utilize the minimum contracted days, the Company would be obligated to pay the rig operator a variable rate based on days not utilized under the contracts. As at March 31, 2009, the payments that would be due under the agreement (assuming no drilling days used) are as follows:

	2009	2010	2011	2012	2012	Subsequent to 2013
Drilling Contract	\$319	\$616	\$935	\$1,211	\$319	Nil

- (c) In connection with the November, 2007 property acquisition from PetroHunter, the Company may be required to pay a performance payment of US \$9.8 million in cash at such time prior to November 6, 2010 if either: (i) production from the assets reaches 5,000 barrels of oil per day; or (ii) proven reserves from the assets is greater than 50 million barrels of oil. As at March 31, 2009, there was no production from and no reserves attributable to these assets.

## 12. SEVERANCE BENEFITS

During the first quarter 2009, the Company realized a number of staff terminations. As a result, the Company has included severance benefits in the aggregate amount of \$431,000 in general and administrative costs in the Company's financial statements. All severance benefits have been paid as at March 31, 2009.

## 13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company is exposed to financial and market risk in a range of financial instruments including cash, accounts receivable, certain investments and accounts payable. The Company manages its risk through its policies and processes, but the Company generally has not used derivative financial instruments to manage these risks.

### (a) Fair value of financial instruments

The following tables set out the Company's classification carrying amount and fair values of its financial assets and liabilities as at March 31, 2009 and December 31, 2008:

	Classification	2009		2008	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	Held-for-trading (i)	\$13,471	\$13,471	\$24,059	\$24,059
Accounts receivable	Loans and receivables (i)	9,664	9,664	9,536	9,536
Investment in MAV Notes	Held-for-trading (ii)	1,288	1,288	1,288	1,288
Other investments	Available-for-sale (iii)	-	-	7,768	7,768
Accounts payable and accrued liabilities	Other financial liabilities (iv)	(16,654)	(16,654)	(34,409)	(34,409)

The fair values of financial assets and financial liabilities are calculated on the basis of information available at the balance sheet date using the following methods:

- (v) The fair value of cash and cash equivalents and accounts receivable approximates their carrying amounts due to the short-term nature of the instruments.
- (vi) The fair value of the Company's investment in MAV Notes is determined by a 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.

- (vii) Investment in shares of a private company are valued at fair market value based on some comparable transactions involving the issuance of additional shares of the private company.
- (viii) The fair value of accounts payable and accrued liabilities approximates their carrying amounts due to the short-term nature of the instruments.

**(b) Commodity price risk**

Commodity price risk is the risk that future cash flows will fluctuate as a result of changes in the price of oil and natural gas. Commodity prices are impacted by world economic events that effect supply and demand, which are generally beyond the Company's control. Changes in crude oil and natural gas prices may significantly affect the Company's results of operations, costs generated from operating activities, capital spending and the Company's ability to meet its obligations. The majority of the Company's production is sold under short-term contracts, consequently Pearl is at risk to near term price movements. The Company manages this risk by constantly monitoring commodity prices and factoring them into operational decisions, such as contracting or expanding its capital expenditures program. At this time, the Company does not use derivative financial instruments to manage its exposure to this risk.

**(c) 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) prices received for its crude oil and natural gas are primarily determined in reference to US dollars; (ii) certain expenditure commitments, deposits, accounts receivable, and accounts payable which are denominated in US dollars, and (iii) its operations in the United States. The Company manages this risk by monitoring foreign exchange rates and evaluating their effects on using Canadian or US vendors as well as timing of transactions. At this time, the Company has not entered into any fixed rate contracts. As at March 31, 2009, the Company held US\$4,182,000 in cash and short-term deposits.

As at March 31, 2009, if US\$ exchange rates had been \$0.10 lower with all other variables held constant, after tax earnings for the period would have been approximately \$185,000 higher, due to an increased foreign exchange gain. An equal opposite impact would have occurred to net earnings had exchange rates been \$0.10 higher. The Company considers this risk to be limited and does not hedge this risk.

**(d) Credit Risk**

Credit risk is the risk that a third party fails to meet its contractual obligations that could result in the Company incurring a loss.

The Company's accounts receivable are primarily with oil and gas marketers and joint venture partners. Receivables from oil and gas marketers are generally collected on the 25<sup>th</sup> day of the month following production. The Company attempts to mitigate this risk by assessing the financial strength of its counterpart and entering into relationships with larger purchasers with established credit history. During the first quarter of 2009, the Company has not experienced any collection issues with its marketers. At March 31, 2009, over 67% of total accounts receivables are for accrual revenues. Receivables from joint venture partners arise when the Company conducts joint operations on behalf of its partners and invoices them for their share of costs. To mitigate the risk of non-payment from joint venture partners the Company can require partners to pay certain costs in advance as well as the Company has the ability to withhold production from partners in the event of non-payment.

The Company typically does not obtain collateral or security from its joint venture partners or oil and gas marketers. The carrying amounts of accounts receivable represent the maximum credit exposure.

As at March 31, 2009, the Company held \$13.5 million in cash at various major banks throughout Canada and the USA, as well as \$1.3 million in investments. At March 31, 2009, two Canadian chartered banks each held approximately 40% of our cash and short term deposits. Cash balances in excess of the Company's day to day requirements are invested at the bank in short-term deposits of less than 30 days.

**(e) Interest Rate Risk**

Interest rate risk refers to the risk that a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate risk in relation to interest expense on its revolving credit facility. At this time, the Company is not drawn on this facility and, as a result, the Company considers this risk to be limited. In addition, the Company is exposed to interest rate risk on its excess cash balances and certain investments.

**(f) Liquidity Risk**

Liquidity risk is the risk the Company is unable to meet its financial obligations as they come due. The Company uses operating cash flows, bank credit facilities and equity offerings to fund its capital requirements.

The Company manages this risk by maintaining a conservative balance sheet with minimal use of long term debt. As at March 31, 2009, the Company had a \$47 million credit facility with no amounts outstanding, and a positive working capital position of \$8.6 million. The Company believes it has sufficient funding from these sources to meet its foreseeable obligations. The maturity dates for the Company's financial liabilities are as follows:

	<b>&lt;6 Months</b>	<b>6 months -1 Year</b>	<b>1-2 Years</b>
Accounts payable and accrued liabilities	\$16,654	-	-

Subsequent to March 31, 2009 the Company entered into an agreement to issue additional common shares for gross proceeds of \$46 million (See note 15) which will initially be used to augment working capital, but ultimately will be used to fund the Company's capital expenditure programs.

**(g) Capital management**

The Company defines capital as working capital, total debt and equity. The current capital management strategy is designed to minimize the use of long term debt and maintain positive working capital. This strategy should provide the financial flexibility to fund the Company's capital program and profitable growth opportunities. The unutilized \$47 million credit facility capacity provides liquidity to the Company. This structure can be adjusted as a result of changes in economic conditions or risks associated with its oil and gas assets. During 2008, the Company elected to eliminate its existing bank debt from the sale of certain non-strategic assets. In order to maintain or adjust its capital structure, the Company may from time to time issue additional common shares. As a result of the economic global downturn access to its capital markets may be limited. In addition, the Company's credit facilities are based on its petroleum and natural gas reserves whose values are impacted by, among other things, global commodity prices. The Company will adjust its capital spending if access to external capital sources is unavailable. In order to manage the balance in the Company's capital structure, some of the financial tests that Pearl considers is debt to equity ratios, debt to cash flow from operating activities and interest coverage tests.

Financial covenants associated with the Company's credit facility are reviewed regularly and controls are in place to maintain compliance with these covenants. The only financial covenant in the Company's credit facility is to maintain a working capital ratio of 1:1 at the end of each fiscal quarter. Working capital is defined as current assets plus unutilized credit under the credit facilities compared to current liabilities. The

Company was in compliance with these covenants throughout the first quarter of 2009.

#### 14. SEGMENTED INFORMATION

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

	<b>Three Months Ended March 31, 2009</b>		
	<b>Canada</b>	<b>USA</b>	<b>Consolidated</b>
<b>Total revenues, net of royalties</b>	\$ 12,802	\$ 144	\$ 12,946
Expenses	34,952	1,513	36,465
Foreign currency loss (gain)	(373)	(80)	(453)
Net income (loss) before income taxes	(21,777)	(1,289)	(23,066)
Income taxes	(2,550)	-	(2,550)
<b>Net (loss)</b>	<b>(19,227)</b>	<b>(1,289)</b>	<b>(20,516)</b>
<b>Segment assets</b>	<b>440,272</b>	<b>10,564</b>	<b>450,836</b>
<b>Segment petroleum and natural gas properties</b>	<b>420,541</b>	<b>3,220</b>	<b>423,761</b>
<b>Capital additions</b>	<b>\$ 1,659</b>	<b>\$ 1,488</b>	<b>\$ 3,147</b>
	<b>Three Months Ended March 31, 2008</b>		
	<b>Canada</b>	<b>USA</b>	<b>Consolidated</b>
<b>Total revenues, net of royalties</b>	\$ 43,636	\$ 379	\$ 44,015
Expenses	49,136	254	49,390
Foreign currency gain	(4)	(31)	(35)
Income (loss) before income taxes	(5,496)	156	(5,340)
Income taxes (recovery)	(1,559)	9	(1,550)
<b>Net income (loss)</b>	<b>(3,937)</b>	<b>147</b>	<b>(3,790)</b>
<b>Segment assets</b>	<b>529,679</b>	<b>54,558</b>	<b>584,237</b>
<b>Segment petroleum and natural gas properties</b>	<b>471,534</b>	<b>49,801</b>	<b>521,335</b>
<b>Capital additions</b>	<b>\$ 13,395</b>	<b>\$ 4,117</b>	<b>\$ 17,512</b>

#### 15. SUBSEQUENT EVENTS

On April 20, 2009 the Company issued 52,334,000 special warrants of Pearl at a price of \$0.88 per special warrant for aggregate gross proceeds of \$46 million. Each special warrant is convertible into one common share of the Company.

#### 16. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in 2009.

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The report for the quarter ending June 30, 2009 will be published on or before August 14, 2009