



MANAGEMENT DISCUSSION AND ANALYSIS (“MD&A”)

The following MD&A of Pyramid Petroleum Inc. (“Pyramid” or the “Company”), dated August 28, 2008, should be read in conjunction with the Company’s unaudited interim consolidated financial statements for the three and six months ended June 30, 2008 and the audited consolidated financial statements for the year ended December 31, 2007, which have been filed on www.SEDAR.com.

BASIS OF PRESENTATION

The consolidated financial data presented below has been prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”) for the Company and its wholly owned subsidiaries. The reporting and the measurement currency is the United States dollar. This MD&A and the accompanying unaudited interim consolidated financial statements for the three and six months ended June 30, 2008, have been approved by the Board of Directors and Audit Committee of the Company.

NON-GAAP MEASURES

Within this MD&A references are made to terms commonly used in the oil and gas industry. Cash flow from operations, cash flow per share, and net oil and gas revenue are terms not defined by Canadian GAAP and are referred to as non-GAAP measures. Cash flow from operations represents net (loss) income for the period adjusted for non-cash items in the Consolidated Statements of Net (Loss) Income as detailed on the Consolidated Statements of Cash Flows. Cash flow per share is calculated based on the weighted average number of common shares outstanding consistent with the calculation of net income per share. Net oil and gas revenue represents revenue less royalties and operating expenses. Management believes that net oil and gas revenue is a useful supplemental measure as it provides an indication of the Company’s operating performance, leverage and liquidity.

In conformity with National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities, natural gas volumes have been converted to barrels of oil equivalent (“boe”) using a conversion ratio of six thousand cubic feet (“mcf”) of natural gas to one barrel of oil (“bbl”). This ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Readers are cautioned that boe’s may be misleading, particularly if used in isolation.

FORWARD-LOOKING INFORMATION

Certain statements herein may constitute forward-looking information, which can generally be identified as such because of the context of the statements including words such as believes, anticipates, expects, plans, estimates, or words of a similar nature. The forward-looking statements are based on current expectations and are subject to known and unknown risks, uncertainties, and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results.

All such forward-looking information is based on certain assumptions and analyses made by Pyramid in light of the Company’s experience and perception of historical trends, current conditions and expected future developments, as well as other factors Pyramid believes are appropriate in the circumstances. The risks, uncertainties, and assumptions are difficult to predict and may affect operations, including, without limitation: the risks of foreign operations; foreign exchange fluctuations; commodity prices; equipment and labor shortages; inflationary costs; general economic conditions; industry conditions; changes in applicable environmental, taxation and other laws and regulations as well as how such laws and

regulations are interpreted and enforced; the ability of oil and natural gas companies to raise capital; the effect of weather conditions on operations and facilities; the existence of operating risks; volatility of oil and natural gas prices; oil and natural gas product supply and demand; uncertainties associated with estimating reserves; incorrect assessments of the value of acquisitions; geological, technical, drilling and processing problems; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; increased competition; stock market volatility; opportunities available to or pursued by Pyramid; and other factors, many of which are beyond the Company's control. The foregoing factors are not exhaustive.

FUNCTIONAL AND REPORTING CURRENCY

Effective April 1, 2007, the Company changed its functional currency from the Canadian dollar to the U.S. dollar. This change was made as a result of the acquisition of MC Offshore Petroleum, LLC with its capital expenditures, revenues and expenses denominated in U.S. dollars becoming the predominant currency for the Company's cash flows. Concurrent with the change of functional currency to the U.S. dollar, the Company also changed its reporting currency to the U.S. dollar effective April 1, 2007. For comparative purposes, historical financial statements have been translated into the reporting currency of U.S. dollars using the current rate method. Under this method, assets and liabilities are translated at the closing rate in effect at the end of the comparative period; revenues, expenses and cash flows are translated at the average rate in effect for the period; and equity transactions are translated at historical rates.

All references to dollar amounts herein are in U.S. dollars.

DESCRIPTION OF BUSINESS

Pyramid was incorporated pursuant to the provisions of the Business Corporations Act (Alberta) on March 11, 2005 as a Capital Pool Company as defined in Policy 2.4 of the TSX Venture Exchange. The Company closed its Initial Public Offering (IPO) on October 19, 2005. The Company completed its Qualifying Transaction (the "Qualifying Transaction") on May 4, 2006 and started trading as a non Capital Pool Company on May 12, 2006. The Qualifying Transaction was constituted by the acquisition of certain oil and gas assets located in Alberta, Canada and Montana, United States from a founding shareholder of the Company. On October 3, 2006, the Company purchased the remaining working interest owned by its Officer and Director in certain oil and gas properties where the Company had earlier purchased a working interest as part of the Qualifying Transaction.

On August 31, 2006, the Company completed the acquisition of a varying working interest, ranging from 1.25% to 5%, in certain oil and gas properties in the Gulf of Mexico from an arms-length party through a company controlled by an Officer and Director.

On April 1, 2007 the Company closed its purchase of a 20% membership share interest in a limited liability company, MCOP Offshore Petroleum Company (the "LLC"). On May 17, 2007, the Company increased its share ownership in the LLC to 50%. The LLC was organized for the purpose of acquiring an interest in certain oil and gas properties from an arms length party, consisting of varying non-operated working interests, ranging from 25% to 100%, in 46 producing and 16 non producing oil and gas wells in the Gulf of Mexico.

As the LLC is controlled and operated jointly by the members, the acquisition is considered to be the acquisition of an interest in a joint venture whereby only the Company's proportionate interest in the LLC is consolidated.

The assets acquired in August 2006 and those through the LLC are referred to as GOM Assets in this MD&A.

On June 18, 2008 the Company closed on the sale of its interests in oil and gas assets located in Alberta, Canada and Montana, United States to an unrelated party. The contract sales amount of \$6.3 million

consisted of \$5.8 million cash and \$500,000 adjustment to the purchase price of the assets acquired from the unrelated party, as described below.

On June 18, 2008 the Company closed on the acquisition of a 25% working interest in oil and gas assets located in offshore Texas state waters from an unrelated party. The contract acquisition cost of \$1.5 million consisted of a \$500,000 adjustment in the sales price of the Alberta and Montana properties described above and a promissory note in the amount of \$1.0 million.

Pyramid is a reporting issuer in British Columbia, Alberta and Ontario and trades on the TSX Venture Exchange (“TSXV”) under the symbol PYR.

CONSOLIDATED RESULTS HIGHLIGHTS

Following is the summary of financial results for the Company for the three and six months ended June 30, 2008 and 2007.

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Statement of Operations and Deficit				
Oil and gas sales (\$), net of royalties	7,911,854	3,216,621	15,474,746	3,935,065
Total sales volumes (boe 6:1) - net of royalties	87,907	58,761	209,592	75,869
Daily sales volumes (boe 6:1) - net of royalties	966	646	1,152	419
Oil and gas sales per boe (\$)	90.00	54.74	73.83	51.87
Net oil and gas revenue (\$)	5,775,503	2,335,805	11,431,056	2,860,995
Net oil and gas revenue per boe (\$)	65.70	39.75	54.54	37.71
Net income for the period (\$)	(892,913)	353,090	980,896	468,467
Net income per share – basic and diluted (\$)	(0.02)	0.01	0.03	0.01
Statement of Cash Flows				
Cash flow from operations (\$)	4,286,158	1,170,513	8,596,564	1,503,792
Cash flow per share - basic and diluted (\$)	0.11	0.03	0.23	0.04
Weighted average number of shares – basic	37,473,541	36,617,458	37,395,568	36,611,310

RESULTS OF OPERATIONS

Revenues, net of royalties, for the three and six months ended June 30, 2008 were \$7,911,854 and \$15,474,746, respectively. Revenues for the comparable periods in 2007 were \$718,444 and \$3,935,065. The increases in revenue are primarily due to the LLC acquisition at March 29, 2007, and higher commodity prices in 2008. Operating expenses for the three and six months ended June 30, 2008 were \$2,136,351 and \$4,043,690, respectively. Operating expenses for the same periods in 2007 were \$880,816 and \$1,074,070, respectively. The increases in operating expenses are also attributed to the LLC acquisition. General and administrative expenses for the three and six months ended June 30, 2008 were \$673,855 and \$1,146,723, respectively. General and administrative expenses for the comparable periods in 2007 were \$232,129 and \$363,925, respectively. The increases in general and administrative expenses are due to increased activity resulting from the LLC acquisition as well as increased compliance and operational requirements of a larger combined company. Depreciation, depletion, and accretion expenses

for the three and six months ended June 30, 2008 were \$1,469,073 and \$3,431,721, respectively, in comparison with \$666,079 and \$869,384, respectively, for the same periods in 2007. The increases in depreciation, depletion and accretion expenses are due to the increase in the Company's asset base combined with the increase in production volumes resulting from the LLC acquisition. The Company incurred a loss on disposition of property and equipment in the amount of \$3,138,990 for the three and six months ended June 30, 2008. Disposition of the property and underlying proved reserves resulted in a change in the Company's cost depletion rate that was in excess of 20%, requiring that the loss be charged to operations rather than the Company's full cost pool. Stock-based compensation expenses for the three and six months ended June 30, 2008 were \$302,477 and \$324,706, respectively. The expenses were attributable to the fair value of stock options granted during the periods.

Net (loss) income for the three and six months ended June 30, 2008 was (\$892,913) and \$980,896, respectively, compared to \$658,420 and \$773,797, respectively, for the comparative periods in 2007.

Cash flow from operations for the three and six months ended June 30, 2008 was \$4,286,158 and \$8,596,564, respectively, compared to \$1,170,513 and \$1,503,792 for the same periods in 2007.

A summary of the results of operations for last eight quarters is as follows:

Three Months ended (\$)	2008 Q2	2008 Q1	2007 Q4	2007 Q3	2007 Q2	2007 Q1	2006 Q4	2006 Q3	2006 Q2
Net oil and gas revenue ⁽¹⁾	5,775,503	5,655,553	4,279,937	3,752,702	2,240,355	491,374	581,771	443,388	90,720
Net income (loss)	(892,913)	1,873,809	1,727,978	397,234	549,051	10,070	(1,956,577)	29,204	(113,508)
Net income (loss) per share	(0.02)	0.05	0.05	0.01	0.01	-	(0.05)	-	(0.01)
Cash flow from operations ⁽¹⁾	4,286,158	4,310,406	4,571,623	2,118,455	1,223,255	236,183	85,436	333,950	92,841
Cash flow from operations/share	0.11	0.12	0.12	0.06	0.03	0.01	-	0.01	-
Net capital expenditures	293,395	716,361	1,054,414	2,428,737	1,120,144	147,204	1,654	270,065	102,879

PRODUCTION VOLUMES

The Company's production volumes, net of royalties, for the comparative quarters are as follows:

	Q1 2008				Q1 2007			
	Gas	Oil	NGL	Total	Gas	Oil	NGL	Total
	mcf/d	bbls/d	bbls/d	boe/d	mcf/d	bbls/d	bbls/d	boe/d
Alberta	36	-	-	6	39	-	-	7
Montana	630	9	-	114	648	11	-	118
Gulf of Mexico	3,236	460	139	1,139	350	5	-	63
Total	3,902	469	139	1,259	1,037	16	-	188

	Q2 2008				Q2 2007			
	Gas	Oil	NGL	Total	Gas	Oil	NGL	Total
	mcf/d	bbls/d	bbls/d	boe/d	mcf/d	bbls/d	bbls/d	boe/d
Alberta	30	0	-	5	41	-	-	7
Montana	535	9	-	98	653	10	-	119
Gulf of Mexico (1)	1,943	447	93	863	1,919	385	-	705
Total	2,508	455	93	966	2,613	395	-	831

(1) Reduced by gas imbalance settlements during the period of 590 mcf/d (98 boe/d)

CAPITAL EXPENDITURES

Capital expenditures totaled \$293,395 and \$1,009,756 for the three and six months ended June 30, respectively, and \$1,242,413 and \$1,389,617 for the three and six months ended June 30, 2007, respectively.

The capital expenditures incurred during the three months ended June 30, 2008, include prospect acquisition costs in the amount of \$216,000 for the Company's participation in offshore drilling prospects.

DEBT AND WORKING CAPITAL

As at June 30, 2008, the Company had current assets of \$11,145,777 and current liabilities of \$10,901,013. Included in current liabilities is a term note in the amount of \$1,559,898 for which debt service payments are required from approximately 80% of net operating revenues from the properties that are collateralized to the lenders. Also included in current liabilities are related party amounts payable to companies controlled by an Officer and Director of the Company in the amount of \$1,088,479.

The following table summarizes the cash flow from operating, investing and financing activities for the three and six months ended June 30, 2008 and 2007:

	Three months ended March 31		Six months ended June 30	
	2008	2007	2008	2007
Cash from operating activities (\$)	7,940,059	287,705	11,656,835	533,332
Cash provided (used) by financing activities (\$)	(9,285,004)	1,065,017	(12,969,927)	1,264,348
Cash provided (used) by investing activities (\$)	2,480,235	(1,172,170)	3,665,129	(1,720,621)

At June 30, 2008, the Company had the following contractual obligations, including debt of \$2,559,898.

	Total	Less than 1 year	1-3 years	After 3 years
Term note ⁽¹⁾	\$ 1,559,898	\$ 1,559,898	\$ -	\$ -
Due to related parties	1,088,479	1,088,479	-	-
Convertible debenture	815,757	-	815,757	-
Promissory note ⁽²⁾	1,000,000	-	1,000,000	-
Drilling commitments ⁽³⁾	3,084,000	3,084,000	-	-
Asset Retirement Obligations ⁽⁴⁾	24,046,790	209,078	1,349,815	22,487,897
Premises lease	730,568	196,424	405,510	128,634
Total contractual obligations	\$ 32,325,492	\$ 6,137,879	\$ 3,571,082	\$ 22,616,531

⁽¹⁾ The term note is paid in full as of the reporting date.

⁽²⁾ The promissory note was issued in conjunction with an acquisition that closed in June 2008. The note carries an interest rate of 8%, payable monthly, and the principal is due in December 2010.

⁽³⁾ The obligation for drilling commitment is for a 3 well farm-in agreement whereby the Company is not liable to any penalty or charges if the Company decides to not participate in subsequent wells after the first well. Pyramid plans to raise equity financing to fund its participation in these wells.

⁽⁴⁾ Undiscounted future cash flows, of which \$12,350,000 of Asset Retirement Obligation will be covered by performance bonds in place or sinking fund arrangements as described in financial statements note 6, for which \$2,918,588 is in the form of cash collateral as at June 30, 2008. Subsequently, another \$1,375,000 of cash deposits were made in the collateral account.

Upon abandonment, the Company would receive approximately \$4,380,300 of salvage proceeds and release of any cash collateral in the bonds plus accrued interest.

OUTSTANDING SHARE DATA

Common shares

As of June 30, 2008 and December 31, 2007, the Company had a total of 37,692,039 and 37,317,595 common shares outstanding, respectively. There has been no change in the number of common shares outstanding as at the date of this MD&A.

A total of 8,728,716 common shares remained in escrow at June 30, 2008. The following table outlines the future releases of those shares from escrow.

Release Date	November 11, 2008	May 11, 2009
Number of shares	4,364,358	4,364,358

Broker Warrants

As at December 31, 2007 and June 30, 2008, the Company had 65,644 broker warrants outstanding. There has been no change in the number of warrants outstanding as at the date of this MD&A.

Stock Options

As at December 31, 2007, the Company had 900,000 stock options outstanding. In February 2008, the Company granted 200,000 stock options to an investor relations firm. In May 2008 the Company granted 2,110,000 stock options to employees, officers and directors of the Company, and 230,000 options to acquire common stock were exercised, resulting in an increase in the number of stock options outstanding as at the date of this MD&A to 2,980,000.

RELATED PARTY TRANSACTIONS

During the three and six months ended June 30, 2008, the Company paid \$28,181 and \$57,598, respectively (three and six months ended June 30, 2007 – \$54,534 and \$109,069, respectively) of interest on amounts due to related parties. Disclosure of amounts due to related parties is provided in note 10 of the unaudited interim consolidated financial statements for the three and six months ended June 30, 2008.

During the three and six months ended June 30, 2008, the Company paid \$nil and \$87,346 of contract operating fees to a related party controlled by an Officer and Director of the Company.

As at June 30, 2008, accounts receivable included \$236,274 (December 31, 2007 – \$236,274) due from the LLC for capital expenditures paid by the Company on behalf of the LLC.

COMMITMENTS

The Company is required to contribute 20% of the monthly net profits from the properties owned through the LLC towards an abandonment fund (the “Fund”) established by the Seller as an additional guarantee against the plugging and abandonment liabilities associated with the properties.

Net profits is defined in the Fund agreement as: the monies and revenues payable from gross production of the properties less (i) costs and expenses incurred attributed to the properties with respect to all existing wells located on the properties, including but not limited to the costs and expenses of operating the wells and for producing, treating and storing production from the wells; (ii) capital expenditures related to the properties; (iii) certain taxes assessed against production relating to the property; and (iv) all royalty

burdens and other lease burdens affecting the properties. Where the net profit for a particular month is determined to be negative (a net loss), no contribution to the Fund is required for the related month.

Contributions to the Fund commence based on the net profits of the March 2008 production month for which \$1,345,033 has been incurred as at June 30, 2008. The Company's maximum amount of contribution to the Fund is \$5.0 million. Upon satisfactory performance of plugging and abandonment obligations, the Company may request a release of the bonding amount and funds may be withdrawn from the Fund to a maximum of the Fund balance.

The Company has secured \$5.0 million of uncollateralized performance bonds through an unrelated corporation (the "Lender") with whom the Company also has a term note related to the acquisition of LLC membership shares. The Lender obtained the bonds through a surety company for which it has posted a letter of credit and corporate guarantee in favor of certain regulatory authorities. In connection with these bonds, the Company is required to pay the Lender a fee at a rate of 10% per annum on the \$5 million bond amount. During the three and six months ended June 30, 2008, the Company paid \$124,657 and \$249,315, respectively, of fees which are included in interest expense in the unaudited interim consolidated statements of net (loss) income for the three and six months ended June 30, 2008.

Upon full repayment of the term note, the Company will continue to make monthly installments to the Lender, up to a total of \$5.0 million, which will be deposited to an account in the LLC's name to provide for cash collateral on the bonds to replace the Lender's letter of credit and corporate guarantee. The installments are based on 80% of the monthly net proceeds (revenue less royalties, net profits interests and direct operating expenses) from certain Gulf of Mexico properties to be not less than \$500,000 per month. In August 2008 the Company funded an initial deposit of \$1,375,000 to the cash collateral account.

All bonds become available for release once the subject properties are abandoned and satisfactorily reclaimed at which time all cash collateral will be returned to the LLC.

FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company's financial instruments include cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The carrying values of these financial instruments approximate their fair values due to their relatively short periods to maturity.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

Information on the Company's financial instruments and financial risk management is discussed in note 19 to the unaudited interim consolidated financial statements for the three and six months ended June 30, 2008.

CAPITAL MANAGEMENT

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include working capital and shareholders' equity. The Company monitors capital based on annual funds from operations and capital expenditure budgets, which

are updated as necessary and are reviewed and periodically approved by the Company's Board of Directors.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other facts that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

In order to maintain or adjust the capital structure, the Company considers its forecasted funds from operations while attempting to finance an acceptable capital expenditure program including acquisition opportunities, the current level of bank credit available from the Company's lender, the level of bank credit that may be attainable from its lender as a result of petroleum and natural gas reserve growth, the availability of other sources of debt with different characteristics than existing debt, the sale of assets, limiting the size of the capital expenditure program and the issue of new equity if available on favorable terms. The Company's capital structure is not subject to external restrictions.

There has been no change in the Company's approach to capital management during the period ended June 30, 2008.

SUBSEQUENT EVENTS

- (a) On July 31, 2008, the Company paid the remaining balance of \$1,559,898 of the Term Note as described in note 9.
- (b) On August 7, 2008, the Company made an initial payment of \$1,375,000 for bond collateral as described in note 6 (c).
- (c) On August 19, 2008, the Company's properties that were acquired in August 2008, as described in note 10(d) of the financial statements, were included in a sale of the property interests by the Related Company's Bank. At June 30, 2008 the Company reported a balance owed to the Related Company in the amount of \$747,212. As a result of the sale the entire payable balance will be paid in full with no further amounts due to, or from, the Related Company.

CORPORATE OUTLOOK

The Company acquired significant assets in the Gulf of Mexico area during the year ended December 31, 2007, as detailed in 'Description of Business'. With this acquisition the Company established the Gulf of Mexico as a core area for growth and intends to pursue further acquisitions and explorations in that area. The Company is focusing on developing the unproved categories of reserves acquired during the acquisitions, while continuing to acquire more oil and properties in the Gulf of Mexico, utilizing the experience of the management team.

The Company will strive to create sustainable growth in reserves, production, and cash flow through focusing on the creation of a diversified portfolio of development and exploration properties. This process requires careful selection of good quality projects and the current management team has the required experience to do this. The Company understands that it is at an early stage of operations and that it would be prudent to apply risk management techniques, adopting a 'portfolio' approach toward capital expenditures.

CHANGES IN ACCOUNTING POLICIES

On January 1, 2008, the Company adopted the new or revised Canadian accounting standards for financial instruments – presentation, financial instruments – disclosure, capital disclosures and inventories as disclosed in note 3 to the unaudited interim consolidated financial statements for the three and six

months ended June 30, 2008. The adoption of these policies had no impact on the Company's financial statements.

PENDING ACCOUNTING PRONOUNCEMENTS

The Company is currently assessing the impact of the following new standards on its consolidated financial statements:

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

In 2005, the Accounting Standards Board of Canada ("AcSB") announced that accounting standards in Canada are to converge with IFRS. The AcSB has indicated that Canadian entities will need to begin reporting under IFRS by the first quarter of 2011 with appropriate comparative data from the prior year. Under IFRS, the primary audience is capital markets and as a result, there is significantly more disclosure required, specifically for quarterly reporting. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy which must be addressed.

(ii) Goodwill and Intangible Assets

In January 2008, Section 3064 Goodwill and Intangible Assets was issued to replace Section 3062 Goodwill and Other Intangible Assets and Section 3450 Research and Development Costs. This standard aligns Canadian GAAP with IFRS and will be effective on October 1, 2008.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified by securities regulations and that information required to be disclosed is accumulated and communicated to management.

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of Corporation's disclosure controls and procedures as of June 30, 2008 and have concluded that they are adequate and effective to provide reasonable assurance that material information related to the Company is made known to them by others within the Company. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

INTERNAL CONTROLS AND FINANCIAL REPORTING

The Chief Executive Officer and Chief Financial Officer of the Company are responsible for designing internal control over financial reporting in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. We have assessed the design of our internal control over financial reporting and during this process we identified certain weaknesses in internal controls over financial reporting. Due to the limited number of staff at the Company, it is not feasible to achieve complete segregation of incompatible duties. The CEO and CFO have been with the Company since its inception and have extensive industry experience. They are actively involved in the Company's on-going activities. As such, the capabilities and involvement of the CEO and CFO serve to mitigate the structural weakness of internal controls. Their efforts, together with the active involvement of the board of directors, are directed to minimize the risk of a material misstatement in financial reporting. However, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement.

CRITICAL ACCOUNTING ESTIMATES

The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles. A comprehensive discussion of the Company's significant accounting policies is contained in note 3 to the audited consolidated financial statements for the year ended December 31, 2007. The Company's significant accounting policies are subject to estimates and key judgments about future events, many of which are beyond management's control. A detailed discussion of the critical accounting estimates of the Company is provided in the December 31, 2007 Management's Discussion and Analysis.

BUSINESS RISKS AND UNCERTAINTIES

The Company was recently incorporated and began operations in May 2006 after the completion of the Qualifying Transaction. It has a short history of earnings and has never paid any dividends. The Company expects to have increased earnings from assets acquired and additional acquisitions that the Company is pursuing, although there is no plan to pay any dividends now or in future; instead these earnings will be employed by the Company for future growth plans.

The Company is exposed to several operational risks inherent in exploring, developing, producing and marketing crude oil and natural gas. These inherent risks include: economic risk of finding and producing reserves at a reasonable cost; financial risk of marketing reserves at an acceptable price given current market conditions; cost of capital risk associated with securing the needed capital to carry out the Company's operations; risk of environment impact and credit risk of non-payment for sales contracts and joint venture partners.

The Company attempts to control operating risks by maintaining a disciplined approach to implementation of its exploration and development programs. Exploration risks are managed by hiring experienced technical professionals and by concentrating the exploration activity on specific core regions that have multi-zone potential where the Company has experience and expertise. The Company also generates internal prospects and participates in projects where ownership interest is considered sufficient to minimize risk. Operational control allows the Company to manage costs, timing and sales of production and to ensure new production is brought on-stream in a timely manner.

The Company maintains a comprehensive insurance program to reduce risk to an acceptable level and to protect it against significant losses.

CORPORATE INFORMATION

Head Office:	Suite 780, 910 – 7 Avenue SW Calgary, Alberta, Canada Tel: (403) 234-9000 Fax: (403) 770-8370
Operations Office:	Suite 1950, 1800 West Loop South Houston, Texas Tel: (281) 822-0801 Fax: (281) 822-0802
Officers:	President and CEO – Ilyas M. Chaudhary CFO – Mansoor A. Anjum
Directors:	Ilyas M. Chaudhary William E. Richards Raymond L. LaGarde Saad Shaarawi Mansoor A. Anjum
Independent Engineers:	Netherland Sewell & Associates, Inc. Haas Petroleum Engineering Services, Inc.
Auditors:	BDO Dunwoody LLP
Solicitor:	Macleod Dixon LLP
Listing:	The TSX Venture Exchange Trading symbol: PYR
Transfer Agent and Registrar:	Valiant Trust Company
Website:	www.pyramidpetroleum.com

Pyramid Petroleum Inc.
Interim Consolidated Financial Statements

For the three and six months ended
June 30, 2008 and 2007

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NOTICE TO THE READER:

The accompanying unaudited interim consolidated financial statements of Pyramid Petroleum Inc. for the three and six months ended June 30, 2008 and 2007 have been prepared by management and approved by the Board of Directors of the Company. These statements have not been reviewed by the Company's external auditors.

On behalf of the Board:

Signed _____ Director
William B. Richards

Signed _____ Director
Mansoor A. Anjum

Pyramid Petroleum Inc.
Interim Consolidated Balance Sheets
(unaudited)

Stated in U.S dollars	June 30 2008	December 31 2007
Assets		
Current		
Cash	\$ 3,499,283	\$ 1,147,346
Prepaid expenses	927,196	105,387
Accounts receivable	4,077,720	3,473,235
Inventory	105,625	137,610
Due from related parties (note 10)	2,535,953	—
	<u>11,145,777</u>	<u>4,863,578</u>
Property and equipment (note 5)	21,971,383	30,583,504
Bond collateral (note 6)	2,918,588	1,537,884
	<u>\$ 36,035,748</u>	<u>\$ 36,984,966</u>
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 8,042,928	\$ 2,700,367
Deferred payment (note 7)	—	1,250,000
Revolving demand loan (note 8)	—	4,035,200
Term note (note 9)	1,559,898	5,059,898
Current portion of due to related parties (note 10)	1,088,479	2,840,452
Current portion of asset retirement obligation (note 12)	209,708	194,174
	<u>10,901,013</u>	<u>16,080,091</u>
Convertible debentures (note 11)	815,757	866,481
Asset retirement obligation (note 12)	12,459,698	10,982,591
Promissory note (note 13)	1,000,000	—
Future income taxes	209,573	209,573
	<u>25,386,041</u>	<u>28,138,736</u>
Shareholders' Equity		
Equity instruments (note 14)	8,301,273	8,131,636
Contributed surplus (note 15)	446,364	155,892
Equity component of convertible debentures	30,436	32,976
Retained earnings	1,698,841	717,945
Accumulated other comprehensive income (loss) (note 16)	172,793	(192,219)
	<u>10,649,707</u>	<u>8,846,230</u>
	<u>\$ 36,035,748</u>	<u>\$ 36,984,966</u>
Nature of operations (note 1)		
Commitment (note 22)		
Subsequent events (note 23)		

The accompanying notes are an integral part of these interim consolidated financial statements

Pyramid Petroleum Inc.

Interim Consolidated Statements of Net (Loss) Income and Retained Earnings
(Deficit)
(unaudited)

Stated in U.S. Dollars	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Revenue				
Petroleum and natural gas, net of royalties (note 4)	\$ 7,911,854	\$ 3,216,621	\$ 15,474,746	\$ 3,935,065
Interest revenue	60,069	–	126,515	–
Commodity contracts	–	–	–	(75,964)
	<u>7,971,923</u>	<u>3,216,621</u>	<u>15,601,261</u>	<u>3,859,101</u>
Expenses				
Operating expenses	2,136,351	880,816	4,043,690	1,074,070
General and administrative	673,855	232,129	1,146,723	363,925
Interest (note 17)	324,661	347,127	720,509	439,266
Depreciation, depletion and accretion	1,469,073	666,079	3,431,721	869,384
Loss on disposition of property and equipment (note 5)	3,138,990	–	3,138,990	–
Stock-based compensation (note 14)	302,477	–	324,706	–
Foreign exchange loss (gain)	45,282	361,033	(109,812)	232,665
Fair value adjustments on financial instruments (note 10)	271,127	71,017	446,488	105,994
	<u>8,361,816</u>	<u>2,558,201</u>	<u>13,143,015</u>	<u>3,085,304</u>
(Loss) income before income taxes	(389,893)	658,420	2,458,246	773,797
Current income tax provision	503,020	305,330	1,477,350	305,330
Net (loss) income for the period	(892,913)	353,090	980,896	468,467
Retained earnings (deficit), beginning of period	2,591,754	(1,851,011)	717,945	(1,966,388)
Retained earnings (deficit), end of period	\$ 1,698,841	\$ (1,497,921)	\$ 1,698,841	\$ (1,497,921)
Net (loss) income per share (note 14)				
Basic	\$ (0.02)	\$ 0.01	\$ 0.03	\$ 0.01
Diluted	(0.02)	0.01	0.03	0.01

Pyramid Petroleum Inc.

Interim Consolidated Statements of Comprehensive (Loss) Income
(unaudited)

Stated in U.S. Dollars	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Net (loss) income for the period	\$ (892,913)	\$ 353,090	\$ 980,896	\$ 468,467
Foreign exchange adjustment on change in functional and reporting currency (note 2)	–	–	–	56,748
Foreign exchange adjustment on disposal of property and equipment (note 5)	365,012	–	365,012	–
Comprehensive (loss) income for the period	\$ (527,901)	\$ 353,090	\$ 1,345,908	\$ 525,215

The accompanying notes are an integral part of these interim consolidated financial statements

Pyramid Petroleum Inc.
Interim Consolidated Statements of Cash Flows
(unaudited)

Stated in U.S dollars	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Cash provided by (used in)				
Operating activities				
Net (loss) income for the period	\$ (892,913)	\$ 353,090	\$ 980,896	\$ 468,467
Add: non-cash items				
Petroleum and natural gas revenue, net of royalties as settlement of related party balances	(231,885)	—	(407,425)	—
Operating and other expenses incurred through related party balances	220,149	—	654,320	—
Stock-based compensation	302,477	—	324,706	—
Interest and accretion	20,508	27,820	46,912	30,932
Depreciation, depletion and accretion	1,469,073	666,079	3,431,721	869,384
Loss on disposition of property and equipment	3,138,990	—	3,138,990	—
Unrealized foreign exchange (gain) los: Fair value adjustments on financial instruments	(11,368)	52,507	(20,044)	29,015
	<u>271,127</u>	<u>71,017</u>	<u>446,488</u>	<u>105,994</u>
	4,286,158	1,170,513	8,596,564	1,503,792
Change in non-cash working capital (note 18)	3,653,901	(882,808)	3,060,271	(970,460)
	<u>7,940,059</u>	<u>287,705</u>	<u>11,656,835</u>	<u>533,332</u>
Financing activities				
Net (repayment of) proceeds from revolving demand loan	(3,823,735)	3,754,400	(4,035,200)	3,754,400
Share issue proceeds	69,000	20,950	69,000	20,950
Proceeds from convertible debentures, net of issue costs	—	215,810	—	723,674
Repayment of term note	(2,000,000)	—	(3,500,000)	—
Repayment of loans payable	—	(2,229,610)	—	(2,282,141)
Net repayment and advances to related parties	(3,530,269)	(696,533)	(4,253,727)	(952,535)
Deferred payment	—	—	(1,250,000)	—
	<u>(9,285,004)</u>	<u>1,065,017</u>	<u>(12,969,927)</u>	<u>1,264,348</u>
Investing activities				
Expenditures on property and equipment	(293,395)	(1,242,413)	(1,009,756)	(1,389,617)
Proceeds on disposition of property and equipment	3,331,937	—	5,131,937	—
Acquisition, net of cash acquired	—	(141,220)	—	(542,467)
Abandonment fund contribution (note 6)	(946,651)	—	(1,345,033)	—
Change in non-cash working capital (note 18)	388,344	211,463	887,981	211,463
	<u>2,480,235</u>	<u>(1,172,170)</u>	<u>3,665,129</u>	<u>(1,720,621)</u>
Foreign exchange loss on cash held in a foreign currency	(88)	236	(100)	(906)
Increase in cash	1,135,202	180,788	2,351,937	76,153
Cash, beginning of period	<u>2,364,081</u>	<u>7,385</u>	<u>1,147,346</u>	<u>112,020</u>
Cash, end of period	\$ 3,499,283	\$ 188,173	\$ 3,499,283	\$ 188,173

The accompanying notes are an integral part of these interim consolidated financial statements

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

1. Nature of Operations and Basis of Presentation

Pyramid Petroleum Inc. ("Pyramid" or the "Company") was incorporated under the Alberta Business Corporations Act on March 11, 2005. The Company started as a Capital Pool Company and completed its qualifying transaction on May 4, 2006 when it acquired certain oil and gas interests. The Company is involved in exploration, development and production of petroleum and natural gas in Canada and the United States.

The unaudited interim financial statements of Pyramid Petroleum Inc. (the "Company") have been prepared by management following the same accounting policies and methods of computation as the audited consolidated financial statements of the Company for the year ended December 31, 2007, except that certain disclosures have been condensed or omitted. In this regard, these interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2007.

These financial statements are stated in U.S. dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The preparation of interim financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and 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. The financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality and within the framework of the significant accounting policies.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Pyramid Petroleum Company, a Delaware corporation, and Pyramid GOM, Inc., a Texas corporation.

The operating results for the three and six months ended June 30, 2008 may not be indicative of the results for the year ended December 31, 2008.

2. Functional and Reporting Currency

Effective April 1, 2007, the Company changed its functional currency from the Canadian dollar to the U.S. dollar. This change was made as a result of the acquisition of MC Offshore Petroleum, LLC (note 4) with its capital expenditures, revenues and expenses denominated in U.S. dollars becoming the predominant currency for the Company's cash flows. Concurrent with the change of functional currency to the U.S. dollar, the Company also changed its reporting currency to the U.S. dollar effective April 1, 2007. For comparative purposes, historical financial statements have been translated into the reporting currency of U.S. dollars using the current rate method. Under this method, assets and liabilities are translated at the closing rate in effect at the end of the comparative period; revenues, expenses and cash flows are translated at the average rate in effect for the period; and equity transactions are translated at historical rates. The exchange difference resulting from the translation on April 1, 2007 was an unrealized foreign exchange gain of \$56,748 for the three months ended March 31, 2007 which has been included in accumulated other comprehensive income (loss) presented in shareholders' equity and disclosed in note 16.

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

3. Changes in Accounting Policies

On January 1, 2008, the Company adopted the new or revised Canadian accounting standards for financial instruments – disclosures, financial instruments – presentation and capital disclosures. These standards have been adopted prospectively and, therefore, prior periods have not been restated. The adoption of these standards had no impact on opening deficit or opening accumulated other comprehensive income.

(a) Financial instruments – disclosures and financial instruments – presentation

Section 3862 Financial Instruments – Disclosures and Section 3863 Financial Instruments – Presentation replace Section 3861 Financial Instruments – Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements.

(b) Capital disclosures

Section 1535 Capital Disclosures requires additional disclosures of objectives, policies and processes for managing capital. In addition, disclosures include whether the Company has complied with externally imposed capital requirements.

(c) Inventories

Section 3031 Inventories aligns Canadian GAAP with International Financial Reporting Standards.

4. Acquisition and Net Profit Interest

On April 1, 2007, the Company acquired a 20% interest in the membership shares of MC Offshore Petroleum, LLC (the “LLC”) and an additional 30% interest on May 17, 2007. The LLC was organized for the purpose of acquiring interests in certain petroleum and natural gas properties located in the Gulf of Mexico (the “Gulf of Mexico properties”) from an arms length party (the “Seller”). A company controlled by an Officer and Director of the Company (the “Agent Company”) acted as an agent in the organization of the LLC and the acquisition of properties and retained an option (the “Option”) to buy up to 3.5% of the LLC’s membership shares at the Company’s cost.

On January 1, 2008, the Option was exercised and converted to a 3.5% Net Profit Interest (“NPI”) in the underlying assets owned by the LLC for \$879,778 of consideration. The consideration was paid through the reduction of the Company’s indebtedness to the Agent Company (note 10(c)) and offset against the Company’s petroleum and natural gas assets to which the NPI applies.

The NPI shall be distributed subject only to withholding of any plugging and abandonment obligations on the related assets, with payments commencing in February 2008. During the three and six months ended June 30, 2008, the Company distributed \$296,296 and \$615,957, respectively, of NPI which has been included in petroleum and natural gas sales, net of royalties, in the interim consolidated statements of net (loss) income.

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

5. Property and Equipment

	June 30 2008	December 31 2007
Petroleum and natural gas properties	\$ 29,480,819	\$ 37,336,868
Accumulated depletion and impairment	(7,509,436)	(6,753,364)
	<u>\$ 21,971,383</u>	<u>\$ 30,583,504</u>

In June 2008, the Company sold its Alberta and Montana properties to an unrelated company (the "Purchaser") for total proceeds of \$5,631,937 comprised of \$5,131,937 and a \$500,000 credit against the acquisition of property from the Purchaser as described below. The change in the Company's depletion due to the disposition was greater than 20%. As a result, the Company has reported a \$3,138,990 loss on the disposition of property and equipment as the net book value of the disposed properties was in excess of the proceeds received.

In June 2008, the Company acquired a 25% working interest in the Brazos 440 area in Texas state waters from the Purchaser for total consideration of \$1,597,095 comprised of the \$500,000 credit against the above disposition, a \$1.0 million promissory note (note 13) and \$97,095 of closing adjustments paid in cash.

The Company did not capitalize any general and administrative costs to the Company's petroleum and natural gas properties during the six months ended June 30, 2008 (December 31, 2007 – \$42,384).

The calculation of depletion and depreciation included an estimated \$5,641,330 (December 31, 2007 – \$5,641,330) for future development capital costs associated with proved undeveloped reserves. The Company excluded \$229,614 (December 31, 2007 – nil) for the cost of unproved properties and \$4,380,300 (December 31, 2007 – \$4,380,300) for salvage values from the depletion calculation.

At June 30, 2008, the Company performed a ceiling test calculation for each of its cost centers and determined that there was no impairment.

6. Bond Collateral

	June 30 2008	December 31 2007
Zero-coupon bond	\$ 1,573,555	\$ 1,537,884
Abandonment fund	1,345,033	–
	<u>\$ 2,918,588</u>	<u>\$ 1,537,884</u>

(a) Zero-coupon bond

Bond collateral in the amount of \$1,573,555 (December 31, 2007 – \$1,537,884) is the amortized cost of a zero-coupon bond with a face value of \$2.35 million which matures in March 2017. This bond represents the Company's share of cash collateral, at amortized cost, for performance bonds provided by the LLC to the Seller of the Gulf of Mexico properties as a guarantee for plugging and abandonment liabilities (note 4).

During the three and six months ended June 30, 2008, the Company recognized \$17,835 and \$35,671, respectively, of accretion included in the reported amount of interest and accretion in the interim consolidated statements of net income based on a 4.64% discount rate and a 10 year maturity.

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

6. Bond Collateral (continued)

(b) Abandonment fund

The Company is required to contribute 20% of the monthly net profits from the properties owned through the LLC (note 4) towards an abandonment fund (the "Fund") established by the Seller as an additional guarantee against the plugging and abandonment liabilities associated with the properties.

Net profits is defined in the Fund agreement as: the monies and revenues payable from gross production of the properties less (i) costs and expenses incurred attributed to the properties with respect to all existing wells located on the properties, including but not limited to the costs and expenses of operating the wells and for producing, treating and storing production from the wells; (ii) capital expenditures related to the properties; (iii) certain taxes assessed against production relating to the property; and (iv) all royalty burdens and other lease burdens affecting the properties.

Where the net profit for a particular month is determined to be negative (a net loss), no contribution to the Fund is required for the related month. In the event of default by the LLC, the Seller has the right to demand that the Fund be immediately funded.

Monthly contributions to the Fund commenced based on the net profits of the March 2008 production month, for which \$1,345,033 has been contributed as at June 30, 2008. The Company's maximum amount of contribution to the Fund is \$5.0 million. Upon satisfactory performance of plugging and abandonment obligations, the Company may request a release of the bonding amount and funds may be withdrawn from the Fund to a maximum of the Fund balance.

(c) Uncollateralized performance bonds

In addition to the cash collateral bond and Fund described above, the Company has secured \$5.0 million of additional uncollateralized performance bonds through an unrelated corporation (the "Lender") with whom the Company also has a term note (note 9). The Lender obtained the bonds through a surety company for which it has posted a letter of credit and corporate guarantee in favor of certain regulatory authorities. In connection with these bonds, the Company is required to pay the Lender a fee at a rate of 10% per annum on the \$5.0 million bond amount. During the three and six months ended June 30, 2008, the Company paid \$124,657 and \$249,315 of fees which are included in interest expense in the interim consolidated statements of net (loss) income.

Upon full repayment of the term note described in note 9, the Company will continue to make monthly installments to the Lender, up to a total of \$5 million, which will be deposited to an account in the LLC's name to provide for cash collateral on the bonds to replace the Lender's letter of credit and corporate guarantee. The installments are based on 80% of the monthly net proceeds (revenue less royalties, net profits interests and direct operating expenses) from certain Gulf of Mexico properties to be not less than \$500,000 per month.

All bonds become available for release once the subject properties are abandoned and satisfactorily reclaimed at which time all cash collateral will be returned to the LLC.

7. Deferred Payment

As at December 31, 2007, the \$1,250,000 deferred payment related to the LLC's purchase of the Gulf of Mexico properties. The deferred payment was unsecured, bearing an interest rate of 7% and was repaid in March 2008.

8. Revolving Demand Loan

The revolving demand loan, collateralized by a charge over the Company's Montana and Alberta assets, was repaid in June 2008 following the sale of the properties as described in note 5.

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

9. Term Note

In conjunction with the acquisition described in note 4, the Company assumed a term note (the "Note") from an unrelated corporation (the "Lender") in the principal amount of \$9,059,898 for which the balance outstanding at June 30, 2008 was \$1,559,898 (December 31, 2007 – \$5,059,898).

The Note bears interest at 10% calculated at a daily rate and is collateralized by the petroleum and natural gas assets in the Gulf of Mexico held by the LLC and for which the LLC members have pledged their member share certificates to the Lender. Principal and accrued interest on the Note are repayable in consecutive principal installments of 80% of the monthly net proceeds (revenue less royalties, net profits interests and direct operating expenses) from the related Gulf of Mexico properties to be not less than \$500,000 in principal per month plus accrued interest commencing on May 31, 2007 or at the discretion of the lender.

During the three and six months ended June 30, 2008, the Company made \$2.0 million and \$3.5 million, respectively, of principal installments and paid \$67,405 and \$180,439, respectively, of interest to the Lender.

The entire balance of the Note as at June 30, 2008 has been reported as current as the principal is less than the sum of the Company's minimum monthly principal requirement for the next 12 months.

10. Due from (to) Related Parties

Transactions with related parties have been recognized at agreed to exchange amounts, adjusted to amortized cost as appropriate, as disclosed below. Any difference between the agreed to cash exchange amount and the estimated fair value of a loan on inception has been recognized immediately in the interim consolidated statements of net income as a fair value adjustment on financials instruments.

	June 30 2008	December 31 2007
Due from a related company (a)	\$ 2,535,953	\$ –
Due to an Officer and Director of the Company (b)	\$ (64,741)	\$ (567,690)
Due to a related company (c)	(276,526)	(1,256,668)
Due to a related company (d)	(747,212)	(1,016,094)
	<u>\$ (1,088,479)</u>	<u>\$ (2,840,452)</u>

(a) Due from a related company

As at June 30, 2008, the estimated amortized cost of amounts due from companies indirectly controlled by an Officer and Director of the Company was \$2,535,953 (December 31, 2007 – nil). The receivable, comprised of net advances and petroleum and natural gas revenues due from the related companies and \$171,060 of fair value adjustments to amortized cost, is unsecured and non-interest bearing with no fixed terms of repayment. The amortized cost was based on an estimated fair value interest rate of 16% and repayment over an average period of 1 year.

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

10. Due from (to) Related Parties (continued)

(b) Due to an Officer and Director of the Company

As at June 30, 2008, the Company was indebted to an Officer and Director of the Company in the amount of \$64,741 consisting of accrued interest on a \$524,774 unsecured, 8% note payable which was repaid on March 26, 2008. As at December 31, 2007, the \$567,690 amortized cost of note payable was based on an estimated fair value interest rate of 15% and a lump-sum principal and interest repayment on March 31, 2008. During the three and six months ended June 30, 2008, the Company was charged \$2,631 and \$12,523, respectively, of interest related to this note and unpaid amounts.

(c) Due to a related company

As at June 30, 2008, the estimated amortized cost of amounts owed to companies indirectly controlled by an Officer and Director of the Company was \$276,526 (December 31, 2007 – \$1,256,668). The indebtedness, comprised of net advances and operating costs and capital expenditures incurred by the related companies on behalf of the Company and \$47,171 of fair value adjustments to amortized cost, is unsecured and non-interest bearing with no fixed terms of repayment. The amortized cost was based on an estimated fair value interest rate of 16% and repayment over 1.5 years.

(d) Due to a related company

At June 30, 2008, the Company owed \$747,212 (December 31, 2007 – \$1,016,094) to a company (the "Related Company"), who is a related party controlled by an Officer and Director of the Company. The amount due is a prorated allocation of the loan (the "Loan") from the Related Company's bank (the "Bank") at the time certain assets were acquired in August 2006. Based on the terms and conditions of this indebtedness on inception, fair value approximated carrying value.

The amount due bears an interest rate equal to LIBOR plus 2.5%, which is the rate charged by the Bank, and is repayable from 70% of the net operating revenue from the properties. The effective interest rate charged during the six months ended June 30, 2008 was 8.2% and related interest included in the outstanding balance at June 30, 2008 was \$36,776.

The Company is not a party to the credit agreement between the Related Company and the Bank. Under the terms of the Company's agreement with the Related Company, the Related Company holds title to the subject properties as collateral for the Loan. It was expected that legal title to the properties would be transferred to the Company on the Related Company's repayment of the Loan in its entirety.

The Related Company was in breach of certain financial Bank covenants at December 31, 2007 for which the property and equipment carrying value of the Company's share of related collateral is \$1,549,918. As a result of the covenant breach, the Bank called the Loan in April 2008 and sold the collateralized properties to repay the Loan in August 2008 for which the proceeds were sufficient to repay the entire obligation without any further recourse.

As at June 30, 2008, the Company has classified the entire amount due as a current liability. In August 2008, the Company will report the collateralized properties as sold and the loan as repaid. See note 23(c).

(e) Contract operator fees

During the first quarter of 2008, the Company paid \$87,346 of contract operator fees to the Related Company who operated certain properties prior to April 1, 2008 after which time the Company took over operatorship.

(f) Other

As at June 30, 2008, accounts receivable included \$236,274 (December 31, 2007 – \$236,274) due from the LLC for capital expenditures paid by the Company on behalf of the LLC.

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

11. Convertible Debentures

Convertible debentures (the "Debentures") issued in February and April 2007 for total gross proceeds of \$828,022 (Cdn \$952,000) have a two year term and bear an interest rate of 12% per annum, payable quarterly. Debenture holders have the option to convert the debentures to common shares of the Company on the basis of one common share for each \$0.44 (Cdn \$0.45) of principal at any time during the term of the Debentures. The Company has an option to call the Debentures at any time after the first anniversary of the closing date if the Company's shares trade at over \$0.662 (Cdn \$0.675) per share for a period of 30 days. 2,115,556 common shares are issuable in the event that the total amount of principal is converted at maturity.

In June 2008, \$63,863 (Cdn \$65,000) of the principal amount of the Debentures was converted into 144,444 common shares of the Company (note 14), reducing the number of remaining issuable shares to 1,971,112.

	June 30 2008	December 31 2007
Liability component	\$ 731,183	\$ 795,046
Unamortized transaction costs	(33,514)	(58,675)
Accumulated accretion of equity component	21,139	13,016
Foreign exchange	96,949	117,094
	<u>\$ 815,757</u>	<u>\$ 866,481</u>
	Cdn \$834,539	Cdn \$860,954

12. Asset Retirement Obligation

Balance – December 31, 2007	\$ 11,176,765
Disposition (note 5)	(504,380)
Acquisition (note 5)	1,598,440
Accretion	398,581
	<u>12,669,406</u>
Current portion	(209,708)
Balance – June 30, 2008	<u>\$ 12,459,698</u>

The following assumptions were used to estimate the June 30, 2008 asset retirement obligation:

Undiscounted cash flows	\$ 24,046,790
Credit adjusted risk-free rate	8%
Inflation rate	2%
Range of expected timing of cash flows	2008 – 2049
Weighted average time to abandonment	8.3 years

See note 6 with respect to bond collateral and an abandonment fund related to abandonment liabilities for the Gulf of Mexico properties.

13. Promissory Note

The Company issued a \$1.0 million promissory note bearing interest at 8% per annum, paid monthly, and maturing on December 31, 2010 as partial consideration for the acquisition of properties described in note 5. An officer and director of the Company provided a personal guarantee for the principal amount of the promissory note.

Pyramid Petroleum Inc.
Notes to the Interim Consolidated Financial Statements
June 30, 2008
(unaudited)

Stated in U.S. Dollars

14. Equity Instruments

(a) Common shares issued

	Number		Amount
Balance – December 31, 2007	37,317,595	\$	8,131,636
Exercise of stock options	230,000		103,234
Conversion of debentures	144,444		66,403
Balance – June 30, 2008	37,692,039	\$	8,301,273

- i) In May 2008, the Company issued 230,000 common shares on the exercise of the same number of stock options for cash proceeds of \$69,000 (Cdn \$69,000). In addition to the cash proceeds, a \$34,234 pro-rata allocation of the options' fair value has been reclassified to the amount for common shares.
- ii) In June 2008, the Company issued 144,444 common shares on the conversion of \$63,863 (Cdn \$65,000) principal amount of Debentures. In addition to the principal amount, a \$2,540 pro-rata allocation of the equity component of convertible debentures has been reclassified to the amount for common shares.

(b) Shares held in escrow

As at June 30, 2008, 8,728,716 common shares remained in escrow. The following table outlines the future releases:

Release Date	November 11, 2008	May 11, 2009
Number of shares	4,364,358	4,364,358

(c) Broker warrants

	Number of Warrants	Weighted average exercise price		Estimated Fair Value
		US \$	Cdn \$	
Balance – December 31, 2007 and June 30, 2008	65,644	0.44	0.45	\$ 17,681

As at June 30, 2008, the outstanding broker warrants have a weighted average life remaining of 0.7 years.

(d) Stock options

As at December 31, 2007, the Company had 900,000 stock options outstanding and exercisable at an exercise price of \$0.30 (Cdn \$0.30) per share, expiring on May 4, 2011.

In February 2008, the Company granted an investor relations firm 200,000 stock options of which 100,000 options are exercisable at \$0.71 (Cdn \$0.70) per share and 100,000 options are exercisable at \$1.01 (Cdn \$1.00) per share. The options vest 25% immediately, 25% on the four month anniversary of the grant date and 50% on the one year anniversary of the grant date. The fair value of these options was estimated to be \$52,790 (\$0.26 per share) using the Black-Scholes pricing model.

In May 2008, the Company granted 2,110,000 stock options to officers, directors and employees exercisable at \$0.58 (Cdn \$0.59) per share. The options vest under various terms specified in the option agreements. The fair value of these options was estimated to be \$1,083,529 (\$0.51 per share) using the Black-Scholes pricing model.

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14. Equity Instruments (continued)

The Black-Scholes pricing model was based on the following significant assumptions:

Expected volatility	147% - 150%
Expected life	5 years
Risk-free interest rate	2.9% - 3.5%
Dividend yield	Nil

During the three and six months ended June 30, 2008, the Company recognized \$302,477 and \$324,706, respectively, of stock-based compensation expense in the interim consolidated statements of net (loss) income.

A continuity of stock options outstanding is provided in the following table:

	Number of options	Weighted average exercise price
Balance – December 31, 2007	900,000	\$0.29 (Cdn \$0.30)
Granted	2,310,000	\$0.60 (Cdn \$0.61)
Exercised	(230,000)	\$0.30 (Cdn \$0.30)
Balance – June 30, 2008	2,980,000	\$0.53 (Cdn \$0.54)
Exercisable	1,151,660	\$0.43 (Cdn \$0.44)

Details of stock options outstanding and exercisable as at June 30, 2008 are as follows:

Exercise price \$	Number outstanding	Weighted average contractual life remaining (years)	Weighted average exercise price	Number exercisable
\$0.29 (Cdn \$0.30)	670,000	2.8	\$0.29 (Cdn \$0.30)	670,000
\$0.58 (Cdn \$0.59)	2,110,000	4.8	\$0.58 (Cdn \$0.59)	381,660
\$0.68 (Cdn \$0.70)	100,000	4.6	\$0.68 (Cdn \$0.70)	50,000
\$0.97 (Cdn \$1.00)	100,000	4.6	\$0.97 (Cdn \$1.00)	50,000
	2,980,000	4.4	\$0.34 (Cdn \$0.35)	1,151,660

(e) Per share amounts

Net (loss) income per share has been calculated using the treasury stock method. The following table reconciles the denominators used for the basic and diluted earnings per share calculations:

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Weighted average number of shares – basic	37,473,541	36,617,458	37,395,568	36,611,310
Dilutive effect of broker warrants	699,961	–	382,493	–
Dilutive effect of stock options	573,246	508,723	307,216	426,999
Weighted average number of shares – diluted	38,746,748	37,126,181	38,085,277	37,038,309

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15. Contributed Surplus

Balance – December 31, 2007	\$	155,892
Stock-based compensation		324,706
Exercise of options (note 14(a))		<u>(34,234)</u>
Balance – June 30, 2008	\$	<u>446,364</u>

16. Accumulated Other Comprehensive Income (Loss)

	June 30 2008	December 31 2007
Balance – beginning of period	\$ (192,219)	\$ (248,967)
Foreign exchange adjustment on change in functional and reporting currency (note 2)	–	56,748
Foreign exchange adjustment on disposal of property and equipment (note 5)	<u>365,012</u>	<u>–</u>
Balance – end of period	<u>\$ 172,793</u>	<u>\$ (192,219)</u>

17. Interest

Interest expense relates to the following:

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Current liabilities	\$ 253,921	\$ 271,189	\$ 580,607	\$ 271,189
Long-term liabilities	42,559	21,404	82,304	59,008
Due to related parties	<u>28,181</u>	<u>54,534</u>	<u>57,598</u>	<u>109,069</u>
	<u>\$ 324,661</u>	<u>\$ 347,127</u>	<u>\$ 720,509</u>	<u>\$ 439,266</u>

18. Supplemental Cash Flow Information

(a) Change in non-cash working capital

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Accounts receivable	\$ (312,549)	\$ (1,822,442)	\$ (604,485)	\$ (2,034,423)
Prepaid expenses	(750,143)	(35,625)	(821,809)	3,705
Accounts payable and accrued liabilities	<u>5,104,937</u>	<u>1,186,722</u>	<u>5,374,546</u>	<u>1,271,721</u>
	<u>\$ 4,042,245</u>	<u>\$ (671,345)</u>	<u>\$ 3,948,252</u>	<u>\$ (758,997)</u>

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18. Supplemental Cash Flow Information (continued)

The change in non-cash working capital has been allocated to the following activities:

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Operating	\$ 3,653,901	\$ (882,808)	\$ 3,060,271	\$ (970,460)
Investing	388,344	211,463	887,981	211,463
	<u>\$ 4,042,245</u>	<u>\$ (671,345)</u>	<u>\$ 3,948,252</u>	<u>\$ (758,997)</u>

(b) Interest and taxes paid

	Three months ended June 30		Six months ended June 30	
	2008	2007	2008	2007
Interest	\$ 286,319	\$ 319,307	\$ 637,926	\$ 408,334
Taxes	\$ —	\$ —	\$ —	\$ —

19. Financial Instruments and Financial Risk Management

The Company's financial instruments include cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The carrying values of these financial instruments approximate their fair values due to their relatively short periods to maturity.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

(a) Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable are with natural gas and liquids marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Purchasers of the Company's natural gas and liquids are subject to credit review to minimize the risk of non-payment. As at June 30, 2008, the maximum credit exposure is the carrying amount of the accounts receivable and accruals of \$4,077,720 (December 31, 2007 – \$3,473,235). As at June 30, 2008, the Company's receivables consisted of \$727,764 from joint venture partners and other trade receivables and \$3,349,956 of revenue receivables from petroleum and natural gas marketers.

Receivables from petroleum and natural gas marketers are typically collected between the 20th and 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any significant collection issues with its petroleum and natural gas marketers.

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19. Financial Instruments and Financial Risk Management (continued)

Substantially all of the \$3,349,956 of revenue receivables from petroleum and natural gas marketers was received in July and August 2008.

Joint venture receivables are typically collected within one to two months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risk exists with joint venture partners as disagreements occasionally arise which increases the potential for non-collection. For properties that are operated by the Company, production can be withheld from joint venture partners who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to joint venture partners from which it can net receivable balances.

The Company did not provide for any doubtful accounts nor was it required to write-off any receivables during the period ended June 30, 2008. The Company would only choose to write-off a receivable balance (as opposed to providing an allowance) after all reasonable avenues of collection had been exhausted.

As at June 30, 2008 the Company considers its receivables to be aged as follows:

Not past due	\$	3,150,861
Past due by less than 90 days		609,884
Past due by more than 90 days		316,975
	<u>\$</u>	<u>4,077,720</u>

As the Company has not entered into any hedging arrangements, it is not exposed to credit risk associated with possible non-performance by counterparties to any such derivative financial instrument contracts.

(b) Liquidity Risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. The Company monitors its total debt position monthly. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. The Company anticipates it will have adequate liquidity to fund its financial liabilities through its future cash flows. The Company's financial liabilities are comprised of accounts payable and accrued liabilities which have expected maturities of less than one year resulting in their current classification on the balance sheet.

i) Market Risk

Market risk consists of currency risk, commodity price risk and interest rate risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with a risk management policy that has been approved by the Board of Directors.

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19. Financial Instruments and Financial Risk Management (continued)

ii) Currency risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. As the majority of the Company's petroleum and natural gas sales and related expenditures are denominated in U.S. dollars, the Company does not consider such exposures to be significant.

As disclosed in note 21 a portion of the Company's operations are undertaken in Canada. The Company does not consider the exposure to fluctuations in the Canadian dollar to be significant.

The Company had no outstanding forward exchange rate contracts in place at June 30, 2008.

iii) Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above. Should the Company choose to mitigate commodity price risk through the use of financial derivatives and physical delivery fixed price sales contracts, all such contracts would require approval of the Board of Directors. There were no commodity price risk contracts outstanding at June 30, 2008.

iv) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on related party indebtedness (note 10(d)) which bear interest at a floating rate. For the three and six months ended June 30, 2008, if interest rates had been 1% lower with all other variables held constant, earnings for the period would have been \$2,242 and \$4,488 higher, respectively, due to lower interest expense. An equal and opposite impact would have occurred had interest rates been higher by the same amounts. The Company had no interest rate swap or financial contracts in place at June 30, 2008.

20. Capital Management

The Company's objective when managing capital is to maintain a flexible capital structure which will allow it to execute its capital expenditure program, which includes expenditures in oil and gas activities which may or may not be successful. Therefore, the Company monitors the level of risk incurred in its capital expenditures to balance the proportion of debt and equity in its capital structure.

The Company considers its capital structure to include working capital and shareholders' equity. The Company monitors capital based on annual funds from operations and capital expenditure budgets, which are updated as necessary and are reviewed and periodically approved by the Company's Board of Directors.

The Company manages its capital structure and makes adjustments by continually monitoring its business conditions including the current economic conditions, the risk characteristics of the Company's petroleum and natural gas assets, the depth of its investment opportunities, current and forecasted net debt levels, current and forecasted commodity prices and other facts that influence commodity prices and funds from operations such as quality and basis differentials, royalties, operating costs and transportation costs.

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20. Capital Management (continued)

In order to maintain or adjust the capital structure, the Company considers its forecasted funds from operations while attempting to finance an acceptable capital expenditure program including acquisition opportunities, the current level of bank credit available from potential lenders, the level of bank credit that may be attainable from lenders as a result of petroleum and natural gas reserve growth, the availability of other sources of debt with different characteristics than existing debt, the sale of assets, limiting the size of the capital expenditure program and the issue of new equity if available on favorable terms. The Company's capital structure is not subject to external restrictions.

There has been no change in the Company's approach to capital management during the period ended June 30, 2008.

21. Segmented Information

The Company undertakes exploration and development of oil and gas properties in Canada and the United States and has disclosed key financial data based on separate jurisdictions. Any allocation of costs between segments is done at cost and based on time allocated to the various projects.

	For the three months ended					
	June 30, 2008			June 30, 2007		
	Canada	United States	Total	Canada	United States	Total
	\$	\$	\$	\$	\$	\$
Revenues, net of royalties	28,459	7,883,395	7,911,854	23,771	3,192,850	3,261,621
Net income (loss)	(519,475)	(373,438)	(892,913)	(105,316)	458,406	353,090
Per share						
- Basic and diluted	(0.01)	(0.01)	(0.02)	-	0.01	0.01

	For the six months ended					
	June 30, 2008			June 30, 2007		
	Canada	United States	Total	Canada	United States	Total
	\$	\$	\$	\$	\$	\$
Revenues, net of royalties	48,057	15,426,689	15,474,746	45,267	3,889,798	3,935,065
Net income (loss)	(485,712)	1,466,608	980,896	(129,354)	597,821	468,467
Per share						
- Basic and diluted	(0.01)	0.04	0.03	(0.01)	0.02	0.01

	June 30, 2008			December 31, 2007		
	Canada	United States	Total	Canada	United States	Total
		\$	\$	\$	\$	\$
Total assets	522,636	35,513,112	36,035,748	743,680	36,241,286	36,984,966
Property and equipment	413,362	21,558,021	21,971,383	691,011	29,892,493	30,583,504
Expenditures on property and equipment	(35,360)	1,045,116	1,009,756	529,610	4,220,889	4,750,499

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22. Commitment

On April 16, 2008, the Company agreed to participate for a 20% working interest in a three-well drilling program in the Gulf of Mexico. The Company's estimated share of drilling and completion costs is \$3.3 million, of which approximately \$216,000 had been incurred as at June 30, 2008.

23. Subsequent Events

Except as disclosed elsewhere in these interim consolidated financial statements, the following events occurred subsequent to year end:

- (a) On July 31, 2008, the Company paid the remaining balance of \$1,559,898 of the Term Note as described in note 9.
 - (b) On August 7, 2008 the Company made an initial payment of \$1,375,000 for bond collateral as described in note 6 (c).
 - (c) On August 19, 2008, the Company's properties that were acquired in August 2006, as described in note 10(d), were included in a sale of the property interests by the Related Company's Bank. At June 30, 2008 the Company reported a balance owed to the Related Company in the amount of \$747,212. As a result of the sale the entire payable balance will be paid in full with no further amounts due to, or from, the Related Company.
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24. Prior Year Comparatives

Certain prior year comparatives have been reclassified to conform with current year presentation.