

**Montello Resources Ltd.**

**Interim  
Financial  
Statements  
(Unaudited– Prepared by Management)**

**October 31, 2005**

Head Office  
P.O. Box 49057  
2833 - 595 Burrard Street  
Vancouver, BC, V7X 1C4  
Tel 604 689-1799  
Fax 604-689-8199  
Web page [www.montello.com](http://www.montello.com)  
Email [ir@montello.com](mailto:ir@montello.com)

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

**NOTICE TO USERS**

December 28, 2005

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

**“MONTELLO RESOURCES LTD.”**

# MONTELLO RESOURCES LTD.

## Balance Sheet

Canadian Funds

	Oct 31, 2005 (unaudited)	Jul 31, 2005 (audited)
<b>ASSETS</b>		
Current		
Cash	\$ 49,143	\$ 79,858
Reclamation deposit	40,372	40,372
Marketable securities (Note 4)	28,167	28,167
Advances to related party	-	2,703
Accounts receivable and prepaid expenses	49,903	47,677
	<b>167,585</b>	<b>198,777</b>
Exploration advance	42,892	39,817
Property and equipment net of depreciation, (note 6)	14,471	14,884
Resource properties (Note 7, 14)	1,842,399	1,378,084
	<b>\$ 2,067,347</b>	<b>\$ 1,631,562</b>
<b>LIABILITIES</b>		
Current		
Accounts payable and accrued liabilities(note 9(e))	\$ 255,881	\$ 243,960
	<b>255,881</b>	<b>243,960</b>
Advances from affiliated company (Note 5)	1,279,734	1,279,407
	<b>1,535,615</b>	<b>1,523,367</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital, (note 8, 14)	16,084,704	15,575,284
Share subscriptions	218,005	122,850
Contributed surplus	788,366	425,361
Deficit	(16,559,343)	(16,015,300)
	<b>531,732</b>	<b>108,195</b>
	<b>\$ 2,067,347</b>	<b>\$ 1,631,562</b>

Approved by the directors

"Patrick Power", Director

"Jeannine Davies", Director

# MONTELLO RESOURCES LTD.

## Interim Statement of Income or Loss

For the Periods Ended October 31, 2005 & October 31, 2004  
(Unaudited, prepared by management)  
Canadian Funds

	Three Months Ended..	
	2005	2004
<b>General and administrative expense</b>		
Accounting and audit	\$ 6,000	\$ 3,805
Amortization	413	-
Bank charges and interest	499	546
Consulting fees	65,772	15,000
Filing fees	6,176	1,425
Legal fees	2,062	984
Management fees	36,000	15,000
Office	366	48
Promotion	3,745	-
Rent	8,175	7,500
Stock compensation	363,005	-
Transfer agent fees	569	1,279
Travel	42,749	15,988
Website hosting	235	525
	<b>535,766</b>	<b>62,100</b>
<b>Loss before undernoted items</b>	<b>535,766</b>	<b>62,100</b>
Interest income	(97)	(7)
Foreign exchange (gain) or loss	8,374	3,570
<b>Loss for the period</b>	<b>544,043</b>	<b>65,663</b>
<b>Deficit, beginning of period</b>	<b>16,015,300</b>	<b>15,072,544</b>
<b>Deficit, end of period</b>	<b>\$ 16,559,343</b>	<b>\$ 15,138,207</b>
Loss (gain) per share basic and diluted	\$ 0.01	\$ 0.01

# MONTELLO RESOURCES LTD.

## Interim Statement of Cash Flows

For the Periods Ended October 31, 2005 & October 31, 2004  
(Unaudited, prepared by management)  
Canadian Funds

	Three Months Ended..	
	2005	2004
Operating activities		
Gain (loss) for the period	\$ (544,043)	\$ (65,663)
Items not involving cash		
Depreciation	413	-
Stock compensation expense	363,005	-
	(180,625)	(65,663)
Changes in non-cash working capital items	12,398	7,694
Net cash used in operating activities	(168,227)	(57,969)
Financing activities		
Issuance of share capital	509,420	-
Share subscriptions	95,155	-
Advances from affiliated company	327	322,140
Net cash provided by financing activities	604,902	322,140
Investing activities		
Resource property expenditures	(464,315)	(199,639)
Exploration advance	(3,075)	-
Net cash used in exploration activities	(467,390)	(199,639)
Net increase (decrease) in cash	(30,715)	64,532
Cash, beginning of period	79,858	(2,853)
Cash, end of period	\$ 49,143	\$ 61,679

# MONTELLO RESOURCES LTD.

## Notes to Interim Financial Statements

---

October 31, 2005

(Unaudited, prepared by management)

Canadian Funds

### 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 financial statements should the Company be unable to continue as a going concern.

### 2. Nature of Operations

The Company is in the process of exploring its 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) Oil and gas properties

The Company follows the full cost method of accounting for its oil and gas properties, whereby all costs of exploring for and developing oil and gas reserves are capitalized to cost centres on a country-by-country basis. Such costs include land acquisition costs, geological costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, cost of production and gathering equipment and general and administrative charges related to acquisition, exploration and development activities. Proceeds from the disposal of oil and natural gas properties are applied against capitalized costs. Gains or losses are not recognized on disposals unless crediting the proceeds against capitalized costs would materially alter the rate of depletion.

The amounts shown for oil and gas properties represent costs to date and are not intended to reflect present or future values.

The capitalized costs together with estimated future capital costs associated with the development of proven reserves are depleted and amortized using the unit of production method based on proven oil and natural gas reserves, before royalties, determined by Company and independent engineers. For purpose of the depletion and amortization calculations, oil and natural gas reserves are converted to a common unit of measure based upon their relative energy content.

## Notes to Interim Financial Statements

---

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

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

#### **Oil and gas properties** (continued)

In applying the cost method, the Company performs a ceiling test which restricts capitalized costs less accumulated depletion and amortization from exceeding the estimated undiscounted value of future net revenues from proved oil and natural gas reserves less estimated future removal and site restoration costs, general and administrative expenses, financing costs and income taxes. In calculating the ceiling test, the year end prices of oil and natural gas are used and all costs are estimated to be constant.

The Company periodically reviews the cost associated with undeveloped properties to determine whether the costs will be recoverable. If the results of the review indicate an impairment has occurred, the cost of the property or the amount of the impairment is added to the full cost pool.

Estimated future removal and site restoration costs are provided for using the unit-of-production method. These costs are based on year end engineering estimates of the anticipated costs of the site restoration in accordance with current legislation and industry practices. The annual charge is recorded as additional depletion and amortization.

Where the Company's exploration development and production activities related to oil and gas are conducted jointly with others the accounts reflect only the Company's proportionate interest in such activities.

#### **(b) Values**

The amounts shown for oil and gas 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.

## Notes to Interim Financial Statements

---

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

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

#### (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.

#### (g) **Share capital**

Common shares issued for non-monetary consideration are recorded at their fair market value based upon the trading price of the Company's shares on the TSX Venture Exchange on the date of the agreement to issue the shares or the date of share issuance, whichever is lower.

The proceeds from shares issued pursuant to flow-through share financing agreements are credited to share capital and the tax benefits related to the exploration expenditures incurred pursuant to these agreements are transferred to the purchaser of the flow-through shares. When the proceeds of flow-through financings are received, the Company becomes committed to incurring the underlying exploration expenditures on a "best efforts" basis; however, the Company does not recognize such future expenditures as liabilities for purposes of its financial reporting.

Costs incurred to issue shares are deferred until the shares are issued, at which time these costs are charged to share capital.

#### (h) **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.

## Notes to Interim Financial Statements

---

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

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

#### (i) **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.

#### (j) **Use of estimates**

The preparation of interim financial statements in accordance 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 year. Actual results could differ from these estimates.

#### (k) **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 year. 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 year.

#### (l) **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 year 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.

## Notes to Interim Financial Statements

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

### 3. Significant Accounting Policies (continued)

#### (m) 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.

#### (n) Impairment of long-lived assets

On August 1, 2004, the Company adopted the new CICA Handbook Section 3063 "Impairment of Long-Lived Assets" recommendations. These recommendations provide accounting guidance for the recognition, measurement and disclosure of impairment of long-lived assets, including property, plant and equipment and intangible assets with finite useful lives. They require the recognition of an impairment loss for a long-lived asset when events or changes in circumstances causes its carrying value to exceed the total undiscounted future cash flows expected from its use and eventual disposition. The impairment loss is calculated by deducting the fair value of the asset from its carrying value. This change in accounting policy has been applied prospectively. Adoption of CICA 3063 has no effect on these interim financial statements.

#### (o) Asset retirement obligations

On August 1, 2004, the Company has adopted the new CICA accounting standard on "Asset Retirement Obligations". Under the new standard the Company is required to record a liability for the estimated future costs associated with legal obligations relating to the reclamation and closure of its oil and gas properties. This amount is initially recorded at its discounted present value with subsequent annual recognition of an accretion amount on the discounted liability. An equivalent amount is recorded as an increase to oil and gas properties and amortized over the useful life of the properties. As the Company does not currently have any legal obligations relating to the reclamation of its oil and gas properties, the adoption of this standard had no impact on the accounts of the Company.

### 4. Marketable Securities

Marketable securities consist of shares in a public company related by a common director, which as at October 31, 2005 had a quoted market value of \$133,760 (July 31, 2005: \$197,162).

# MONTELLO RESOURCES LTD.

## Notes to Interim Financial Statements

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

### 5. 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.

### 6. Property and Equipment

October 31	Cost	Accumulated Amortization	2005 Net Carrying Amount	2004 Net Carrying Amount
Machinery and equipment	\$ 13,907	\$ 1,738	\$ 12,169	\$ -
Office equipment	2,631	329	2,302	-
	<u>\$ 16,538</u>	<u>\$ 2,067</u>	<u>\$ 14,471</u>	<u>\$ -</u>

### 7. Resource Properties

October 31	2005	2004
Morgan and Scott, Tennessee	\$ 1,357,410	\$ 199,639
Tsuu T'ina, Alberta	482,291	-
Fentress, Tennessee	<u>2,698</u>	<u>2,698</u>
	<u>\$ 1,842,399</u>	<u>\$ 202,337</u>

Acquisition costs and deferred exploration and development expenditures during the periods ended October 31, 2005 and 2004 were as follows:

October 31	2005	2004
Property acquisition costs		
Balance, beginning of period	\$ 356,431	\$ -
During the period		
Additions	-	172,833
Written off	-	-
Balance, end of period	<u>356,431</u>	<u>172,833</u>
Deferred exploration expenditures		
Balance, beginning of period	1,021,653	2,698
During the period		
Camp	-	9,904
Development costs	422,108	16,902
Drilling	42,207	-
Written off	-	-
Balance, end of period	<u>1,485,968</u>	<u>29,504</u>
Total resource properties costs	<u>\$ 1,842,399</u>	<u>\$ 202,377</u>

# MONTELLO RESOURCES LTD.

## Notes to Interim Financial Statements

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

### 7. **Resource Properties** (continued)

#### (a) Morgan and Scott, Tennessee

During the year ended July 31, 2005, the Company paid \$351,046 toward the acquisition of various oil and gas leases covering lands and equipment located in Morgan and Scott Counties, Tennessee. As at October 31, 2005, the Company has incurred exploration and development expenditures of \$1,357,410 (2004: \$Nil) on the property.

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

#### (b) Tsuu T'ina, Alberta

During the year ended July 31, 2005, the Company entered into a joint venture agreement whereby it acquired the right to earn a 2.5% working interest in certain oil and gas leases located near Calgary, Alberta by paying 5% of costs. The Company paid \$5,385 as its share of costs to secure the leases. As at October 31, 2005, the Company has incurred exploration expenditures of \$482,291 (2004: \$Nil) on the property.

The Company can also elect to participate in the drilling of certain other drill locations, earning a 2.5% working interest by paying 2.5% of costs.

#### (c) 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.

### 8. **Share Capital**

October 31	<u>2005</u>	<u>2004</u>
Authorized:		
100,000,000 Common shares without par value		
Issued:		
89,217,797 Common shares (2004: 65,407,130 shares)	\$ <u>16,107,204</u>	\$ <u>14,208,680</u>

# MONTELLO RESOURCES LTD.

## Notes to Interim Financial Statements

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

### 8. Share Capital (continued)

(a) Changes in issued common shares during the periods ended October 31, 2005 and 2004 were as follows:

October 31	2005		2004	
	Number of Shares	\$ Amount	Number of Shares	\$ Amount
Beginning of period	84,975,924	15,575,284	65,407,130	14,208,680
Issued for cash pursuant to private placements	2,039,565	265,143	-	-
Issued for cash on exercise of warrants	1,000,000	100,000	-	-
Issued for cash on exercise of options	1,202,308	144,277		
End of period	<u>89,217,797</u>	<u>16,084,704</u>	<u>65,407,130</u>	<u>14,208,680</u>

(b) During the period ended October 31, 2005, the Company issued 2,039,565 units for cash proceeds of \$265,143 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 \$0.20 per share, exercisable until September 15, 2007.

(c) During the period ended October 31, 2005, the Company issued 1,202,308 common shares for cash of \$144,277 on the exercise of stock options. The Company issued 1,000,000 common shares for cash of \$100,000 on the exercise of warrants

(d) As at October 31, 2005, outstanding warrants are as follows:

Number of Warrants	Exercise Price	Expiry Date
3,449,666	\$0.15	February 8, 2006
10,661,667	\$0.10	December 16, 2006
3,650,461	\$0.20	May 6, 2007
820,000	\$0.20	June 8, 2007
2,039,565	\$0.20	September 15, 2007
<u>20,621,359</u>		

# MONTELLO RESOURCES LTD.

## Notes to Interim Financial Statements

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

### 8. **Share Capital** (continued)

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

Number of Shares	Exercise Price	Expiry Date
266,000	\$0.16	November 16, 2005
2,825,000	\$0.14	July 18, 2006
1,297,692	\$0.10	December 29, 2009
1,450,000	\$0.12	February 18, 2010
1,900,000	\$0.13	September 19, 2010
<u>7,738,692</u>		

The fair value of these options were determined on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions.

	2005
Risk-free interest rate	3.25%
Expected life of options	5 years
Annualized volatility	116%
Dividend rate	-

### 9. **Related Party Transactions**

- (a) During the three month period ended October 31, 2005, the Company incurred management fees of \$36,000 (2004: \$15,000) with directors of the Company.
- (b) During the three month period ended October 31, 2005, the Company incurred \$3,650 for accounting fees (2004: \$3,805) with an officer of the Company.
- (c) During the three month period ended October 31, 2005, the Company incurred rent of \$7,500 (2004: \$7,500) with a company related by a director in common.
- (d) During the three month period ended October 31, 2005, the Company sold no shares (2004: nil shares) of Arctic Star Diamond Corp., a company related by a common director.
- (e) As at October 31, 2005, accounts payable and accrued liabilities include \$18,840 (2004: \$195,124) due to directors and nil (2004: \$ 3,745) due to an officer of the Company.

## Notes to Interim Financial Statements

---

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

### 10. 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 October 31, 2005, the lawsuit is still ongoing and the merit of the claim cannot be assessed.

### 11. Segmented Information

The Company operates in one segment. As at October 31, 2005, the Company has resource properties totalling \$1,360,108 (2004: \$202,337) located in the United States and \$482,291 (2004: \$Nil) located in Canada. All other assets and operations are in Canada.

### 12. 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.

## Notes to Interim Financial Statements

---

October 31, 2005  
(Unaudited, prepared by management)  
Canadian Funds

### 13. 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 October 31, 2005 and 2004, the fair value of receivables and payables approximate their carrying value due to the immediate short-term maturity of these instruments.

### 14. Subsequent Events

Subsequent to October 31, 2005:

The Company entered into an agreement to purchase 100% of the issued and outstanding shares of Moonshine Resources Ltd. ("Moonshine"). Moonshine is an arm's length private company engaged in oil and gas exploration and production in Alberta. The Company agreed to pay consideration of \$850,000, payable by the issuance of 6,538,462 common shares of the Company at a deemed cost of \$0.13 per share.

The Company entered into an agreement to purchase certain oil and gas assets located in Alberta. The Company agreed to pay cash consideration of \$724,500.

The Company entered into a convertible loan agreement, subject to regulatory acceptance, in the principal amount of \$1,000,000. The loan, which has a maturity date of November 30, 2008, is payable as to \$27,778 per month, plus interest, commencing on December 31, 2005. The loan bears interest at the rate of 12% per annum, with interest in the first year calculated on the original amount of the loan, regardless of the principal balance outstanding.

The loan is convertible, at any time prior to maturity, into units of the Company at a conversion rate of \$0.18 per unit. Upon conversion, 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 \$0.25 per share, exercisable until maturity.

The loan is secured by a pledge of the Company's interest in certain oil and gas assets located in Alberta and 60% of all production proceeds received by the Company from those assets.

**Montello Resources Ltd.**

**Management Discussion and Analysis**

**For the Three Months Ended October 31, 2005**

**As at December 28, 2005**

Suite 2833- 595 Burrard Street  
P.O. Box 49057  
Vancouver, British Columbia  
V7X 1C4

Phone 604-689-1799  
Fax 604-689-8199  
Web page [www.montello.com](http://www.montello.com)  
Email [ir@montello.com](mailto:ir@montello.com)

**Management Discussion And Analysis  
For The Three Months Ended October 31, 2005**

**DATE OF REPORT**            December 28 2005

**OVERALL PERFORMANCE**

*General*

The following discussion and analysis, prepared as of December 28, 2005, should be read in conjunction with the unaudited financial statements for the three months ended October 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 Statement for the years ended July 31, 2005 and 2004 and the Management Discussion and Analysis for those years

The Company is a junior natural resource company engaged in the acquisition, exploration and development of natural resource (oil and gas) properties. The Company is a reporting issuer in British Columbia and Alberta and trades on the TSX Venture Exchange under the symbol MEO. The Company does not have any subsidiaries.

During the quarter the Company signed a letter of intent to acquire all the shares of Moonshine Resources Limited (“Moonshine”), of which Mr. Dwayne Tyrkalo (“Tyrkalo”) is President. Moonshine is an arm’s length privately held Alberta Oil and Gas Exploration-Production Company located in Calgary, Alberta. Moonshine currently produces approximately 17 BOE per day and has a large land base in the Peace River Arch of Northwestern Alberta. The Company will acquire all of the issued and outstanding shares of Moonshine for CAD \$850,000 payable in common shares of the Company at a deemed price of CAD \$0.13 per share (6,538,462 common shares), subject to TSX Venture Exchange acceptance.

The Company also signed a letter of intent with Silver Peak Industries Ltd. (“Silver Peak”) an arm’s length privately held Alberta Oil and Gas Exploration-Production Company, to acquire certain oil and gas assets in the Province of Alberta which are contiguous to the land package being acquired from Moonshine. The assets of Silver Peak which are being acquired by the Company are currently producing approximately 21 BOE per day. The purchase price of these assets is CAD \$724,500, subject to Exchange acceptance.

During the quarter the Company closed a private placements for gross proceeds of \$265,143. The Company also granted a total of 1,900,000 options during quarter ended October 31, 2005.

***Oil and Gas Property******Morgan and Scott Counties Property, Tennessee***

To October 31, 2005 the Company has paid approximately \$351,000 for the acquisition of various oil and gas leases covering lands and equipment located in Morgan and Scott Counties, Tennessee. The leases are subject to a 5% production royalty.

***Fentress County Property, Tennessee***

The Company also holds a 230 acre oil and gas lease located in Gentress county, Tennessee which it acquired in October 2002 for \$2,698.

***Arapahoe Joint Venture, Alberta***

In June 2005 the Company entered into a joint venture agreement with Arapahoe Energy Corporation pursuant to which the Company has a 5% participating interest (2.5% net) in land located on the Tsuu T'ina First Nation (Sarcee Indian) Reserve west of the city of Calgary, Alberta.

***Peace River Arch of Northwestern Alberta.***

On September 16, 2005 the Company signed a letter of intent to acquire all the shares of Moonshine Resources Limited ("Moonshine"). Moonshine is a privately held Alberta Oil and Gas Exploration-Production Company located in Calgary, Alberta. The Company will acquire all of the issued and outstanding shares of Moonshine for CAD \$850,000 payable in common shares of the Company at a deemed price of CAD \$0.13 per share (6,538,462 common shares).

***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 the Morgan and Scott property, and the Fentress property, both are oil and gas projects located in Tennessee. The operator of the Arapahoe Joint Venture is C1 Energy Ltd.

On the Tennessee properties, the Company is presently focused on the re-working of its 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.

On the Arapahoe property, subsequent to the fiscal year end a test well had been drilled, logged and cased to a depth of 3,300 metres subsurface. It is currently awaiting completion and production testing.

As at October 31, 2005 the Company has incurred an aggregate of \$1,360,108 of exploration expenditures and acquisition costs on the Tennessee properties and an aggregate of \$482,291 of exploration expenditure and acquisition costs on the Arapahoe property.

## RESULTS OF OPERATIONS

### *Analysis of Financial Condition as at October 31, 2005 vs. October 31, 2004*

The Company recorded a net loss of \$544,043 (\$0.01 per share) for the three months ended October 31, 2005 as compared to a loss of \$65,663 (\$0.01 per share) for the three months ended October 31 2004. The change is mainly due to stock option compensation for the employee stock options issued in the current quarter.

General and administrative expenses increased by \$473,666 from \$62,100 during the quarter ended October 31, 2004 to \$535,766 during the quarter ended October 31, 2005. The increase is due generally to stock option compensation using Black Schoels stock volatility calculation of \$363,005. Also the Moonshine Resources acquisition created an increase in corporate activity. Management fees increased by \$21,000, travel fees increased by \$26,761 and consulting fees increased by \$50,797. These increases were brought about primarily from the property acquisitions in Alberta from negotiations with Silver Peak Industries in August and September.

All other general and administrative expenses on a year over year basis are similar and consistent with the Company's ongoing operations.

## SUMMARY OF QUARTERLY RESULTS

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

	2005	2005	2005	2005	2004	2004	2004	2004
	Oct 31	July 31	Apr 30	Jan 31	Oct 31	July 31	Apr 30	Jan 31
Total Revenue	97	844	124	124	7	27	15	0
Net loss	544,043	357,361	313,278	350,326	65,663	1,246,778	151,273	161,553
Loss (gain) per share basic and diluted	0.01	0.01	0.01	0.01	0.01	0.02	(0.01)	0.01

## LIQUIDITY

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 is engaged in the acquisition, exploration and development of natural resource (oil/gas) properties. The Company has entered into agreements to acquire interests in the properties described above under the heading "Overall Performance - Oil and Gas Properties".

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.

**OFF-BALANCE SHEET ARRANGEMENTS**

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

**RELATED PARTY TRANSACTIONS**

During the three month period ended October 31, 2005, the Company incurred management fees of \$36,000 (2004: \$15,000) with directors of the Company. During the three month period ended October 31, 2005, the Company incurred rent of \$7,500 (2004: \$7,500) with a company related by a director in common. As at October 31, 2005, accounts payable and accrued liabilities include \$18,840 (2004: \$195,124) due to directors and nil (2004: \$ 3,745) due to an officer of the Company.

**PROPOSED TRANSACTION**

The Company has entered into a letter of intent to acquire all the shares of Moonshine Resources Limited (“Moonshine”). Moonshine is an arm’s-length privately held company with a large land base in northwestern Alberta and currently producing approximately 17 BOE per day. Upon closing of the transaction the Company will pay Moonshine \$850,000, payable in 6,538,462 shares of the Company at a deemed price of \$0.13 per share. The TSX Venture Exchange approved the acquisition on November 3, 2005, closing has not yet occurred.

The Company also entered into a letter of intent to acquire oil and gas assets located in the same area as the Moonshine property from an arm’s-length party. The assets are currently producing approximately 21 BOE per day. Consideration is \$724,000 cash. The TSX Venture Exchange approved the acquisition on November 3, 2005.

To finance these acquisitions the Company has entered into a convertible loan agreement with Filices Enterprises Ltd. The amount of the loan is \$1,000,000 and it is convertible into units of the Company at a rate of \$0.18 per unit. Each unit consists of one common share of the Company and one warrant. Each warrant is exercisable into one common share of the Company until the maturity of the loan which is November 30, 2008. The loan agreement is subject to TSX Venture Exchange approval.

**FINANCIAL INSTRUMENTS AND OTHER 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.

## **OTHER MD&A REQUIREMENTS**

### **Outstanding Share Data**

- a) 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.
- b) As at October 31, 2005, the Company had a total of 89,217,797 common shares issued and outstanding. As at October 31 2004, the Company had a total of 65,407,130 common shares issued and outstanding.
- c) As at October 31, 2005, the Company had 20,621,359 share purchase warrants and 7,738,692 stock options outstanding. As at October 31, 2004, the Company had 3,449,666 share purchase warrants and 4,395,372.00 stock options outstanding.

## **SUBSEQUENT EVENTS**

Subsequent to the date of these financial statements the Company entered into an agreement to purchase 100% of the issued and outstanding shares of Moonshine Resources Ltd. ("Moonshine"). Moonshine is an arm's length private company engaged in oil and gas exploration and production in Alberta. The Company agreed to pay consideration of \$850,000 payable by the issuance of 6,538,462 common shares of the Company at a deemed cost of \$0.13 per share.

The Company entered into an agreement to purchase certain oil and gas assets located in Alberta. The Company agreed to pay cash consideration of \$724,500.

The Company entered into a convertible loan agreement, subject to regulatory acceptance, in the principal amount of \$1,000,000. The loan, which has a maturity date of November 30, 2008, is payable as to \$27,778 per month, plus interest, commencing on December 31, 2005. The loan bears interest at the rate of 12% per annum, with interest in the first year calculated on the original amount of the loan, regardless of the principal balance outstanding.

The loan is convertible, at any time prior to maturity, into units of the Company at a conversion rate of \$0.18 per unit. Upon conversion, 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 \$0.25 per share, exercisable until maturity. The loan is secured by a pledge of the Company's interest in certain oil and gas assets located in Alberta and 60% of all production proceeds received by the Company from those assets.