

**Montello Resources Ltd.**  
**Management's Discussion and Analysis**  
**For the Six Months Ended January 31, 2010**

**Report Date: September 15, 2010**

The following is a discussion and analysis of the operations, results, and financial position of the Company as at January 31, 2010 and for the six months ended January 31, 2010, and should be read in conjunction with the interim consolidated financial statements for the six months ended January 31, 2010 and 2009 and the audited consolidated financial statements 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 at the well head. When it comes to Production Information, readers should be aware that historical results are not necessarily indicative of future performance.

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**DESCRIPTION OF BUSINESS**

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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**

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**Properties**

During the year ended July 31, 2009 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 ended July 31, 2009 and during the current quarter 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.

During the year ended July 31, 2009, 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**

During the year ended July 31, 2009, on June 23, 2009, Dennis Petke, CA of Vancouver, British Columbia was appointed Chief Financial Officer, replacing Mr. Williams, and joined the board of directors on July 6, 2009, replacing Trent Moore. In the current quarter Mr. Petke has been working with the current CEO, former CEO and the ASC and the TSX-V to discharge his responsibility 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. During the current quarter, the Company continues to implement systems to ensure accurate and timely financial reporting in the future.

During the quarter, Montello was 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.

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**Administrative matters (continued)**

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 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. Montello is in the process of negotiating a settlement and will update its shareholders accordingly.

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**Pincher Creek (continued)**

Subsequent to January 31, 2010, on August 22, 2010 Montello entered into a Letter of Intent with Tosca Capital Corp. ("Tosca") of Vancouver, British Columbia to sell a 5% working interest in its Pincher Creek Oil and Gas asset for \$250,000. See Material contracts below.

**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 ended July 31, 2009, no capital costs were incurred at Grouard, Alberta. As of the date of this report, the operator remains in financial difficulty and until that situation is corrected, Montello does not contemplate participating in any optimization programs, or facility construction.

**OIL AND GAS PROPERTIES – TENNESSEE, USA**

**Overview**

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.

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**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.

Attempts were made during the three months ended October 31, 2009 to produce from the Morgan Highpoint #3 well. The tubing and rods were removed and examined for damage and wax build up. No damage or wax was found and the tubing and rods were run back into the hole. The well bore was then treated with chemicals with a hope of stimulating flow. This did not happen and it was decided that the 500 feet of open hole needed a very large "frac" to stimulate flow. This was deemed to a much too expensive procedure in the present economic environment and an operation not agreed to by Montellos' partners. Montello is in the process of looking for alternative farm-in partners in all its projects in Tennessee.

**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**

	<b>2009</b>	<b>2008</b> <b>(restated)</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
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 year ended July 31, 2008. 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 in the year ended July 31, 2009 to those in the year ended July 31, 2008 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.

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**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 year ended July 31, 2008 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 year ended July 31, 2008 was \$3,936,231 compared to nil for the year ended July 31, 2009.

**SUMMARY OF QUARTERLY RESULTS**

	<b>2010 Jan. 31</b>	<b>2009 Oct. 31</b>	<b>2009 July 31</b>	<b>2009 April 30</b>
Total revenues	Nil	6,942	\$5,967	\$29,536
Loss from operations	(143,630)	(139,383)	\$(194,981)	\$(200,812)
Loss per share, basic and diluted	Nil	Nil	Nil	Nil

	<b>2009 Jan. 31</b>	<b>2008 Oct. 31</b>	<b>2008 July 31</b>	<b>2008 April 30</b>
Total revenues	\$62,007	\$100,004	\$182,389	\$104,060
Loss from operations	\$(3,030,674)	\$(396,681)	\$(2,300,121)	\$(124,300)
Loss per share, basic and diluted	\$(0.02)	Nil	\$(0.01)	Nil

**Revenue**

For the three months ended January 31, 2010 there was no revenue as the well in Tennessee is shut down and the Pincher Creek well is still not on-line due to the inability of the operator of record to obtain the permits to do so at this time. Revenue in the quarter ended October 31, 2009, was the result of adjustments and corrections made for revenue earned in prior periods. 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 January 31, 2010 were approximately \$195,000 lower than the same quarter last year due to management's cost reduction measures and a small amount expenses relating to the Tennessee operations. Expenses in the previous year for the same quarter included \$40,000 audit fee, accounting expenses of \$30,000 (\$3,000 same quarter this year), consulting expenses of approximately \$90,000 (\$53,500 same quarter this year) and legal expenses of \$12,500. General and administrative expenses were approximately \$30,000 higher this quarter than the previous quarter due primarily to contractor and legal expenses related to the Pennine legal matter and legal costs related to the management cease trade matter.

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**General and Administrative Expenses (continued)**

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, 2008 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 in the three months ended January 31, 2010, were primarily from additional expenses incurred in relation to the attempts to produce from the Morgan Highpoint #3 well. The USD\$35,000 bond relating to the Oneida wells that were transferred to a partner company of Montello's were retained by the government of Tennessee for work not performed by the new owners. This amount was included in production costs for the three months ended October 31, 2009 along with other costs related to work on Morgan Highpoint #3 well. Production costs for four quarters preceding October 31, 2009, 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**

The loss from operations in the three months ended January 31, 2010 was lower by \$2,700,000 than the same period last year due to a \$3,515,546 write down of the Sarcee property during the three months ended January 31, 2009. The loss from operations in the three months ended October 31, 2009 is lower than the same period last year due to lower general and administration costs, the absence of stock based compensation, a gain on foreign exchange of \$4,400 versus a loss of \$111,802 and lower depletion, depreciation and accretion. 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.

**LIQUIDITY AND CAPITAL RESOURCES**

During the six months ended January 31, 2010, significant cash flows were as follows: Cash outflows for operating activities were \$287,747 (2009 – \$29,069). Cash outflow from Investing activities was Nil (2009 - \$154,036) as the Company was reorganizing its affairs. Cash from financing was also Nil (2009 – Inflow \$55,622) due to the company's inability to obtain equity financing while cease traded.

As at January 31, 2010, the Company had a working capital deficit of \$865,388 (July 31, 2009 - \$591,537) and an accumulated deficit of \$30,148,767 (July 31, 2009 –\$29,863,243).

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**LIQUIDITY AND CAPITAL RESOURCES (continued)**

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 six months ended January 31, 2010 the Company was involved in the following related party transactions:

(a) Management fees of \$60,000 (2009 – \$31,225) were paid or accrued to the Chief Executive Officer of the Company.

(b) Management fees of \$45,000 (2009 – \$Nil) were paid or accrued to the Chief Financial Officer of the Company.

As at January 31, 2010, the Company owes \$2,907 (July, 31, 2009 - \$Nil) to the Chief Executive Officer of the Company which is non-interest bearing, unsecured, and due on demand.

As at January 31, 2010, the Company owes \$7,797 (July, 31, 2009 - \$7,750) to 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.

**OFF-BALANCE SHEET ARRANGEMENTS**

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

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**OTHER MATTERS**

**Material contracts**

Subsequent to January 31, 2010, on August 22, 2010, Montello entered into a has entered into a Letter of Intent with Tosca Capital Corp. ("Tosca") of Vancouver, British Columbia to sell a 5% working interest in its Pincher Creek Oil and Gas asset for \$250,000.

Tosca is the general manager of Pincher Creek Limited Liability Partnership of Vancouver, the entity which will receive the net income from the production of the 5% interest and make distributions to the limited partners. Within 12 months of the commencement of production, Tosca has the option to convert its interest to shares in Montello.

**Legal Proceedings**

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 0.26 kilometer 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. Montello is in the process of negotiating a settlement and will update its shareholders accordingly.

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.

**Disclosure of Outstanding Share Data**

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

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

**Investor Relations**

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

**Regulatory Matters**

During the three months ended January 31, 2010, Montello was 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.

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**Regulatory Matters (continued)**

Subsequent to January 31, 2010, on August 16, 2010 Montello filed its annual audited financial statements and annual management's discussion and analysis for the year ended July 31, 2009. Even though both the annual reporting requirements and the interim reporting requirements have been met at the time of this filing, the cease trade order ("CTO") issued by the Alberta Securities Commission ("ASC") on January 29, 2010 will remain in effect until the application

The Company expects to apply for the revocation order during the month of September 2010. Upon revocation of the cease trade order by the ASC, Montello will then apply for reinstatement of trading to the TSX Venture Exchange.

**SUBSEQUENT EVENTS**

On March 31, 2010 the Company signed a promissory note for a loan of \$37,500 from Tosca Capital Corp. ("Tosca"), a private Vancouver company that bears interest at 10% per annum beginning November 1, 2010 and with a maturity date of April 30, 2011.

On May 31, 2010 the Company signed a promissory note for a loan of \$50,000 from Tosca Capital Corp., a private Vancouver Company that bears interest at 10% per annum beginning November 1, 2010 and with a maturity date of April 30, 2011.

On July 31, 2010 the Company signed a promissory note for a loan of \$12,500 from Tosca Capital Corp., a private Vancouver Company that bears interest at 10% per annum beginning November 1, 2010 and with a maturity date of April 30, 2011.

On August 22, 2010, Montello entered into a Letter of Intent with Tosca Capital Corp. of Vancouver, British Columbia to sell a 5% working interest in its Pincher Creek Oil and Gas asset for \$250,000. Tosca is the general manager of Pincher Creek Limited Liability Partnership of Vancouver.

On August 6, 2010, the Company received USD\$12,500 from the sale of an un-utilized pump jack on the Morgan High Point #3 property. The pump jack was sold to potential farm-in partners who Montello has been negotiating with on a farm-in agreement. The expectation is that the cost of drilling new wells and the cost of working over certain wells will be paid entirely by the party farming in with Montello and the other partners maintaining a gross over-riding royalty.

On September 13, 2010, Montello entered into a settlement agreement with Pennine to resolve all claims against Pennine and Desmond Smith. The settlement and the related releases are subject to court approval.

**RISK FACTORS**

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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.

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**Exploration, Development and Production Risks (continued)**

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 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.

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**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 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.

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**Insurance (continued)**

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.

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](http://www.montello.com) and on [www.sedar.com](http://www.sedar.com).