

Montello Resources Ltd.
Management's Discussion and Analysis
For the Year Ended July 31, 2009

Report Date: August 16, 2010

The following is a discussion and analysis of the operations, results, and financial position of the Company as at and for the year ended July 31, 2009, and should be read in conjunction with the audited consolidated financial statements for the year ended July 31, 2009. The audited financial statements and related notes are presented in accordance with Canadian generally accepted accounting principles.

Forward Looking Information

In addition to historical information, the MD&A contains forward-looking statements that are generally identifiable as any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events of performance (often, but not always, through the use of words or phrases such as "will likely result," "expected," "is anticipated," "believes," "estimated," "intends," "plans," "projection" and "outlook"), are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such forward-looking statements.

Actual results achieved during the forecast period will vary from the information provided herein as a result of numerous known and unknown risks and uncertainties and other factors. Such factors include, but are not limited to: risks associated with the Company's stage of development; competitive conditions; share price volatility; risks associated with crude oil and natural gas exploration and development; risks related to the inherent uncertainty of reserves and resources estimates; possible imperfections in title to properties; the volatility of crude oil and natural gas prices and markets; environmental regulation and associated risks; loss of key personnel; operating and insurance risks; the inability to add reserves; risks associated with industry conditions; the ability to obtain additional financing on acceptable terms if at all; non operator activities; the inability of investors in certain jurisdictions to bring actions to enforce judgments; equipment unavailability; potential conflicts of interest; risks related to operations through subsidiaries; risks related to foreign operations; currency exchange rate risks and other factors, many of which are beyond the control of the Company. Accordingly, there is no representation by Montello that actual results achieved during the forecast period will be the same in whole or in part as that forecast. Further, Montello undertakes no obligation to update or revise any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by applicable securities laws.

Financial outlook information contained in this MD&A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management's assessment of the relevant information currently available. Readers are cautioned that such financial outlook information contained in this MD&A should not be used for purposes other than for which it is disclosed herein.

Note Regarding Production Information, Boe and Mcfe

In this MD&A, Boes are derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil (6 Mcf:1 bbl) and Mcfes are derived by converting oil to gas in the ratio of one barrel of oil to six thousand cubic feet of gas (1 bbl:6 Mcf). Per barrel oil equivalent amounts ("boe") and one thousand cubic feet of gas equivalent ("Mcfe") amounts may be misleading, particularly if used in isolation. A boe conversion of 6 Mcf of natural gas to 1 bbl of oil, or a Mcfe conversion ratio of 1 bbl of oil to 6 Mcf of natural gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency

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at the well head. When it comes to Production Information, readers should be aware that historical results are not necessarily indicative of future performance.

DESCRIPTION OF BUSINESS

The Company is a reporting issuer in British Columbia and Alberta. The Company is a junior natural resource company engaged in the acquisition, exploration and development of oil and gas properties in Canada and the U.S.A. The Company is listed on the TSX Venture Exchange ("TSX-V") under the symbol *MEO*, and classified as a junior resource company.

As a junior resource company, Montello's primary business is to identify, explore and develop opportunities in the oil and gas resource sector through acquisition or joint venture. The Company currently holds a 25% working interest in the 1-11-4-29W4 discovery well in the Pincher Creek field and also an option on over 10,000 acres within the same focus area. In Tennessee, Montello is a partner in 5 wells. A 48% interest in two wells in the John Bowen property and a 35% interest in three wells in the Morgan Highpoint property.

With consideration given to depressed natural gas prices, the Company is assessing its plan for further exploration and development to develop certain assets and sell, partner or farm-out others to create the most value for the shareholders.

HIGHLIGHTS

Properties

During the year the Company had invested in programs at Mulligan, Alberta to correct deficiencies in a water injection shortfall as well as to potentially improve production levels and reduce operating costs. Management was dissatisfied with the results and could not foresee any economic benefit to continuing to work on the properties and as a result, they were sold in the year.

During the year no capital costs were incurred at Grouard, Alberta. The operator is currently in financial difficulty and until that situation is corrected, Montello does not contemplate participating in any optimization programs, or facility construction.

Montello and its JV Partners at Sarcee were unable to proceed on a re-completion program and when the May deadline between the operator and the leaseholder was not met, the opportunity was lost and the property was written off.

At the end of the quarter January 31, 2009, Nexgen earned an interest of 7% into the Bowen Lands and Accompanying Assets from Montello as per an amendment in a revised equalization agreement dated November 9, 2008. The Tennessee JV Partnership finished a deep gas test in the John Bowen #2 Well that was unsuccessful leading to the focusing of efforts on how to proceed in shallower zones of potential interest. Drilling and completion work is on hold in Tennessee pending resolution of such issues as the ongoing ability of the partnership to fund, oil and gas price forecasts, as well as local logistical concerns.

Administrative matters

On August 11, 2008, Michael A. Williams, B. Comm, FCA, of Calgary, Alberta, assumed the duties of Chief Financial Officer. On June 23, 2009, Dennis Petke, CA of Vancouver, British

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Colombia was appointed Chief Financial Officer, replacing Mr. Williams, and joined the board of directors on July 6, 2009, replacing Trent Moore. Mr. Petke's main responsibility was to review the historical financial recording and reporting systems and make changes as needed to ensure the company was able to meet all continuous disclosure obligations.

Mr. Petke has been working with the current CEO, former CEO and the ASC and the TSX-V to meet this responsibility. As part of the process the Company changed auditors and performed a complete detailed review and adjustment to all financial reporting for the entire year. The Company is implementing systems to ensure accurate and timely financial reporting in the future.

Montello had been subject to a voluntary management cease trade order issued by the Alberta Securities Commission (the "ASC") on December 1, 2009 related to the delay in its filing of the Annual Disclosure (the "MCTO") which was set to expire on January 29, 2010. After lengthy discussions with its auditors, Montello confirmed with the ASC that the Required Filings would not be ready prior to the expiry of the MCTO. As a result, On January 29, 2010, the Alberta Securities Commission issued a general Cease Trade Order against the Company for failure to file its audited financial statements, management's discussion and analysis, and related CEO and CFO certifications for the year ended July 31, 2009 and its interim unaudited financial statements and interim management's discussion and analysis for the quarter ended October 31, 2009. In turn, the Company's securities were suspended from trading on the TSX Venture Exchange until such time as the Cease Trade Order has been revoked and the Company meets TSX Venture Exchange requirements in relation to reinstatement of trading, including meeting Tier Maintenance Requirements.

OIL AND GAS PROPERTIES – ALBERTA, CANADA

Pincher Creek

Montello entered into a farm-in agreement to participate in the recompletion of the Pincher Creek 1-11-4-29W4 well. By farming into the petroleum and natural gas rights in the lands which were held by Pennine Petroleum Corporation at the time, the Company earned a 25% interest before payout, 15% after payout in a discovery well that is capable of producing high grade condensate and associated gas from two zones. By paying an additional fee Montello earned a 25% in the remainder of the interests at Pincher Creek.

The recompletion of the well was initiated on August 30, 2007 and resulted in completions in the Cadomin and Brown Sand with initial swabbing rates of up to 337 barrels of condensate and 500 Mcf. per day of natural gas. The success of this well enhanced the prospectivity of the group's lands in the area.

Pincher Creek has been one of the most prolific fields in Alberta. It is a structurally controlled, over-thrusted imbricate stack that has been producing since 1947 and has produced some 600 Bcf. of gas and over one million barrels of associated liquids from the Mississippian-age carbonates of the Turner Valley (Rundle) formation.

On January 28, 2009 a public hearing was held in Pincher Creek by the Energy Resources Conservation Board ("ERCB") to review the application by the Operator of the property to obtain access for the construction of a pipeline to tie into the Waterton Gas Plant. The result of this meeting was to have Pennine granted the pipeline license. However, Pennine was unsuccessful in securing right of entry with the landowners and also unsuccessful in applying for an extension to the license as the company was on Global Refer at the time. Pennine is no longer on Global Refer

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and Montello has been informed that the Pipeline License will be reapplied for in the third quarter of 2010. On August 19, 2009, Pennine sold its interest to a private company, later identified as Highwood Oil and Gas, but operatorship has not been transferred at this time. It is understood that the ERCB has been reviewing both the pipeline license and the license transfers. To Montello's knowledge, though not confirmed by correspondence from the operator, the pipeline extension was declined and must be resubmitted. Montello is unaware at this time if Pennine will remain the operator of record or if the license will be submitted by the new owners; however, Montello has been informed that a new license application will be submitted shortly. In addition, although Montello has earned its interest in Pincher Creek, Pennine has failed to novate Montello's interest.

As a result of the delay of novating Montello interest in Pincher Creek and Pennine's inability to bring the well to production in a timely manner, on October 26, 2009 Montello initiated a statement of claim against Pennine Petroleum for the total sum of \$2,500,000, primarily due to lost revenues. Pennine responded to claim on October 28, 2009. The legal action has not been settled and Montello will notify its shareholders of any significant changes.

Mulligan

After evaluating potential enhancement of its Mulligan properties in Northwest Alberta Montello made the decision to sell both its non-operated and operated interests in this area. During the year ended July 31, 2009, the Company sold 100% of its interest in its Mulligan Oil and Gas Properties in northern Alberta for aggregate net proceeds of \$221,000. Montello sold its 15% interest in the 81-8 lands to the major partner, Texokcan, including all its wells and facilities for a net sum of \$111,000 and all of its interests in the 82-8 lands to a private company for the net proceeds of \$110,000. These lands had been operating at a net loss and management made the decision to allocate its resources to more productive assets currently owned and to future purchases.

Grouard

In December 2007, Montello, under a farm-in agreement, participated in the drilling of two exploratory wells in the Grouard area of northwestern Alberta. Under the farm-in agreement the company paid 50% of the drilling, completion and equipping costs to earn a 35% interest. By participating in the wells Montello earned a 35% interest in 1,470 gross acres of P&NG rights with additional drilling locations. Both of the earning wells were production tested and deemed capable of gas production of 150 Mcf. Per day. A gathering system is required to place the wells on production.

During the year no capital costs were incurred at Grouard, Alberta. The operator is currently in financial difficulty and until that situation is corrected, Montello does not contemplate participating in any optimization programs, or facility construction.

Sarcee

Montello, under a farmout agreement held a 2.5% interest in 2,560 acres of petroleum and natural gas rights on lands in the T'suu Tina Reserve. In November 2007, the Company increased its interest to 8.5% by issuing 11,663,333 shares at \$0.30 per share to Vanguard Exploration Corp. for an additional 6% working interest. Due to the lack of activity on the property and management's unwillingness to accept the new terms for continuance (which were not deemed to be economic) the lands were returned to the T'sui Tina Band in May 2009. On July 22, 2009, all assets and liabilities related to the Sarcee Property were transferred to Canadian Phoenix Resources Corp. for which a Quit Claim was signed on September 10, 2009

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OIL AND GAS PROPERTIES – TENNESSEE, USA

Montello and its JV Partners Austin Developments Ltd., Nexgen Petroleum Corp., signed a letter dated July 5, 2008 formally confirming Farm-out and Participation agreements dated March 10 and April 11, 2008, whereby Nexgen Petroleum Corp was confirmed a having earned 30% undivided working interests in the said test wells and farm out lands for the Lavender #1, Southeast #1, and Southeast #2 Wells (otherwise known as the Morgan Highpoint Project Wells #5, #3, and #4). This letter also stated that from and after July 1, 2008 all operations on these Farm-out lands and test wells would be governed by CAPL Operating Procedure including the Accounting Procedure.

Immediately subsequent to this on July 7, 2008, a Joint Operating and Equalization Agreement was also formally signed by the Morgan Highpoint JV Partners with regards to anticipated operations to be carried out in the "Bowen Block / Bowen Lands. Also subject to specific terms, for example, based on economic viability of the John Bowen #2 Well, Nexgen could elect to earn an additional undivided 5% working interest in the Bowen Block from Montello. During the year ended July 31, 2009 Nexgen purchased the additional 5% interest for gross proceeds of US\$446,000.

John Bowen

During the year ended July 31, 2009, the Company and its JV partners sold 107 acres of land and associated buildings for gross proceeds of US\$248,000 netting US\$98,648 after deducting liabilities and for costs incurred on the sale. Montello and its partners retain a 3.7 acre parcel around the two Bowen well bores and the access road to the well sites, along with all mineral rights. It is the company's view that rather than attempting to operate the Tennessee property from Canada it intends to cede its operatorship in all its properties to a farm-in partner.

Morgan Highpoint

In the prior year Montello was exploring the potential of the shallower zones such as the Chattanooga Shales in the surrounding area. Due to the current wellhead price for gas the Company has no immediate plans to exploit and test these shallower gas zones. Instead Montello had decided to try to stimulate and clean up the Morgan Highpoint #3. In late 2009 Montello began work on this well in the 500 foot open section at the base of the wellbore, from where oil had previously flowed. The results of this work proved that rather than the oil emulsifying the zone though fractured was tight and largely impermeable and not conducive to flow without a large fracture program over the whole of the 500 feet of open wellbore. Montello did not deem this process to be economic at this time and has been working with local companies with the view to farming out its interests.

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SELECTED ANNUAL INFORMATION

The Company's fiscal year 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:

Summary of Annual Results

	2009	2008 (restated)	2007
	\$	\$	\$
Revenues	197,515	552,613	451,364
Net loss	(3,823,148)	(4,274,858)	(3,338,562)
Loss per share, basic and diluted	(0.02)	(0.02)	(0.03)
Total assets	6,803,590	11,040,819	4,202,972

RESULTS OF OPERATIONS

Revenues

The company had revenues of \$197,515 for the year ended July 31, 2009 compared to \$552,613 in the prior year. The significant decrease is due primarily to the Mulligan wells being shut in for the construction of a water pipeline and for overhaul of the compressor station at the 14-23-81-8W6 Battery. During the year the Mulligan properties were transferred to Texokcan. These wells made up the bulk of the company's production.

Production costs

Despite a reduction in revenue for the year production costs were similar to those in the prior year primarily due to the construction of the water pipeline on the 14-23 to resolve the voidage problem in the Mulligan Area in order to be compliant with the ERCB regulations. Shut downs and repairs as noted above were also responsible for the increased production costs as well.

General and Administrative Expenses

General and administrative expenses, not including stock-based compensation, for the year ended July 31, 2009 were approximately \$600,000 higher than in the prior year primarily due to \$474,000 in allowances for bad debts. The Company will actively pursue collection in the coming year. The balance of the increase is due to a legal and accounting expenses related to management changes, the AGM and continuous disclosure matters. Stock-based compensation included in the prior year was \$3,936,231 compared to nil for the current year.

SUMMARY OF QUARTERLY RESULTS

	2009 July 31	2009 April 30	2009 Jan. 31	2008 Oct. 31
Total revenues	\$5,967	\$29,536	\$62,007	\$100,004
Loss from operations	\$(194,981)	\$(200,812)	\$(3,030,674)	\$(396,681)
Loss per share, basic and diluted	Nil	Nil	\$(0.02)	Nil

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	2008 July 31	2008 April 30	2008 Jan. 31	2007 Oct. 31
Total revenues	\$182,389	\$104,060	\$102,904	\$193,349
Loss from operations	\$(2,300,121)	\$(124,300)	\$(20,966)	\$(1,829,451)
Loss per share, basic and diluted	\$(0.01)	Nil	Nil	\$(0.01)

Revenue

Revenue for the quarter ended July 31, 2009, April 30, 2009 and January 31, 2009 were much lower than previous quarters due to decreased production from Mulligan. The Mulligan wells which were responsible for the bulk of the company's production were shut in for the construction of a water pipeline during the month of December and for overhaul of the compressor station at the 14-23-81-8W6 Battery. The lack of production from the 14-23 was due to repairs needed on the compressor. Other production interruptions were due to pump jack motor repairs carried out on the 6-9 and treator on the 14-4. Revenue also dropped sharply beginning in January 31 2009 compared to previous quarters due to the drop in the commodity prices. Revenues for the four quarters in the year ended July 31, 2008 were fairly consistent.

General and Administrative Expenses

General and administrative expenses for the three months ended July 31, 2009 were approximately \$149,000, approximately \$35,000 higher than the quarter ended April 30, 2009 due to accrued audit fees, legal fees and additional expenses related to continuous disclosure matters and costs incurred to bringing the company back trading from the cease trade invoked by ASC on December 1, 2009. General and administrative expenses for the three months ended April 30, 2009 were the highest of the last eight quarters at \$318,600, mostly due to legal and accounting expenses related to management changes, the AGM and continuous disclosure matters. General and administrative expenses for the October 31, 2009 quarter were approximately \$30,000 higher than the preceding four quarters due to management changes and additional expenses related to the Tennessee operations. Typical general and administrative expenses for those four quarters were approximately \$150,000 on average with the July 31, 2008 including additional expenses related to the year end audit.

Production costs

Production costs for the last four quarters exceeded revenue due to the production problems described above. Production costs as a percentage of revenue were fairly consistent at approximately 30% for the four quarters of the year ended July 31, 2008.

Loss from operations

Loss from operations in the three months ended July 31, 2009 and April 30, 2009 are fairly consistent as they relate primarily to production costs, depreciation, depletion and accretion costs as well as production costs offset by very low revenue. Net loss from operations in the quarter ended January 31, 2009 was the highest of the eight quarters due to the write down of the Sarcee oil and gas property. The loss for the three months ended October 31, 2008 included \$69,000 in stock-based compensation and a foreign exchange loss of \$111,802. The loss of \$2,300,141 for the three months ended July 31, 2008 included stock-based compensation expense of approximately \$2,228,000. The loss for the quarter ended January 31, 2008 was lower than other quarters due to a foreign exchange gain of \$137,475. The loss of \$1,829,451 for the three months ended October 31, 2007 included stock-based compensation expense of approximately \$1,708,000.

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LIQUIDITY AND CAPITAL RESOURCES

During the year ended July 31, 2009, significant cash flows were as follows: financing activities included the issuance of common shares and flow through common shares totaling \$280,593 (2008 - \$4,658,235). Investing activities included additions to oil and gas properties of \$297,498 (2008 - \$5,708,046) offset by \$889,302 in proceeds from oil and gas property dispositions. Cash outflows for operating activities were \$1,165,411 (2008 - \$1,616,725).

As at July 31, 2009, the Company had a working capital deficit of \$591,537 (2008 - \$101,608) and an accumulated deficit of \$29,863,243 (2008 - \$26,040,095).

The Company has financed its operations to date primarily through the issuance of common shares for private placements and on the exercise of stock options and warrants. The Company continues to seek capital through various means including the issuance of equity and/or debt.

The financial statements have been prepared on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to have profitable operations in the future.

The Company's future capital requirements will depend on many factors, including costs of exploration and development of the properties, cash flow from operations, costs to complete well production if warranted, competition and global market conditions. The Company's growing working capital needs may require it to obtain additional capital to operate its business.

The Company will depend partly on outside capital to complete the exploration and development of its resource properties. Such outside capital will include the sale of additional common shares and debt financing. There can be no assurance that capital will be available as necessary to meet these continuing exploration and development costs or, if the capital is available, that it will be on terms acceptable to the Company. The issuances of additional equity securities by the Company may result in a significant dilution in the equity interests of its current shareholders. If the Company is unable to obtain financing in the amounts and on terms deemed acceptable, the business and future success may be adversely affected.

RELATED PARTY TRANSACTIONS

During the years ended July 31, 2009 and 2008, the Company was involved in the following related party transactions:

- (a) Management fees of \$84,240 (2008 - \$117,500) were paid to the former Chief Executive Officer of the Company.
- (b) Management fees of \$98,725 (2008 - \$nil) were paid to the President of the Company.
- (c) Management fees of \$9,000 (2008 - \$nil) were paid to a director of the Company, who was appointed and resigned during the year.
- (d) Management fees of \$45,000 (2008 - \$nil) were incurred to the former Chief Financial Officer of the Company.
- (e) Management fees of \$15,000 (2008 - \$nil) were incurred to the Chief Financial Officer of the Company.

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- (f) Professional fees of \$63,339 (2008 - \$172,884) were incurred to an accounting firm of which a former director is a partner.
- (g) As at July 31, 2009, the Company owes \$21,292 (2008 - \$nil) to the former Chief Financial Officer of the Company which is non-interest bearing, unsecured, and due on demand.
- (h) As at July 31, 2009, the Company owes \$7,750 (2008 - \$nil) to the current Chief Financial Officer of the Company which is non-interest bearing, unsecured, and due on demand.

These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any off-balance sheet arrangements.

OTHER MATTERS

Legal Proceedings

In fiscal 2008, litigation was brought against the Company by a drilling contractor. Settlement payment was made and accepted by the contractor. During fiscal 2009, the contractor sued the Company for an additional \$151,554 but the lawsuit was subsequently dropped.

On October 26, 2009, Montello Resources Ltd. filed with the Court of Queen's Bench of Alberta a statement of claim against Pennine Petroleum and its president Desmond Smith. The statement of claim alleges that the defendants breached their obligations by failing to prepare and circulate assignment and conveyance documents for the Section 11 lands and Section 12 lands located near Pincher Creek, Alberta; failing to make payments to landowners required to enable the construction and operation of a .26 kilometre pipeline for the 1-11 Well; and failing to initiate drilling in the deep Rundle formation by 31 March 2009. In the statement of claim, Montello has sought various forms of relief, including but not limited to damages of \$2,500,000, an order that Pennine convey its interest in 11-4-29 W4M to Montello, and an order that Pennine be removed as operator.

During the year ended July 31, 2009, the Company was sued for \$23,174 relating to a builders' lien for work performed on a minerals lease. A default judgment of \$24,717 was entered against the Company on May 12, 2010. This amount was recorded in accrued liabilities as at July 31, 2009.

There are no ongoing legal proceedings of any kind initiated by third parties against the company and there are no contingent liabilities and no default under debt or other contractual obligations. There were no special resolutions passed by shareholders.

Material contracts

The Company did not enter into any material contracts during the period.

Disclosure of Outstanding Share Data

As at August 13, 2010, the Company had 199,325,406 common shares issued and outstanding

As at August 13, 2010, the Company did not have any share purchase warrants or stock options outstanding.

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Investor Relations

The Company did not enter into any investor relations contracts in the period.

Regulatory Matters

Montello had been subject to a voluntary management cease trade order issued by the Alberta Securities Commission (the "ASC") on December 1, 2009 related to the delay in its filing of the Annual Disclosure (the "MCTO") which was set to expire on January 29, 2010. After discussions with its auditors, Montello confirmed with the ASC that the Required Filings would not be ready prior to the expiry of the MCTO.

As a result, on January 29, 2010, the Alberta Securities Commission issued a general Cease Trade Order against the Company for failure to file its audited financial statements, management's discussion and analysis, and related CEO and CFO certifications for the year ended July 31, 2009 and its interim unaudited financial statements, interim management's discussion and analysis for the quarter ended October 31, 2009.

In turn, the Company's securities were suspended from trading on the TSX Venture Exchange until such time as the Cease Trade Order has been revoked and the Company meets TSX Venture Exchange requirements in relation to reinstatement of trading, including meeting Tier Maintenance Requirements.

Upon completion and filing of the annual audited financial statements, annual management's discussion and analysis for the year ended July 31, 2009, Montello will be prepared to file its now outstanding interim (quarterly) financial statements and management discussion and analysis for the periods ended October 31, 2009, January 31, 2010 and April 30, 2010. The required interim reports were due to be filed 60 days after the end of each quarter end, but the interim filings have been pushed forward due to the 2009 annual financial statement filing deficiency. The procedure is moving as expeditiously as possible but until both the annual reporting requirements and the interim reporting requirements are filed and accepted, the cease trade order ("CTO") issued by the Alberta Securities Commission ("ASC") on January 29, 2010 will remain in effect.

The Company expects to file its three quarters for the year ended July 31, 2010 and apply for the revocation order during the month of August 2010. Upon revocation of the cease trade order by the ASC, Montello will then apply for reinstatement of trading to the TSX Venture Exchange.

Changes in accounting policies including initial adoption

Newly Adopted Accounting Standards

Effective August 1, 2008, the Company adopted the new CICA Handbook Sections: 1535, "Capital Disclosures", 3862, "Financial Instruments – Disclosures", 3863 "Financial Instruments – Presentation", 3031, "Inventories", and 1400, "General Standards of Financial Statement Presentation" (revised).

(i) Capital Disclosures

Section 1535 establishes standards for disclosing information about a company's capital and how it is managed. The company's disclosure should include information about its objectives, policies and processes for managing capital, quantitative data about what the company regards as capital, whether the company has complied with

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any capital requirements and if it has not complied, the consequences of such non-compliance.

(ii) Financial Instruments

Section 3862, "Financial Instruments – Disclosures", requires companies to provide disclosures in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the company manages those risks. The principles in this section complement the principles for recognizing, measuring and presenting financial assets and financial liabilities in Section 3855, "Financial Instruments – Recognition and Measurement", Section 3863, "Financial Instruments – Presentation", and Section 3865, "Hedges".

Section 3863, "Financial Instruments – Presentation", enhances financial statement users' understanding of the significance of financial instruments to a company's financial position, performance and cash flows. This section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset.

The adoption of these standards did not have any impact on the classifications and valuation of the Company's financial instruments.

(iii) Inventories

Section 3031, "Inventories", introduces significant changes to the measurement and disclosure of inventories, including the requirement to measure inventories at the lower of cost and net realizable value, the use of the specific cost method for specific purposes, and the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. Inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversal of write-downs are required to be disclosed. The adoption of this standard did not have any impact on the Company's financial statements.

(iv) General Standards of Financial Statement Presentation

Section 1400, "General Standards of Financial Statement Presentation", provides revised guidance on management's responsibility to assess and disclose the Company's ability to continue as a going concern. The adoption of this standard did not have any impact on the Company's financial statements

Future Changes in Accounting Standards

In June 2009, the Accounting Standards Board ("AcSB") further amended CICA Handbook Section 3862, "Financial Instruments – Disclosures" to include additional disclosures about fair value measurements of financial instruments and to enhance risk disclosure. The additional fair value measurement disclosures include classification of financial instrument fair values in a fair value hierarchy comprising three levels reflecting the significance of the inputs used in making the measurements, described as follows:

- Level 1: Valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

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- Level 2: Valuations based on directly or indirectly observable inputs in active markets for similar assets or liabilities, other than Level 1 prices, such as quoted interest or currency exchange rates; and
- Level 3: Valuations based on significant inputs that are not derived from observable market data, such as discounted cash flow methodologies based on internal cash flow forecasts.

These amendments are required to be adopted for fiscal years ending after September 30, 2009, but early adoption is permitted. The adoption of this section is not expected to have a material effect on the Company's consolidated financial statements.

In January 2009, the AcSB issued CICA Handbook Sections 1582, "Business Combinations", 1601, "Consolidated Financial Statements" and 1602, "Non-controlling Interests" which replace CICA Handbook Sections 1581, "Business Combinations" and 1600, "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under IFRS. Section 1582 is applicable for the Company's business combinations with acquisition dates on or after August 1, 2011. Early adoption of this section is permitted. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company's interim and annual consolidated financial statements for its fiscal year beginning August 1, 2011. Early adoption of this section is permitted and all three sections must be adopted concurrently. The adoption of these sections is not expected to have a material effect on the Company's consolidated financial statements.

In February 2008, the AcSB issued CICA Handbook Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Intangible Assets", and Section 3450, "Research and Development Costs". Section 3064 establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Company's interim and annual financial statements for its fiscal year commencing on August 1, 2009. The Company is currently assessing the impact of the new standard and has not yet determined its effect on the Company's consolidated financial statements.

International Financial Reporting Standards ("IFRS")

In February 2008, the AcSB confirmed that public companies will be required to prepare interim and annual financial statements under International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011. The transition date of August 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended July 31, 2011. Management is currently assessing the impact of adopting IFRS and it has not yet determined its effect on the Company's financial statements.

The Company is currently developing its IFRS conversion plan with priority being placed on those standards likely to have a significant impact. The Company's analysis will include identifying the differences between IFRS and the Company's current accounting policies, assessing the impact of the difference, and where necessary, analyzing the various policies that it could elect to adopt. Changes in accounting policies are likely, and may materially impact the Company's financial statements.

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Financial Instruments and Other Instruments

The Company classifies all financial instruments as either held-for-trading, available-for-sale, held-to-maturity, loans and receivables or other financial liabilities. Financial instruments are required to be measured at fair value on initial recognition. Measurement in subsequent periods depends on the financial instruments classification. Held-for-trading instruments are measured at fair value with unrealized gains and losses recognized in results of operations. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income. Instruments held-to-maturity, loans and receivables and other financial liabilities are measured at amortized cost.

The Company has classified its cash and cash equivalents as held-for-trading. Receivables are classified as loans and receivables. Accounts payable, accrued liabilities and amounts due to related parties are classified as other financial liabilities.

(a) Fair Values

The fair values of financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and amounts due to related parties, approximate their carrying values due to the relatively short-term maturity of these instruments.

(b) Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of cash and cash equivalents. The Company limits its exposure to credit loss by placing its cash and cash equivalents with high credit quality financial institutions. The carrying amount of financial assets represents the maximum credit exposure.

(c) Foreign Exchange Rate Risk

The Company operates in Canada and U.S. The Company is exposed to foreign exchange risk due to fluctuations in exchange rate of U.S. dollar. Foreign exchange risk arises from purchase transactions as well as financial assets and liabilities denominated in U.S. dollars.

(d) Interest Rate Risk

The Company's cash and cash equivalents and restricted cash contain highly liquid investments that earn interest at market rates. The Company manages its interest rate risk by maximizing the interest earned on excess funds while maintaining the liquidity necessary to fund daily operations. Fluctuations in market interest rates do not have a significant impact on the Company's results of operations due to the short term to maturity of the investments held.

(e) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company currently settles its financial obligations out of cash. The ability to do this relies on the Company raising equity financing in a timely manner and by maintaining sufficient cash in excess of anticipated needs.

(f) Price Risk

The Company is exposed to price risk with respect to commodity prices. The Company's ability to raise capital to fund exploration and production activities is subject to risks associated with fluctuations in the market price of commodities.

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RISK FACTORS

There are a number of risks facing participants in the Canadian oil and gas industry and the Canadian mining industry. Some of the risks are common to all businesses while others are specific to the sector. The following reviews the general and specific risks and includes the Company's approach to managing these risks.

Risks in the Canadian Oil and Gas Industry

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by the Company will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof. The long-term commercial success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that the Company will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, the Company may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, completion, and operating costs. Completion of a well does not ensure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees. Oil and gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Prices, Markets and Marketing

Demand for crude oil and natural gas produced by the Company exists within North America, however, crude oil prices are affected by worldwide supply and demand fundamentals, while natural gas prices are affected by North American supply and demand fundamentals, all of which are beyond the control of the Company. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of the Company's oil and gas reserves. The Company might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in the Company's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition to establishing

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markets for its oil and natural gas, the Company must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by the Company will be affected by numerous factors beyond its control. The Company will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil actually produced. The ability of the Company to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. The Company will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. The Company has limited direct experience in the marketing of oil and natural gas and utilizes the expertise of a marketing consultant.

Inflation Risks

Inflation risks subject the Company to potential erosion of product netbacks. For example, domestic prices for oil and natural gas production equipment and services can inflate the costs of operations.

Substantial Capital Requirements

The Company anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. If the Company's revenues or reserves decline, it may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing, or cash generated by operations will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Company. Future activities may require the Company to alter its capitalization significantly. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on its financial condition, results of operations or prospects. Failure to obtain such financing on a timely basis could cause the Company to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If the Company's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect the Company's ability to expend the necessary capital to replace its reserves or to maintain its production. Should the Company's cash flow from operations be insufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or that it will be available on acceptable terms. The Company may enter into transactions to acquire assets or shares of other businesses. These transactions may be financed partially or wholly with debt, which may increase the Company's debt levels above industry standards.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require the Company to incur costs to remedy such discharge. No assurance can be given that environmental laws will not result in a curtailment of

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production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect the Company's financial condition, results of operations or prospects.

Insurance

The Company's involvement in the exploration for and development of oil and gas properties may result in liabilities for pollution, blow-outs, property damage, personal injury or other hazards. Although the Company has obtained insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, the Company may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to the Company.

The occurrence of a significant event that is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on the Company's financial position, results of operations or prospects.

Competition

The Company actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial resources. The Company's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators. The oil and gas industry is highly competitive. The Company's competitors for the acquisition, exploration, production and development of oil and natural gas properties, and for capital to finance such activities, include companies that have greater financial and personnel resources available to them. Certain of the Company's customers and potential customers are themselves exploring for oil and natural gas, and the results of such exploration efforts could affect the Company's ability to sell or supply oil or gas to these customers in the future. The Company's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment. The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a competitive cost and produce these reserves in an economic and timely fashion. In periods of increased activity these services and supplies can become difficult to obtain. The Company attempts to mitigate this risk by developing strong long term relationships with suppliers and contractors and maintaining close working relationships with industry partners.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Disclosure controls and procedures are defined under Multilateral Instrument 52-109 – Certification of Disclosure Controls in Issuers' Annual and Interim Filings ("MI 52-109"). The Company is required to perform an evaluation of disclosure controls and procedures annually and to disclose management's conclusions about the effectiveness of these disclosure controls and procedures in its annual MD&A. The Company has established, and is maintaining disclosure controls and procedures to provide reasonable assurance that material information relating to the Company is disclosed in annual and interim filings or other reports and recorded, processed, summarized and reported within the time periods specified as required by securities regulations.

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The Company has conducted a review and evaluation of its disclosure controls and procedures for the financial year ended July 31, 2009, with the conclusion that the Company did not have an effective system of disclosure controls and procedures as defined under MI 52-109. The deficiencies in the system resulted in two cease trade orders when financial information could not be filed in a timely manner.

The Company has a small staff with varying degrees of knowledge concerning the various regulatory disclosure requirements. The Company is not of a sufficient size nor does it possess the financial resources to internally maintain specialists in this area. As a result, the Company must rely upon the assistance of its advisors and consultants and as such, they form a part of the disclosure controls and procedures. In addition to being aware of the disclosure requirements, proper disclosure also necessitates sufficient involvement in the affairs of the Company such that information is communicated and received to allow the assessment of any necessary disclosure requirements. Accordingly, it is essential that there be effective communication among those individuals who manage and govern the affairs of the Company, principally the Board of Directors and senior management.

To improve the system, the Company has engaged management and consultants experienced in the area of public company disclosure, who will work together with its legal counsel to assist in recognizing, interpreting, understanding and complying with the various securities regulations disclosure requirements. In addition the Company will ensure it has an active Board and management with open lines of communication.

Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting ("ICFR"). The Company's ICFR is designed to provide reasonable assurance regarding the reliability of the Company's financial reporting for external purposes in accordance with accounting principles generally accepted in Canada to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. Internal control over financial reporting includes: maintaining records that in reasonable detail accurately and fairly reflect our transactions and dispositions of the assets of the Company; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements in accordance with generally accepted accounting principles; providing reasonable assurance that receipts and expenditures are made in accordance with authorizations of management and the directors of the Company; and providing reasonable assurance that unauthorized acquisition, use or disposition of company assets that could have a material effect on the Company's financial statements would be prevented or detected on a timely basis.

Management assessed the effectiveness of the Company's ICFR as of July 31, 2009. Based on this assessment, the Company's Chief Executive Officer and Chief Financial Officer have determined that, as of July 31, 2009 the Company's internal control over financial reporting were not effective we have identified several potential weaknesses in our controls. Due to the limited number of staff at the Company, there is an inherent weakness in the system of internal controls due to our inability to achieve appropriate segregation of duties. The limited number of staff has also led us to identify a weakness with respect to accounting for complex and non-routine accounting transactions in the previous year, when the Company did not have a sufficient number of finance personnel with technical accounting knowledge to address all complex and non-routine accounting matters. These weaknesses have resulted in a misstatement in our prior year annual financial statements and as such have been classified as material weaknesses.

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Changes in Internal Controls

To mitigate the risk of material misstatement in financial reporting in the future, the Company, along with qualified management, has engaged on an as needed basis qualified finance personnel with sufficient technical accounting knowledge to address all oil and gas accounting matters and complex and non-routine accounting matters that may arise. Management and Board review are also being utilized to mitigate the risk of material misstatement in financial reporting, and also to ensure that existing internal controls remain effective.

Limitations of Controls and Procedures

The Company's management, including the Chief Executive Officer and the Chief Financial Officer, believe that any disclosure controls and procedures or internal controls over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

Further details on the Company via its news releases, financial statements and MD&A's are available on the Company's website www.montello.com and on www.sedar.com.