Montello Resources Ltd.

Management Discussion and Analysis

(Unaudited Financials by Management)

For the Three Months Ended October 31, 2006

Date Submitted: January 18, 2007

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NOTICE OF NO AUDITOR REVIEW

The accompanying unaudited interim financial statements have been prepared by management and approved by the Audit Committee and Board of Directors.

The Company's independent auditors have not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditors.

October 31, 2006

Montello Resources Ltd.
Consolidated Balance Sheets
(Unaudited: Prepared by Management)
Canadian Funds

ASSETS	October 31, 2006	July 31, 2006
Current		
Cash	$ **94,683**	$ 89,292
Reclamation deposit	**11,231**	11,317
Marketable securities (Note 4)	**18,617**	18,617
Accounts receivable and prepaid expenses	**559,126**	335,572
	683,657	454,798
Exploration advance	**7,790**	15,443
Equipment (Note 6)	**12,540**	13,200
Resource properties (Note 7)	**1,998,111**	2,131,618
Asset retirement obligation	**162,463**	162,463
	$ **2,864,561**	$ 2,777,522

LIABILITIES AND SHAREHOLDERS' EQUITY

	October 31, 2006	July 31, 2006
Current		
Accounts payable and accrued liabilities (Note 10 (b))	$ **1,351,892**	$ 1,107,076
Convertible loan payable (Note 8)	**-**	870,562
	1,351,892	1,977,638
Advances from affiliated company (Note 5)	**379,772**	272,696
Reserve for asset retirement obligation	**224,129**	224,129
	1,955,793	2,474,463
Shareholders' equity		
Share capital (Note 9)	**19,192,864**	17,980,440
Contributed surplus	**835,149**	749,294
Deficit, per accompanying statements	**(19,119,245)**	(18,426,675)
	908,768	303,059
	$ **2,864,561**	$ 2,777,522

Continuing operations (Note 1)

Approved by the directors:

"William R. Cawker"
Director – William R. Cawker

"Dwayne Tyrkalo"
Director – Dwayne S. Tyrkalo

See accompanying notes.

Montello Resources Ltd.
Consolidated Interim Statements of Operations and Deficit
For the Three Months Ended October 31
(Unaudited: Prepared by Management)
Canadian Funds

	2006	2005
Revenue		
Oil and gas sales	$ **274,818**	$ -
Direct expenses		
Operating	**156,477**	-
Gross profit	**118,341**	-
Expenses		
Accounting and audit	**8,856**	6,000
Amortization and depletion	**225,015**	413
Bank charges and interest	**20,965**	499
Consulting fees	**81,160**	65,772
Filing fees	**5,929**	6,176
Legal fees	**6,253**	2,062
Management fees	**135,350**	36,000
Office	**6,922**	366
Promotion	**11,137**	3,745
Property examination	**13,669**	-
Public relations	**22,500**	-
Rent	**1,196**	8,175
Shareholders' information	**5,240**	-
Stock compensation	**225,217**	363,005
Transfer agent fees	**-**	569
Travel	**41,312**	42,749
Website hosting	**-**	235
	810,721	535,766
Loss before undernoted items	**(692,380)**	(535,766)
Interest income	**-**	97
Foreign exchange loss	**(190)**	(8,374)
Loss for the period	**(692,570)**	(544,043)
Deficit, beginning of period	**(18,426,675)**	(16,015,300)
Deficit, end of period	$ **(19,119,245)**	$ (16,559,343)
Loss per share	$ **(0.01)**	$ (0.01)
Weighted average number of shares outstanding	**108,581,958**	7,558,536

See accompanying notes.

Montello Resources Ltd.
Consolidated Interim Statements of Cash Flows
For the Three Months Ended October 31
(Unaudited: Prepared by Management)
Canadian Funds

	2006	2005
Cash provided by (used in)		
Operating activities		
Loss for the period	$ **(692,570)**	$ (544,043)
Items not affecting cash:		
Amortization and depletion	**225,015**	413
Stock compensation expense	**225,217**	363,005
	(242,338)	(180,625)
Changes in non–cash working capital items, net	**(849,214)**	12,398
	(1,091,552)	(168,227)
Investing activities		
Resource property expenditures	**(90,848)**	(464,315)
Exploration advance	**(7,653)**	(3,075)
	(83,195)	(467,390)
Financing activities		
Shares issued	**1,073,062**	509,420
Share subscriptions	**-**	95,155
Advances from (to) affiliated company	**107,076**	327
	1,180,138	604,902
Increase (decrease) in cash during the period	**5,391**	(30,715)
Cash, beginning of period	**89,292**	79,858
Cash, end of period	$ **94,683**	$ 49,143
Changes in non-cash working capital items consist of:		
Decrease in reclamation deposit	$ **86**	$ -
Decrease in advances to related party	**-**	2,703
Increase in accounts receivable	**(223,554)**	(2,226)
Increase in accounts payable and accrued liabilities	**244,816**	11,921
Decrease in convertible loan payable	**(870,562)**	-
	$ **(849,214)**	$ 12,398

Supplemental disclosure with respect to cash flows (Note 11)

See accompanying notes.

1. INTERIM REPORTING AND CONTINUANCE OF OPERATIONS

While the information presented in the accompanying interim financial statements is unaudited, it includes all adjustments which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows for the interim periods presented. Except as disclosed below, these interim financial statements follow the same accounting policies and methods of their application as the Company's audited July 31, 2006 annual financial statements. It is suggested that these interim financial statements be read in conjunction with the Company's July 31, 2006 audited financial statements.

These 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. The continued operations of the Company are dependent upon the existence of recoverable reserves, the ability of the Company to obtain financing to complete the development, and upon future profitable production or proceeds from disposition from its petroleum properties. These financial statements do not include any adjustments to the amounts and classifications of assets that might be necessary should the Company be unable to continue operations.

2. NATURE OF OPERATIONS

The Company 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) Principles of consolidation

These consolidated financial statements include the accounts of the Company, its 100% interest in Montello Resources USA Ltd. Corp., which was incorporated in Delaware, USA on March 2, 2005, and its 100% interest in Moonshine Resources Ltd.

3. **SIGNIFICANT ACCOUNTING POLICIES** (continued)

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

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 centers 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 the 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.

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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) 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.

(d) Cost of maintaining resource properties

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

(e) Marketable securities

Marketable securities are stated at lower of cost or market.

(f) 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.

(g) 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.

(h) 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.

3. **SIGNIFICANT ACCOUNTING POLICIES** (continued)

(i) **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.

(j) **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.

(k) **Use of estimates**

The preparation of 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.

(l) **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.

(m) **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.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(n) 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 year. Translation gains and losses are reflected in loss for the year.

(o) Impairment of long-lived assets

An impairment loss is recognized for long-lived assets including property, plant and equipment and intangible assets with finite useful lives, 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.

(p) Asset retirement obligation

The fair value of a liability for an asset retirement obligation is recognized in the year in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and subsequently amortized over the asset's useful life.

4. MARKETABLE SECURITIES

Marketable securities consist of shares in a public company, which as at October 31, 2006 had a quoted market value of $40,909 (July 31, 2006: $33,566).

5. ADVANCES FROM AFFILIATED COMPANY

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

6. EQUIPMENT

	October 31, 2006			July 31, 2006
	Cost	Accumulated Amortization	Net Carrying Amount	Net Carrying Amount
Computer hardware	$ 1,496	$ 269	$ 1,227	$ 1,292
Machinery and equipment	13,907	4,395	9,512	10,013
Office equipment	2,632	831	1,801	1,895
	$ 18,035	$ 5,495	$ 12,540	$ 13,200

7. RESOURCE PROPERTIES

		October 31, 2006		July 31, 2006
Tennessee	$	5,000	$	5,000
Alberta		1,993,111		2,126,618
	$	1,998,111	$	2,131,618

Acquisition costs and deferred exploration and development expenditures during the periods ended October 31, 2006 and July 31, 2006 were as follows:

		October 31, 2006		July 31, 2006
Property acquisition costs				
Balance, beginning of period	$	1,421,997	$	356,431
During year				
Additions		4,100		1,523,646
Depletion		(149,667)		(458,080)
Balance, end of period		1,276,430		1,421,997
Deferred exploration expenditures				
Balance, beginning of period		709,621		1,021,652
During year				
Development costs and drilling		86,748		518,304
Depletion		(74,688)		(830,335)
Balance, end of period		721,681		709,621
Total resource properties costs	$	1,998,111	$	2,131,618

(a) Tennessee

As at October 31, 2006, the Company has incurred exploration and development expenditures of $1,574,775 (July 31, 2006: $1,574,775) on properties. During the year end July 31, 2006, the properties were written down to $5,000.

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

The Company signed a mineral lease on a 253 acre property located in Morgan County, Tennessee. The Company together with its joint venture partner Austin Developments earns a 50-per-cent participating interest in each well and associated contiguous land package by reimbursing the Company for 100 per cent of all costs involved in the acquisition, drilling, completion, stimulation, and equipping to production stage of each well.

7. RESOURCE PROPERTIES

(b) Alberta

(i) 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 Sarcee, Alberta by paying 5% of costs. The Company paid $5,385 as its share of cost to secure the leases.

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.

(ii) During the year ended July 31, 2006, the Company purchased certain oil and gas assets located near Mulligan from Silver Peak Industries Ltd. for consideration of $724,000 in cash.

During the year-ended July 31, 2006, the Company purchased 100% of the issued and outstanding shares of Moonshine Resources Ltd., an arm's length private company, engaged in oil and gas exploration and production in Alberta. The Company paid consideration of $850,000, payable by the issuance of 6,538,462 common shares of the Company at a deemed price of $0.13 per share. Resource properties acquired was $1,030,036.

The acquisition is accounted for by the purchase method, and accordingly, the operating results of Moonshine Resources Ltd. for the period from August 1, 2005 to November 30, 2005 are included in the Statement of Operations and Deficit.

(iii) During the period ended October 31, 2006, all of assets and liabilities of the Company's subsidiary, Moonshine Resources Ltd., was transferred to the Company at net book value.

7. **RESOURCE PROPERTIES** (continued)

(c) Details relating to the assets acquired, liabilities assumed and consideration given are as follows:

Assets acquired:		
Current assets		
Cash	$ 19,414	
Accounts receivable	147,950	167,364
Property and equipment		
Petroleum properties and natural gas	1,030,036	
Other assets	1,615	1,031,651
Asset retirement obligation		104,589
		1,303,604
Liabilities assumed:		
Accounts payable and accrued liabilities	360,004	
Current taxes payable	1,213	361,217
Asset retirement obligation		92,387
		453,604
Net assets acquired		850,000
Total consideration		$ 850,000

8. **CONVERTIBLE LOAN PAYABLE**

During the first quarter ended October 31, 2006, the Company extinguished the $870,562 convertible loan payable by issuing 7,919,209 Units under a debt restructuring agreement. Each Unit consists of one common share and one common share purchase warrant entitling the holder to purchase one additional common share of the Company at a price of $0.11 per share for a period of two years expiring September 20, 2008.

9. **SHARE CAPITAL**

	October 31, 2006	**July 31, 2006**
Authorized:		
Unlimited Common shares without par value		
Issued:		
113,332,552 Common shares (July 31,2006: 103,438,343 shares)	$ 19,192,864	$ 17,980,440

9. **SHARE CAPITAL** (continued)

(a) Changes in issued common shares during the period ended October 31, 2006 and July 31, 2006 were as follows:

	October 31, 2006		July 31, 2006	
	Number of Shares	**$ Amount**	**Number of Shares**	**$ Amount**
Beginning of period	103,438,343	17,980,440	84,975,924	15,575,284
Issued for cash pursuant to private placements (Notes 9(b) and 9(c) and 9(d))	-	-	3,998,449	490,326
Issued for cash on exercise of warrants	225,000	22,500	3,845,000	384,500
Issued for cash on exercise of options	1,750,000	319,362	3,452,308	680,330
Issued in settlement of investment (Note 9(e))	-	-	7,166,662	850,000
Issued in settlement of convertible loan (Note 8)	7,919,209	870,562	-	-
End of period	113,332,552	19,192,864	103,438,343	17,980,440

(b) During the year-ended July 31, 2006, the Company issued 2,039,565 units for cash proceeds of $254,691 (net of a $10,452 finder’s fee) pursuant to a private placement. Each unit consists of one common share and on 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 year-ended July 31, 2006, the Company issued 1,628,884 units for cash proceeds of $192,735 (net of a cash finder’s fee of $19,020) 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 November 18, 2007.

(d) During the year-ended July 31, 2006, the Company issued 330,000 flow-through units for cash proceeds of $42,900 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 share at an exercise price of $0.20 per share, exercisable until May 19, 2008.

(e) During the year-ended July 31, 2006, the Company purchased all of the issued and outstanding shares of Moonshine Resources Ltd. for a price of $768,334 (net of a $81,666 finder’s fee) paid by issuing 6,538,462 common shares at $0.13. The Company also issued 628,200 common shares for a finder’s fee at a deemed value of $0.13.

9. **SHARE CAPITAL** (continued)

(f) Warrants

During the three months ended October 31, 2006, 225,000 warrants with an exercise price of $0.10 per share were exercised.

(g) Stock options

During the three months ended October 31, 2006, 1,250,000 stock options with an exercise price of $0.10 per share were exercised and 500,000 stock options with an exercise price of $0.11 were exercised.

During the three months ended October 31, 2006, options to purchase common shares have been granted to directors, officers, key employees and consultants. A total of 3,302,000 common shares have been reserved pursuant to stock option agreements exercisable at a range of $0.105 to $0.11 per share for terms expiring between August 15, 2011 and September 14, 2011.

For the three months ended October 31, 2006, the Company recorded stock-based compensation expenses totalling $225,217.

The fair value of each option granted was estimated on the grant date using the Black-Scholes option pricing model with the following weighted average assumptions for the awards granted since the beginning of the year.

Risk-free interest rate	4.00 – 4.13%
Expected life of options	5 years
Annualized volatility	53.55 – 58.13%
Dividend rate	0.00%

9. **SHARE CAPITAL** (continued)

(h) Share purchase warrants outstanding

The Company has the following warrants outstanding as at October 31, 2006.

Number of Warrants	Exercise Price	Expiry Date
7,591,667	$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
1,828,884	$0.20	November 18, 2007
7,919,209	$0.11	September 20, 2008
23,849,786		

	Number of Warrants	Exercise Price	Expiry Date
Balance, July 31, 2006	16,155,577	$0.10 - $0.20	December 16, 2206 to November 18, 2007
Granted during the three months ended October 31, 2006	7,919,209	$0.11	September 20, 2008
Exercised during the period	(225,000)	$0.10	December 16, 2006
Balance, October 31, 2006	23,849,786		

(i) As at October 31, 2006, outstanding stock options to directors, consultants, and employees are as follows:

Number of Shares	Exercise Price	Expiry Date
250,000	$0.10	December 29, 2009
1,900,000	$0.13	September 16, 2010
1,100,000	$0.11	January 6, 2011
4,216,834	$0.10	June 7, 2011
1,677,000	$0.105	August 15 to 16, 2011
1,625,000	$0.11	September 14, 2011
10,768,834		

9. **SHARE CAPITAL** (continued)

	Number of Options	Weighted Average Exercise Price
Balance, July 31, 2006	9,216,834	$0.11
Exercised	(1,250,000)	$0.10
Exercised	(500,000)	$0.11
Granted	1,677,000	$0.105
Granted	1,625,000	$0.11
Balance, October 31, 2006	10,768,834	$0.11

10. **RELATED PARTY TRANSACTIONS**

(a) During the period ended October 31, 2006, the Company incurred management fees and consulting fees of $216,510 (2005: $39,650) with directors and officers of the Company.

(b) As at October 31, 2006, accounts payable and accrued liabilities include $338,729 (2005: $18,840) due to directors and officers of the Company.

11. **SUPPLEMENTAL DISCLOSURE OF NON-CASH OPERATING, INVESTING AND FINANCING ACTIVITIES**

Significant non-cash transactions during the period ended October 31, 2006 and year ended July 31, 2006:

Period ended October 31, 2006:

The Company extinguished the $870,562 convertible loan payable by issuing 7,919,209 units under a debt restructuring agreement.

Year ended July 31, 2006:

The Company purchased 100% of the issued and outstanding shares of Moonshine Resources Ltd., an arm's length private company, engaged in oil and gas exploration and production in Alberta. The Company paid consideration of $850,000, payable by the issuance of 6,538,462 common shares of the Company at a deemed price of $0.13 per share.

The Company issued 628,200 common shares for finder's fee at a deemed value of $0.13 per share.

12. **SEGMENTED INFORMATION**

The Company operates in one segment. As at October 31, 2006, the Company has resource properties totalling $5,000 (July 31, 2006: $5,000) located in the United States and $1,998,111 (July 31, 2006: $2,131,618) located in Canada. All other assets and operations are in Canada.

13. **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.

14. **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, 2006 and July 31, 2006, the fair value of receivables and payables approximate their carrying value due to the immediate short-term maturity of these instruments.

15. **SUBSEQUENT EVENTS**

Subsequent to October 31, 2006:

(a) 3,630,621 options were granted to directors, officers, and consultants at an exercise price of $0.11 per share until December 21, 2011.

(b) 700,000 options were granted to a consultant at an exercise price of $0.11 per share until November 9, 2011.

(c) 50,000 stock options were exercised at $0.11 per share, 1,422,000 stock options were exercised at $0.10 per share, 800,000 stock options were exercised at $0.105 per share and 150,000 stock options were exercised at $0.11 per share.

(d) 7,475,000 warrants at an exercise price of $0.10 per share were exercised with 116,667 warrants being left expired.

(e) The Company issued 12,720,000 units for cash proceeds of $1,272,000 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 $0.13 per share, exercisable until December 13, 2008.

15. **SUBSEQUENT EVENTS** (continued)

(f) The Company issued 6,419,000 flow-through units for cash proceeds of $898,600 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 March 22, 2008.

	FOR QUARTER ENDED Y	M	D	DATE OF REPORT Y	M	D
ISSUER DETAILS NAME OF ISSUER MONTELLO RESOURCES LTD.	06	10	31	07	01	18

ISSUER ADDRESS				
P.O. BOX 1757, STATION M				
CALGARY	PROVINCE AB	POSTAL CODE T2P 2L8	ISSUER FAX NO. (403) 241-9197	ISSUER TELEPHONE NO. (403) 241-9197
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DIRECTOR'S SIGNATURE	PRINT FULL NAME	DATE SIGNED Y	M	D
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Montello Resources Ltd.

Management Discussion and Analysis

For the Three Months Ended October 31, 2006

Date Submitted: January 18, 2007

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MONTELLO RESOURCES LIMITED
MANAGEMENT DISCUSSION AND ANALYSIS
QUARTERLY REPORT
October 31, 2006

DATE OF REPORT: **January 18, 2007**

OVERALL PERFORMANCE

GENERAL

This Management Discussion and Analysis ("MD&A") of Montello Resources Limited ("the "Company") provides analysis of the Company's financial results for the first three months of fiscal 2007 commencing August 1, 2006 and ending October 31, 2006. The following information should be read in conjunction with the accompanying unaudited financial statements as at October 31, 2006 and the July 31, 2006 audited financial statements and the notes to the audited financial statements. All amounts are stated in Canadian dollars unless otherwise indicated.

Production information is commonly reported in units of barrel of oil equivalent ("boe"). For purposes of computing such units, natural gas is converted to equivalent barrels of oil using a conversion factor of six thousand cubic feet to one barrel of oil. This conversion ratio of 6.1 is based on an energy equivalent wellhead value for the individual products. Such disclosure of boes may be misleading, particularly if used in isolation. Readers should be aware that historical results are not necessarily indicative of future performance.

NON-GAPP MEASURES

All financial information in this MD&A is prepared in accordance with Canadian generally accepted accounting principles *("GAAP")*, as an indicator of the Company's performance. All financial information is presented in Canadian dollars unless otherwise indicated.

The Company is incorporated in the Province of British Columbia (extra-provincially registered in the Province of Alberta).

FORWARD-LOOKING STATEMENTS

Certain information regarding Montello set forth in this report, including management's assessment of Montello's future plans and operations contains forward-looking statements that involve substantial known and unknown risks and uncertainties. These risks and uncertainties, many of which are beyond Montello's control, include the impact of general economic conditions and specific industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, and competition from other producers, the lack of available qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. The Company believes the expectations reflected in these forward-looking statements and information are reasonable, but no assurance can be given that these expectations will prove to be correct, and such forward-looking statements and information included in this discussion should not be unduly relied upon. Such forward-looking statements and information speak only as of the date of this discussion and the Company does not undertake any obligation to publicly update or revise any forward-looking statements or information, except as required by applicable laws.

In particular, this discussion may contain forward-looking statements and information pertaining to the following:

- The quality of and future net revenues from our reserves;
- Oil, NLG's and natural gas production levels;
- Commodity prices, foreign currency exchange rates and interest rates;
- Capital expenditure programs and other expenditures;
- Supply and demand for oil, NLG's and natural gas;
- Expectations regarding the Company's ability to raise capital and to continually add to reserves through acquisitions and development;
- Schedules and timing of certain projects and the Company's strategy for growth;
- The Company's future operating and financial results; and
- Treatment under governmental and other regulatory regimes and tax, environmental and other laws.

The Company's actual results could differ materially from those anticipated in these forward-looking statements and information as a result of both known and unknown risks, in this discussion and those set forth below:

- Volatility in market prices for oil, NLG's and natural gas;
- Changes or fluctuation in oil, NGL's and natural gas production levels;
- Changes in foreign currency exchange rates and interest rates;
- Changes in capital and other expenditure requirements and debt service requirements;
- Liabilities and unexpected events inherent in oil and gas operations, including geological, technical, drilling and processing problems;
- Uncertainties associated with estimating reserves;
- Competition for, amongst other things, capital, acquisition of reserves, undeveloped lands and skilled personnel;
- Incorrect assessment of the value of acquisitions;
- The Company's success at acquisition, exploration and development of reserves;
- Changes in general economic, market and business conditions in Canada and North America;
- Actions by governmental or regulatory authorities including changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry; and
- Changes in environmental or other legislation applicable to the Company's operations, and the Company's ability to comply with current and future environmental and other laws.

Many of the risk factors and other specific risks and uncertainties are discussed in further detail throughout this discussion and analysis, the discussion and analysis for the year ended July 31, 2006.

Additional information related to the Company, is available through the internet on the Company's SEDAR profile at www.sedar.com. Readers are also referred to the risk factors described in other documents the Company files from time to time with securities regulatory authorities. Copies of these documents are available on the TSX Venture website as well as the Company's website, www.montello.com.

BUSINESS OVERVIEW

Montello Resources Limited ("the Company) is a junior natural resource company engaged in the acquisition, exploration, and development of 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. During the year, the Company hired a new management team and appointed a new Board of Directors. The new management team began taking over the reigns shortly after approval of the Company's acquisition of Moonshine Resources Ltd. in December 2005. The Company's head office and administration has subsequently been moved to Calgary, Alberta, Canada. The current CEO-Chairman, came aboard in early July, which was the last month of fiscal 2006. The new Corporate Secretary, joined Montello on June 30, while a new Board member was appointed on November 6 2006 with the stepping down of another member.

It has been the objective of the new Board to reduce debt, improve the debt to equity ratio for the Company, and to evaluate all of Montello's investments, and to develop, abandon, and/or acquire investments to maximize returns by the Company and to improve its working capital position.

During the first quarter of fiscal 2007, the Company entered into a debt settlement agreement announced on Friday, September 15, 2006 with an arm's length creditor issuing 7,919,209 common shares at $0.11 per share plus 7,919,209 share purchase warrants entitling the holder to purchase an additional share of the Company at a price of $0.11 per share for 2 years expiring September 20, 2008, in satisfaction of debt totaling $870,563.00. There was a four month hold on the trading of these shares until January 22, 2007.

Current Operations

During the year, the Company commenced receiving revenues from its Moonshine Oil and Gas properties. The Company has limited operating income and cash flow and its continued existence has relied almost exclusively upon equity financing activities to date. An increase in cash flow and operating income, therefore must come from acquisitions and by the drill bit otherwise, only slow progress could be expected in the immediate future. Setting up the foundations to achieve this goal has been a priority in the first quarter of fiscal 2007 ended October 31, 2006. It remains the main focus for the ongoing second quarter ending January 31, 2007 and third quarter ending April 30, 2007. Montello continues to investigate new and safe technologies that are assisting current and new project undergoing evaluation.

On October 10, 2006, the Company announced the signing of a mineral lease on 253-acres referred to as “the Blowout Property” located in Morgan County, Tennessee in conjunction with its joint venture partner Austin Developments (TSX Venture Exchange symbol - AUL). The joint ventured property referred to as "The Blowout Property", borders beside the well-known Pryor Oil Company property, which was drilled in the Elmer Howard-White Unit #1, Permit 9893, and experienced a blow-out in July of 2002.

PROPERTY EXPLORATION 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 the Mulligan Property, and in Tennessee. The operator of the Sarcee was C1 Energy Ltd. and is now Arapahoe Energy. Technical reports and news releases discussing progress in the Company’s properties can be viewed on the SEDAR website at www.sedar.com.

OIL AND GAS PROPERTIES

Morgan and Scott County Properties, Tennessee

The Company owns oil and gas wells in primarily in Morgan and Scott Counties in Tennessee. At the end of June 2006, the Company focused on reworking the “Tex Flora Well” (officially known as the John Bowen #1). Upon re-completing and commencing evaluation for economic potential, Management felt it was prudent to immediately commence negotiations on the “Blowout Project Lands”. It was anticipated that negotiations would take two to three weeks but successful completion of this acquisition was not announced until October 10, 2006. “Tex Flora” was shut-in during the prolonged negotiation period and remains shut-in until after completion of the “Blowout Project” when it will be re-evaluated.

Both the “Tex Flora Well” and the Brooks property are owned jointly with Austin Developments (“Austin”) wherein Austin has earned a 50% participating interest in each well and associated contiguous land package by reimbursing Montello for CDN $176,386.22 on December 27, 2006 for a total equalization payment of approximately US $788,151.00 for 100 per cent of all costs involved in the acquisition, drilling, completion, stimulation, and equipping to production stage of all Tennessee operations. This makes Montello 50-50 Joint Venture Partners in all existing operations in Tennessee.

Austin also made an advance of approximately CDN $260,000.00 on December 27, 2006 towards earning up to a 50% working interest in the Blowout Project (which has a Farm-Out Agreement and an AMI.) Austin is in the final stages of closing their Approved Funding

Expenditure ("AFE") and has pledged to fund the balance owing up to US $3 million by mid January. Should Austin decide not to fund 100%, the Company has other interested parties.

The Company continues to focus its efforts on the Blowout Project in Morgan County, Tennessee, which the Company anticipates as being one of the most significant drilling projects in the Southeast Region. Montello has completed a detailed drilling program involving drilling specialists in Canada and the US. To-date this project has taken a large portion of Montello's engineering efforts.

Mulligan (Peace River Arch), Alberta

The Company owns various working interests in 6,720 **acres** of land in the Mulligan area in Northern Alberta. At present this area contains four producing oil wells, one producing gas well, four shut-in gas wells; one shut-in oil well and two identified drilling locations. The production is subject to new Crown royalties and various gross overriding royalties. The Company's lands in this area have oil production from Triassic (Charlie Lake member) and natural gas production from the Upper Mississippian Stoddart Grop (Kiskatinaw), and the lower Cretaceous (Gething formation). The Company acquired the Mulligan properties in September 15, 2005.

The Company is still working on enhancing the Mulligan properties. The Company has successfully used water flooding as a technique to increase production in the Charlie Lake Zone in Section 23-81-8 W6M and is investigating the use of the same procedure in offsetting operated properties. The focus is to drill two wells and work over two. With the water-flood enhancement program in place, a re-work of our injection well is required (6-23-81-8-W6). This will start in late February and will allow Montello to ramp up water injection to increase oil production as high as two fold. Production decline is due to the cessation of a water injectivity test into the Charlie Lake B Pool to determine injectivity response and the subsequent pending of AEUB water flood approval as well as natural decline. Water Flood Approval has now been received from the AEUB and water injection is anticipated to commence during the first part of the third quarter. It is anticipated that production levels will increase to the 20 to 25 BOPD.

MONTELLO RESOURCES LTD. WORKING INTEREST PRODUCTION			
Month		**Month**	
August	835 BBLS	August	27 BOPD
September	642 BBLS	September	21 BOPD
October	576 BBLS	October	16 BOPD

Sarcee, Alberta

The Company, under a farm-out agreement, owns a 2.50 percent working interest in 2,560 acres on four sections of land in this area by paying 5.00 percent of the gross capital development expenditures. These lands contain one well and one identified drilling location.

Production will be subject to Indian Royalties, which are equivalent to Alberta New Crown royalties plus 6.5 percent gross overriding royalty. The unit of interest is the Mississippian (Visean) age Turner Valley Formation of the Rundle Group.

As of late, the Company has elected not to spend any time related to this project as the original operator, C1 Energy, was replaced with Arapahoe Energy. With the re-organization of the corporations and the First Nations; there has not been any activity and Montello awaits updated plans with regards to going forward..

SELECTED FINANCIAL INFORMATION

The Company's fiscal period ends on July 31, of each year. The following is a summary of certain selected audited financial information for the last three completed fiscal years of the Company:

Operating Results

After acquiring Moonshine Resource Ltd., the Company became actively involved in operating different oil & gas wells. The Company has started generating oil & gas revenue since then. That explains why oil & gas sales and direct operating expenses for the First Quarter in 2007 has increased compared to same period in 2006.

Amortization & depletion expenses has increased significantly in the first quarter of 2007 compared to 2006 from $413.00 to $225,015.00 due to more well locations has started generating revenue since acquisition of Moonshine Resources Ltd.

The Company obtained a convertible debenture in the amount of $1,000,000.00 with annual interest rate of 12% since November of 2005. Since the loan was obtained after the first quarter of 2006, loan interest in the first quarter of 2007 with amount of $20,965.00 was significantly higher than the amount of $499.00 in the first quarter of 2006.

The Company has become an oil & gas operator since October 31, 2005, new management team and additional consultants have to be brought in to manage the oil & gas operation. As a result, consulting fees have increased from $65,772.00 in First Quarter of 2006 to $81,160.00 in the First Quarter of 2007. Also, management fees have increased from $36,000.00 in First Quarter of 2006 to $135,350.00 in First Quarter of 2007.

In general, office & promotion in the First Quarter of 2007 for a total of $18,059.00 was higher than the amount of $4,111.00 in the First Quarter of 2006 due to additional operation from Moonshine Resources Ltd.

Subsequent to the First Quarter of 2007, the Company has successfully attracted additional financing through different private placements. To be able to obtain these financing, the Company has incurred more expense in public relations and shareholders' information in the First Quarter of 2007 in the amount of $27,740.00 compared to $0 in the First Quarter of 2006.

SUMMARY OF ANNUAL RESULTS

	2006	2005	2004
Revenues	$ 363,351	$ -	$ -
Operation costs and royalties	49,854	-	-
Property write-downs	1,144,465	-	-
General and Administrative Expenses	1,580,406	948,817	321,576
Net Income (Loss)	(2,411,374)	(942,756)	(1,305,426)
Loss per share	(0.02)	(0.01)	(0.02)
Total Assets	2,777,523	1,631,562	48,706
Long Term Liabilities	496,825	1,279,407	378,412
Dividends(1)	-	-	-

(1) There were no material factors affecting the comparability of the foregoing financial data. In general the Company's net losses correlate to increases or decreases in corporate activity, as the case may be, associated with increases or decreases in the acquisition and exploration of is resource properties. Such changes in activity level are largely driven by the availability of risk capital from the junior resource capital markets necessary to finance the acquisition and exploration of resource properties. Similarly, the year-over-year fluctuation in total assets correlates to write-offs of resource properties from time to time and increases in the carrying value of the Company's resource properties resulting from the cost of acquisition of resource properties and the cost of exploring those properties;

(2) These unaudited interim consolidated 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.

SUMMARY OF QUARTERLY RESULTS

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

	2007	2006			
($,000s)	**First Quarter October, 31**	**Fourth Quarter July, 31**	**Third Quarter April, 30**	**Second Quarter January, 31**	**First Quarter- October, 31**
Total Revenues	$ 275	$ 237	$ 26	$ 134	$ 97
Net Loss	$ (693)	$ (1,467)	$ (248)	$ (152)	$ (544)
Loss Per Share	$ (0.01)	$ (0.02)	$ (0.01)	$ (0.01)	$ (0.01)

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

LIQUIDITY

The Company has negative working capital of $668,235.00 as of October 31, 2006 compared to negative working capital of $1,522,840.00 on July 31, 2006. The Company had cash and cash equivalents of $94,683.00 as on October 31, 2006 compared to $89,292.00 as on July 31, 2006;

On September 27, 2006 the Company eliminated $870,563.00 in debt with an equity issue. Montello issued 7,919,209 units with a hold period of four months until January 22, 2007. Each unit consists of one common share purchase warrant entitling the holder to purchase an additional share of Montello at $0.11 per share for 2 years expiring September 20, 2008;

The Company raised $22,500.00 through the exercise of warrants between August 1 and October 31. There was no money raised via private placements or share subscriptions during this time. However, $2,848,320.00 net of finder's fees was subsequently raised between November 1 and December 31, 2006 through Warrants, Flow Through and Non Flow Through Private Placements. (*See Subsequent Events section for further details.)*

Of note during the First Quarter 2007 ended October 31, 2006:

Montello granted 177,000 incentive stock options on August 16, 2006 to an Officer of the Company. The exercise price of these options was $0.105 per share with an expiry date of August 15, 2011;

On August 17, 2006 the Company granted a total of 1,500,000 common shares to Directors, Officers and Consultants at a price of $0.105 per share, exercisable until August 16, 2011;

On September 15, 2006, Montello granted a total of 1,625,000 incentive stock options to Directors, Officers and Consultants for a common share price of $0.11 per share, exercisable until September 14, 2011.

Since incorporation, Montello’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, acquisition(s) and exploration program(s). While there are presently no known specific trends, events or uncertainties that are likely to result in Montello’s liquidity decreasing in any material way over the next year, it is unlikely that significant cash would be generated from operations if Management didn’t continue to pursue significant projects like the Blowout Lease in Tennessee. The Company intends to strongly pursue its goals of engaging in the acquisition, exploration and development of oil and gas properties.

While there can be no assurance that financing, whether debt or equity, will always be available in the amount(s) required at any particular time or for any particular period or, if available, that it can be obtained on satisfactory terms. The Company is currently interested in looking at agreements to acquire interests in additional projects or Oil and Gas Properties. 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 ongoing project commitments or debt - 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 properties covered by an agreement. Further, should the Company be unable to obtain sufficient equity financing for working capital, it may be unable to take on or meet 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.

DIVIDEND RECORD AND POLICY

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

CAPITAL RESOURCES

The Company does not have any contractual obligations or commitments for material expenditures.

CRITICAL ACCOUNTING ESTIMATES

Management is often required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Company.

OFF-BALANCE SHEET ARRANGEMENT

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

PROPOSED TRANSACTIONS

There were no proposed transactions.

CRITICAL ACCOUNTING ESTIMATES

Not applicable to venture issuers.

CHANGES IN ACCOUNTING POLICIES

The Company has not changed any of its accounting policies as compared to those disclosed in its unaudited financial statements for the First Quarter ended October 31, 2005.

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.

Outstanding Share Data

The Company's authorized share capital consists of unlimited 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 October 31, 2006, Montello had a total of 113,327,552 common shares issued and outstanding as compared to October 31, 2005 when the company had 113,332,552 according to records provided by the Company's Transfer Agent. As at December 29, 2006, the Company had a total of 142,368,552 common shares issued and outstanding.

SUBSEQUENT EVENTS

Subsequent to October 31, 2006, the Company issued 2,422,000 common shares for proceeds of $247,700.00 on the exercise of stock options. The Company also issued 7,475,000 common shares for proceeds of $ 747,500.00 on the exercise of warrants expiring December 16, 2006;

A business consultant, who joined Montello's Board of Directors on November 6, 2006, was granted 700,000 incentive stock options on November 10, 2006 at an exercise price of $0.11 per share expiring on November 9, 2011;

On December 19, 2006 the TSX Venture Exchange accepted for filing documentation with respect to a Non-Brokered Private Placement announced November 9, 2006 and November 14, 2006. Gross Proceeds of $1,272,000.00 was raised via the sale of 12,720,000 units priced at $0.10 per unit. The company initially announced this Non-Brokered Private Placement financing for $695,000.00. The unit offering consisted of 12,720,000 shares and 12,720,000 share purchase warrants to purchase 12,720,000 shares at $0.13 for a two year period. There is a 4 month hold applicable for the shares and finder's fees of 6% totaling $69,780.00 were payable on the placement in accordance to the policies of the TSX Venture Exchange. The proceeds of the private placement will be used for general working capital purposes and for further potential oil and natural gas mineral lease acquisitions;

On December 29, 2006 the TSX Venture Exchange accepted for filing documentation with respect to a Non-Brokered Flow-Through Private Placement announced December 19, 2006. Gross Proceeds of $898,600.00 were raised via the sale of 6,419,000 Flow-Through units consisting of 6,419,000 shares at $0.14 per share and 6,419,000 share purchase warrants to purchase 6,419,000 shares at $0.20 for a period of 15 months from the date of issuance. The common shares issued pursuant to the Private Placement will be subject to a four-month hold period expiring April 23, 2007. The proceeds from the Private Placement will be used to drill on the Company's Northwestern Alberta Properties;

Also subsequent to the Quarter ended October 31, Montello granted 3,630,621 incentive stock options to Directors, Officers and Consultants at an exercise price of $0.11 per share on December 22, 2006. These incentive stock options will expire on December 21, 2011;

The Company appointed new Corporate Counsel, Burnstall Winger LLP of 1600, 333 – 7 Avenue S.W., Calgary, Alberta. T2P 2Z1.

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