

**Primary Petroleum Corporation**

Management Discussion and Analysis – Six Months ended November 30, 2007

(in Canadian dollars unless otherwise indicated)

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### **MANGAGEMENT DISCUSSION AND ANALYSIS**

The following management's discussion and analysis (MD&A) is a review of operations, current financial position and outlook for Primary Petroleum Corporation ("Primary" or the "Corporation") for the six months ended November 30, 2007. The MD&A should be read in conjunction with the audited consolidated financial statements for the years ended May 31, 2007 and 2006 and the related notes thereto. The accompanying unaudited interim consolidated financial statements of Primary have been prepared by management and approved by the Corporation's Audit Committee and Board of Directors. These interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates. This MD&A is based on information available to January 25, 2008.

### **FORWARD LOOKING STATEMENTS**

The MD&A contains certain forward-looking statements that involve substantial known and unknown risks and uncertainties which could cause actual events or results to differ materially from those reflected in the MD&A. Forward looking statements are based on estimates and opinions of the Corporation's management at the time the statements were made. The Corporation assumes no obligation to update forward-looking statements should circumstances or management's estimates change except as required under applicable laws. Readers are cautioned not to place undue reliance on the forward-looking information.

Additional information regarding Primary is available under the Corporation's profile on SEDAR at [www.sedar.com](http://www.sedar.com) or the Corporation's website at [www.primarypetroleum.com](http://www.primarypetroleum.com).

### **RESULTS OF OPERATIONS**

#### **Overview**

Primary is an exploration and development Canadian oil and gas corporation with its head office and operations based in Calgary, Alberta. The Corporation's mandate is exploration and development of the Western Sedimentary basin in the USA and Canada with a current focus on its significant land holdings in Montana, USA.

During the second quarter Primary achieved the following:

- Completed its Initial Public Offering for gross proceeds of \$8.5 million.
- Completed its planned 3D seismic shoot on its Pondera-Teton prospect lands in Montana providing further clarity to the drilling locations and priority of those locations for the fiscal third quarter drilling program.
- Increased its land holding in Montana by acquiring 100% interest in 54,798 acres.

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- Announced the acquisition of a private Montana based limited liability company, AP Petroleum Company LLC (“AP Petroleum”). AP Petroleum owns 100% interest in the Prairie Dell gas field, 31 producing wells with related production facilities. This acquisition will increase the Corporation’s undeveloped land in Montana by 81,300 gross acres (78,500 net acres) and will more than double the Corporation’s current gas production of 300 million cubic feet (“mcf”) per day to 700 mcf per day.

### **Revenues**

During the three months ended November 30, 2007, the Corporation’s oil and natural gas revenues increased from \$52,512 to \$162,398. Oil and natural gas revenue for the nine months ended November 30, 2007 also more than doubled from \$112,261 to \$326,688. The increase in current year oil and gas revenues is primarily from the successful gas well the Corporation drilled in the Swimming area in NE Alberta that came on stream in late November of 2006. This well has produced an average of 300 mcf per day at an average natural gas price of \$6.08 per mcf. The prior period oil and gas revenues are primarily related to a producing oil well at Little Bow that was sold in May 2007.

The Corporation earned interest income of \$58,380 for the three months ended November 30, 2007 which is 33% higher than \$43,883 for the comparable period. The increase is due to the higher cash balance resulting from the successful completion of the Corporation’s initial public offering on September 12, 2007. However, interest income for the six months ended November 30, 2007 was slightly lower at \$74,886 versus \$86,855 for the prior comparable period. This is the result of lower invested unused cash balances for the period June 1, 2007 to the completion of the IPO due to the capital expenditures for the exploration and development of its Montana Oil and Gas Properties.

### **Royalties**

The Corporation’s royalties as a percentage of sales on the producing well at Swimming, Alberta for the three months and six months ended November 30, 2007 were 49% and 46% respectively. This royalty rate reflects the crown royalty rate and the 15% override royalty pursuant to the farm-in agreement. The prior period royalty as a percentage of sales for both the three months and six months ended November 30, 2006 was 14% which represented the rate on the producing oil well at Little Bow.

### **Operating Costs**

Operating costs for both the three months and six months ended November 30, 2007 were \$29,615 and \$46,610 compared to \$55,193 and \$67,860 in 2006 as a result of lower operating costs for the gas well at Swimming versus the oil well at Little Bow.

### **General and Administrative Expense**

The Corporation’s general and administrative expenses for the three month and six month period ended November 30, 2007 were \$429,816 (2006 - \$253,648) and \$768,418 (2006 - \$464,155). The increase is a direct result of strengthening the management team, becoming a publicly traded company and expanding oil and gas operations.

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The Corporation does not capitalize general and administration expenses. The following table provides a breakdown of the Corporation's general and administrative expenses:

	Three Months ended November 30		Six Months ended November 30	
	2007	2006	2007	2006
Management compensation	\$ 57,960	\$ 61,083	\$ 117,960	\$ 86,583
Other compensation (i)	150,051	139,479	309,714	232,953
Legal, audit and public company	98,263	8,295	116,615	41,158
Office rent and other expenses	34,338	35,457	63,095	40,794
Technical software and supplies	47,002	8,782	88,098	22,105
Insurance	14,103	9,576	19,381	17,771
Travel and promotion	21,900	9,643	44,442	45,702
Other	6,199	(18,667)	9,113	(22,911)
	<b>\$ 429,816</b>	<b>\$ 253,648</b>	<b>\$ 768,418</b>	<b>\$ 464,155</b>

(i) Other compensation includes land, geological, and engineering consulting fees.

### Other Expenses

The stock-based compensation expense of \$10,078 for the three months ended November 30, 2007 and \$177,602 for the six months then ended relates to the Corporation's adoption of an incentive stock option plan in February 2007. The Corporation has primarily used consultants to achieve the growth to date and as a result the fair value of the stock options granted to consultants must be revalued each reporting period. The lower expense for the three months ended November 30, 2007 is due to the fair value adjustment resulting from the lower trading value of the Corporation's stock as at November 30, 2007.

The interest and accretion on the convertible notes is \$127,957 for the three months ended November 30, 2007 and \$166,289 for the six months ended as compared to \$74,335 reported for both comparable periods of 2006. The convertible notes were issued in September and October 2006. Accordingly, the increase in the interest and accretion expense is due to the notes being outstanding throughout the six months ended November 30, 2007.

During the three and six months ended November 30, 2007 the Corporation incurred a foreign currency translation expense of \$79,416 and \$86,031 respectively. Upon completing the initial public offering the Corporation increased its holdings of US dollars as it was about to commence the 3D seismic shoot in Montana. The exchange loss is due to the weakening US dollar between September and November 30, 2007. The foreign exchange gains in the comparative periods of November 30, 2006 were \$19,620 for the three months ended and \$31,397 for the six months ended, reflecting a strengthening US dollar during those periods.

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

For the three months ended November 30, 2007, the Corporation incurred \$187,971 of DD&A expense as compared to \$412,948 for the same period ended in 2006. DD&A for the six months ended November 30, 2007 is \$349,611 (2006 - \$915,164). The higher DD&A expense for 2006 is due to ceiling test write-downs included in the DD&A expense for the three months ended and six months ended November 30, 2006.

### Net Loss

For the three months ended November 30, 2007 and 2006, the Corporation had a loss from operations of \$723,884 and \$687,672, respectively. The net loss for the six month period ended November 30, 2007 was \$1,342,466 (2006 - \$1,306,975). The Corporation’s net loss in these periods reflects the early stage of oil and gas operations of the Corporation.

### Property and Equipment

The following table illustrates the capital spending by quarter for the six months ended November 30, 2007:

	Q1	Q2	Total
Lease acquisition	\$ 506,715	\$ 622,324	\$ 1,129,039
Geological & geophysical	92,004	1,083,352	1,175,356
Drill, complete & equip	387,265	137,513	524,778
Facilities and flowlines	1,847	7,457	9,304
Office	3,476	4,257	7,733
Total	\$ 991,307	\$ 1,854,903	\$ 2,846,210

During the fiscal second quarter the Corporation’s capital spending for land acquisition was primarily for increasing its undeveloped land base in Montana. The most significant capital expenditure for the second quarter was for the completion of the Pondera – Teton 3-D seismic program necessary to confirm and prioritize the drilling locations for the third quarter.

### Income Taxes

Primary has approximately \$11,500,000 of tax pools and \$2,600,000 of non-capital loss carry-forwards available for deduction against future taxable income. Non-capital losses begin to expire in 2015. The future tax asset has not been recognized due to the uncertainty of the Corporation’s ability to generate the income to utilize the benefit of the tax pools.

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### Segmented Information

The Corporation operates in one reportable operating or industry segment which is the exploration and development of resource property. The Corporation does report information relating to exploration and development on a geographical basis split between Canada and the United States.

For the three months and six months ended November 30, 2007 and 2006, all oil and gas revenues and interest income were recorded in Canada, as were interest expense and depletion and depreciation. Net income attributed to the United States for the three months ended November 30, 2007 is \$6,432 as compared to a loss of \$6,598 in 2006. For the six months ended November 30, 2007 the Corporation reported a loss of \$1,136 for US operations as compared to a loss of \$15,434 for the comparable period last year. Overall net income or loss from US operations represents less than 1% of the Corporations net loss for those reporting periods.

Due to the Corporation's growing focus on its opportunities in Montana, capital spending in the United States as a percentage of the Corporation's total expenditures is increasing. Capital spending in the United States was \$1,662,465 for the quarter ended November 30, 2007 (90% of the total) compared to \$760,717 (37%) for the second quarter last year. Accordingly, capital spending of \$2,203,401 for the six months ended November 30, 2007 (77% of the total) is higher than the \$1,757,610 (49%) spent in the prior period.

The loan receivable of \$183,887 relates entirely to oil and gas operations in the United States.

Property and equipment in the United States was \$6,808,921, 80% of the total \$8,543,248, as at November 30, 2007.

### SUMMARY OF QUARTERLY RESULTS

(000's )	2008		2007				2006	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	\$ 141	\$ 111	\$ 153	\$ 172	\$ 89	\$ 94	\$ 40	\$ 6
Loss	(647)	(619)	(776)	(1,117)	(688)	(619)	(2,853)	(57)
Loss per share (basic and fully diluted)	(0.02)	(0.02)	(0.03)	(0.05)	(0.03)	(0.02)	(0.21)	(0.01)

Due to the Corporation's early stage of operations, oil and gas production revenue does not support the Corporation's expenses resulting in losses each quarter. The losses in the third fiscal quarter of 2007 and the fourth fiscal quarter of 2006 are higher due to ceiling test write-downs.

### Liquidity and Capital Resources

On September 12, 2007, the Corporation completed an initial public offering (the "Offering") of 8,500,000 units at the price of \$1.00 per unit for gross proceeds of \$8,500,000. Each unit consisted of one common share and one-half of a share purchase warrant. Each warrant is exercisable at a price of \$1.35 per share prior to September 12, 2009. In relation to this offering, the Corporation incurred a cash commission of 8% of the gross proceeds, issued 100,000 units for a corporate finance fee, issued 745,000 agent's warrants exercisable at a price of \$1.35 per share prior to September 12, 2009.

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The Corporation's working capital balance is \$2,405,715 at November 30, 2007 compared with \$948,072 as at May 31, 2007. The increase is due to the successful completion of the Offering on September 12, 2007 offset by the inclusion of \$2,250,000 of convertible notes as a current liability as their maturity date is less than one year from November 30, 2007.

As at January 25, 2007, the Corporation had issued 35,518,317 common shares. As at that date it, has also issued warrants and granted options to purchase up to 18,883,020 common shares pursuant to subscription receipts, warrants and grants under the Corporation's Option Plan.

Primary's capital budget for the remaining six months of the fiscal year is approximately \$4.9 million. In addition the cash consideration for the acquisition of AP Petroleum LLC is \$2.7 million. Primary will require additional funding to complete its planned capital program and the acquisition of AP Petroleum LLC. Additional capital will be in the form of equity, debt, joint venture farmouts or some combination thereof. The Corporation's future operations are dependent upon its ability to obtain additional financing and ultimately achieve profitable operations. The outcome of these matters cannot be predicted with certainty at this time.

### **Asset retirement obligation**

The asset retirement obligation results from the Corporation's net ownership interests in petroleum and natural gas assets including well sites and gathering systems. The Company estimates the net present value of its asset retirement obligation based on total undiscounted future liabilities measured as at November 30, 2007 of \$273,432 (May 31, 2007 – \$389,573), using a credit adjusted risk free interest rate of 8% and an inflation rate of 2% over a period of one to three years. For the six months ended November 30, 2007 the Corporation incurred \$45,351 of additions and revisions, \$11,510 of accretion and \$173,002 of costs related to asset retirement.

### **Related Party Transactions**

During the six month period ended November 30, 2007, the Corporation had the following related party transactions occurring in the normal course of operations and were recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties:

- a) Management and consulting fees totaling \$120,000 (2006 – \$85,500) were charged to the Corporation by companies controlled by directors and officers of the Corporation. At November 30, 2007, \$nil (May 31, 2007 - \$10,600) payable in relation to these services is included in accounts payable and accrued liabilities.
- b) Legal fees of \$1,350 (2006 – \$nil) were charged to the Corporation by a legal firm of which a director of the Corporation is a member. At November 30, 2007 \$468 (May 31, 2007 – \$4,160) payable in relation to these services is included in accounts payable and accrued liabilities.

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### Commitments

The Corporation has the following long term commitments;

- a) Pursuant to an agreement dated July 26, 2006, the Corporation has committed to purchase a minimum of 100,000 and up to 300,000 net mineral acres in Montana, with a net revenue interest of not less than 85% to the Corporation, at a cost of US \$12.50 per acre plus the issue of one-half of a common share of the Corporation for each acre acquired. 79,232 acres were acquired as of November 30, (May 31, 2007 – 35,000). As at November 30, 2007, the Corporation has accrued a liability of \$39,616 (May 31, 2007 – \$17,500) with respect to the issuance of the shares, but has not yet issued the shares.
- b) Pursuant to an agreement dated August 31, 2006, finder's fees are payable by the Corporation upon the completion of certain Powder River prospect land acquisitions in Montana. The amount of final obligation is not determinable at this time. The fees are payable on the basis of the issuance of one common share of the Corporation for each acre acquired. 79,232 acres were acquired as of November 30, 2007 (May 31, 2007 – 35,000). As at November 30, 2007, the Corporation has accrued a liability of \$79,232 (May 31, 2007 – \$35,000) with respect to the issuance of the shares, but has not yet issued the shares.
- c) The Corporation has a five year lease agreement expiring on March 1, 2012 with a minimum rent of \$123,172 per annum excluding operating costs.

The Company does not have any other off-balance sheet financing arrangements.

### Subsequent events

- (a) On December 14, 2007, the Corporation acquired all of the issued and outstanding units of AP Petroleum Corporation LLC ("AP"), a Montana limited liability company involved in the production of natural gas in the state of Montana. The acquisition will be accounted for by the purchase method of accounting. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of the acquisition. The Company is in the process of finalizing the estimated fair values and therefore, the allocation of the purchase price is subject to change.

<b>Net assets acquired:</b>	
Working capital	\$ 162,762
Petroleum and natural gas properties	4,198,628
Asset retirement obligation	(658,985)
	<b>3,702,405</b>
<b>Consideration:</b>	
Cash	2,708,421
Issuance of 1,205,049 shares (i)	641,524
Issuance of 269,529 shares as a finders fee	169,803
Issuance of warrants	117,657
Cash transaction costs	65,000
	<b>\$ 3,702,405</b>

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- (i) The issuance of the shares was valued at \$0.63 (the average 5 day trading price of the Company's stock including the day of the announcement of November 29, 2007). Each unit of common stock will consist of one common share plus a one year warrant exercisable into one common share at a price of \$1.10. In addition, the Company incurred a finders fee which will be settled with the issuance of 269,529 common.
  
- (b) On January 15, 2008 the Corporation settled its note receivable of \$178,701 as of November 30, 2007 in exchange for the assignment of the oil and natural gas leases held for security and a cash payment of US \$45,000.

### **Financial Reporting Controls**

Management of Primary is responsible for designing and maintaining internal controls over financial reporting and disclosure controls and procedures. Internal controls over financial reporting and disclosure controls and procedures are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with Canadian GAAP. These controls may not prevent or detect fraud or misstatements because of inherent limitations in any system of internal controls. During the review of the design of the Corporation's control system over financial reporting, it was noted that, due to the limited number of staff at Primary, it is not feasible to achieve complete segregation of duties. The limited number of staff may also result in identifying weaknesses in accounting for complex or non-routine transactions due to a lack of the technical resources within the Corporation. There were no significant changes in the design of the Corporation's internal controls over financial reporting or disclosure controls and procedures during the reporting period.

### **Changes in Accounting Policies**

As of June 1, 2007, the Corporation adopted the CICA Handbook Section 1506 "Accounting Changes", Section 1530 "Comprehensive Income", Section 3251 "Equity", Sections 3855 "Financial Instruments – Recognition and Measurement", 3862 "Financial Instruments – Disclosures", 3863 "Financial Instruments – Presentation" and Section 3865 "Hedges". These standards have been applied retrospectively and did not result in any changes to the presentation or restatements of the Corporation's prior period financial statements.

- (a) Section 1506 "Accounting Changes" for changes in accounting policies and correction of errors shall be applied retrospectively with restatement unless otherwise permitted or where impractical to determine, changes in accounting estimates shall be applied prospectively.
  
- (b) Section 1530 "Comprehensive Income" establishes standards for reporting and disclosing of comprehensive income and other comprehensive income which resulted in the change in equity (net assets) of the Corporation from non-owner resources except those resulted from investments by owners and distributions to owners, but excluded from net income.

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- (c) Section 3251 “Equity” establishes standards for the reporting and disclosing equity and changes in equity during the Corporation’s reporting periods and is applied in conjunction with Section 1530 “Comprehensive Income”.
- (d) Section 3855 “Financial Instruments – Recognition and Measurement” establishes standards for recognizing and measuring financial instruments including financial assets, financial liabilities and non-financial derivatives. After initial recognition at fair value all financial instruments shall be accounted for subsequently as follows:
  - (i) Held for trading financial instruments are measured at fair value with gains or losses recognized in earnings immediately.
  - (ii) Held-to-maturity investments, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest rate method. The amortization of transaction costs, premiums or discounts and impairment losses are recorded in earnings when occurred.
  - (iii) Available-for-sale financial assets are measured at fair value with gains or losses, except impairment losses, recognized in other comprehensive income and transferred to earnings when the asset is derecognized.
  - (iv) Non-financial derivatives must be classified as held for trading and are measured at fair value as derivative assets and liabilities with gains or losses recognized in earnings immediately unless they are designated as part of hedging relation and meet the necessary criteria.
- (e) Section 3862 “Financial Instruments – Disclosures”, 3863 “Financial Instruments – Presentation” establishes new standards for the disclosure of financial instruments and their presentation. These two Sections are applied in conjunction with Section 1530 “Comprehensive Income”, Sections 3855 “Financial Instruments – Recognition and Measurement” and Section 3865 “Hedges”.
- (f) Section 3865 “Hedges” establishes certain criteria for the alternative accounting treatment of non-financial derivatives otherwise would have been accounted for under Section 3855 “Financial Instruments – Recognition and Measurement”. Under hedge accounting, gains and losses on non-financial derivatives classified as effective hedges are included in other comprehensive income until such time at which the hedge is realized.

The Corporation does not have any prior period accounting changes, hedges or any adjustments in other comprehensive income and therefore comprehensive income is currently equal to net income.

Effective June 1, 2008, the Corporation will be required to adopt the CICA Section 1535 “Capital Disclosures” which establishes additional reporting of objectives, policies and processes of how the Corporation manages its capital as well as its compliance with externally imposed capital requirement.

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### **Outlook**

Management of Primary is very excited about the Corporation's upcoming Teton drilling program in Montana which commenced January 18, 2008. The key targets for these wells are the Madison oil and Sunburst gas formations. The estimated depth for the wells is approximately 3500 feet (1067 meters) and management anticipates that the program should be complete in approximately three months.

In addition the Corporation is testing a gas well at Twin Lakes, Alberta. Early results are very encouraging, however tie-in will be contingent analysis of the final test results and available funding.

During the next quarter management of Primary will be evaluating its options for raising additional capital to complete its capital program. The Corporation's future operations are dependent upon its ability to obtain additional financing and ultimately achieve profitable operations.