

**MONTELLO RESOURCES LTD.**

Interim Consolidated Financial Statements

January 31, 2011

(Expressed in Canadian dollars)

(Unaudited)

## **READERS' NOTE**

### **Responsibilities for Financial Statements**

The accompanying interim consolidated financial statements for Montello Resources Ltd. (the "Company") have been prepared by management in accordance with Canadian generally accepted accounting principles. These consolidated financial statements, which are the responsibility of management, are unaudited and have not been reviewed by the Company's auditors. Management believes the consolidated financial statements are free of material misstatement and present fairly, in all material respects, the financial position of the Company as at January 31, 2011 and July 31, 2010 and the results of its operations and its cash flows for the six months ended January 31, 2011 and 2010.

**MONTELLO RESOURCES LTD.**

Consolidated balance sheets

As at January 31, 2011 and July 31, 2010

(Expressed in Canadian dollars)

	January 31, 2011 \$ (Unaudited)	July 31, 2010 \$
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	15,717	5,745
GST and HST receivable	71,992	55,993
	87,709	61,738
<b>Oil and gas properties (Note 3)</b>	<b>6,402,152</b>	<b>6,427,810</b>
	<b>6,489,861</b>	<b>6,489,548</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	898,781	944,690
Due to related parties (Note 8)	68,085	49,869
Loans payable (Note 4)	237,500	100,000
	1,204,366	1,094,559
<b>Asset retirement obligations (Note 5)</b>	<b>58,542</b>	<b>55,404</b>
	<b>1,262,908</b>	<b>1,149,963</b>
<b>Shareholders' Equity</b>		
Share capital (Note 6)	30,712,240	30,712,240
Contributed surplus	4,974,844	4,974,844
Deficit	(30,460,131)	(30,347,499)
	5,226,953	5,339,585
	<b>6,489,861</b>	<b>6,489,548</b>

Nature of operations and continuance of business (Note 1)

Subsequent events (Note 13)

Approved on behalf of the Board:

/s/ "Peter Brown"

Peter Brown, Director

/s/ "Dennis Petke"

Dennis Petke, Director

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

**MONTELLO RESOURCES LTD.**

Consolidated statements of operations, comprehensive loss, and deficit  
Three and Six months ended January 31, 2011 and 2010  
(Expressed in Canadian dollars)  
(Unaudited)

	For the Three Months Ended January 31,		For the Six Months Ended January 31,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Revenue				
Oil and gas sales	-	-	-	6,942
Royalty expense	-	(2,511)	-	(8,045)
	-	(2,511)	-	(1,103)
Depletion, depreciation and accretion	595	5,821	2,828	11,673
Foreign exchange loss (gain)	(8,923)	1,931	(15,113)	(2,526)
General and administrative	73,872	124,574	148,417	218,821
Production costs	-	11,304	-	56,453
Recovery of legal expense	-	-	(23,500)	-
	65,544	143,630	112,632	284,421
Net loss and comprehensive loss for the period	(65,544)	(146,141)	(112,632)	(285,524)
Deficit, beginning of period	(30,394,587)	(30,002,626)	(30,347,499)	(29,863,243)
Deficit, end of period	(30,460,131)	(30,148,767)	(30,460,131)	(30,148,767)
Loss per share, basic and diluted	(0.00)	(0.00)	(0.00)	(0.00)
Weighted average shares outstanding	199,325,406	199,325,406	199,325,406	199,325,406

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

**MONTELLO RESOURCES LTD.**

Interim Consolidated statements of cash flows  
Three and Six months ended January 31, 2011 and 2010  
(Expressed in Canadian dollars)  
(Unaudited)

	For the Three Months Ended January 31,		For the Six Months Ended January 31,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Operating activities				
Net loss for the period	(65,544)	(146,141)	(112,632)	(285,524)
Items not affecting cash:				
Depletion, depreciation and accretion	595	5,821	3,138	11,673
Changes in non-cash operating working capital:				
Accounts receivable, GST receivable and prepaid expenses	(7,571)	(23,426)	(15,999)	(25,691)
Accounts payable and accrued liabilities	(25,414)	51,644	(45,909)	30,133
Due to related parties	(32,467)	5,901	18,216	(18,338)
	(130,401)	(106,201)	(153,186)	(287,747)
Investing activities				
Proceeds from sale of oil and gas properties	13,000	–	25,658	–
	13,000	–	25,658	–
Financing activities				
Proceeds from loans payable	124,500	–	137,500	–
	124,500	–	137,500	–
Change in cash and cash equivalents	7,099	(106,201)	9,972	(287,747)
Cash and cash equivalents, beginning of period	8,618	146,759	5,745	328,305
Cash and cash equivalents, end of period	15,717	40,558	15,717	40,558
Cash and cash equivalents consists of:				
Cash	15,717	10,215	15,717	463,836
Term deposits	–	30,343	–	30,000
	15,717	40,558	15,717	493,836
Supplemental disclosures:				
Interest paid	–	–	–	–
Income tax paid	–	–	–	–

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

## MONTELLO RESOURCES LTD.

Notes to the consolidated financial statements  
Six months ended January 31, 2011 and 2010  
(Expressed in Canadian dollars)  
(Unaudited)

### 1. NATURE OF OPERATIONS AND CONTINUANCE OF BUSINESS

Montello Resources Ltd. (the "Company") is engaged in the acquisition, exploration and development of oil and natural gas properties in western Canada and Tennessee, USA.

These 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 carrying values as shown in these consolidated financial statements should the Company be unable to continue as a going concern. As at January 31, 2011, the Company has incurred cumulative losses of \$30,460,131 (July 31, 2010 - \$30,347,499) and has a working capital deficiency of \$1,116,657 (July 31, 2010 - \$1,032,821). The Company's ability to meet its obligations and maintain its operations is contingent upon attaining profitable operations, successful completion of additional financing arrangements and the continuing support of its creditors. Management is also aware that significant material uncertainties exist, related to current economic conditions that could cast significant doubt upon the Company's ability to continue to finance its operations. These factors represent a liquidity risk and create doubt as to the ability of the Company to continue as a going concern. The financial statements do not reflect adjustments which may be required should the Company be unable to raise additional funds to continue operations.

### 2. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The consolidated financial statements of the Company are prepared in accordance with Canadian generally accepted accounting principles. The financial statements include the accounts of the Company and its wholly owned subsidiary, Montello Resources USA Ltd. All inter-company transactions and balances have been eliminated upon consolidation. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position and the results of operations for the interim period presented herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year or for any future period. Notes to the consolidated financial statements which would substantially duplicate the disclosure contained in the audited financial statements for the Year Ended July 31, 2010 have been omitted.

### 3. OIL AND GAS PROPERTIES

	Cost	Accumulated depletion	Disposals	January 31, 2011 Net carrying value	July 31, 2010 Net carrying value
	\$	\$	\$	\$	\$
Canada	4,669,774	2,379,551	(13,000)	2,277,223	2,290,223
United States	4,137,587	–	(12,658)	4,124,929	4,137,587
	6,427,810	2,379,551	(25,658)	6,402,152	6,427,810

During the year ended July 31, 2008, the Company purchased Sarcee Oil and Gas Property ("Sarcee Property") from Vanguard Exploration Corp. for \$3,499,000 which was settled through the issuance of 11,663,333 shares of the Company. 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.

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 net proceeds of \$221,000.

## MONTELLO RESOURCES LTD.

Notes to the consolidated financial statements  
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### 3. OIL AND GAS PROPERTIES (continued)

During the year ended July 31, 2009, the Company sold a portion of its interest in the John Bowen Oil and Gas Property in Tennessee, United States to a partner for gross proceeds of US\$446,000.

During the year ended July 31, 2009, the Company and its partners sold the surface rights to their John Bowen Property, resulting in net proceeds of US\$98,648 after costs incurred on the sale.

On June 8, 2010 Montello entered into a Letter of Intent with Tosca Capital Corp. ("Tosca"), an unrelated British Columbia private company to sell a 5% working interest in its Pincher Creek property for total cash consideration of \$250,000. The transaction was finalized on February 2, 2011 upon full payment of \$250,000 (Note 4 and Note13).

On December 8, 2010 the Company entered into an option agreement to sell up to 10% working interest in its Pincher Creek property to the future operator of the property (the "Optionee"). Consideration for the first 5% working interest is \$260,000, payable \$185,000 in cash and \$75,000 in costs related to the Company's full portion of future pipeline and surface facilities required to put the well into production, carried by the Optionee. Upon signing the option agreement the Company received a non-refundable deposit of \$13,000 from the Optionee. The remaining cash consideration of \$172,000 is due and payable by December 31, 2010, which was not received by the Company, resulting in termination of the option agreement. The Company recorded the non-refundable deposit of \$13,000 as reduction to the acquisition cost of Pincher Creek property.

At July 31, 2010, the depletion calculation excluded undeveloped land and unproved properties of \$4,606,463 (2009 - \$4,611,284) from the cost centres.

As at July 31, 2010, the Company applied the ceiling test to its oil and gas properties as at July 31, 2010, and determined there was \$nil impairment to the properties (2009 - \$2,330,661). The following independent petroleum engineering benchmark prices were used:

	OIL WTI US\$/STB	GAS GRP \$/MMBTU
2011	83	5.08
2012	86	5.60
2013	90	6.30
2014	93	6.80
2015	96	7.10
Percentage change thereafter	+/-2%	+/-2%

### 4. LOANS PAYABLE

As at January 31, 2011, the Company owes a total of \$237,500 for loan proceeds received from Tosca. The loan bears interest at 10% per annum (starting on November 1, 2010 for \$62,500, starting on December 1, 2010 for \$37,500 and starting on February 1, 2011 for \$13,000), are unsecured, and due on April 30, 2011.

On February 2, 2011, the Company received an additional \$12,500 from Tosca, resulting in total loan proceeds of \$250,000 from Tosca. The full loan principal of \$250,000 was applied as consideration for the 5% working interest in the Company's Pincher Creek property (Note 3) and all interest accrued on the loans has been waived by Tosca.

## MONTELLO RESOURCES LTD.

Notes to the consolidated financial statements  
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### 5. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations were estimated by management based on the Company's net ownership interest in all wells and facilities. This includes all estimated costs to reclaim and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. As at January 31, 2011, the Company has estimated the net present value of its total asset retirement obligations to be \$58,542 (July 31, 2010 - \$55,404) based on total estimated cash flows to settle the obligations of \$138,450. These obligations are expected to be settled during the period from 2011 to 2020. The estimated cash flows have been discounted using an average credit-adjusted risk free rate of return of 12.5% and an inflation rate of 2%.

The following table reconciles the asset retirement obligations:

	Six months ended January 31, 2011 \$	Year ended July 31, 2010 \$
Balance, beginning of period	55,404	47,596
Liabilities disposed through capital dispositions	—	—
Changes in prior year estimates	—	1,652
Accretion	3,138	6,156
Balance, end of period	58,542	55,404

### 6. SHARE CAPITAL

Common Shares

Authorized: Unlimited number of common shares without par value

Issued and outstanding:

	Number of shares	\$
Balance, July 31, 2008	189,637,686	30,493,662
Issued pursuant to private placements – non flow-through	8,823,088	253,677
Issued pursuant to private placements – flow-through	864,632	40,143
Share issuance costs	—	(13,227)
Fair value of warrants issued pursuant to private placements	—	(49,743)
Reduction from renunciation of flow-through tax benefit	—	(12,272)
Balance, July 31, 2009, July, 2010 and January 31, 2011	199,325,406	30,712,240

### 7. SHARE PURCHASE WARRANTS

The following table summarizes the continuity of share purchase warrants:

	Number of Warrants	Weighted Average Exercise Price \$
Balance, July 31, 2009	7,900,000	0.05
Expired	(7,900,000)	0.05
Balance, July 31, 2009, July, 2010 and January 31, 2011	—	—

## MONTELLO RESOURCES LTD.

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### 8. RELATED PARTY TRANSACTIONS

During the six months ended January 31, 2011, the Company was involved in the following related party transactions:

- (a) Management fees of \$60,000 (2010 - \$60,000) were incurred to the President of the Company.
- (b) Management fees of \$45,000 (2010 - \$45,000) were incurred to a company controlled by the Chief Financial Officer of the Company.
- (c) As at January 31, 2011, the Company owes \$21,292 (July 31, 2010 - \$21,292) to the former Chief Financial Officer of the Company which is non-interest bearing, unsecured, and due on demand.
- (d) As at January 31, 2011, the Company owes \$23,928 (July 31, 2010 - \$6,126) to the President of the Company which is non-interest bearing, unsecured, and due on demand.
- (e) As at January 31, 2011, the Company owes \$44,157 (July 31, 2010 - \$22,451) to a company controlled by the 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 have been recorded at their exchange amounts, which are the amounts agreed upon by the transacting parties.

### 9. CAPITAL MANAGEMENT

The Company manages its capital to maintain its ability to continue as a going concern and to provide returns to shareholders and benefits to other stakeholders. The capital structure of the Company consists of cash and cash equivalents and equity comprised of issued share capital, contributed surplus and deficit.

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issues or by undertaking other activities as deemed appropriate under the specific circumstances.

The Company is not subject to externally imposed capital requirements and the Company's overall strategy with respect to capital risk management remains unchanged from the year ended July 31, 2010.

### 10. FINANCIAL INSTRUMENTS AND RISKS

#### (a) Fair Values

Assets and liabilities measured at fair value on a recurring basis were presented on the Company's balance sheet as at January 31, 2011 as follows:

	Fair Value Measurements Using			Balance, \$
	Quoted prices in active markets for identical instruments (Level 1) \$	Significant other observable inputs (Level 2) \$	Significant unobservable inputs (Level 3) \$	
Cash	15,717	–	–	15,717

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

## **MONTELLO RESOURCES LTD.**

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### **10. FINANCIAL INSTRUMENTS** (continued)

#### (b) Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of cash and cash equivalents and accounts receivable. 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. The Company performs ongoing credit evaluations, does not require collateral and establishes an allowance for doubtful accounts based on the age of the receivable and the specific identification of receivables the Company considers at risk.

#### (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.

### **11. LEGAL PROCEEDING**

During the year ended July 31, 2009, the Company was sued for \$40,700 relating to a builders' lien for work performed on a minerals lease. A default judgment of \$40,700 was entered against the Company on May 12, 2010, of which \$25,217 was paid in May 2010 and \$15,483 was paid in September 2010.

## MONTELLO RESOURCES LTD.

Notes to the consolidated financial statements  
Six months ended January 31, 2011 and 2010  
(Expressed in Canadian dollars)  
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### 12. SEGMENTED INFORMATION

The Company operates in one reportable operating segment, oil and gas exploration and development. Segmented information by geographic area is as follows:

Six months ended January 31, 2011	Canada \$	United States \$	Total \$
Revenue	–	–	–
Oil and gas properties	2,277,223	4,124,929	6,402,152

  

Year ended July 31, 2010	Canada \$	United States \$	Total \$
Revenue	7,521	–	7,521
Oil and gas properties	2,290,223	4,137,587	6,427,810

### 13. SUBSEQUENT EVENTS

On February 2, 2011 the Company received an additional loan of \$12,500 from Tosca, resulting in total loan payable to Tosca of \$250,000. The Company and Tosca finalized the purchase of the 5% working interest in the Company's Pincher Creek Property, as stated in the Letter of Intent dated June 8, 2010 (Note 3), by applying the loan of \$250,000 as full consideration.