

# CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal quarter ended June 30, 2008

Pacific Energy Resources Ltd.

**PACIFIC ENERGY RESOURCES LTD.**

**INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)  
FOR THE PERIOD ENDED JUNE 30, 2008**



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# CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal quarter ended June 30, 2008

Pacific Energy Resources Ltd.

## UNAUDITED INTERIM FINANCIAL STATEMENTS

In accordance with National Instrument 51-102 released by the Canada Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited financial statements for the period ended June 30, 2008.

## NOTICE TO THE READER OF THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

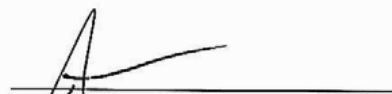
The accompanying financial statements of Pacific Energy Resources Ltd. and the accompanying interim consolidated balance sheet as at June 30, 2008 and the interim consolidated statements of operations, accumulated deficit and other comprehensive loss and cash flows for the six months period ended are the responsibility of the Company's management.

These consolidated financial statements have not been reviewed on behalf of the stockholders by the independent external auditors of the Company, Meyers Norris Penny LLP.

The interim consolidated financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with Canadian generally accepted accounting principles.



Darren Katic  
President

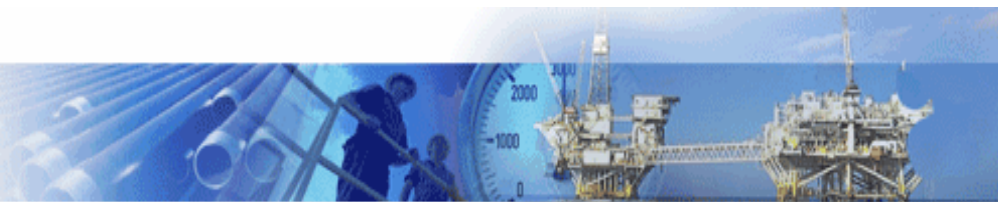


Jerrett Creed  
Chief Financial Officer

Date: August 14, 2008



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# CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal quarter ended June 30, 2008

Pacific Energy Resources Ltd.

## CONSOLIDATED BALANCE SHEETS (STATED IN US DOLLARS AND THOUSANDS)

### ASSETS

	<u>June 30, 2008</u> (Unaudited)	<u>December 31, 2007</u>
<b>CURRENT ASSETS</b>		
Cash	\$ 6,355	\$ 7,245
Restricted cash	129	1,302
Accounts receivable	26,074	13,353
Other receivables	146	1,411
Inventory	6,832	8,556
Assets held for sale	43,576	43,318
Prepays and other current assets	<u>4,699</u>	<u>7,387</u>
	<b>87,811</b>	<b>85,572</b>
<b>LONG-TERM ASSETS</b>		
Performance bonds and deposits	4,168	4,946
Investments - abandonment	98,528	94,483
Equity investment	13,178	13,626
Asset retirement receivable	—	—
Property and equipment	5,647	4,333
Petroleum and natural gas properties	<u>497,945</u>	<u>488,911</u>
	<b>619,466</b>	<b>606,299</b>
	<u><b>\$ 707,277</b></u>	<u><b>\$ 691,871</b></u>



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# CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal quarter ended June 30, 2008

Pacific Energy Resources Ltd.

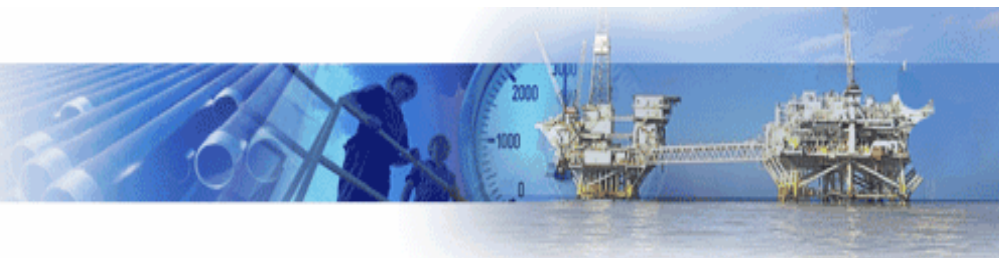
## CONSOLIDATED BALANCE SHEETS (STATED IN US DOLLARS AND THOUSANDS) (Continued)

### LIABILITIES AND SHAREHOLDERS' EQUITY

	<u>June 30,</u> <u>2008</u> (Unaudited)	<u>December 31,</u> <u>2007</u>
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 51,863	\$ 32,808
Accrued interest	14,518	4,148
Due to related parties	76	61
Notes payable, current portion	470,906	430
Derivative liability, current portion	240,498	34,247
Liabilities held for sale	36,433	18,957
Other liabilities	<u>6,574</u>	<u>—</u>
	<b>820,868</b>	<b>90,651</b>
<b>LONG-TERM LIABILITIES</b>		
Notes payable, net of current portion	31,368	433,441
Asset retirement obligation	58,441	56,306
Derivative liability, net of current portion	—	55,251
Other liabilities	<u>69</u>	<u>5,957</u>
	<b>89,878</b>	<b>550,955</b>
Non-controlling interests related to liabilities held for sale	7,755	7,755
Economic dependence		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital	20	19
Subscriptions and subscriptions receipts	—	9,308
Contributed surplus	8,655	5,452
Warrants	24,117	24,117
Additional paid in capital	239,105	207,429
Accumulated other comprehensive loss	( 240,497)	( 82,716)
Deficit	<u>( 242,624)</u>	<u>( 121,099)</u>
	<u>( 211,224)</u>	<u>42,510</u>
	<b>\$ 707,277</b>	<b>\$ 691,871</b>



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# CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal quarter ended June 30, 2008

Pacific Energy Resources Ltd.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(STATED IN US DOLLARS AND THOUSANDS

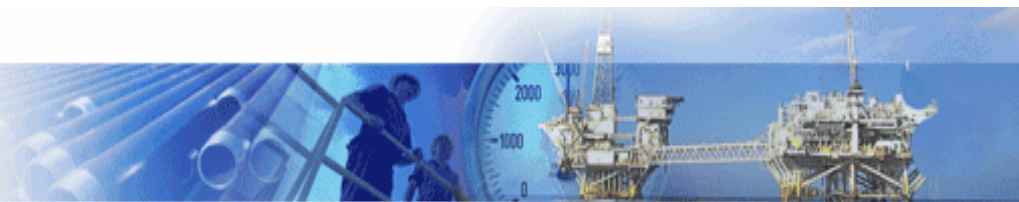
EXCEPT PER SHARE AMOUNTS)

(Unaudited)

	For the Three Months Ended		For the Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
<b>REVENUES</b>				
Oil and gas production revenue	\$ 69,721	\$ 9,660	\$ 122,425	\$ 12,943
Production expenses	( 22,885)	( 6,408)	( 48,972)	( 9,684)
Transportation expense	( 1,098)	( 329)	( 2,170)	( 412)
Royalties	( 15,533)	( 2,595)	( 25,583)	( 3,199)
Realized gain (loss) on derivatives	( 18,095)	—	( 28,581)	—
Interest and dividends	1,452	69	3,656	714
Loss from nonconsolidated subsidiary	( 228)	—	( 448)	—
Other revenue	36	391	56	494
	<u>13,370</u>	<u>788</u>	<u>20,383</u>	<u>856</u>
<b>EXPENSES</b>				
General and administrative	2,703	954	6,854	2,069
Stock compensation expense	1,860	313	3,203	625
Liquidated damages	1,400	—	3,240	—
Interest - cash	17,437	1,547	38,439	4,503
Interest - non-cash	7,106	1,871	19,477	1,872
Accelerated expensing of accretion and amortization of deferred financing costs	—	—	48,398	—
General exploration	769	—	990	—
Depreciation, depletion and amortization	7,001	5,365	13,430	6,739
	<u>38,276</u>	<u>10,050</u>	<u>134,031</u>	<u>15,808</u>
<b>LOSS FROM CONTINUING OPERATIONS</b>				
BEFORE INCOME TAX	( 24,906)	( 9,263)	( 113,648)	( 14,952)
Income tax expense	—	( 10)	—	( 35)
<b>NET LOSS FROM CONTINUING OPERATIONS</b>	<u>( 24,906)</u>	<u>( 9,273)</u>	<u>( 113,648)</u>	<u>( 14,987)</u>
<b>LOSS FROM DISCONTINUED OPERATIONS</b>	<u>( 8,432)</u>	<u>( 3,019)</u>	<u>( 7,877)</u>	<u>( 3,752)</u>
<b>NET LOSS</b>	<u>(\$ 33,338)</u>	<u>(\$ 12,292)</u>	<u>(\$ 121,525)</u>	<u>(\$ 18,739)</u>
Basic and diluted loss per share from continuing operations	(\$ 0.12)	(\$ 0.08)	(\$ 0.56)	(\$ 0.13)
Basic and diluted loss per share from operations held for sale	( 0.04)	( 0.02)	( 0.04)	( 0.03)
Basic and diluted loss per share	<u>(\$ 0.16)</u>	<u>(\$ 0.10)</u>	<u>(\$ 0.60)</u>	<u>(\$ 0.16)</u>



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# CONSOLIDATED FINANCIAL STATEMENTS

for the fiscal quarter ended June 30, 2008

Pacific Energy Resources Ltd.

**CONSOLIDATED STATEMENTS OF ACCUMULATED DEFICIT,  
COMPREHENSIVE LOSS AND ACCUMULATED OTHER COMPREHENSIVE LOSS**  
(STATED IN US DOLLARS AND THOUSANDS)  
**For the six months ended**  
**(Unaudited)**

	<u>June 30,</u>	
	<u>2008</u>	<u>2007</u>
<b><u>CONSOLIDATED STATEMENT OF ACCUMULATED DEFICIT</u></b>		
ACCUMULATED DEFICIT – BEGINNING OF PERIOD	(\$ 121,099)	(\$ 22,350)
Net Loss	( 121,525)	( 18,739)
ACCUMULATED DEFICIT – END OF PERIOD	<u>(\$ 242,624)</u>	<u>(\$ 41,089)</u>

**CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS**

NET LOSS	(\$ 121,525)	(\$ 18,739)
Other comprehensive loss, being unrealized hedging losses	( 157,781)	—
COMPREHENSIVE LOSS	<u>(\$ 279,306)</u>	<u>(\$ 18,739)</u>

**CONSOLIDATED STATEMENT OF ACCUMULATED OTHER COMPREHENSIVE LOSS**

ACCUMULATED OTHER COMPREHENSIVE LOSS, BEGINNING OF PERIOD	(\$ 82,716)	\$ —
Unrealized hedging losses	( 157,781)	—
ACCUMULATED OTHER COMPREHENSIVE LOSS END OF PERIOD	<u>(\$ 240,497)</u>	<u>(\$ —)</u>



PACIFIC ENERGY



**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(STATED IN US DOLLARS AND THOUSANDS)  
**For the six months ended**  
**(Unaudited)**

	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss from continuing operations	(\$ 113,648)	(\$ 14,987)
Adjustments to reconcile net loss to net cash from operating activities:		
Net loss from operations held for sale	( 7,877)	( 3,752)
Depreciation, depletion and amortization	13,430	6,739
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	67,874	1,872
Deferred income taxes		25
Non cash interest and dividend income	( 3,267)	( 714)
Stock compensation expense	3,203	625
Liquidated damages	3,240	-
Loss from unconsolidated subsidiary	448	-
Changes in operating assets and liabilities:		
Cash-restricted	1,173	( 8,345)
Receivables	( 11,456)	( 2,052)
Inventory	1,724	-
Prepaid expenses and other current assets	2,688	( 1,507)
Accounts payable and accrued liabilities	29,425	2,058
Other liabilities	-	( 311)
Derivative liability	11,318	4,488
Due to related parties	15	16
Net Cash Provided By (Used In)		
Operating Activities From Continuing Operations	( 1,710)	( 15,845)
Net Cash Provided By (Used In)		
From Discontinued Operations	5,006	1,590
Net Cash Provided By (Used In)		
Operating Activities	3,296	( 14,255)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Cash paid for restricted and short-term investments	-	( 1,129)
Petroleum and natural gas property expenditures	( 21,376)	( 18,695)
Payments on asset retirement obligation	( 269)	-
Net Cash Used In Investing Activities		
From Continuing Operations	( 21,645)	( 19,824)
Net Cash Used In Investing Activities		
From Discontinued Operations	( 50)	( 360)
Net Cash Used In Investing Activities	( 21,695)	( 20,184)



**PACIFIC ENERGY**



**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(STATED IN US DOLLARS AND THOUSANDS)

**For the six months ended**  
**(Unaudited)**  
**(Continued)**

	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Cash received for common shares issued	19,129	1,571
Payments on notes payable	—	—
Cash received for notes payable issued	1,000	24,338
Net Cash Provided By Financing Activities		
From Continuing Operations	20,129	25,909
Net Cash Used In Financing Activities		
Used In Discontinued Operations	( 2,619)	( 126)
<b>Net Cash Provided By Financing Activities</b>	<b>17,510</b>	<b>25,783</b>
<b>NET CHANGE IN CASH</b>	( 2,063)	( 312)
<b>CASH, BEGINNING OF PERIOD</b>	<b>8,547</b>	<b>15,000</b>
<b>CASH, END OF PERIOD</b>	<b>\$ 6,484</b>	<b>\$ 14,688</b>



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**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**  
FOR THE PERIOD ENDED JUNE 30, 2008

*(All amounts in thousands unless otherwise specified)*

**1. BASIS OF PRESENTATION**

The unaudited interim Consolidated Financial Statements include the accounts of Pacific Energy Resources Ltd. and its subsidiaries (“PER or “the Company”), and are presented in accordance with Canadian generally accepted accounting principles. PER's operations are in the business of exploration for and development of crude oil and natural gas in Alaska and California.

The unaudited interim Consolidated Financial Statements have been prepared following the same accounting policies and methods of computation as the annual audited Consolidated Financial Statements for the year ended December 31, 2007, except as noted below. The disclosures provided below are incremental to those included with the annual audited Consolidated Financial Statements. The interim Consolidated Financial Statements should be read in conjunction with the annual audited Consolidated Financial Statements and the notes thereto for the year ended December 31, 2007.

***Economic Dependence***

The Company’s primary sources of borrowings are pursuant to three credit agreements with affiliates of The Goldman Sachs Group, Inc. (“Goldman”) and Silver Point Finance LLC (“Silver Point”). These affiliates are also significant owners of common shares and warrants. An affiliate of The Goldman Sachs Group, Inc. is the counterparty for the Company’s commodity swaps. The credit and swap agreements contain covenants and restrictions, including a requirement that all cash receipts are to be deposited into lockboxes and require the Company to obtain Goldman or Silver Point approval for the disbursement of funds out of the lockboxes.

As at June 30, 2008 and as of the date of these financial statements, the Company was not in compliance with all covenants under these agreements, and accordingly all amounts due under the credit agreements and the derivative liability associated with the swap agreement have been classified as current liabilities as of June 30, 2008, in accordance with accounting requirements.. However, neither Goldman nor Silver Point has expressed any demand for repayment of amounts outstanding under the credits agreements nor expressed any demands under the swap agreements. Negotiations for amendment of the agreements are underway.

The Company’s ability to continue operations as planned, including capital spending on the schedule desired, is dependent upon a successful amendment of these agreements with Goldman and Silver Point, however no assurance can be given that the negotiation for amendment of the agreements will be completed on terms satisfactory to the Company. These financial statements have been prepared on the basis of a successful negotiation of amendments with the lenders.



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These financial statements do not include potentially material adjustments that might be necessary if management's plans are not successful.

## 2. CHANGES IN ACCOUNTING POLICIES AND PRACTICES

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

- "Inventories", Section 3031. The new standard replaces the previous inventories standard and requires inventory to be valued on a first-in, first-out or weighted average basis, which is consistent with PER's former accounting policy. The new standard allows the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. The adoption of this standard had no impact on PER's Consolidated Financial Statements.
- "Financial Instruments – Presentation", Section 3863 and "Financial Instruments – Disclosures", Section 3862. The new disclosure standard increases PER's disclosure regarding the nature and extent of the risks associated with financial instruments and how those risks are managed (See Note 11). The new presentation standard carries forward the former presentation requirements.
- "Capital Disclosures", Section 1535. The new standard requires PER to disclose its objectives, policies and processes for managing its capital structure (See Note 12).



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*(All amounts in thousands unless otherwise specified)*

### 3. PROPERTY AND EQUIPMENT AND PETROLEUM AND NATURAL GAS PROPERTIES

The asset categories of property and equipment and petroleum and natural gas properties at June 30, 2008 and December 31, 2007 were as follows:

	<b>June 30, 2008</b>		
	Cost	Accumulated depletion, depreciation and accretion	Net Book Value
Petroleum and natural gas properties and facilities	\$ 520,304	\$ 25,633	<b>\$ 494,671</b>
Property and equipment	6,243	596	<b>5,647</b>
	<b>\$ 526,547</b>	<b>\$ 26,229</b>	<b>\$ 500,318</b>

	December 31, 2007		
	Cost	Accumulated depletion, depreciation and accretion	Net Book Value
Petroleum and natural gas properties and facilities	\$ 544,364	\$ 16,665	\$ 527,699
Properties and equipment	5,178	398	4,780
	<b>\$ 549,542</b>	<b>\$ 17,063</b>	<b>\$ 532,479</b>

Included in petroleum and natural gas properties and facilities at June 30, 2008 and December 31, 2007 are undeveloped properties and work in progress of \$32,636 and \$14,618 respectively, which are not subject to depletion and depreciation.



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*(All amounts in thousands unless otherwise specified)*

#### 4. RELATED PARTY TRANSACTIONS

Transactions with related parties are measured at their fair value as determined by management.

- a) In April 2008, the Company received a \$1.0 million unsecured loan from a shareholder. The loan bears interest at 9% and is due on demand.
- b) As of June 30, 2008 and December 31, 2007, the Company owed \$75.8 and \$21.5 respectively, to a related party for amounts incurred by the related party on the Company's behalf. These amounts are non-interest bearing and due on normal trade terms.
- c) During the first six months of 2007, the Company incurred legal costs of approximately \$152.0 thousand with a company owned, until October 31, 2007, by one of the Company's directors. A balance of approximately \$10.8 thousand was owed at June 30, 2007.

#### 5. INTEREST

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Interest expense - cash	\$ 17,437	\$ 1,547	\$ 38,439	\$ 4,503
Interest expense – non-cash	7,106	1,871	19,476	1,872
Total interest expense	24,543	3,418	57,915	6,375
Interest and dividend income <sup>(1)</sup>	(1,452)	(69)	(3,643)	(714)
Net interest expense	\$ 23,091	\$ 3,349	\$ 54,272	\$ 5,661

<sup>(1)</sup> Interest income is primarily related to asset abandonment funds in various financial institutions.



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*(All amounts in thousands unless otherwise specified)*

## 6. NOTES PAYABLE

The 2007 and 2008 activity of all notes payable was as follows:

	Liability Component		Equity Component
	Face Value	Carrying Value	Fair Value
Balance at December 31, 2006	\$ 48,916	\$ 30,865	\$ 10,668
Proceeds	491,104	459,286	31,818
Payments	(40,114)	(40,114)	-
Less deferred financing costs	-	(29,235)	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	8,995	28,794	-
Balance at December 31, 2007	508,901	449,596	42,486
Proceeds	1,000	1,000	-
Payments	(2,619)	(2,619)	-
Accretion of discounts, amortization of deferred financing costs and interest paid in kind	13,029	69,059	-
Transferred to liabilities held for sale	(18,037)	(14,762)	(7,755)
<b>Balance at June 30, 2008</b>	<b>\$ 502,274</b>	<b>\$ 459,853</b>	<b>\$ 34,731</b>



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*(All amounts in thousands unless otherwise specified)*

**Notes Payable**

Description	6/30/2008	12/31/2007
Goldman Sachs and Silver Point		
Beta senior secured	\$ 65,000	\$ 65,000
Alaska first lien	108,000	108,000
Alaska second lien	277,000	277,000
Accrued interest - paid in kind	19,906	8,269
Face value of notes payable to Goldman Sachs and Silver Point	469,906	458,269
Forest zero coupon note	31,368	29,976
Unsecured shareholder	1,000	-
Total face value of debt	\$ 502,274	\$ 488,245
Unamortized discounts	-	(27,097)
Unamortized debt issue costs	-	(27,277)
Book value of debt	\$ 502,274	\$ 433,871
Current portion of long term debt	(470,906)	(430)
<b>Long term portion of note payable</b>	<b>\$ 31,368</b>	<b>\$ 433,441</b>



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(All amounts in thousands unless otherwise specified)

## 7. ASSET RETIREMENT OBLIGATIONS

The following table summarizes the changes in the Company's abandonment obligations during 2007 and 2008:

	<b>Asset Retirement Obligation</b>	<b>Asset Retirement Receivable</b>	<b>Net Amount</b>
Balance at December 31, 2006	\$ 1,655	\$ 585	\$ 1,070
Acquisitions	53,453	-	53,453
Retirements	(142)	-	(142)
Additions	-	-	-
Accretion	3,059	45	3,104
Balance at December 31, 2007	58,025	630	57,395
Acquisitions	-	-	-
Retirements	(269)	-	(269)
Additions	-	-	-
Accretion	2,212	24	2,236
Transfer to operations held for sale	(1,527)	(654)	(873)
<b>Balance at June 30, 2008</b>	<b>\$ 58,441</b>	<b>\$ -</b>	<b>\$ 58,441</b>

## 8. INCOME TAXES

The provision for income taxes is as follows:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	2008	2007	2008	2007
Current	\$ -	\$ -	\$ -	\$ 10
Future tax	-	25	-	25
	<u>\$ -</u>	<u>\$ 25</u>	<u>\$ -</u>	<u>\$ 35</u>



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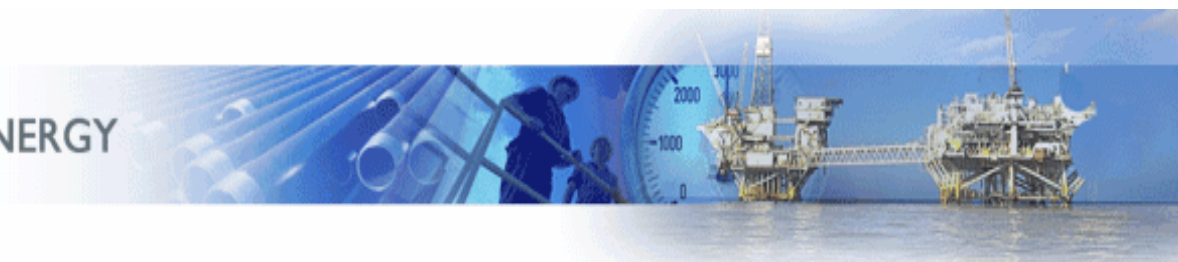
*(All amounts in thousands unless otherwise specified)*

**9. SHARE CAPITAL**

	<b>Number of Shares</b>		<b>Share Capital</b>		<b>Additional Paid In Capital</b>
<b>Balance – December 31, 2006</b>	<b>77,598</b>	<b>\$</b>	<b>8</b>	<b>\$</b>	<b>39,531</b>
Warrants exercised	2,068		-		3,332
Shares issued for acquisitions	10,000		1		24,630
Shares issued for debt	4,750		1		11,255
Shares issued for debt issue costs	3,097		-		7,000
Stock options exercised	31		-		27
Shares issued for damages	648		-		1,624
Common stock issued	88,450		9		120,030
<b>Balance – December 31, 2007</b>	<b>186,642</b>	<b>\$</b>	<b>19</b>	<b>\$</b>	<b>207,429</b>
Shares issued for debt issue costs	2,063		-		4,882
Warrants exercised	1		-		22
Shares issued for damages	3,899		-		3,240
Common stock issued	12,171		1		23,532
<b>Balance – June 30, 2008</b>	<b>204,776</b>	<b>\$</b>	<b>20</b>	<b>\$</b>	<b>239,105</b>



**PACIFIC ENERGY**



*(All amounts in thousands unless otherwise specified)*

## 9. SHARE CAPITAL (Continued)

### *Stock Options*

PER has a stock-based compensation plan that grants employees options to purchase common shares of the Company. Option exercise prices are the market price for the common shares on the date the options were issued. Options granted under the plan have varying vesting schedules, but are generally fully exercisable after three years and expire five years after the date granted.

The following tables summarize the information about options to purchase common shares at June 30, 2008:

	<b>Number of Options (in thousands)</b>	<b>Weighted Average Exercise Price per Share (CAD\$)</b>
Outstanding, beginning of period	<b>12,002</b>	<b>\$2.06CAD</b>
Granted during the period	<b>6,992</b>	<b>\$1.45CAD</b>
Forfeited during the period	<b>(448)</b>	<b>\$2.08CAD</b>
Outstanding, end of period	<b>18,546</b>	<b>\$1.91CAD</b>
Exercisable, end of period	<b>6,325</b>	<b>\$1.33CAD</b>



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*(All amounts in thousands unless otherwise specified)*

## 9. SHARE CAPITAL (Continued)

The following table sets forth the change in contributed surplus at June 30, 2008:

	<b>Contributed Surplus</b>	
Opening balance	\$	<b>5,452</b>
Additions from issuance of stock options		<b>3,203</b>
Closing balance	\$	<b>8,655</b>

## 10. PER SHARE AMOUNTS

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the periods. Diluted per share amounts reflect the potential dilution that could occur if stock options or warrants to purchase common shares were exercised and converted to common shares. The treasury stock method of calculating diluted per share amounts is used whereby an proceeds from the exercise of stock options or warrants plus unamortized stock-based compensation that are in the money assume to be used to purchase common shares of the Company at average market price during the period. Basic and diluted weighted average outstanding shares are the same as the Company has net losses.

<b>Period</b>	<b>Weighted Average Outstanding Shares</b>
Six months ended June 30, 2008	203,200
Six months ended June 30, 2007	117,333



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*(All amounts in thousands unless otherwise specified)*

## 11. FINANCIAL INSTRUMENTS

The Company holds various forms of financial instruments. The nature of these instruments and its operations expose the Company to market risk, credit risk and liquidity risks. The Company manages its exposure to these risks by operating in a manner that minimizes this exposure. While management monitors and administers these risks, the Board of Directors has the overall responsibility for the establishment and oversight of the Company's risk management framework. The Board will establish policies in setting risk limits and controls and monitor these risks in relation to market conditions.

### Market risk

Market risks are generally those risks that are outside of the control of the Company. These are: commodity prices, foreign currency exchange rates and interest rates. The objective of the Company is to mitigate exposure to these risks, while maximizing returns to the Company.

#### *a) Commodity price risk*

Due to the volatility of commodity prices the Company is potentially exposed to adverse consequences in the event of declining prices. The Company may enter into oil and natural gas contracts in order to protect its cash flow on future sales. The contracts reduce the fluctuation in sales revenue by locking in prices with respect to future deliveries of oil and natural gas. As at June 30, 2008, the Company had the following contracts outstanding:



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**Alaska**

Type	Volume	BPD	Term	Price (\$/bbl) <sup>(A)</sup>	Type
Swap	503,577	2,737	June 30 - December 31, 2008	\$ 68.16	Financial
Swap	907,999	2,488	January 1 - December 31, 2009	\$ 67.21	Financial
Swap	675,422	1,850	January 1 - December 31, 2010	\$ 67.21	Financial
Swap	272,416	746	January 1 - December 31, 2011	\$ 67.21	Financial
Swap	132,812	363	January 1 - September 30, 2012	\$ 67.21	Financial

(A) Swap price based on WTI

**Beta**

Type	Volume	BPD	Term	Price (\$/bbl) <sup>(B)</sup>	Type
Swap	141,904	771	June 30 - December 31, 2008	\$ 58.26	Financial
Swap	260,512	714	January 1 - December 31, 2009	\$ 57.30	Financial
Swap	232,400	637	January 1 - December 31, 2010	\$ 57.30	Financial
Swap	207,460	568	January 1 - December 31, 2011	\$ 57.10	Financial
Swap	110,633	302	January 1 - September 30, 2012	\$ 56.90	Financial

(B) Swap price based on Midway Sunset

**Total**

Type	Volume	BPD	Term	Price (\$/bbl)	Type
Swap	645,481	3,508	June 30 - December 31, 2008	\$ 65.98	Financial
Swap	1,168,511	3,201	January 1 - December 31, 2009	\$ 65.00	Financial
Swap	907,822	2,487	January 1 - December 31, 2010	\$ 64.67	Financial
Swap	479,876	1,315	January 1 - December 31, 2011	\$ 62.84	Financial
Swap	243,445	665	January 1 - September 30, 2012	\$ 62.52	Financial

Swaps associated with operations held for sale are not included, contracts were terminated with the sale of assets in July 2008.



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*(All amounts in thousands unless otherwise specified)*

## 11. FINANCIAL INSTRUMENTS (Continued)

### *b) Foreign currency exchange risk*

All of PER's petroleum and natural gas sales and expenses and monetary assets and liabilities are denominated in United States dollars, and are not impacted by the exchange rate between the United States and foreign currency. PER common shares are traded on the Toronto Stock Exchange and the Company's ability to raise capital funds by issuance of new shares may be impacted by the foreign currency exchange rate between the Canadian dollar and the United States dollar. As of June 30, 2008 the Company did not have any commitments to issue new shares on the Toronto Stock Exchange.

### *c) Interest rate risk*

The Company's credit facilities are subject to floating rates and are, therefore, exposed to fluctuations in the market rate of interest. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. The Company is required under its credit agreements to hedge against the interest rate risk associated with the floating rate debt facilities. The Company was required to enter into interest rate hedges on or before March 22, 2008. The Company has not entered into any interest rate hedges and has been in discussions with the lenders as to the appropriate strategy, timing, and amount of interest to hedge based on the anticipated restructuring of the credit facilities.

A fluctuation in interest rates of 1.0% would change interest expense by \$4.7 million per year based on the outstanding floating rate debt as of June 30, 2008.

### *Credit risk*

Substantially all of the accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. The Company generally extends unsecured credit to these customers and, therefore, the collection of accounts receivable may be affected by changes in economic or other conditions. Management believes the risk is mitigated by entering into transactions with long-standing, reputable, counterparties and partners. Receivables related to the sale of the Company's petroleum and natural gas production are from major oil and gas companies who have excellent credit ratings. These revenues are normally collected by the 20<sup>th</sup> day of the month following delivery. The Company has not experienced any credit loss in the collection of its accounts receivable.

### *Liquidity risk*



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Liquidity risk would occur if the Company is not able to meet its financial obligations as they come due. See also Note 1 – Economic Dependence.

*Fair values of financial instruments*

The carrying value of financial instruments, which include accounts receivable, derivative financial instruments, accounts payable and accrued liabilities approximates amounts at which these instruments could be exchanged in a transaction between knowledgeable and willing parties. The fair value of accounts receivable, and accounts payable and accrued liabilities approximates their carrying amounts due to their short term nature. The fair value of derivative financial instruments is determined by calculating the difference between the contracted price and published forward price curves as at the balance sheet date, multiplying this price differential by the contracted commodity volumes, and discounting the product to present value. The Company's notes payable bear interest at a floating market rate and accordingly the fair market value approximates the carrying value. The carrying and fair values of the Company's financial instruments as at June 30, 2008 are as follows:

	<b>Carrying Value</b>	<b>Fair Value</b>
<b><u>Financial Assets</u></b>		
Loans and receivables:		
Accounts receivable	<b>26,074</b>	<b>26,074</b>
Other receivables	<b>146</b>	<b>146</b>
<b><u>Financial Liabilities</u></b>		
Held-for-trading:		
Derivative liabilities	<b>240,498</b>	<b>240,498</b>
Other financial liabilities:		
Accounts payable and accrued liabilities	<b>51,863</b>	<b>51,863</b>
Notes payable	<b>502,274</b>	<b>502,274</b>



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## 12. CAPITAL DISCLOSURES

The Company's debt balance of \$502.3 million reflects the debt portion (as of June 30, 2008) of the funding of acquisitions of the Alaska assets in August 2007 and Beta Unit in March 2007, and the funding of the first stages of a significant capital expenditure program to develop these assets to increase production. The Company plans to reduce to this amount by 20-25 percent during the balance of 2008. The first part of this reduction recently occurred, with \$63 million of proceeds from the July 2008 asset sale (Note 13) used to repay a portion of this indebtedness. In addition, the Company is working towards the establishment of a surety line to allow it to replace approximately half of the approximate \$100 million in cash it has on deposit for abandonment liability and performance deposits. If the Company is able to secure a new surety line, a portion of the long term investments for abandonment freed up as a result thereof would also be used to repay a portion of this indebtedness. Finally, operating cash flow is being used to partially fund capital expenditures to increase production and revenues. Further alternatives to reduce the Company's leverage ratio include additional asset sales, securing third party investors for a portion of the capital program and equity sales. These alternatives are under review to determine the best course of action to increase shareholder value.

As disclosed in Note 1 – Economic Dependence, the Company is currently renegotiating amendment to its credit agreements with Goldman and Silver Point, although no assurance can be given that the Company will achieve its objectives in such renegotiation.

Over time, once the Company's leverage ratio is reduced, the Company expects to refinance its then-remaining Goldman and Silver Point notes payable with a conventional reserve-based loan at a significantly lower interest rate; however, no assurance can be given that conventional financing at desirable rates will be available at such time.

## 13. OPERATIONS HELD FOR SALE AND SUBSEQUENT EVENT

During the quarter ended June 30, 2008, the Company entered into an agreement with a buyer whereby the Company would sell to the buyer its L.A. Basin onshore California assets and its San Joaquin onshore assets for approximately \$135 million (net of customary purchase price adjustments). The sale was completed in July 2008.



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*(All amounts in thousands unless otherwise specified)*

**13. OPERATIONS HELD FOR SALE AND SUBSEQUENT EVENT (Continued)**

The following tables present financial information related to operations held for sale for the six months ended June 30:

	<u>2008</u>	<u>2007</u>
<b>REVENUES</b>		
Oil and gas production revenue, net	\$10,444	\$4,516
Unrealized gain (loss) on derivatives	(11,316)	(4,488)
Realized gain (loss) on derivatives	(2,568)	129
Interest and dividends	24	52
Other revenue	4	120
	<u>(3,412)</u>	<u>329</u>
<b>EXPENSES</b>		
General and administrative	459	370
Interest – cash	708	1,019
Interest – non-cash	1,657	1,657
Depreciation, depletion and amortization	1,641	1,035
	<u>4,465</u>	<u>4,081</u>
<b>LOSS BEFORE INCOME TAX</b>	<b>(7,877)</b>	<b>(3,752)</b>
Income tax expense	-	-
<b>NET LOSS</b>	<b><u>(\$7,877)</u></b>	<b><u>(\$3,752)</u></b>



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*(All amounts in thousands unless otherwise specified)*

**13. OPERATIONS HELD FOR SALE AND SUBSEQUENT EVENT (Continued)**

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Cash	\$ 1,186	\$ 2,134
Accounts receivable	3,497	2,582
Other receivables	76	991
Prepays and other current assets	-	102
Performance bonds and deposits	520	646
Asset retirement receivable	654	630
Property and equipment	413	447
Petroleum and natural gas properties	37,230	38,786
	<u>\$ 43,576</u>	<u>\$ 46,318</u>
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 1,788	-
Notes payable	14,763	\$ 15,725
Asset retirement obligation	1,527	1,720
Other liabilities	256	212
	<u>18,334</u>	<u>17,657</u>
Non-controlling interests	7,755	7,755
	<u>\$ 26,089</u>	<u>\$ 25,412</u>
<b>NET INVESTMENT</b>	<u>\$ 17,487</u>	<u>\$ 20,906</u>



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*(All amounts in thousands unless otherwise specified)*

### **13. OPERATIONS HELD FOR SALE AND SUBSEQUENT EVENT (Continued)**

The net sales proceeds were \$127,750, being the gross sales proceeds of \$135,000 less customary purchase price adjustments of \$7,250 (being principally cash flow from the effective date to the closing date). The net sales proceeds were used as follows:

Partial repayment of Beta sr. secured credit facility	\$ 44,972
Repayment of Laurus Master Fund Ltd. note payable (included in liabilities held for sale)	18,037
Termination of commodity swaps	29,678
Laurus Master Fund Ltd. share of proceeds	6,022
Payment of closing costs	1,222
Addition to working capital	27,819
Total use of net sales proceeds	<u>\$ 127,750</u>



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