

INTERIM FINANCIAL STATEMENTS

(Unaudited – Prepared by Management)

ISSUER DETAILS NAME OF ISSUER		FOR QUARTER ENDED Y M D			DATE OF REPORT Y M D		
MONTELLO RESOURCES LTD.		05	01	31	05	03	31
ISSUER ADDRESS							
SUITE 2833 – 595 BURRARD STREET, P.O. BOX 49057							
CITY/		PROVINCE	POSTAL CODE	ISSUER FAX NO.	ISSUER TELEPHONE NO.		
VANCOUVER		BC	V7X 1C4	604-689-8199	604-689-1799		
CONTACT PERSON			CONTACT'S POSITION		CONTACT TELEPHONE NO.		
PATRICK POWER			PRESIDENT		604-689-1799		
CONTACT EMAIL ADDRESS			WEB SITE ADDRESS				
ir@montello.com			www.montello.com				
DIRECTOR'S SIGNATURE			PRINT FULL NAME		DATE SIGNED Y M D		
“PATRICK POWER”			PATRICK POWER		05	03	31
DIRECTOR'S SIGNATURE			PRINT FULL NAME		DATE SIGNED Y M D		
“JEANNINE DAVIES”			JEANNINE DAVIES		05	03	31

MONTELLO RESOURCES LTD.
INTERIM FINANCIAL STATEMENTS
JANUARY 31, 2005
(Unaudited – Prepared by Management)

**Montello Resources Ltd.
#2833 – 595 Burrard Street
P.O. Box 49057
Vancouver, B.C.
V7X 1C4**

NOTICE TO USERS

March 31, 2005

The accompanying interim financial statements have not been reviewed by an auditor.

“MONTELLO RESOURCES LTD.”

Montello Resources Ltd.
Balance Sheet
As at January 31, 2005
(Unaudited – Prepared by Management)

<u>ASSETS</u>	January 31, 2005	July 31, 2004
Current		
Cash	\$ 107,975	\$ -
Reclamation deposit	27,839	-
Marketable securities (Note 4)	19,163	10,163
Accounts receivable	38,078	17,841
Oil and gas inventory	<u>9,165</u>	<u>-</u>
	202,220	28,004
Investment (Note 5)	9,004	18,004
Property and equipment (Note 7)	16,538	-
Resource properties (Note 8)	<u>380,511</u>	<u>2,698</u>
	<u>\$ 608,273</u>	<u>\$ 48,706</u>

LIABILITIES AND SHAREHOLDERS' DEFICIENCY

Current		
Bank indebtedness	\$ -	\$ 2,853
Accounts payable and accrued liabilities (Note 10 (b))	281,758	525,008
Advances from related party (Note 10 (c))	<u>6,297</u>	<u>6,297</u>
	288,055	534,158
Accounts payable (Notes 9(a) and 11)	-	65,000
Advances from affiliated company (Note 6)	<u>654,677</u>	<u>313,412</u>
	<u>942,732</u>	<u>912,570</u>
Shareholders' deficiency		
Share capital (Notes 9 and 17)	14,904,180	14,208,680
Deficit, per accompanying statement	<u>(15,238,639)</u>	<u>(15,072,544)</u>
	<u>(334,459)</u>	<u>(863,864)</u>
	<u>\$ 608,273</u>	<u>\$ 48,706</u>

Continuing operations (Note 1)

Contingent liability (Note 13)

Approved by the directors:

"Patrick Power"
 Director – Patrick Power

"Jeannine Davies"
 Director – Jeannine Davies

See accompanying notes.

Montello Resources Ltd.
Interim Statement of Operations and Deficit
Six Months Ended January 31, 2005
(Unaudited – Prepared by Management)

	Three Months Ended January 31, 2005	Three Months Ended January 31, 2004	Six Months Ended January 31, 2005	Six Months Ended January 31, 2004
Expenses				
Accounting and audit	\$ 3,050	\$ 1,464	\$ 6,855	\$ 2,891
Bank charges and interest	357	248	903	437
Communications	125	65	125	65
Consulting fees	18,000	15,000	33,000	30,000
Filing fees	10,767	3,585	12,192	3,585
Interest on long-term debt	-	4,304	-	8,532
Legal fees	15,786	(257)	16,770	1,141
Management fees	29,003	15,000	44,003	30,000
Office	5,135	251	5,183	527
Property examination	(713)	-	15,275	-
Rent	7,777	7,500	15,277	14,569
Shareholder information	13,673	11,050	13,673	11,050
Transfer agent's fees	3,127	2,286	4,406	3,411
Travel and public relations	7,371	-	7,371	311
Website hosting	3,100	1,050	3,625	1,050
	116,558	61,546	178,658	107,569
Loss before undernoted items	(116,558)	(61,546)	(178,658)	(107,569)
Interest income	124	-	131	2
Foreign exchange	335	943	(3,235)	943
Recovery of resource property costs written off	15,667	-	15,667	-
Write-off of resource properties	-	(100,950)	-	(103,297)
Loss for the period	(100,432)	(161,553)	(166,095)	(209,921)
Deficit, beginning of period	(15,138,207)	(13,815,486)	(15,072,544)	(13,767,118)
Deficit, end of period	\$ (15,238,639)	\$ (13,977,039)	\$ (15,238,639)	\$ (13,977,039)
Loss per share	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.01)

See accompanying notes.

Montello Resources Ltd.
Interim Statement of Cash Flows
Six Months Ended January 31, 2005
(Unaudited – Prepared by Management)

	Three Months Ended January 31, 2005	Three Months Ended January 31, 2004	Six Months Ended January 31, 2005	Six Months Ended January 31, 2004
Cash provided by (used in)				
Operating activities				
Loss for the period	\$ (100,432)	\$ (161,553)	\$ (166,095)	\$ (209,921)
Items not affecting cash:				
Recovery of resource property costs written off	(15,667)	-	(15,667)	-
Write-off of resource properties	-	100,950	-	103,297
	(116,099)	(60,603)	(181,762)	(106,624)
Changes in non-cash working capital items:				
Decrease (increase) in reclamation deposit	(27,839)	-	(27,839)	-
Decrease (increase) in accounts receivable	(18,135)	(2,831)	(20,237)	(5,216)
Decrease (increase) in oil and gas inventory	(9,165)	-	(9,165)	-
Increase (decrease) in advance from related party	-	100	-	100
Increase (decrease) in accounts payable and and accrued liabilities	(237,379)	25,420	(227,583)	59,772
	(408,617)	(37,914)	(466,586)	(51,968)
Investing activities				
Purchase of property and equipment	(16,538)	-	(16,538)	-
Resource property expenditures	(178,174)	-	(377,813)	(2,347)
	(194,712)	-	(394,351)	(2,347)
Financing activities				
Shares issued	630,500	-	630,500	-
Advances from (repayment to) affiliated company	19,125	38,145	341,265	54,243
	649,625	38,145	971,765	54,243
Increase (decrease) in cash during the period	46,296	231	110,828	(72)
Cash (bank indebtedness), beginning of period	61,679	-	(2,853)	303
Cash, end of period	\$ 107,975	\$ 231	\$ 107,975	\$ 231

Supplemental disclosure with respect to cash flows (Note 11)

See accompanying notes.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited - Prepared by Management)

1. **Continuing Operations**

These interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern which assume that the Company will realize its assets and discharge its liabilities in the normal course of business. Realization values may be substantially different from the carrying values as shown in the interim financial statements should the Company be unable to continue as a going concern.

2. **Nature of Operations**

The Company in the process of exploring its mineral properties and oil and gas properties and has not determined whether these properties contain reserves which are economically recoverable.

The recoverability of amounts shown for resource properties and related deferred costs is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development and future profitable production from the properties or proceeds from disposition.

3. **Significant Accounting Policies**

(a) **Resource properties**

(i) **Mineral properties**

Acquisition costs of mineral properties together with direct exploration and development expenditures thereon are deferred in the accounts. When production is attained these costs will be amortized. When deferred expenditures on individual producing properties exceed the estimated net realizable value, the properties are written down to the estimated value. Costs relating to properties abandoned are written off when the decision to abandon is made.

(ii) **Oil and Gas Properties**

The Company follows the full cost method of accounting for oil and gas operations in accordance with Canadian guidelines. Under this method, all costs associated with the acquisition, exploration and development of oil and gas reserves are capitalized in cost centers on a country-by-country basis. Such costs include property acquisition costs, geological and geophysical studies, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells and overhead expenses directly related to these activities.

Depletion is calculated for producing properties by using the unit-of-production method based on proved or estimated reserves, before royalties, as determined by management of the Company or independent consultants. Sales or dispositions of oil and gas properties are credited to the respective cost centers and any gain or loss is recognized when all properties in a cost center have been disposed of, unless such sale or disposition significantly alters the relationship between capitalized costs and proved reserves of oil and gas attributable to the cost center. Costs of abandoned oil and gas properties are accounted for as adjustments of capitalized costs and written off to expense.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

3. **Significant Accounting Policies** (continued)

A ceiling test is applied to each cost center and to the aggregate of all cost centers by comparing the net capitalized costs to the estimated future net revenues from production of proved reserves without discount, plus the costs of unproved properties net of impairment. In addition, the ceiling test for the aggregate of all cost centers is required to include the effects of future site restoration costs, general and administrative expenses, financing costs and income taxes. Any excess capitalized costs are written off in the current period as additional depletion. The calculation of future net revenues is based upon prices, costs and regulations in effect at each period-end.

The Company may write off an unproved property under one or more of the following conditions:

- (i) there are no firm plans for further drilling on the unproved property;
- (ii) negative results were obtained from studies of the unproved property;
- (iii) negative results were obtained from studies conducted in the vicinity of the unproved property;
- (iv) the remaining term of the unproved property does not allow sufficient time for further studies or drilling; or
- (v) unproved properties are assessed for impairment on an annual basis by applying factors that rely on historical experience.

(b) **Values**

The amounts shown for oil and gas properties, mineral properties, and deferred exploration costs represent costs to date, and do not necessarily represent present or future values, as they are entirely dependent upon the economic recovery of current and future reserves.

(c) **Cost of maintaining resource properties**

The Company does not accrue the estimated future costs of maintaining its resource properties in good standing.

(d) **Marketable securities**

Marketable securities are stated at lower of cost or market.

(e) **Investments**

The Company accounts for its investments using the cost method. Where in management's opinion there has been a loss in value that is other than a temporary decline, the carrying value is reduced to the estimated realizable value.

(f) **Property and equipment**

Property and equipment are reported at cost. Amortization is provided using the declining balance method at the rate of 20% per annum. Only one-half of the rate is used in the year of acquisition.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

3. **Significant Accounting Policies** (continued)

(g) **Stock-based compensation plan**

The Company accounts for options granted under its fixed stock option plan using the fair value based method of accounting for stock-based compensation. Accordingly, the fair value of the options at the date of the grant is accrued and charged to operations, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

(h) **Environmental expenditures**

The operations of the Company may in the future be affected from time to time in varying degrees by changes in environmental regulations, including those for future removal and site restoration costs. Both the likelihood of new regulations and their overall effect upon the Company are not predictable.

(i) **Use of estimates**

The preparation of interim financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the period. Actual results could differ from these estimates.

(j) **Loss per share**

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on earnings per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the period. For diluted loss per share, the dilutive effect has not been presented separately as it proved to be anti-dilutive.

Loss per share is calculated using the weighted-average number of shares outstanding during the period.

(k) **Income taxes**

Future income taxes are recorded using the asset and liability method. Using the asset and liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment occurs. To the extent that the Company does not consider it more likely than not a future tax asset will be recovered, it provides a valuation allowance against the excess.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

3. **Significant Accounting Policies** (continued)

(l) **Foreign currency translation**

Monetary items are translated at the exchange rate in effect at the balance sheet date; non-monetary items are translated at historical exchange rates. Income and expense items are translated at the average exchange rate for the period. Translation gains and losses are reflected in loss for the period.

4. **Marketable Securities**

Marketable securities consist of shares in a public company related by a common director, which as at January 31, 2005 had a quoted market value of \$119,771 (July 31, 2004: \$106,709).

5. **Investment**

During the year ended July 31, 2001, the Company received 1,500,000 special warrants of Arctic Star Diamond Corp. (“Arctic Star”), a company related by a common director, at a deemed value of \$60,000 as part of the consideration for the sale of a resource property. During the year ended July 31, 2002, the Company exchanged these special warrants, for no additional consideration, into 1,500,000 common shares of Arctic Star (Notes 4 and 6). As at January 31, 2005, the Company has sold 796,000 (July 31, 2004: 796,000) of these shares.

6. **Advances from Affiliated Company**

Advances from affiliated company, related by a common director and in which the Company holds a minority interest, are non-interest bearing and have no specified terms of repayment.

7. **Property and equipment**

	January 31, 2005		July 31, 2004	
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>	<u>Net Carrying Amount</u>
Machinery and equipment	\$ 13,907	\$ -	\$ 13,907	\$ -
Office equipment	<u>2,631</u>	<u>-</u>	<u>2,631</u>	<u>-</u>
	<u>\$ 16,538</u>	<u>\$ -</u>	<u>\$ 16,538</u>	<u>\$ -</u>

8. **Resource Properties**

	January 31, 2005	July 31, 2004
Morgan and Scott, Tennessee	\$ 377,813	\$ -
Fentress, Tennessee	<u>2,698</u>	<u>2,698</u>
	<u>\$ 380,511</u>	<u>\$ 2,698</u>

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

8. **Resource Properties** (continued)

Acquisition costs and deferred exploration and development expenditures during the six months ended January 31, 2005 and the year ended July 31, 2004 were as follows:

	<u>January 31,</u> <u>2005</u>	<u>July 31,</u> <u>2004</u>
Property acquisition costs		
Balance, beginning of period	\$ -	\$ 162,240
During period		
Additions	172,833	20,772
Written off	-	(183,012)
Balance, end of period	<u>172,833</u>	<u>-</u>
Deferred exploration expenditures		
Balance, beginning of period	2,698	1,024,000
During period		
Camp	-	7,413
Development costs	204,980	-
Drilling (recovery)	-	(3,642)
Written off	-	(1,025,073)
Balance, end of period	<u>207,678</u>	<u>2,698</u>
Total resource properties costs	<u>\$ 380,511</u>	<u>\$ 2,698</u>

(a) Morgan and Scott, Tennessee

During the six months ended January 31, 2005, the Company paid \$172,833 toward the acquisition of various oil and gas leases covering lands and equipment located in Morgan and Scott Counties, Tennessee.

The various oil and gas leases are subject to a 5% production royalty.

(b) Fentress, Tennessee

During the year ended July 31, 2003, the Company acquired a five-year oil and gas lease covering lands located in Fentress County, Tennessee. To acquire the lease the Company paid US \$1,880 (Cdn \$2,698).

The property is subject to a 12.5% production royalty.

(c) Tennessee Gas Project, Tennessee

During the year ended July 31, 2001, the Company entered into agreements with Capital East Ventures (“Capital”) whereby the Company could earn a 66.6% interest, subject to a 15% overriding royalty, in two separate properties. The properties are certain oil and gas leases in Rogersville and Sneedville in Eastern Tennessee. For each property, the Company advanced US\$18,000 for seismic surveys, and was required to spend an additional US\$350,000 in drilling costs and additional completion costs to earn the 66.6% interest.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

8. **Resource Properties** (continued)

During the year ended July 31, 2002, the Company earned its interest in the Rogersville lease by incurring the required expenditures.

During the year ended July 31, 2003, the Company elected not to proceed with the Sneedville lease and wrote off the associated costs of \$38,081. During the year ended July 31, 2004, the Company abandoned the Rogersville lease and wrote off the associated costs of \$1,083,364.

The Company agreed to pay a finder's fee of 5% of the funds expended by the Company on the exploration of each property, and the issuance of 200,000 common shares. During the year ended July 31, 2002, the Company issued the 200,000 common shares at a deemed value of \$20,000 and paid \$23,632. As at July 31, 2004, the Company accrued a liability of \$29,379 for the remaining cash portion due. The Company paid the \$29,379 during the six months ended January 31, 2005.

(d) Otish Mountain, Quebec

During the year ended July 31, 2002, the Company entered into an agreement to acquire a 50% joint venture interest in certain mineral claims located in Quebec. The Company acquired its interest by paying cash of \$100,000.

During the year ended July 31, 2003, the agreement was amended such that the Company could earn an additional 40% interest (90% total interest) in the property by payment of a further \$40,000 (not paid as at July 31, 2003).

During the year ended July 31, 2004, the claims lapsed and the Company wrote off all associated costs.

(e) Valemont, British Columbia

During the year ended July 31, 2001, the Company entered into two agreements with Commerce Resources Corp. whereby the Company could acquire a 100% interest in four mineral claims located in the Cariboo and Kamloops Mining Division, British Columbia. To acquire the interest the Company was required to pay cash of \$25,000 (paid) and staking costs of approximately \$35,000, and issue 400,000 common shares. During the year ended July 31, 2002, the Company issued the 400,000 common shares at a deemed value of \$28,000.

During the year ended July 31, 2003, the claims lapsed and the Company wrote off all associated costs. The Company reimbursed \$20,000 of staking costs during the year ended July 31, 2004, and wrote off the amount during the year then ended.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

9. **Share Capital**

	<u>January 31, 2005</u>	<u>July 31, 2004</u>
Authorized:		
100,000,000 Common shares without par value		
Issued:		
79,437,130 Common shares	\$ <u>14,904,180</u>	\$ <u>14,208,680</u>

- (a) Changes in issued common shares during the six months ended January 31, 2005 and the year ended July 31, 2004 were as follows:

	<u>January 31, 2005</u>		<u>July 31, 2004</u>	
	Number of Shares	\$ Amount	Number of Shares	\$ Amount
Beginning of period	65,407,130	14,208,680	65,407,130	14,208,680
Issued for cash pursuant to private placement (Note 9(b))	12,730,000	630,500	-	-
Issued in settlement of accounts payable	1,300,000	65,000	-	-
End of period	<u>79,437,130</u>	<u>14,904,180</u>	<u>65,407,130</u>	<u>14,208,680</u>

- (b) During the six months ended January 31, 2005, the Company issued 12,730,000 units for cash proceeds of \$630,500 (net of a \$6,000 finder's fee) pursuant to a private placement. Each unit consists of one common share and one non-transferable share purchase warrant. Each warrant entitles the holder to purchase an additional common share at an exercise price of \$0.10 per share, exercisable until December 16, 2006. As at January 31, 2005, all of the warrants remain outstanding.
- (c) During the year ended July 31, 2003, the Company issued 409,500 units for cash of \$49,140 pursuant to a private placement. Each unit consisted of one common share and one non-transferable share purchase warrant. Each warrant entitled the holder to purchase an additional common share at an exercise price of \$0.14 per share, exercisable until August 19, 2004. During the six months ended January 31, 2005, the warrants expired unexercised.
- (d) As at January 31, 2005, outstanding warrants are as follows:

<u>Number of warrants</u>	<u>Exercise price</u>	<u>Expiry date</u>
3,449,666	\$0.15	February 8, 2006
12,730,000	\$0.10	December 16, 2006

During the year ended July 31, 2004, the Company agreed to extend the expiry date of 3,449,666 warrants initially expiring on February 8, 2004 by a period of two years to February 8, 2006.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

9. **Share Capital** (continued)

- (e) (i) As at January 31, 2005, outstanding stock options to directors, consultants, and employees are as follows:

<u>Number of shares</u>	<u>Exercise price</u>	<u>Expiry date</u>
2,372	\$0.10	June 15, 2005
266,000	\$0.16	November 16, 2005
3,725,000	\$0.14	July 18, 2006
2,500,000	\$0.10	December 29, 2009

- (ii) A summary of the Company's stock options as at January 31, 2005 and the changes for the six months then ended is presented below:

	<u>Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life</u>
Balance, beginning of period	4,395,372	\$0.14	1.74 years
Granted	2,500,000		
Expired/Exercised	<u>(402,000)</u>		
Balance, end of period	<u>6,493,372</u>	\$0.13	2.90 years
Number of options exercisable, end of period	<u>6,493,372</u>	\$0.13	2.90 years

10. **Related Party Transactions**

- (a) Related party transactions during the periods noted consist of:

	<u>Three Months Ended January 31, 2005</u>	<u>Three Months Ended January 31, 2004</u>	<u>Six Months Ended January 31, 2005</u>	<u>Six Months Ended January 31, 2004</u>
	\$	\$	\$	\$
Management fees incurred with directors	29,003	15,000	44,003	30,000
Accounting fees incurred with an officer	3,300	1,463	7,105	3,141
Rent incurred with a company related by a director in common	7,500	7,500	15,000	14,569

- (b) As at January 31, 2005, accounts payable and accrued liabilities include \$15,858 (July 31, 2004: \$180,124) due to directors and \$5,593 (July 31, 2004: \$26,837) due to an officer of the Company.
- (c) As at January 31, 2005, advances from related party of \$6,297 (July 31, 2004: \$6,297) is due to a company related by a common director.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

11. **Supplemental Disclosure of Non-Cash Operating, Investing and Financing Activities**

Significant non-cash transactions during the periods noted were:

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2005	2004	2005	2004
Shares issued in settlement of accounts payable	\$ <u>65,000</u>	\$ <u>-</u>	\$ <u>65,000</u>	\$ <u>-</u>

12. **Income Taxes**

A reconciliation of income taxes for the six months ended January 31, 2005 at Canadian statutory rates with the reported income taxes is as follows:

	January 31,	January 31,
	2005	2004
Loss for the period	\$ <u>(166,095)</u>	\$ <u>(209,921)</u>
Income tax recovery at statutory rate of 35.62%	\$ (64,744)	(37,980)
Non-deductible expenses	16,400	10,229
Unrecognized benefits of non-capital losses	49,199	30,688
Other	<u>(855)</u>	<u>(2,937)</u>
Total income tax recovery	\$ <u>-</u>	\$ <u>-</u>

The significant components of the Company's future income tax assets are as follows:

	January 31,	July 31,
	2005	2004
Future income tax assets		
Non-capital losses available for future periods	\$ 1,255,489	\$ 1,206,290
Resource deductions	<u>1,811,378</u>	<u>1,676,801</u>
	3,066,867	2,883,091
Valuation allowance	<u>(3,066,867)</u>	<u>(2,883,091)</u>
	\$ <u>-</u>	\$ <u>-</u>

As at January 31, 2005, the Company has not recorded the potential future income tax benefits of approximately \$3,525,000 (July 31, 2004: \$3,387,000) in non-capital losses which, if unutilized, expire through 2015.

Subject to certain restrictions, as at January 31, 2005, the Company has resource development and exploration expenditures of approximately \$5,085,000 (July 31, 2004: \$4,700,000) available to reduce taxable income of future years. Future tax benefits which may arise as a result of these losses and resource deductions have not been recognized in these interim financial statements and have been offset by a valuation allowance.

As at January 31, 2005, the Company also has \$140,828 (July 31, 2004: \$140,828) in capital loss carryforward.

Montello Resources Ltd.
Notes to the Interim Financial Statements
January 31, 2005
(Unaudited – Prepared by Management)

13. **Contingent Liability**

During the year ended July 31, 1997, the Company with other parties (the “Companies”), entered into an agreement with Supra Oil and Gas Corporation (“Supra”) whereby the Companies were allowed to view certain geophysical data pertaining to various properties in Alberta.

If the Companies decided to proceed to field operations, consideration was to be paid in two stages. Upon notification that they intended to go forward, the Companies would have to issue collectively \$150,000 of their shares pro-rata based on the October 29, 1997 closing market price of each of the Companies’ shares and fund (pro-rata) a \$250,000 exploration program which was to include drilling. Upon completing the drill program, had the Companies wished to continue work on the properties, they were to issue a further collective \$450,000 of their shares (pro-rata) and transfer a 10% interest in the properties to the private corporation.

During the year ended July 31, 1998, Supra filed a claim in the amount of \$150,000 and further damages against the Companies for payments not yet received. The Companies claim that the geophysical data was misrepresentational and induced the Companies to expend considerable costs in developing the properties. The Company has filed a Statement of Defence denying any liability. As at January 31, 2005, the lawsuit is still ongoing and the merit of the claim cannot be assessed.

14. **Segmented Information**

The Company operates in one segment. As at January 31, 2005, the Company has resource properties totalling \$380,511 (July 31, 2004: \$2,698) located in the United States. All other assets and operations are in Canada.

15. **Environmental Protection Practices**

The Company is subject to the laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. The Company may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest. The Company is not aware of any existing environmental problems related to any of its current or former properties that may result in material liability to the Company.

16. **Financial Instruments**

The Company’s financial instruments consist of cash, reclamation deposit, marketable securities, accounts receivable, accounts payable and accrued liabilities, and advances. Unless otherwise noted, it is management’s opinion that the Company is not exposed to significant interest or credit risks arising from these financial instruments. As at January 31, 2005 and July 31, 2004, the fair value of receivables and payables approximate their carrying value due to the immediate short-term maturity of these instruments.

17. **Subsequent Event**

Subsequent to January 31, 2005, the Company proposes, subject to regulatory acceptance, to issue 4,600,000 units at a price of \$0.13 per unit pursuant to a private placement. Each unit will consist of one common share and one non-transferable share purchase warrant. Each warrant will entitle the holder to purchase an additional common share at an exercise price of \$0.20 per share, exercisable for a period of two years.

MONTELLO RESOURCES LTD.

(“the Company”)

FORM 51-102F1

INTERIM MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE SIX MONTH PERIOD ENDED JANUARY 31, 2005

ISSUER DETAILS		FOR QUARTER ENDED Y M D			DATE OF REPORT Y M D		
NAME OF ISSUER MONTELLO RESOURCES LTD.		05	01	31	05	03	31
ISSUER ADDRESS SUITE 2833 – 595 BURRARD STREET, P.O. BOX 49057							
CITY/ VANCOUVER	PROVINCE BC	POSTAL CODE V7X 1C4	ISSUER FAX NO. 604-689-8199	ISSUER TELEPHONE NO. 604-689-1799			
CONTACT PERSON PATRICK POWER		CONTACT'S POSITION PRESIDENT			CONTACT TELEPHONE NO. 604-689-1799		
CONTACT EMAIL ADDRESS ir@montello.com		WEB SITE ADDRESS www.montello.com					
DIRECTOR'S SIGNATURE “PATRICK POWER”		PRINT FULL NAME PATRICK POWER			DATE SIGNED Y M D 05 03 31		
DIRECTOR'S SIGNATURE “JEANNINE DAVIES”		PRINT FULL NAME JEANNINE DAVIES			DATE SIGNED Y M D 05 03 31		

**INTERIM MANAGEMENT DISCUSSION AND ANALYSIS
FOR THE SIX MONTH PERIOD ENDED JANUARY 31, 2005**

The following discussion and analysis, prepared as of March 31, 2005, should be read in conjunction with the unaudited interim financial statements for the six months ended January 31, 2005 and related notes attached thereto, which are prepared in accordance with Canadian generally accepted accounting principles. All amounts are stated in Canadian dollars unless otherwise indicated.

The reader should also refer to the annual audited financial statements for the years ended July 31, 2004 and 2003, and the Management Discussion and Analysis for those years.

Statements in this report that are not historical facts are forward-looking statements involving known and unknown risks and uncertainties, which could cause actual results to vary considerably from these statements.

Additional information related to the Company is available for view on the SEDAR website at www.sedar.com.

GENERAL DEVELOPMENT OF THE BUSINESS

The Company is engaged in the acquisition, exploration and development of natural resource (oil/gas and mineral) properties.

The Company does not have any subsidiaries.

Significant Acquisitions and Dispositions

Oil and Gas Property

Morgan and Scott Counties Property, Tennessee

In September and October 2004 the Company paid approximately \$173,000 for the acquisition of various oil and gas leases covering lands and equipment located in Morgan and Scott Counties, Tennessee.

The various oil and gas leases are subject to a 5% production royalty.

Property Exploration and Development Plans and Work Programs Status

The Company plans to continue exploration work on its currently held resource properties, subject to availability and timing of financing (including, where applicable, the ability to meet cash calls from the project operator) and data analysis from work programs.

For properties in which the company is the operator, results of exploration programs, including technical disclosure, are prepared by or under the supervision of a qualified person.

For properties in which the Company is not the operator, results of exploration programs are provided to the Company by the project operator.

The Company is the project operator for both of its currently held resource properties – the Morgan and Scott property, and the Fentress property – both are oil and gas projects located in Tennessee.

At present, the Company is focused on the re-working of its recently acquired Morgan/Scott wells – with a goal of bringing these wells on line and into production again. The wells are a combination of oil, gas and oil, and gas wells that were shut-in in 1985 due to low oil and gas prices.

Technical reports and news releases discussing progress on the Company's properties can be viewed on the SEDAR website at www.sedar.com.

Use of Proceeds from Equity Financings

During the six months ended January 31, 2005 and to the date of this report, there were no material differences in the actual use of proceeds from previous disclosure regarding the intended use of proceeds.

SELECTED FINANCIAL INFORMATION

The following table presents certain selected financial information on a quarterly basis:

	Fiscal 2005 Second Quarter	Fiscal 2005 First Quarter	Fiscal 2004 Fourth Quarter	Fiscal 2004 Third Quarter	Fiscal 2004 Second Quarter	Fiscal 2004 First Quarter	Fiscal 2003 Fourth Quarter	Fiscal 2003 Third Quarter
Total revenues	\$124	\$7	\$27	\$15	-	\$2	\$2	-
Income (loss) before discontinued operations & extraord. items	(\$100,432)	(\$65,663)	(\$1,246,778)	\$151,273	(\$161,553)	(\$48,368)	(\$1,170,807)	(\$52,113)
Earnings (loss) per share before discontinued operations & extraord. items	(\$0.01)	(\$0.01)	(\$0.02)	\$0.01	(\$0.01)	(\$0.01)	(\$0.02)	(\$0.01)
Net income (loss)	(\$100,432)	(\$65,663)	(\$1,246,778)	\$151,273	(\$161,553)	(\$48,368)	(\$1,170,807)	(\$52,113)
Net earnings (loss) per share	(\$0.01)	(\$0.01)	(\$0.02)	\$0.01	(\$0.01)	(\$0.01)	(\$0.02)	(\$0.01)

Dividend Record and Policy

The Company has not declared any dividends since incorporation and does not intend to declare dividends in the foreseeable future. If the Company generates earnings in future, it expects that they will be retained to finance future growth and, where appropriate, retire debt.

Results of Operations

Liquidity and Capital Resources

Since incorporation, the Company's capital resources have been limited. In addition to having to rely upon cash generated from operations, the Company has had to rely upon the sale of equity and debt securities for cash required for administration, acquisitions and exploration programs, among other things. While there are presently no known specific trends, events or uncertainties that are likely to result in the Company's liquidity decreasing in any material way over the next year, it is unlikely that significant cash will be generated from operations over this period. Since the Company is unlikely to have significant cash flow, the Company will have to continue to rely upon equity and debt financing during such period. There can be no assurance that financing, whether debt or equity, will always be available to the Company in the amount required at any particular time or for any particular period or, if available, that it can be obtained on terms satisfactory to the Company. The Company does not have any commitments for material capital

expenditures over either the near or long term and none are presently contemplated over normal operating requirements.

Effect of Recent Developments on Operations

The Company is engaged in the acquisition, exploration and development of natural resource (oil/gas and mineral) properties. The Company has entered into agreements to acquire interests in the properties described above under the heading “Significant Acquisitions and Dispositions”.

The main business risks facing the Company over the next several years relate to the availability of equity capital to finance the acquisition, exploration and development of existing and future exploration and development projects. The availability of equity capital to junior resource companies is affected by commodity prices, global economic conditions, and economic conditions and government policies in the countries of operation, among other things. These conditions are beyond the control of the management of the Company and have a direct effect on the Company’s ability to raise equity capital.

The Company’s working capital and liquidity fluctuate in proportion to its ongoing equity financing activities. The Company requires a certain amount of liquid capital in order to sustain its operations and in order to meet various obligations as specified under the Company's resource property acquisition agreements. Should the Company fail to obtain future equity financing due to reasons as described above, it will not be able to meet these obligations and may lose its interests in the properties covered by the agreements. Further, should the Company be unable to obtain sufficient equity financing for working capital, it may be unable to meet its ongoing operational commitments.

Exploration and development of natural resources involve substantial expenditures and a high degree of risk. Few properties which are explored are ultimately developed into producing properties. Accordingly, the Company has no material revenue, writes off its natural resource properties from time to time, and operates at a loss. Continued operations are dependent upon ongoing equity financing activities.

Analysis of Three Months Ended January 31, 2005 vs. Three Months Ended January 31, 2004

As at January 31, 2005, the Company had a working capital deficiency of \$85,835 versus a working capital deficiency of \$644,917 as at January 31, 2004 – a decrease in deficiency of roughly \$559,000. The decrease is due mainly to:

- i) the retirement of a \$190,000 debenture in April 2004
- ii) completion of a \$630,000 equity financing in December 2004 – resulting in a paydown of accounts payable of roughly \$203,000
- iii) an increase in cash and cash equivalents (as a result of the December 2004 equity financing) of roughly \$155,000

General and administrative expenses increased by roughly \$55,000 from \$61,546 during the

three months ended January 31, 2004 (“2nd quarter 2004”) to \$116,558 during the three months ended January 31, 2005 (“2nd quarter 2005”). The increase is due mainly to the increased level of corporate activity brought about by the acquisition of the Morgan/Scott (Tennessee) property in September/October 2004 – and the related \$630,000 equity financing completed in December 2004. Specifically, legal fees increased by roughly \$16,000, management fees by \$14,000, filing fees by \$7,000 and travel (to evaluate the property and secure financing) by \$7,000 – accounting for most of the increase in general and administrative expenses.

Net cash used in operating activities increased by roughly \$370,000 from \$37,914 in 2nd quarter 2004 to \$408,617 in 2nd quarter 2005. The increase is due primarily to a \$263,000 decrease in accounts payable, the \$55,000 increase in general and administrative expenses noted above, and a \$52,000 increase in cash and cash equivalents.

Net cash used in investing activities increased by roughly \$195,000 from \$Nil in 2nd quarter 2004 to \$194,712 in 2nd quarter 2005. The increase is due to the development work undertaken on the Morgan/Scott property of roughly \$178,000 and the purchase of equipment for use on the property of roughly \$17,000 – both in 2nd quarter 2005.

Net cash provided by financing activities increased by roughly \$611,000 from \$38,145 in 2nd quarter 2004 to \$649,625 in 2nd quarter 2005. The increase is due to the \$630,000 equity financing completed in December 2004 and a \$19,000 decrease in advances from an affiliated company (Arctic Star Diamond Corp.) in 2nd quarter 2005.

Analysis of Financial Condition as at January 31, 2005 vs. July 31, 2004

As at January 31, 2005, the Company had a working capital deficiency of \$85,835 versus a working capital deficiency of \$506,154 as at July 31, 2004 – a decrease in deficiency of roughly \$420,000 from the July 31, 2004 year-end. The decrease in deficiency is due primarily to a \$243,000 decrease in accounts payable and a \$174,000 increase in cash and cash equivalents – both as a result of the \$630,000 equity financing completed in December 2004.

CONTRACTUAL OBLIGATIONS/COMMITMENTS

The Company entered into a public relations agreement with KCrew Communications Inc. (“KCrew”) dated February 28, 2005 (i.e. subsequent to January 31, 2005). Under the agreement, the Company agreed to pay KCrew a fee of \$10,000 per month for the provision of investor relations services by KCrew for a period of three months commencing March 1, 2005.

The Company does not have any other contractual obligations/commitments for material expenditures

OUTSTANDING SHARE DATA

The Company’s authorized share capital consists of 100,000,000 common shares without par

value. The Company has only one kind and class of shares and there are no unusual rights or restrictions attached to that class.

As at January 31, 2005, the Company had a total of 79,437,130 common shares issued and outstanding.

In December 2004 the Company issued 12,730,000 units for cash proceeds of \$630,500 (net of a \$6,000 finder's fee) pursuant to a private placement. Each unit consists of one common share and one non-transferable share purchase warrant. Each warrant entitles the holder to purchase an additional common share at an exercise price of \$0.10 per share, exercisable until December 16, 2006.

Also in December 2004 the Company issued 1,300,000 common shares in settlement of accounts payable totalling \$65,000.

See "SUBSEQUENT EVENT" below for details of a proposed share issuance (private placement) subsequent to January 31, 2005.

As at January 31, 2005, the Company had 16,179,666 share purchase warrants and 6,493,372 stock options outstanding.

RELATED PARTY TRANSACTIONS

During the six months ended January 31, 2005, the Company incurred management fees of \$44,003 (2004: \$30,000) with directors, and accounting fees of \$7,105 (2004: \$3,141) with the Secretary of the Company.

During the six months ended January 31, 2005, the Company incurred office rent of \$15,000 (2004: \$14,569) with a company related by a common President.

FINANCIAL INSTRUMENTS

It is management's opinion that the fair value of the Company's cash, reclamation deposit, marketable securities, accounts receivable, accounts payable and accrued liabilities, and advances approximate their carrying value due to the relatively short periods to the maturity of the instruments.

The maximum credit risks exposure for all financial assets is the carrying value of those assets.

None of the Company's financial instruments are denominated in U.S. dollars, and the Company does not use derivative instruments or foreign exchange contracts to hedge against gains or losses arising from foreign exchange fluctuations.

CONTINGENCIES

The Company is still a party to an action commenced by Supra Oil and Gas Corporation in 1997. The claim is described in the attached interim financial statements and no steps have been taken on the action during the six months ended January 31, 2005 or to the date of this report.

SUBSEQUENT EVENT

Subsequent to January 31, 2005, the Company proposes, subject to regulatory acceptance, to issue 4,600,000 units at a price of \$0.13 per unit pursuant to a private placement. Each unit will consist of one common share and one non-transferable share purchase warrant. Each warrant will entitle the holder to purchase an additional common share at an exercise price of \$0.20 per share, exercisable for a period of two years.