

**Primeline Energy Holdings Inc. (TSX Venture-PEH)  
Management Discussion and Analysis for the Year Ended March 31, 2008  
(Prepared by Management)**

**Introduction**

This management discussion and analysis is dated July 24, 2008 and takes into account information available up to that date. It should be read in conjunction with the Company's audited consolidated financial statements and related notes for the year ended March 31, 2008, which have been prepared in accordance with Generally Accepted Accounting Principles in Canada. All amounts in this discussion and analysis are expressed in Canadian dollars unless otherwise noted.

**Cautionary Note Regarding Forward-Looking Statements**

Except for historical information, the following disclosures contain statements which may be considered to be forward-looking information. Such statements are made based on management's judgment and expectations, and assumptions which management believes to be reasonable. Forward-looking information is usually identified by words such as "could", "expects", "intends", "estimates", "projects", "believes", "may", "likely" and "potential", and is inherently subject to risks and uncertainties beyond management's and the Company's control. Material factors that could cause actual results to differ from any conclusions contained in forward-looking information include the results of exploration; whether deferred exploration costs are ultimately recovered; whether the Company's assets, including estimated resources, can be realised; possible decreases in future oil and gas prices; possible increases in estimated costs of future production; the results of negotiations with Chinese municipal, provincial and other regulatory authorities; changes in government legislation and regulations; various operational factors; and whether new financing may be procured or new exploration partners obtained to enable the Company to continue its exploration activities. Some of the material factors and assumptions applied in drawing such conclusions are the prospectivity for discovery of the Lishui Gas Play outside the 2 wells which it presently contains, and the remainder of Block 25/34; that a ready and profitable market will exist for oil and gas which may be discovered in such areas, and that infrastructure for bringing such oil and gas to market may be constructed on economic terms; that if a natural gas grid is established in Zhejiang Province, gas demand in that region will continue to expand; that an Agreement in Principle can be concluded on acceptable terms; that pipelines presently planned for will in fact be constructed; that China will continue to adopt more market-based pricing systems; and that environmental surveys and other studies necessary for production of oil and gas will be completed according to present timelines. Actual results may differ materially from those anticipated in the forward-looking statements.

**Company and Project Overview**

Primeline Energy Holdings Inc. ("PEHI" or the "Company") is focused exclusively on upstream oil and gas opportunities in China. The Company owns rights in and operates an exploration concession of 7,006 sq km in the East China Sea ("Block 25/34") pursuant to a Petroleum Contract dated March 24, 2005 ("Petroleum Contract") entered into with China National Offshore Oil Corporation ("CNOOC"). Under the Petroleum Contract, Primeline Energy China Ltd. ("PECL"), a wholly owned subsidiary of the Company, and Primeline Petroleum Corporation ("PPC"), an affiliated company, act jointly as "Contractor". PECL and

PPC own 75% and 25% respectively of the Contractor's interests in the Petroleum Contract. Primeline Energy Operations International Ltd. ("PEOIL"), another wholly owned subsidiary of the Company, is designated as "Operator" under the Petroleum Contract. References below to 'Primeline' refer generally to the Company, PECL, PEOIL and PPC.

Pursuant to the Petroleum Contract, the Contractor is required to fund all the exploration costs and CNOOC has the right to participate in up to 51% of any commercial development by paying its pro rata share of the development and operating costs required for production of any oil or gas. The Company has the right to recover exploration costs from the future production.

Primeline has an existing gas discovery, Lishui 36-1, within Block 25/34 through two wells with DST tested flow rates of 9.9 and 12.6 MMcfd of natural gas. There are several related prospects in the vicinity of the discovery with reasonable geological chances of discovering further gas or oil (generally referred to as the "Lishui Gas Play") which the Company has evaluated and is planning to drill and which, in a success case, will expand the current resource base. Furthermore, the Company believes that there is hydrocarbon potential, in addition to the Lishui Gas Play, in the remainder of Block 25/34.

## **Annual Progress Review**

### ***Dual Development and Exploration Strategy***

During the year under review, the Company has pursued its dual strategy of continuing to work towards a stand-alone development for the existing Lishui 36-1 discovery, based on the currently confirmed resources, whilst at the same time continuing its efforts to secure a drilling rig for step out exploration of the nearby prospects to expand the current resource base. The development of Lishui 36-1 may not by itself bring the Company significant income in the near term but it would confirm the market for gas to be produced from Block 25/34 and establish a production facility for the Lishui Gas Play. The confirmation of the market and the creation of the production facility would not only significantly enhance the potential value of any additional resources which may be discovered in the Lishui 36-1 discovery itself (the probable and possible category resources) but, more importantly, it would greatly enhance the value of any additional resources discovered in the Lishui Gas Play and beyond.

Accordingly, during the year, the Company's activities have comprised

- the feasibility study and gas market development for the proposed commercialisation of the Lishui 36-1 discovery;
- prospect evaluation, including the selection and surveys of well locations in the Lishui Gas Play and drilling preparation; and
- geological and geophysical evaluation of the available seismic data for the remainder of the 7,006 sq km Block 25/34

### ***Commercialisation of the Lishui 36-1 Discovery***

The Company's existing gas discovery, Lishui 36-1, has only a relatively small resource base from the two successful wells drilled to date and was previously regarded as sub-commercial. However, as a result of the general escalation of world oil and gas prices over the last 12

months, the continued economic growth of China and the recent rapid growth of gas infrastructure in China, the Company now regards it as a potentially commercial discovery.

In view of such market developments, in early 2007, Primeline and CNOOC conducted a pre-feasibility business opportunity study which concluded that the discovery may have a commercial value as a result of the improving gas market conditions in China. Accordingly, in March/April 2008, Primeline and CNOOC commenced a formal development feasibility study, starting with registering the reserves with the Chinese State Reserve Committee (these are not reserves for TSX Venture Exchange purposes under NI 51-101). Based on the initial results of the formal feasibility study, which were received in September 2007, the Company and CNOOC then commenced negotiations with the Zhejiang Provincial Government and Wenzhou Municipal Authority with the intention of agreeing in principle terms for a gas sale contract.

### ***Lishui 36-1 Resources Registration and Auditing***

In early 2007 Primeline commissioned CNOOC to prepare a reserve report for the Lishui 36-1 discovery in accordance with the Chinese government regulations in order to obtain “Development Reserves” status. The report, which is an essential component of any official development plan submission as well as the fundamental basis for any discussions relating to a gas sale contract, was completed and reviewed by CNOOC Reserve Office in June 2007. The reserve report was then submitted through CNOOC to the State Reserves Committee and approval was granted on July 5, 2007. It should be noted that the existence of a reserve report approved under Chinese government regulation does not mean the Company has “reserves” within the meaning of NI 51-101 as these are two different regulatory regimes.

At the same time, in order to comply with the TSX reporting requirements, Primeline retained McDaniel & Associates (<http://www.mcdan.com/>) of Calgary to carry out an independent resource audit. In July 2007, McDaniel submitted to the Company its independent resource estimate for Block 25/34 for filing with the TSX Venture Exchange in accordance with NI 51-101. McDaniel’s report concluded that Lishui 36-1 has a best estimate Contingent Resource (recoverable pure hydrocarbon gas) of 122 Bcf (45 Bcf Primeline gross share) of gas and 2.6 MMbbls of condensate (0.9 MMbbls Primeline gross share). The Contingent Resource estimate is based on a best estimate Discovered Original Resources (Gas Initially In Place (“GIIP”)) for the property of 292 bcf. The report stated that the term “contingent resources” is used rather than “reserves” since “commerciality of the existing discovery, Lishui 36-1, had not been confirmed”. The full text of the McDaniel’s report is available on the Company’s website ([www.pehi.com](http://www.pehi.com)).

### ***Feasibility Study***

On July 3, 2007, Primeline commissioned CNOOC China Ltd., Shanghai and CNOOC Research Centre to prepare a full feasibility study for the commercialisation of the Lishui 36-1 Discovery. The feasibility study covers reservoir engineering, development drilling and completion engineering, production engineering, design of the development facilities including platform, pipeline and onshore terminal, HSE and the detailed costing of all aspects of the development and future production operations. These are standard requirements for an offshore feasibility study and CNOOC Research Centre is the most authoritative body for offshore development feasibility studies and development plans in China.

Numerous development options were evaluated during the study, various review meetings were held between Primeline and CNOOC and the whole process was monitored by Primeline's technical team. The engineering elements of the feasibility study, including the cost and economics evaluation, were initially reviewed in September 2007 and then completed in December 2007 and Primeline received the formal report in early 2008.

### ***Natural Gas Market in Wenzhou***

Wenzhou is the closest major city to Primeline's gas discovery, being situated on the coast only 140 km away. However, Wenzhou is not connected to any gas grid and current gas usage in the city is restricted to LPG. Primeline had been in general discussion with the Wenzhou Municipal Authority for some time with regard to the possible utilisation of gas from the Lishui Gas Play. Whilst Primeline received positive support from Wenzhou with regard to possible gas sale arrangements, as they are naturally keen to encourage the establishment of a supply of natural gas to their city, it was not possible for there to be any substantive negotiation until either Primeline discovered additional recoverable gas or, as has been the case, market changes created the possibility that development of the existing discovery on a stand alone basis may be commercially feasible.

Thus, following the increases in gas prices in China, and based on the preliminary engineering and costing information provided by the feasibility study, Primeline and CNOOC formally approached the Wenzhou Municipal Authority and the Zhejiang Provincial Government in September 2007 to discuss the principles of a take-or-pay gas sales contract. The aim was to achieve terms which would justify proceeding with the preparation and submission of an Overall Development Plan (ODP) for the development of the discovery.

Prior to September 2007 it had not been anticipated that a provincial wide gas grid would be established in Zhejiang Province in the near future and so much of the initial discussions with the Wenzhou authorities had centred on how the gas might be utilised in Wenzhou alone which was effectively a green field situation. However, the announcement by CNPC in August 2007 of the proposed Second West to East Gas Pipeline meant that a gas grid connected to Wenzhou would be established in the southern part of the Province far earlier than otherwise expected. As a result, the gas distribution strategy of Zhejiang Province was changed to utilise gas from the proposed Second West to East Gas Pipeline and it became apparent that the utilisation of gas from Block 25/34 would now have to be agreed at a Provincial level. The negotiations were then delayed not only by the need for Zhejiang Province to formulate its gas distribution strategy in the light of the proposed Second West to East Gas Pipeline but also by the changes in both the Provincial and Municipal governments during the period from November 2007 until March 2008. The discussions recommenced in April 2008.

### ***China Energy Market***

Historically, natural gas has not been a major fuel in China but its share in the country's energy mix is now rapidly increasing. In 2006 natural gas represented about 3% of the entire energy mix, compared to the world average of 25%, and the Chinese Government has recently announced plans to raise this percentage to 5.3% by 2010. Total consumption in 2006 was circa 57 bcm so the proposed target represents a total of 122.9 bcm in 2010. Rapid development of the natural gas industry is now one of China's strategic policies in order to help resolve its acute energy shortage and to achieve its target for pollution reduction. Part of

this strategy is to encourage the transportation of gas from West China and other countries around China, including Russia and Central Asia, where there are significant resources, to East China where demand is highest and the energy shortage is most acute.

China's first major West to East Gas Pipeline, built by China National Petroleum Corp. (CNPC), parent company of Petrochina Ltd. (NYSE:PTR, [www.petrochina.com.cn](http://www.petrochina.com.cn)), was completed in 2004 and now carries approximately 14 bcm of gas per annum from the Tarim Basin along a 4,000 kms pipeline which terminates at Shanghai. There were initial concerns that there would be insufficient demand for the gas, but now demand exceeds supply and prices have recently increased.

In order to respond to the increasing demand, there are now three new West to East pipelines planned for the near future, two of which will be able to supply gas to Zhejiang Province:

- As referred to above, in August 2007, CNPC announced proposals for a Second West to East pipeline with a capacity of 30 bcm per annum. The pipeline, which will be over 6,000 kms, is planned to run from Turkmenistan through Xinjiang to Guangzhou in Southern China, branching at Nanchang to run east to Shanghai and passing through western and northern Zhejiang Province. Approval from Central Government was granted in October 2007 and construction commenced in February 2008 with gas supply due to start in 2011. CNPC signed agreements in July 2007 to import 30 bcm of natural gas over the next 30 years from Turkmenistan to supply this pipeline. However, Wenzhou is the furthestmost point of the proposed provincial pipeline grid which will be connected to that pipeline.
- In addition, China Petroleum and Chemical Corp. (Sinopec, NYSE:SNP, [www.sinopec.com.cn/](http://www.sinopec.com.cn/)) has started laying a natural gas pipeline that will run from south west Sichuan Province to Shanghai. This new pipeline, with the total pipeline capacity of 17 bcm, is expected to supply 12 bcm per annum by 2010 to cities along the pipeline, including northern Zhejiang Province.

In the past, the Chinese Government has held state-set gas prices below international LNG market levels but strong demand for gas, coupled with pollution targets, has meant that it has been forced to obtain supplies from foreign sources at market prices. As a result, there has been significant upward pressure on prices and, in late November 2007, the Chinese Government announced increases in prices for all major gas pipelines which are now getting closer to international LNG prices. China is currently buying LNG on the spot market and CNPC and CNOOC have recently reported signing long term LNG supply contracts at prices well above the current North American gas prices.

These recent developments are clearly indicative of a maturing gas market with a more market-driven pricing system which will benefit the development of Block 25/34 in the long term. Thus, it is apparent that a nation-wide gas grid is in the process of being established in China and the East China region, as the most industrialised region, will be the frontrunner for this improved gas infrastructure.

### ***Zhejiang Energy and Provincial Grid***

Zhejiang Province has a total population of circa 50 million and a land area of 101,800 sq kms. It rates as the 4<sup>th</sup> largest provincial economy within China and has enjoyed double digit annual growth during the last 25 years. The 2007 total GDP is RMB1,846 billion (US\$266

billion) or US\$5,261 per capita. Its export size and growth is impressive, reaching US\$128 billion in 2007. The Province has almost no primary energy supply except for its hydro-energy potential and about 91% of its energy needs have to be imported from outside the Province, including 113 million tons of coal and 21.2 million tons (circa 150 mmbbl) of crude oil in 2006. In 2006, its energy consumption heavily relied on coal (62%), then oil (22%), with hydro and nuclear energy at 9.1% and natural gas at only 1.1%, way below the national level of 2.5% and miniscule compared with the average international level of 25% in the total energy mix.

Zhejiang Province currently has a provincial natural gas grid of 330km in the northern part of the Province serving the major cities in the area including Hangzhou, Huzhou, Jiaxin and Shaoxin and which is fed by the first West to East Gas pipeline. This provincial gas grid is owned and operated by Zhejiang Natural Gas Development Corp. As part of the Zhejiang Province gas distribution policy, it is now intended that the Provincial Gas Grid will be developed and expanded to connect other major cities within the Province, including Wenzhou, to the proposed Second West to East Gas Pipeline, to the Sichuan Gas to East Pipeline and to LNG imports. The planned annual throughput of the Zhejiang provincial grid by 2015 is estimated at over 6 bcmpa.

The development of this Provincial Grid presents an exciting opportunity for Primeline in that, rather than endeavouring to create a gas utilisation market in a greenfield situation in Wenzhou alone, it will now be possible to supply to a rapidly developing market via the grid which is to be established serving all the major cities in the Province and beyond. It is apparent from other natural gas grids in China that once supply has been established then there is rapid expansion of demand.

#### ***Gas Sale Agreement with Zhejiang/Wenzhou and possible Overall Development Plan***

As of the date of this MD &A, Primeline and CNOOC are continuing their discussions and negotiations with the Zhejiang Provincial Government and Wenzhou Municipal Authority, aiming for an agreement in principle to be entered into with a government controlled entity for the sale of gas from the existing Lishui 36-1 discovery.

If an agreement in principle is signed on acceptable terms, Primeline intends, subject to the approval of the Joint Management Committee appointed pursuant to the Petroleum Contract, to proceed with the preparation of an Overall Development Plan (“ODP”) for the development of the production facilities without delay. The ODP work will involve further engineering design and, more importantly, survey work to allow the detailed design to be confirmed.

The survey work includes the site survey for the production platform, a routeing survey for the pipeline, a survey for the onshore terminal site and environmental surveys. Two environmental surveys are required, one in the spring and the other in the autumn. The spring survey was commissioned in May and was carried out by Primeline's contractor, China Second Oceanographic Research Institute, assisted and monitored by Primeline's feasibility study contractors, CNOOC Research Centre and CNOOC Ltd. Shanghai. The field work was completed in May followed by analysis and the preparation of the report. The final report is expected in October 2008. The spring environmental survey was commissioned in anticipation that an agreement in principle for the sale of gas would be signed in the near future. It is currently intended that the autumn survey will be undertaken in September /

October if the agreement in principle has been entered into. Other survey work will only be commissioned after the agreement in principle is signed.

In addition, Primeline and CNOOC have, during the latter half of 2007 and early 2008, been working with the Wenzhou Municipal Authority on the selection of the site for the landing point of the proposed offshore pipeline and the onshore gas processing terminal. A preliminary location has been agreed and close cooperation with the government on planning, land acquisition and other preparation work will be required once the ODP has commenced to ensure that the site for this onshore facility can be secured and ready on time for the proposed future development.

## **Exploration Activities**

### ***Lishui 36 Gas Play and New 3D Seismic Data***

During 2006/2007, Primeline completed the acquisition of 550 sq km 3D seismic. That data was then merged with the previous 3D data to make a total full fold data set of 737 sq km, covering the Lishui 36-1 discovery and nearby prospects. The data was then evaluated in order to define prospect leads and possible drilling locations in the area adjacent to the discovery. The Company completed the processing of the merged 737 sq km 3D seismic data in May 2007, which confirmed the existence of very exciting channel and canyon systems and several sizeable prospects have been mapped in this new play concept area. Geophysical features associated with the Lishui 36-1 gas discovery, including direct hydrocarbon indicators (DHIs) such as AVO (Amplitude Versus Offset) anomalies and bright spots, are also found on these prospects. Tertiary channel sands are a proven play type in Western Africa and the Gulf of Mexico. AVO anomalies are often due to gas effects in the sands and these anomalies help differentiate bright spot gas sands from other bright reflectors.

These nearby prospects and leads could provide significant resource additions for Primeline. McDaniel's estimate of Prospective Resources is based on the best estimate of the Undiscovered Original Resources (or Gas Initially In Place – GIIP) for each of the six prospects and ranges between 14 and 971 Bcf, and the sum of the Property Gross Unrisked Mean Prospective Resources (recoverable pure hydrocarbon gas) of 792 Bcf gas and 21.8 MMbbls Condensate. "Prospective Resources" are defined as quantities of oil and gas which are estimated on a given date to be potentially recoverable from undiscovered accumulations and calculated on a probabilistic basis. McDaniel estimates that the geological chances of success for each of the six prospects ranges from 26% to 46%, McDaniel thus arrived at a Property Gross Risked Mean Prospective Resources for the six prospects close to Lishui 36-1 discovery (within 15 kms) of 279 Bcf of gas (103 Bcf Primeline gross share) and 7.7 MMbbls of condensate (2.8 Mbbls Primeline gross share).

On the basis of the available data, Primeline has agreed with CNOOC the two best locations for the next exploration drilling in the Block 25/34 and has completed the well design. In November 2007, the Company entered into a services contract with China Oilfield Services Ltd. ("COSL") for the site survey of those two proposed well locations. The site survey was completed in December 2007, using vessel NH 503, a survey boat owned by COSL. COSL ([www.cosl.com.cn](http://www.cosl.com.cn)), a Hong Kong/Shanghai-listed company, is the leading oilfield services provider in the offshore China market.

The Company plans to drill at least one well in the Lishui Gas Play and is currently in discussions with drilling contractors and CNOOC to secure a rig for the drilling programme. Whilst rig availability continues to be scarce in current market conditions the Company has seen some easing of conditions recently and believes rig availability in the region is improving.

### ***Remainder of Block 25/34 and Regional Prospectivity***

The current 3D seismic area is only 10% of the total contract area of Block 25/34, which covers the majority of the Lishui West Basin. In and around this basin there are a total of seven previously drilled wells (in addition to Primeline's discovery wells) that had various forms of hydrocarbon shows and flows. The Company believes that channel and canyon systems, with DHI support, are likely to extend across the basin and could be developed as future drilling targets, in addition to the prospects already identified. As a result, the Company believes there are likely to be significant additional hydrocarbon resources in the West Lishui Basin to be discovered.

During the year, the Company has continued its regional geological and geophysical evaluation, the next stage of which will involve re-processing part of the existing 23,000 km of 2D seismic data and reviewing the information from 12 wells previously drilled in the region by other companies. The Company has, since November 2007, been conducting a thorough testing programme for the re-processing of seismic data as the 23,000 km 2D seismic available to the Company is of various vintages spanning over 20 years. On June 30, 2007, the Company signed a contract with Hispec (effective July 4, 2008) to reprocess a total of 3,520 km 2D seismic data based on agreed parameters from the testing programme. The total cost of the contract, based on the final processing sequence selected by the Company, is expected to be in the order of US\$250,000 to US\$350,000.

Hispec (<http://www.hispecgeo.com>) is a geophysical service company specializing in seismic processing. They have developed various leading edge processing techniques and software which have been successfully applied to Primeline's 3D re-processing in 2005/2006 and the recent test project. Under the contract, Hispec will reprocess the existing Primeline data in order to improve the quality of the data to aid the regional evaluation.

This regional evaluation will identify and document the exploration potential in the Basin to provide the Company with prospect inventories that will guide future exploration work programmes in the remainder of Block 25/34 outside the Lishui 36-1 Gas Play area covered by 3D seismic data.

### ***Petroleum Contract Extension***

The Petroleum Contract for Block 25/34 originally provided for an exploration period of seven years from the date of commencement, which was May 1, 2005. The exploration period was divided into three separate phases of three, two, and two years respectively. The provisions relating to the minimum exploration work provide that during the first phase of the exploration period the contractors are required to complete the acquisition of 200 sq km of 3D seismic and drill one well of 2,500m with a minimum exploration expenditure of US\$6 million. During the first phase Primeline acquired a total of 550 sq km of 3D seismic and spent in excess of US\$10 million but, due to the lack of availability of drilling rigs, has been unable to drill the required well. Accordingly, in view of the rig market conditions, CNOOC

agreed to extend the first phase of the exploration period by an additional period of twelve months.

By an Amendment Agreement dated February 18, 2008 between CNOOC, PECL and PPC, it was agreed that the Petroleum Contract for Block 25/34 be amended to provide that the first exploration period shall be for a period of four years from the date of commencement on May 1, 2005 provided that one of the two subsequent two-year exploration periods will be reduced by a corresponding period of one year unless otherwise agreed with CNOOC. The minimum exploration requirement for each of phases 2 and 3 is the drilling of one well to 2,500m and with a minimum expenditure of US\$5 million.

### **Corporate Development**

On November 1, 2007, Primeline appointed CHF Investor Relations (Cavalcanti Hume Funfer Inc., "CHF") as its investor relations counsel to provide corporate communications services to the Company.

Under the terms of the agreement between CHF and the Company, CHF agreed to provide investor relations services for an initial period of twelve months ending October 31, 2008. Thereafter, cancellation by either party requires three months notice. CHF are paid \$6,000 per month in fees plus allowable disbursements. In addition, CHF were granted an option to purchase 250,000 shares in the capital of the Company at an exercise price of \$2.00 per share. These options, which comply with the requirements of TSX Venture Exchange Policy 3.4, are subject to a quarterly vesting schedule over an eighteen-month period and are otherwise in accordance with the Company's Stock Option Plan.

In addition, CHF and a substantial shareholder of the Company, Primeline International Holdings Inc. entered into an agreement whereby market-making services are undertaken on behalf of the Company for a monthly fee of \$1,500. The market-making activity is undertaken by CHF through a registered broker in compliance with the guidelines established by the TSX Venture Exchange Policy 3.4.

In addition to the options awarded to CHF, the Company also awarded options to some of its executive directors, management and consultants to purchase up to 625,000 shares in capital stock of the Company at an exercise price of \$2.00 per share. These options were awarded in November 2007 following an annual review of options, the previous review having been in November 2006, and vest and are otherwise in accordance with the Company's Stock Option Plan.

On April 4, 2006, as part of a private placing of shares, the Company issued warrants to subscribe at any time on or before April 4, 2008 for a total of 11,799,999 shares in the Company at C\$2.00 per share ("the Warrants"). As at the expiry date the shares in the Company were trading at less than the warrant exercise price and accordingly none of the warrants were exercised and have now lapsed.

### **Financial Information**

As discussed in note 11 of the consolidated financial statements, the Company's previously reported 2007 results have been restated to adjust error in the Company's recorded stock-

based compensation expenses. The financial information analysis below is based upon the restated 2007 amounts in the comparison to the current year financial statements.

### ***Results of Operation***

The Company's consolidated audited results for the financial year ended March 31, 2008 were a loss of \$1,956,299, compared to a loss of \$5,471,408 for the previous year. The decrease in loss of \$3,515,109, or 64.2%, was mainly due to the recognition of stock-based compensation which decreased by \$5,269,676 from the previous year, partially offset by the increase of exchange loss of \$1,618,877 from currency translation. The exchange rate for C\$/US\$ fell from 1.149 to 1.023 during the year. Loss per share was \$0.04 (2007 - \$0.12).

### ***Liquidity and Capital Resources***

As at March 31, 2008, net current assets of the Company amounted to \$10,243,258, whereas net current assets of \$14,175,756 were recorded in the prior year. The current asset ratio for the year was 9.81:1 (2007 – 15.42:1). The decrease in net current assets of \$3,932,498 was mainly due to the decrease in cash of \$3,701,585, which cash was largely utilized for petroleum exploration costs.

During the year, exploration expenditure of \$2,806,928, including a foreign exchange gain of \$14,484 (2007 - \$9,721,469, which included a foreign exchange loss of \$63,360), was incurred and was financed mainly from the net proceeds of the Private Placement. As at March 31, 2008, the total amount of deferred petroleum exploration expenses incurred and capitalized amounted to \$31,747,134 (2007 - \$28,940,206) and may be broken down as follows:

	<u>2008</u>	<u>2007</u>
	\$	\$
Exploration Drilling Related Services		
Drilling services	5,634,766	5,634,766
Drilling technical supervision and evaluation	318,394	318,394
Exploration Geological & Geophysical Surveys & Work		
Geological & geophysical survey acquisition & processing	9,544,442	8,970,420
Technical evaluations & management	3,956,256	3,566,523
Pre-development study	690,505	-
Interests on funding of deferred exploration expenditures	3,550,713	3,553,393
Deferred costs acquired from Primeline Petroleum Corporation	1,394,307	1,394,307
Project administration	2,369,157	2,103,881
Salaries and benefits	3,182,154	2,560,293
Travel and accommodation	1,376,830	1,094,135
Contract signing fee	539,917	539,917
Foreign exchange gain	(810,307)	(795,823)
	<u>31,747,134</u>	<u>28,940,206</u>

The increase of \$574,022 in geological and geophysical survey acquisition and processing costs from 2007 to 2008 reflected the costs of the seismic survey of the drilling sites within the Lishui Gas Play undertaken in 2008 and of interpreting the data gathered. Moreover, \$690,505 was spent on the pre-development feasibility study (\$Nil in 2007). Technical evaluation and management were \$3,956,256 in 2008, an increase of \$389,733 from the \$3,566,523 recorded in 2007. The increase reflects the consultancy work undertaken in relation to the ongoing exploration programme.

Project administration costs may be further broken down as follows:

	<u>2008</u>	<u>2007</u>
	\$	\$
Bank charges	11,572	10,649
Office rental	1,345,320	1,225,716
Office supplies	87,740	82,435
Sundries expenses	271,025	181,430
Postage	28,767	24,354
Professional fees	313,706	300,235
Telecommunications	68,904	55,476
Transportations	228,000	216,470
Utilities	14,123	7,116
	<u>2,369,157</u>	<u>2,103,881</u>

The Company had total assets of \$43,153,082 (2007 - \$44,098,993) which were financed by net shareholders' equity of \$41,585,964 (2007 - \$42,687,452), and current liabilities of \$1,162,690 (2007 - \$983,031).

In previous years prior to April 2006, the Company had been financially supported by PIHI in order to enable it to carry out its exploration program and day-to-day operations. This support was provided by way of shareholder's loans. The Private Placement and debt conversion on April 4, 2006 was intended to provide the Company with sufficient funds to complete its minimum commitments under Phase 1 of its exploration program and support its general and administration activities for the year. During 2008, expenditures on deferred petroleum exploration costs of \$2,533,627 was financed from the proceeds of the Private Placement. This was a decrease of \$5,015,163 from 2007 expenditures on deferred petroleum exploration expenses of \$7,548,790. The reduction could be attributed to the fee for 3D seismic marine data acquisition of \$5,981,261 incurred last year.

As at March 31, 2008, the Company had net current assets of \$10,243,258 (2007 - \$14,175,756) and had a deficit of \$9,777,786 (2007 - \$7,821,487). The Company has sufficient funds to meet its minimum expenditure commitments under Phase 1 of its exploration program and support its general and administration activities for the next year, see "Company and Project Overview".

### ***Financial Instruments***

#### *Interest rate exposure*

The Company maintains cash, which is not presently required for operations, on deposit which earns interest at a floating rate.

*Fair value of financial assets and liabilities*

The fair values of deposits, accounts payable and accrued liabilities approximate to their carrying values due to the short term to maturity of those instruments.

Management determined that it is not practical to determine the fair value of advances from PIHI and affiliated companies because of the lack of availability of similar borrowing arrangements on arm's length basis.

The Company is exposed to currency risk to the extent that certain cash deposits are denominated in Canadian Dollars whereas accounts payable are denominated in US Dollars and RMB. The Company adopted C\$/US\$ hedging instruments last year to mitigate the impact of such currency risk and this resulted in the partial conversion of its Canadian Dollars deposit to US Dollars deposit the amount of which was sufficient to meet its US Dollars accounts payable during the year. The Company did not enter into any derivative arrangements this year.

***Transactions with Related Parties and Directors***

During the year ended March 31, 2008, the Company paid or received the following from related parties:

- a) London office rent of \$78,690 (2007 - \$82,575) to a company under common control. The shareholder of that company is also the shareholder of the Company's ultimate holding company, PIHI, a private British Virgin Islands corporation, all of the issued and outstanding shares of which are beneficially owned by Mr. Victor Hwang, President and a director of the Company, and members of the Hwang family.
- b) fees and expenses of \$24,438 (2007 - \$27,175) to a company controlled by Mr. Peter Kely, a director for advisory services relating to investor relations, securities and exchange matters and other administrative services.
- c) advances of \$134,199 (2007 - \$132,207) from a company under common control. The shareholder of that company is also the shareholder of the Company's ultimate holding company PIHI.

These transactions, which occur in the normal course of operations, are measured at the exchange amount, which is the amount of the consideration established and agreed to between the Company and the related parties.

Other related party balances are disclosed elsewhere in the consolidated financial statements.

***Adoption of New Canadian Accounting Pronouncements***

*a) Accounting Changes*

Effective April 1, 2007, the Company adopted revised CICA Section 1506, *Accounting Changes*, which provides expanded disclosures for changes in accounting policies, accounting estimates and corrections of errors. Under this standard, accounting changes should be applied retrospectively unless otherwise permitted or where impracticable to determine. In addition, voluntary changes in accounting policy are made only when required by a primary source of GAAP or the change results in

more relevant and reliable information. The adoption of this section had no material impact on the consolidated financial statements of the Company.

b) *Financial Instruments, Comprehensive Income, and Hedges*

On April 1, 2007, the Company adopted the CICA Handbook Sections 1530, *Comprehensive Income*; Section 3855, *Financial Instruments – Recognition and Measurement*; Section 3861, *Financial Instruments – Disclosure and Presentation*; and Section 3865, *Hedges*.

(i) Financial Instruments

Under Section 3855, financial assets and liabilities, including derivative instruments, are initially recognized and subsequently measured based on their classification as held-for-trading, available for sale financial assets, held to maturity, loans and receivables, or other financial liabilities as follows:

- Held-for-trading financial instruments are measured at their fair value with changes in fair value recognized in net income for the period.
- Available for sale financial assets are measured at their fair value and changes in fair value are included in other comprehensive income until the asset is removed from the balance sheet.
- Held-to-maturity investments, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method.
- Derivative instruments, including embedded derivatives, are measured at their fair value with changes in fair value recognized in net income for the period unless the instrument is a cash flow hedge and hedge accounting applies in which case changes in fair value are recognized in other comprehensive income.

Upon adoption of this new standard, the Company designated its cash and cash equivalents as available for sale, which is measured at fair value. Deposits have been designated as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities and due to related parties are classified as other financial liabilities, which are measured at amortized cost.

Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them.

(ii) Comprehensive Income

Section 1530 introduces the concept of comprehensive income, which is calculated by including other comprehensive income with net income. Other

comprehensive income represents changes in shareholders' equity arising from transactions and other events with non-owner sources such as unrealized gains and losses on financial assets classified as available-for sale.

(iii) Hedges

Section 3865 specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed, as well as the disclosure requirements. Hedge accounting enables the recording of gains, losses, revenues and expenses from derivative financial instruments in the same period as for those related to the hedged item. The Company did not hold any derivative instruments during the year ended March 31, 2008.

The Company has evaluated the impact of these new sections on its consolidated financial statements and determined that no significant transition adjustments were required upon adoption.

c) *Equity*

Effective April 1, 2007, the Company adopted CICA Section 3251, *Equity*, which establishes standards for the presentation of equity and changes in equity during the reporting periods presented. As there are no changes resulting from the adoption of Section 1530, discussed above, the adoption of this policy had no impact on the Company's consolidated financial statements for any of the periods presented.

***Recent Canadian Accounting Pronouncements***

Recent Canadian accounting pronouncements that have been issued but are not yet effective, and which may affect the Company's financial reporting are summarized below:

(i) Capital Disclosures

In December 2006, the Canadian Institute of Chartered Accountants ("CICA") issued Handbook Section 1535, *Capital Disclosures*, which establishes standards for disclosing information about an entity's capital and how it is managed. The entity's disclosure should include information about its objectives, policies and processes for managing capital and disclosure whether or not it has complied and the consequences of non-compliance with any capital requirements to which it is subject. This new standard will become effective for the Company beginning on April 1, 2008. The Company is currently evaluating the impact of this standard.

(ii) Financial Instruments – Disclosures and Financial Instruments - Presentation

In December 2006, the CICA issued Handbook Sections 3862, *Financial Instruments – Disclosures*, and 3863, *Financial Instruments – Presentation*. Section 3862 modifies the disclosure requirements of Section 3861, *Financial Instruments – Disclosure and Presentation*, including required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the extent of risks arising from financial

instruments to which the Company is exposed and how the Company manages those risks, whereas Section 3863 carries forward the presentation related requirements of Section 3861. These new standards will become effective for the Company beginning on April 1, 2008. The Company is currently evaluating the impact of this standard.

(iii) Going Concern

In April 2007, the CICA approved amendments to Handbook Section 1400, *General Standards of Financial Statement Presentation*. These amendments require management to assess an entity's ability to continue as a going concern. When management is aware of material uncertainties related to events or conditions that may cast doubt on an entity's ability to continue as a going concern, those uncertainties must be disclosed. In assessing the appropriateness of the going concern assumption, the standard requires management to consider all available information about the future, which is at least, but not limited to, twelve months from the balance sheet date. The new requirements of the standard are applicable for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company is currently evaluating the impact of this standard.

(iv) International Financial Reporting Standards ("IFRS")

In January 2006, 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") by the end of 2011. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

(v) Goodwill and Intangible Assets

The CICA has also issued the new Handbook Section 3064, "Goodwill and Intangible Assets", which will replace Section 3062, "Goodwill and Intangible Assets". The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. Management is currently assessing the impact of these new accounting standards on its financial statements. Adoption of this standard will result in the withdrawal of EIC 27.

***Subsequent Events***

On May 14, 2008, CNOOC Ltd. Shanghai on behalf of Primeline, entered into an agreement with China Second Oceanographic Research Institute to conduct the Spring Environment survey for an amount of C\$233,280 (RMB 1,600,000).

On April 4, 2008, the warrants to subscribe for a total of 11,799,999 shares in the Company

at C\$2.00 per share which were previously issued by the Company on April 4, 2006, all lapsed, none having been exercised prior to such expiry date.

On May 31 2008, the options to subscribe for a total of 433,000 shares in the Company at C\$1.60 per share which were previously granted by the Company on December 1, 2006, all lapsed and none having been exercised prior to such expiry date.

On June 30, 2008, a subsidiary of the Company, Primeline Energy Operations International Ltd. entered into an agreement with HISPEC Research Corp. to provide 2D seismic reprocessing of 3,517km data for a total cost US\$246,202 plus HFE charges.

### ***Outstanding Share Data***

On April 4, 2006, the Company completed a Private Placement and a Debt Conversion which resulted in the issue of 21,933,333 additional voting common shares and 11,799,999 warrants each exercisable to acquire one common share at a price of \$2.00 per share. Each warrant was exercisable on or before April 4, 2008. On the expiry date, April 4, 2008, none of warrants had been exercised and have all now lapsed. On April 4, 2006, the Company granted 4,500,000 options at an exercise price of \$1.50 per share to directors, officers, employees and consultants, of which 4,300,000 options are outstanding and will expire on April 4, 2011.

On December 1, 2006, the Company awarded options to its non-executive directors, management and consultants to purchase up to 1,200,000 common shares at an exercise price of \$1.60 per share of which 217,000 options have been cancelled by agreement with the option holders, 433,000 options expired on May 31, 2008 and the balance of 550,000 options will expire on November 30, 2011.

On November 1, 2007, the Company awarded options to purchase a total of 875,000 common shares at an exercise price of \$2.00 per share, of which 250,000 options were awarded to CHF Investor Relations, the Company's investor relations counsel, and 625,000 options were awarded to certain of its executive directors, management and consultants. All such options will vest and are otherwise in accordance with the Company's Stock Option Plan, and will expire on October 31, 2012.

As at July 24, 2008, there are 47,020,623 common shares and 5,725,000 stock options outstanding.

### ***Quarter ended March 31, 2008***

The Company realized a profit for the quarter ended March 31, 2008 of \$368,111 compared to a loss of \$4,691,361 for the same period last year. The improvement in results was mainly due to a \$4,571,918 reduction in stock-based compensation expenses..

During the quarter exploration expenditure of \$1,164,469 was incurred, comprising mainly geological and geophysical survey acquisition and processing of \$450,377, pre-development feasibility study of \$228,762 and salaries and benefits of \$185,579. Such amounts were capitalized as deferred petroleum exploration expenses.

### *Selected Annual Information*

Years Ended March 31,	2008 \$	2007 \$ (as restated)	2006 \$
Net loss	(1,956,299)	(5,471,408)	(588,037)
Per basic share	(0.040)	(0.120)	(0.024)
Per diluted share	(0.040)	(0.120)	(0.024)
Total assets	43,153,082	44,098,993	19,587,949
Total long-term financial liabilities	404,428	428,510	8,322,506

The following information has been extracted from the Company's consolidated audited financial statements:

The increase in loss of \$4,883,371 between 2007 and 2006 was mainly due to the recognition of \$5,970,256 of stock-based compensation in 2007.

#### Summary of Quarterly Results (Unaudited)

Quarter Ended	2008 Mar 31 \$	2007 Dec 31\$	2007 Sep 30 \$	2007 Jun 30 \$
Net profit (loss)	368,111	(632,317)	(742,000)	(950,093)
Per basic share	0.008	(0.013)	(0.016)	(0.020)
Per diluted share	0.008	(0.013)	(0.016)	(0.020)

Quarter Ended	2007 Mar 31 \$ (as restated)	2006 Dec 31 \$	2006 Sep 30 \$	2006 Jun 30 \$
Net (loss) profit	(4,691,361)	276,262	(560,212)	(496,097)
Per basic share	(0.100)	0.006	(0.012)	(0.011)
Per diluted share	(0.100)	0.006	(0.012)	(0.011)

The profit for the quarter ended December 31, 2006 of \$276,262 was mainly due to a foreign exchange gain of \$685,618, partially offset by an increase in stock-based compensation of \$528,600. The loss for the quarter ended March 31, 2007 of \$4,691,361 was mainly due to professional fees of \$109,950 and stock-based compensation of \$4,475,470 that were incurred.

The profit for the quarter ended March 31, 2008 of \$368,111 was mainly due to a foreign exchange gain of \$279,182 and FIT income tax rate change of \$100,046, partially offset by professional fees of \$92,075 and office expenses of \$61,357.

PEHI has an investor relations counsel CHF Investor Relations ([www.chfir.com](http://www.chfir.com)) who handles the Company's corporate communications in Canada. Phone: +1 416.868.1079; Fax: +1 416.868.6198. PEHI has a website at [www.primelineenergy.com](http://www.primelineenergy.com) or [www.pehi.com](http://www.pehi.com). The site features information on PEHI, new releases, background information and technical summary of the project.