

**Montello Resources Ltd.**

**Financial Statements**

**For the Three Months Ended October 31, 2007**

## **NOTICE OF NO AUDITOR REVIEW**

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

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

# Montello Resources Ltd.

## Consolidated Balance Sheets

Canadian Funds

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	October 31, 2007 (unaudited)	July 31, 2007 (audited)
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 3,404,718	\$ 3,261,268
Marketable securities	18,617	18,617
Accounts receivable and prepaid expenses	1,544,128	344,248
	<u>4,967,463</u>	<u>3,624,133</u>
<b>Property &amp; equipment (Note 3)</b>	<u>2,347,832</u>	<u>578,839</u>
	<u>\$ 7,315,295</u>	<u>\$ 4,202,972</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 1,397,460	\$ 2,420,734
<b>Asset retirement obligation</b>	<u>222,750</u>	<u>219,729</u>
	<u>1,620,210</u>	<u>2,640,463</u>
<b>Shareholders' equity</b>		
Share capital (Note 4)	26,630,385	21,130,478
Contributed surplus	1,829,119	1,107,230
Warrants	830,269	1,090,038
Deficit	<u>(23,594,688)</u>	<u>(21,765,237)</u>
	<u>5,695,085</u>	<u>1,562,509</u>
	<u>\$ 7,315,295</u>	<u>\$ 4,202,972</u>

Approved by the directors:

"William R. Cawker"

Director – William R. Cawker

"Joseph Dow"

Director – Joseph Dow

*See accompanying notes.*

# Montello Resources Ltd.

## Consolidated Statements of Operations and Deficit

Three Months Ended October 31, 2007 and 2006

(Unaudited)

Canadian Funds

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	<b>2007</b>	<b>2006</b>
	\$	\$
<b>Revenue</b>		
Oil and gas sales	<b>186,909</b>	274,818
Royalty expense	<b>(18,036)</b>	-
Interest income	<b>6,440</b>	-
	<b>175,313</b>	274,818
<b>Expenses</b>		
Production	<b>60,352</b>	156,477
General & administration	<b>148,676</b>	339,524
Interest	-	20,965
Depletion, depreciation & accretion	<b>58,521</b>	225,015
Stock based compensation	<b>1,708,239</b>	225,217
Foreign exchange loss	<b>28,976</b>	190
	<b>2,004,764</b>	967,388
<b>Loss for the period</b>	<b>1,829,451</b>	692,570
<b>Deficit, beginning of period</b>	<b>21,765,237</b>	18,426,245
<b>Deficit, end of period</b>	<b>23,594,688</b>	19,119,245

*See accompanying notes.*

**Montello Resources Ltd.**  
**Consolidated Statements of Cash Flows**  
**Three Months Ended October 31, 2007 and 2006**  
(Unaudited)  
Canadian Funds

	<b>2007</b>	<b>2006</b>
<b>Cash provided by (used in)</b>	\$	\$
<b>Operating activities</b>		
Loss for the period	<b>(1,829,451)</b>	(692,570)
Items not affecting cash:		
Depletion, depreciation & accretion	<b>58,521</b>	225,015
Stock based compensation	<b>1,708,239</b>	225,217
	<b>(62,691)</b>	(242,338)
Changes in non-cash working capital items, net	<b>(2,223,154)</b>	(849,214)
	<b>(2,285,845)</b>	(1,091,552)
<b>Investing activities</b>		
Additions to property & equipment	<b>(1,827,514)</b>	(83,195)
<b>Financing activities</b>		
Proceeds from issuance of shares, net of issue costs	<b>4,256,809</b>	1,073,062
Advances to affiliated company	-	107,076
	<b>4,256,809</b>	1,180,138
<b>Increase in cash during the period</b>	<b>143,450</b>	5,391
<b>Cash, beginning of period</b>	<b>3,261,268</b>	89,292
<b>Cash, end of period</b>	<b>3,404,718</b>	94,683

*See accompanying notes.*

**Montello Resources Ltd.**  
**Notes to the Consolidated Financial Statements**  
**October 31, 2007**  
(unaudited)  
Canadian Funds

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**1. BASIS OF PRESENTATION**

These unaudited interim financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and on a basis consistent with the audited July 31, 2007 financial statements. Accordingly these unaudited interim statements should be read in conjunction with the notes contained in the Company's audited July 31, 2007 financial statements. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of periodic financial statements necessarily involves the use of estimates and approximations. Accordingly, actual results could differ from those estimates. The financial statements have, in management's opinion, been properly prepared using careful judgment within reasonable limits of materiality and within the framework of the significant accounting policies.

Certain prior period comparative figures have been reclassified to conform to the presentation used in the current period.

**2. NATURE OF OPERATIONS**

The Company's principal business activities include the evaluation, acquisition, exploration and development of oil and gas properties in Western Canada and Tennessee, USA. These consolidated financial statements include the accounts of the Company and its 100% interest in Montello Resources USA Ltd., which was incorporated in Delaware, USA on March 2, 2005.

**3. PROPERTY & EQUIPMENT**

	<b>October 31, 2007</b>			<b>July 31, 2007</b>
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>	<u>Net Carrying Amount</u>
Petroleum & natural gas properties				
-Canada	\$ 2,939,008	\$ 2,240,254	\$ 698,754	\$ 457,639
-United States	1,638,438	-	1,638,438	110,560
Office equipment	<u>18,253</u>	<u>7,613</u>	<u>10,640</u>	<u>10,640</u>
	<u>\$ 4,595,699</u>	<u>\$ 2,247,867</u>	<u>\$ 2,347,832</u>	<u>\$ 578,839</u>

**Montello Resources Ltd.**  
**Notes to the Consolidated Financial Statements**  
**October 31, 2007**  
(unaudited)  
**Canadian Funds**

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**4. SHARE CAPITAL**

a. Authorized:  
Unlimited Common shares without  
par value

b. Issued:

	Number of shares	Value
Balance as at July 31, 2007	142,363,552	\$ 21,130,478
Issued for cash, net of fair value of warrants	8,202,166	1,271,336
Issued for cash on exercise of warrants	11,642,780	1,440,578
Issued for cash on exercise of stock options	12,749,495	1,421,967
Fair value transfer on exercise of stock options	-	986,350
Fair value transfer on exercise of warrants	-	485,329
Share issue costs	-	(105,653)
	<u>174,957,993</u>	<u>\$ 26,630,385</u>

c. Share capital transactions during the three months ended October 31, 2007:

- i. In October 2007 the Company completed a private placement of 8,202,166 units @ \$0.18 per unit for gross proceeds of \$1,476,390. The units consist of one common share and one share purchase warrant exercisable into one common share @ \$0.30. \$105,653 of issue costs were incurred including 820,217 broker warrants.
- ii. During the three months ended October 31, 2007 the company issued 11,642,780 common shares on exercise of share purchase warrants ranging from \$0.11 to \$0.20 per share for total cash proceeds of \$1,440,578.
- iii. During the three months ended October 31, 2007 the company issued 12,749,495 common shares on exercise of stock options at various prices ranging from \$0.10 to \$0.15 for total cash proceeds of \$1,421,967. The fair value assigned to these exercised options of \$986,350 has been transferred to share capital from contributed surplus.

**Montello Resources Ltd.**  
**Notes to the Consolidated Financial Statements**  
**October 31, 2007**  
(unaudited)  
Canadian Funds

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d. Stock option plan

The Company has a stock option plan for the benefit of directors, officers, employees and consultants administered by the Board of Directors, in which up to 10% of the issued and outstanding common shares are reserved for issuance. All share options granted vest immediately.

A summary of the status of the stock option plan as of October 31, 2007 and changes during the period then ended is presented below:

	<b>Number of Options</b>	<b>Average Exercise Price</b>
	<hr/>	<hr/>
Balance, July 31, 2007	13,311,355	\$0.11
Exercised	(2,919,834)	\$0.10
Exercised	(6,743,761)	\$0.11
Exercised	(877,000)	\$0.105
Exercised	(1,500,000)	\$0.13
Exercised	(350,000)	\$0.135
Exercised	(358,900)	\$0.15
Cancelled	(200,000)	\$0.15
Granted	2,900,000	\$0.14
Granted	3,529,868	\$0.155
Granted	9,900,000	\$0.21
	<hr/>	<hr/>
Balance, July 31, 2007	<u>16,691,728</u>	<u>\$0.18</u>

# Montello Resources Ltd.

## Notes to the Consolidated Financial Statements

October 31, 2007

(Audited)

Canadian Funds

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d. options continued

The following table summarizes information about options outstanding at October 31, 2007:

<u>Number of Shares</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
200,000	\$0.11	November 9, 2011
360	\$0.11	December 21, 2011
150,000	\$0.135	March 10, 2012
11,500	\$0.11	April 19, 2012
2,900,000	\$0.14	September 6, 2012
3,529,868	\$0.155	October 2, 2012
<u>9,900,000</u>	<u>\$0.21</u>	<u>October 30, 2012</u>
<u>16,691,728</u>		

The Company has recorded stock-based compensation expense of \$ 1,708,239 for the three months ended October 31, 2007. The compensation expense is determined based on the fair value of the options at the grant date. The fair value of each option granted is estimated on the date of granting the options using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

	<u>October 31, 2007</u>
Risk free rate	6.0%
Expected volatility	56.0%
Annual dividend yield	0.0%
Expected life of options	5 years

# Montello Resources Ltd.

## Notes to the Consolidated Financial Statements

October 31, 2007

(unaudited)

Canadian Funds

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### e. Warrants

A summary of the status of Warrants issued and outstanding at October 31, 2007 and changes during the period then ended, is presented below:

	<b>Number of Warrants</b>	<b>Average Exercise Price</b>	<b>Expiry Date</b>
Balance, July 31, 2007	30,921,658	\$0.11-\$0.20	September 15, 2007 to December 13, 2008
Exercised	(350,000)	\$0.20	November 18, 2007
Exercised	(7,914,209)	\$0.11	September 30, 2008
Exercised	(903,571)	\$0.20	March 21, 2008
Exercised	(2,475,000)	\$0.13	December 13, 2008
Granted	9,022,383	\$0.30	October 18, 2008
Expired	(2,039,565)	\$0.20	September 15, 2007
Balance, October 31, 2007	<u>26,261,696</u>	<u>\$0.21</u>	

The Company has the following share common share purchase warrants outstanding at October 31, 2007:

<b>Number of Warrants</b>	<b>Exercise Price</b>	<b>Value \$</b>	<b>Expiry Date</b>
1,478,884	\$0.20	-	November 18, 2007
5,515,429	\$0.20	102,704	March 21, 2008
10,245,000	\$0.13	502,005	December 13, 2008
9,022,383	\$0.30	225,560	October 18, 2008
<u>26,261,696</u>		<u>830,269</u>	

## 5. RELATED PARTY TRANSACTIONS

- (a) During the three months ended October 31, 2007, the Company incurred management fees and consulting fees of \$ 61,133 with directors and officers of the Company.

**Montello Resources Ltd.**

**Management Discussion and Analysis**

**FIRST QUARTER ENDED  
OCTOBER 31, 2007**

**Date Submitted: December 27, 2007**

## **Montello Resources Ltd.**

### **Management Discussion and Analysis For the First Quarter October 31, 2008**

**Date Submitted: December 27, 2007**

#### **OVERALL PERFORMANCE**

##### ***General***

The Company is a junior natural resource company engaged in the acquisition, exploration and development of natural resource (oil and gas) properties. The Company is a reporting issuer in British Columbia and Alberta and trades on the TSX Venture Exchange under the symbol MEO. During the year, the Company hired a new management team and appointed a new Board of Directors. It was the objective of the new board to evaluate all of Montello's investments, and to develop, abandon, and/or acquire investments to maximize returns by the Company and to improve its working capital position.

This Management Discussion and Analysis ("MD&A") of Montello Resources Limited (the "Company") provides analysis of the Company's financial results for the first quarter ended October 31, 2007. It should be read with the unaudited financial statements ended October 31, 2007 and 2006 and related notes attached thereto. The Company is incorporated in the Province of Alberta (extra-provincially registered in the Province of British Columbia).

##### ***Non- Gap Measures***

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

##### ***Production Information Definition***

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

##### ***Forward-Looking Statements***

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

and the Company does not undertake any obligation to publicly update or revise any forward-looking statements or information, except as required by applicable laws. Additional information related to the Company, is available through the internet on the Company's SEDAR profile at [www.sedar.com](http://www.sedar.com). Readers are also referred to the risk factors described in other documents the Company files from time to time with securities regulatory authorities. Copies of these documents are available on the TSX Venture website [www.tsx.com](http://www.tsx.com) as well as the Company's website, [www.montello.com](http://www.montello.com).

## ***BUSINESS OVERVIEW***

In early July, 2007, the Board of Directors announced the appointment of Phil Emrich as the Drilling Advisor /Drilling Manager to Montello Resources USA Ltd. for the kick off of the John Bowen #2 Well. Randy Marshall tendered his resignation effective August 1 and subsequently became the V.P. of Engineering for our Pincher Creek, Alberta Operator, Pennine Petroleum Corp. On July 23, 2007, Max Sloan, a highly respected well-site geologist came aboard finalizing the drill team for Morgan Highpoint. On July 25, approval for the Drill Permit Application was received from the Tennessee Department of Environment and Conservation, Division of Geology, Oil and Gas Program.

On August 1, 2007, the beginning of the first quarter of the 2008 fiscal year, the Company announced the signing of a drilling contract with Houston Texas based Nabors Drilling USA and that mobilization to Morgan Highpoint. Pre-drilling preparations were completed at Morgan Highpoint and final spud date for the John Bowen #2 Test Well was announced on August 15, 2007. Montello's JV Partner Austin Developments Ltd. participated on a two for one basis (80% to earn 40%) by funding US\$2,400,000; Great Northern Oilsands on August 9, 2007 joined the Morgan Highpoint Project Partnership on a two for one basis (10% to earn 5%) by funding US\$300,000 and an additional US\$25,000. Montello's net participating interest was (10% to earn 55%) by funding US\$300,000. On August 21, 2007, Montello as Operator announced preparations to set surface casing at approximately 1200 Feet. Strata Energy Services Inc. of Alberta Canada was contracted to provide Under-balanced Drilling Services for the High Impact Drilling Program at Highpoint, Morgan County, Tennessee.

On August 24, 2007, the Company signed a Letter of Intent along with an AFE to participate in the Mannville Re-Completion of the Pennine et al Pinh Ck 1-11-4-29W4M well at Pincher Creek, Southern Alberta. Montello farmed into the PN&G rights held by Pennine Petroleum Corp. in the Pincher Creek area of Southern Alberta also with the right of Option, to be exercised within 45 days of notification, to participate as to a minimum of 25% of Pennine's interest in the drilling, completion, or abandonment of any proposed well on the lands held within the area of Township 3 and 4 Range 28 to 29 W4M approx. 175 kilometers south of Calgary, consisting of both Crown leases and Freehold leases representing 10,560 gross acres (approx. 4,851.2 net acres) Also an additional option to be exercised within 45 days of notification, to participate as to a minimum 25% of Pennine's interest in the drilling, completion or abandonment of the proposed deep Rundle Test Well to be drilled at the location of 6-12-4-29W4M4. Rundle production is within two miles of the prospective location and the Rundle zone is expected to be encountered at a depth of 3,880 meters. An independent third party Calgary engineering firm has estimated the prospective resources range from 18.0 BCF (raw gas reserves) low estimate, to 24.0 BCF with best estimates up to 30.0 BCF - high estimate.

Pursuit of lower risk drilling opportunities for gas and condensates in Alberta are in line with the Company's business plan to generate revenues in the short term to assist with financing of high impact drilling in Tennessee.

On September 4, 2007, the Company announced that 9 5/8 inch intermediate casing complete with a down-hole deployment valve, was being run to a total depth of 2,200 feet in the John Bowen # 2 Test Well. Montello and its partners elected to run the intermediate casing as a precautionary safety measure in advance of penetrating an anticipated over pressured zone which was present a little over a mile away in Pryor Oil's Howard-White #1 Well drilled in 2002 that resulted in the well blowing out.

On September 5, 2007, the Pincher Creek re-completion was underway as a rig was moved onto the Pennine Pincher Creek 01-004-29 W4M location (known as the 1-11-4-29 W4M well bore). The Company announced that Eric Leslie of Calgary Alberta, ex-PanCanadian Petroleum Ltd. now Encana Corp., would provide consultancy advisory services to Pres-CEO Bill Cawker. The Company also announced that it had engaged K-Crew Communications Inc., of Vancouver, B.C., to provide the company with investor relations services..

On September 13, 2007, the Company announced that it has successfully run 9 5/8" Intermediate casing and cemented it in place on The John Bowen #2 Well ("the Montello Well"). This procedure has been approved by "Tennessee Oil and Gas". Installed in the intermediate casing is a sub-surface Weatherford down hole deployment valve that can be activated to shut off the well.

On September 27, 2007, Pennine Petroleum Corp. our Pincher Creek Alberta operator performed two 60 ton fracture stimulations on the Brown Sand and the Cadomin/Kootenay section in the 1-11-4-29W4 well at. These stimulations resulted in the discovery of two condensate zones with associated gas. The condensate tested from 40 degrees to 46 degrees API but is subject to final evaluation. A successful discovery constitutes a new "play" amongst nearly 10,000 acres of geologically prospective lands. The intent is to continue with a program of further recompletions and drilling through 2008. The concept for this up hole zone play is simply to follow sand development across the structure and access these hydrocarbon-bearing sands via existing well-bores. It is felt that little attention was paid to the overlying Cretaceous and Jurassic sections that were effectively by-passed through en route to the main target at Pincher Creek which has been the Mississippian carbonates further below. Pennine Petroleum WI 37.5% Operator, with Montello 25%, Paramount Resources 25%, and a Private Co. 12.5%, are the JV Partners.

On September 28, 2007, it was announced that the John Bowen #2 Test Well" in Morgan County Tennessee is currently drilled to 5,670 feet. The Upper Cambrian Copper Ridge formation was encountered at approx. 5,300 feet and it was not anticipated to be hydrocarbon-bearing. Circulation was lost while drilling through the Copper Ridge. The fact that large volumes of fluids were lost into the Copper Ridge and then were quickly recovered along with traces of light oil, gas and major water suggest that the zone has very good porosity and excellent permeability in a completely dolomitized host strata.

On October 4, 2007, the Pincher Creek 1-11 Re-completion Project was updated by our operating partner, Pennine Petroleum Corp. The service rig was released having completed its preliminary swabbing / flowing evaluation. of the Brown Sand and the Kootenay/Cadomin formation. The operator will be setting up production equipment to production test the well as soon as possible. The Cadomin / Kootenay formation is a condensate zone with associated gas and no water. Swab results and continued flowing results resulted in average fluid rates of 225 barrels a day with no water cut and up to 500 mcf/day of gas. The API gravity of the condensate averaged 46 degrees. The Brown Sand is a condensate zone with very little associated gas that had an average production after swabbing operations of 140 barrels of fluid a day. The water cut of this fluid was up to 60%. The Company believes this water continues to be frac fluid. The API values of the condensate varied from 41 to 43 degrees. The immediate plans as part of a

development strategy for this area, is to re-complete a second well and drill a well to test the up-dip extension of this discovery along with the underlying Rundle zone.

Montello also announced drilling ahead at 6200 feet at the John Bowen #2 after completing five (5) cement squeezes over the highly porous and permeable Copper Ridge. The cost to drill, test and case the Test Well to date is \$4.0 million. A Supplementary "AFE" of USD \$1.7 million was issued to and paid proportionately by the partners based on their earned interests Montello as to 55%, Austin 40% Great northern 5% associated with the Supplementary AFE.

On October 11, 2007 the Company announced that its John Bowen # 2 Test Well was currently drilling ahead at 7,780 feet in the Rogersville Formation. All formations encountered to date in the Test Well have come in thicker than the geological prognosis that was created before the Test Well commenced drilling. The next day on October 12, 2007, the Company announced that the Rome Formation in the John Bowen # 2 Well ("the Test Well") was encountered, higher than originally anticipated, at 7,850 feet +/- . Montello is preparing to run 7.5" casing to the top of the Rome Formation and will then proceed to drill the Test Well to the basement anticipated to occur at between 8,500 to 9,500 feet.

On October 19, 2007, the TSX Venture Exchange accepted for filing a private placement of 10,000,000 Units at \$0.18; each Unit consists of one common share and one attached share purchase warrant exercisable for a one year period at \$0.30. Finder's fees were paid in certain instances. Montello paid a commission to certain introducing parties by the issuance of an 8% cash commission and broker warrants consisting of Units equivalent to 10% of the number of Units. Gross proceeds were \$1,476,390 (less share acquisition costs – finder's fees).

On October 24, 2007, the Company announced that the John Bowen #2 Well was cased with 7" pipe and that the Company was preparing to drill "ahead" under-balanced using nitrogen. In addition to the \$1.47 Million raised by way of the recently closed Private Placement at \$0.18 per Unit, Montello since August 7th, 2007, had raised over \$2.8 Million by way of the exercising of incentive stock options and warrants.

On October 31, 2007, the Company received an activity update from operator Pennine Petroleum on the new discovery at Pennine Pinch CK 100/01-11-004-29W4M. Engineering was currently evaluating various downhole production schemes to place the Cadomin formation onto production, including the handling of associated natural gas via the selection of condensate lift systems and gas tie-in points. The current plan is to initially produce the Cadomin formation so as to establish optimal production rates. Examination of data collected during the Brown sand completion will be investigated re possibly commingling both zones in the future.

## **PROPERTY EXPLORATION PLANS AND WORK PROGRAMS STATUS**

The Company plans to continue exploration work on its currently held resource properties, subject to availability and timing of financing (including, where applicable, the ability to meet cash calls from the project operator) and data analysis from work programs. For properties in which the Company is the operator, results of exploration programs, including technical disclosure are prepared by or under the supervision of a qualified person. For properties in which the Company is not the operator, results of exploration programs are provided to the

Company by the project operator. The Company is the project operator for the Mulligan Property in Alberta, at Morgan Highpoint in Tennessee, and the 52 shallow wells in Scott, Morgan Counties et al, Tennessee. The operator of the Sarcee Project was C1 Energy Ltd. and has since

been changed to Arapahoe Energy. Montello came in behind JV Partner, Arapahoe Energy and is now recognized as having earned in on the project.

## **OIL AND GAS PROPERTIES**

### **The Morgan Highpoint Joint Venture Project, Tennessee**

In 2006, Montello entered into a Farm-out Agreement with Austin Developments Ltd. whereby Austin advanced US\$2,400,000 to drill and complete the John Bowen #2 Test Well to earn an undivided Net 40% Working Interest ("W.I."). On August 9, 2007, prior to the commencement of drilling on August 15, 2007, Montello announced Great Northern Oilsands Inc. as an additional JV Partner whereby Great Northern agreed to pay 10% of the AFE'd costs to earn an undivided 5% Working Interest in the project lands. Initially, a late January spud date had been planned, however it was subsequently determined that due to the technically challenging nature of the test well, a larger drill rig was required precipitating the need for extending the time required for the pre-drill phase as Engineering and Operations personnel reviewed logistics including a greater need for more specialized drilling technology and equipment, site preparation and additional recruitment of more qualified personnel than was originally anticipated. It was felt that extending the pre-drill period / delay in the spud date until August 15 was prudent. In the interim, Montello was successful in negotiating equipment and additional land agreements in the immediate area so that drilling could begin in August, 2007, with the contracting of Houston-based Nabors Drilling USA, one of the largest contract drillers in the lower 48 states.

### **Scott and Morgan County et al – Shallow Well Leases**

As of July 31, 2007 Montello was the owner of approx. 52 oil and gas wells located with Austin Developments which earned a 50% participating interest in each well and associated contiguous land package by reimbursing Montello December 27, 2006 with an equalization payment for 100 per cent of all costs involved in the acquisition, drilling, completion, stimulation, and equipping of all wells. Subsequently on November 28 and 29, Austin, and Montello, formally announced the closing of an agreement whereby Montello quit claim its 50% interest and operatorship to Austin et al. Benefits include reduction of third party royalties on the John Bowen Lands while allowing Montello to solely focus operational efforts at Morgan Highpoint as well as pursue other potential "high impact deep well opportunities". Other benefits included Austin earning their working interest in the "Morgan Highpoint Project" on a two for one basis (80% gross to earn net 40%).

### **Mulligan (Peace River Arch), Alberta**

The Company owns various working interests in 6,720 acres of land in the Mulligan area in Northern Alberta. This asset contains four producing oil wells, one producing gas well, four shut-in gas wells; one shut-in oil well and two identified drilling locations with waterflood possibilities and voidage replacement enhancement possibilities. The Company continues to work on enhancing the Mulligan properties and successfully demonstrated upside from "water flood / voidage replacement" with pressure maintenance techniques to increase production in the Charlie Lake Zone in Section 23-81-8 W6M. With summer approval of a waterflood enhancement scheme by the "AEUB" (Alberta Energy & Utility Board) in place, re-work of the injection well 6-23-81-8W6M well was completed to enhance oil production in the Charlie Lake Formation at Mulligan was commenced. Up to two potential re-completions and two new drilling locations are being reviewed to develop the proved non-producing and probable reserves in 2008 provided successful negotiation with Joint Venture Partners.

## **Sarcee, Alberta**

The Company, under a farm-out agreement, owned a 2.50 percent working interest in 2,560 acres on four sections of land in this area by paying 5.00 percent of the gross capital development expenditures. These lands contain one well and one identified drilling location and up until July 31, 2007, the Company elected not to spend any time related to this project until the original operator, C1 Energy, was replaced. With the subsequent re-organization of the JV Partnership, Montello recently entered an agreement with Vanguard Exploration Corp. on November 1, 2007 to increase its interest to 8.5% by entering an agreement to purchase an additional undivided 6% working interest from the base of the Mannville Formation to basement underlying Sections 12, 13, 14 and 23 in Twp. 23 Rge. 4 W5M (2,560 acres), hereinafter referred to as "the Sale Lands" which are located on the T'suu Tina Reserve approximately 15 miles west of Calgary Alberta. Included in the acquisition of the Sale Lands is a 6% interest in the suspended 10,957 foot 12-13-23-4 W5M cased potential Rundle Gas Well ("12-13 Well"). The mineral rights underlying the Sale Lands and the 12-13 Well are hereinafter collectively referred to as the "Said Interests".

## **Pincher Creek, Southwestern Alberta**

The company entered into an agreement to participate in the Mannville Re-Completion of the Pennine et al Pinh Ck 1-11-4-29W4M well at Pincher Creek, Southern Alberta by farming into the PN&G rights held by Pennine Petroleum Corporation. Montello is participating as to a minimum of 25% of Pennine's interest in the Pennine Pinch Ck 100/ 01-11-004-29W4M well. The recompletion of the well was initiated on August 30, 2007 and has been recompleted in the Brown and Cadomin sands.

Initial swabbing rates are 337 barrels of condensate and 500 Mcf per day natural gas. The success of this well has resulted in enhanced prospectively in these zones throughout the joint venture partnership's petroleum and natural gas rights in the area. It is anticipated that revenues from this well may commence before the end of the third quarter (April 30, 2008). The Pincher Creek Field 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 to date has produced some 600 BCF of gas and 1 million plus barrels of associated liquids from the Mississippian-age carbonates of the Turner Valley (Rundle) formation.

## SELECTED FINANCIAL 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

	2007	2006	2005
Revenues	\$ 397,162	\$ 363,351	\$ -
Operation costs and royalties	236,859	49,854	-
Amortization & depletion	1,872,500	1,284,799	-
General and Administrative Expenses	1,829,900	1,440,072	948,817
Net Income (Loss)	(3,542,097)	(2,411,374)	(942,756)
Loss per share	(.03)	(0.02)	(0.01)
Total Assets	4,202,972	2,777,523	1,631,562
Long Term Liabilities	219,729	496,825	1,279,407

### Summary of Quarterly Results

	2007 Oct. 31	2007 July 31	2007 April 30	2007 Jan. 31
Total Revenues	193,349	(34)	131	25
Loss before extraordinary items	1,829,451	(1,808)	(584)	(457)
Loss per share	\$(0.10)	(.01)	(.00)	(.00)

	2006 Oct. 31	2006 July 31	2006 April 30	2006 April 30
Total Revenues	275	237	26	134
Loss before extraordinary items	(693)	(1,467)	(248)	(152)
Loss per share	(.02)	(.02)	(.01)	(.01)

## RESULTS OF OPERATIONS

At the quarter ended October 31, 2007, net cash flow from operations decreased to \$62,691 (2006 - \$242,338). During fiscal 2007 investment activities, mostly resource property expenditures came in at \$1,827,514 (2006 - \$83,195). During the year the Company raised \$4,256,809 (2006 - \$1,073,062).

## LIQUIDITY AND SOLVENCY

The Company recorded a net loss of \$1,829,451 (2006 - \$692,570). The Company had a working capital surplus of \$950,372 [July 31, 2007 - (\$1,203,399)].

Operating expenses decreased by \$96,125 to \$60,352 (2006 - \$156,477) lower maintenance costs in Canada.

Accounting and audit increased by \$18,092 to \$28,892 (2006 - \$10,800) due to additional workload with Company's acquisitions. Amortization and depletion expenses decreased by \$166,494 to \$58,521 (2006 - \$225,015) due to a write-down in the value of the Company's Canadian assets in the year ended July 31, 2007. Interest expense was eliminated due to the retirement of all debt last fiscal year. Consulting fees increased by \$8,418 to \$72,418 (2006 -

\$65,000) due to increased staffing levels and increased activities on the various oil and gas projects. Public Relations increased by \$15,831 to \$73,331 (2006 - \$57,500) due to increased travel and investor awareness activities.

## **FINANCING ACTIVITIES**

On October 19, 2007, the TSX Venture Exchange accepted for filing a private placement of 10,000,000 Units at \$0.18; each Unit consists of one common share and one attached share purchase warrant exercisable for a one year period at \$0.30. Finder's fees were paid in certain instances. Montello paid a commission to certain introducing parties by the issuance of an 8% cash commission and broker warrants consisting of Units equivalent to 10% of the number of Units. Gross proceeds were \$1,476,390 (less share acquisition costs – finder's fees).

As at November 30, 2007, the Company issued 12,949,855 common shares for the exercises of options with proceeds \$2,012,860; the Company issued 12,417,780 common shares for the exercise of warrants with proceeds of \$1,577,027.19

### **Stock Options Granted**

On September 6, 2007 the Company granted 2,900,000 stock options at 14 cents per share expiring September 5, 2012. On October 2, 2007, 3,529,868 stock options at 15.5 cents per share were granted expiring October 1, 2012. These warrants expire October 18, 2008. Lastly, on October 30, 2007 the Company granted 9,900,000 stock options at 21 cents per share expiring October 29, 2012.

Since incorporation Montello's capital resources have been limited. In addition to having to rely upon cash generated from operations, the Company has had to rely upon the sale of equity for cash required for administration, acquisition(s) and exploration program(s). It is unlikely that significant cash would be generated from operations if management didn't continue to pursue significant drilling projects with the potential for revenue. The Company intends to strongly pursue its goals of engaging in the acquisition, exploration and development of oil and gas properties on both sides of the Canadian and US border. While there can be no assurance that financing, whether debt or equity, will always be available in the amount(s) required at any particular time or for any particular period or, if available, that it can be obtained on satisfactory terms. The Company is currently interested in looking at agreements to acquire interests in additional projects or Oil and Gas Properties.

The availability of equity capital to junior resource companies is affected by commodity prices, global economic conditions, and economic conditions and government policies in the countries of operation, among other things. These conditions are beyond the control of the management of the Company and have a direct effect on the Company's ability to raise equity capital. The

Company's working capital and liquidity fluctuate in proportion to ongoing project commitments or debt - equity financing activities. The Company requires a certain amount of liquid capital in

order to sustain its operations and in order to meet various obligations as specified under the Company's resource property acquisition agreements. Should the Company fail to obtain future equity financing due to reasons as described above, it will not be able to meet these obligations and may lose its interests in properties covered by an agreement. Further, should the Company be unable to obtain sufficient equity financing for working capital, it may be unable to take on or meet ongoing operational commitments.

Exploration and development of natural resources involve substantial expenditures and a high degree of risk. Few properties which are explored are ultimately developed into producing properties. Accordingly, the Company has no material revenue, writes off its natural resource properties from time to time, and operates at a loss.

## **DIVIDEND RECORD AND POLICY**

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

## **CAPITAL RESOURCES**

The Company is presently entering contractual obligations and commitments in conjunction with its Joint Venture Partners for material expenditures at Morgan Highpoint in Tennessee.

## **OFF-BALANCE SHEET ARRANGEMENT**

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

## **RELATED PARTY TRANSACTIONS**

During quarter ended October 31, 2007, the Company incurred management, consulting and engineering fees of \$30,000 (2006: \$78,391) with directors, and accounting fees of \$27,233 (2006: nil) and accounts payable and accrued liabilities \$39,383 (2006:\$44,378) with officers and director's of the Company.

## **SUBSEQUENT EVENTS**

On December 17, 2007 the Company also proposed a private placement for accredited investors of CDN \$3.51 million non-brokered Flow Through Unit Financing consisting of 1,800,000 Units priced at CDN \$1.95 per Unit. Each Unit is comprised of 10 Flow Through Common Shares and 5 Non-flow Through Common Shares all of which are priced at \$0.13. In addition Montello announced a CDN \$1.2 million non-brokered Private Placement of up to 10 million Units at the price of \$0.12 per Unit. Each Unit consists of one Common Share at \$0.12 and one Common Share Purchase Warrant ("Warrant") priced at \$0.25 for accredited investors. Proceeds received prior to December 31, 2007 from the flow-through portion of the Private Placements will be used by Montello to incur qualifying expenditures, which will be renounced in favour of purchasers for the 2007 taxation year. Finder's fees of 7% in cash and 7% in Warrants will be payable on certain portions of the Private Placements.

The Private Placements are subject to the approval of the TSX Venture Exchange. Proceeds from the Private Placements will be used by Montello to: develop its oil and natural gas prospects in Morgan County, Tennessee; advance exploratory activities on joint venture properties, including Pincher Creek, Sarcee, Grouard, Mulligan as well as to explore lands that Montello may acquire or farm-in to, as well as for general working capital purposes.

## **CRITICAL ACCOUNTING ESTIMATES**

Not applicable to venture issuers.

## **CHANGES IN ACCOUNTING POLICIES**

The Company has not changed any of its accounting policies.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

It is management's opinion that the fair value of the Company's cash and cash equivalents, reclamation deposit, marketable securities, accounts receivable, accounts payable and accrued liabilities, and advances approximate their carrying value due to the relatively short periods to the maturity of the instruments.

The maximum credit risks exposure for all financial assets is the carrying value of those assets. None of the Company's financial instruments are denominated in U.S. dollars, and the Company does not use derivative instruments or foreign exchange contracts to hedge against gains or losses arising from foreign exchange fluctuations.

## **SUBSEQUENT EVENTS**

On November 1, 2007, the Company entered into an agreement to purchase an undivided 6-percent working interest from the base of the Mannville formation to basement underlying sections 12, 13, 14 and 23 in Township 23, Range 4 W5M (2,560 acres), hereinafter referred to as the sale lands. The sale lands are located on the T'suu Tina Reserve (Sarcee) which is located approximately 15 miles west of Calgary, Alta. Included in the acquisition of the sale lands is a 6-percent interest in the suspended 10,957-foot 12-13-23-4 W5M cased potential Rundle gas well (12-13 well). See November 2, 2007 announcement correction from source. The entire purchase price for the Said Interests of \$3,499,000 will be paid in full by Montello issuing to Vanguard 11,663,333 common shares, valued at \$0.30 per share, from treasury, which will be subject to a 4 month hold period. This transaction is subject to approval by the applicable regulatory authorities and provides a net 8.5% interest versus 2.5% in the upcoming recompletion of the 12-13 Well also in the follow-up 7-23 Well Location that Montello has the right to participate in on a straight up basis as to an undivided 8.5% working interest.

On November 2, 2007, the Company announced that Montello's Joint Venture Partnership at Morgan Highpoint purchased the John Bowen Land Package complete with mineral rights. It was stated that the acquisition will reduce the potential royalty payable by Montello and its JV Partners from an estimated 18% down to approximately 8% should the John Bowen Lands be

commercial. The John Bowen # 2 Test Well now has casing set and is currently drilling ahead at 8,000 plus feet. It is anticipated that total depth of the well, as previously estimated, will be 9,500 feet. The Company also issued a correction from source notice, further clarifying the Sarcee Land acquisition from the previous day correcting reserves information.

On November 6, 2007, the Company announced that the JV Partnership at Morgan Highpoint was utilizing the services of Canadian Integrity Drilling Inc. ("CIDI") of Calgary, Alberta for directional drilling optimization to our targeted areas. CIDI has 33 years of directional experience drilling. <http://www.canadianintegrity.com/services.htm>

On November 14, 2007, Montello announced that the John Bowen #2 Test Well was drilled to a total depth of 9,580 feet after having reached what is believed to be the Pre-Cambrian basement after circulating granite samples to surface. The hole is being conditioned and Halliburton has been contracted to handle the logging of the Test Well.

On November 21, 2007, the Company announced casing of the John Bowen # 2 Test Well to 9,557 feet. After releasing the drill rig, the well evaluation process commenced. Furthermore, Montello et al are in the final stage of acquiring additional acreage in Morgan County.

On November 28, 2007, the Company announced that in accordance with National Instrument 51-101 "Standards of Disclosure for Oil and Gas Activities of the Canadian Securities Administrators", that it had filed its reserves data and other oil and gas information (51-101 F1, F2 and F3) for the year ended July 31, 2007. Copies may be obtained on [www.sedar.com](http://www.sedar.com). The Report of Management and Directors on Oil and Gas Disclosure in Form 51-101F3 were also included in the filing.

On November 29, 2007, the Company announced the quit claim of its non-core interests in 52 shallow gas wells to Austin Developments Corp. in various counties in Northern Tennessee. In return for the transfer of the shallow well assets, Montello benefitted from advantageous initial farm in terms which also included cancellation of 3<sup>rd</sup> party royalties. Austin now becomes the operator of these wells, allowing Montello to focus its financial resources and expertise exclusively on potentially high-impact deep drilling operations in Morgan County.

Montello's growth strategy via the drill bit is to seek farm in projects as a non operator in shallow plays, re-completions, etc. back home in Alberta with future potential revenues directed south to US operations. Montello repeated notice of the filing of November 28<sup>th</sup> of reserves data, etc and other oil and gas information (51-101F1, F2 and F3) for the year ended July 31, 2007 on [www.sedar.com](http://www.sedar.com)

On December 4, 2007, Montello announced farming in on two gas exploration wells in the Grouard region of Alberta, 300 km plus northwest of the city of Edmonton. Drilling already had commenced on the first of these two drill holes to the Debolt formation at an estimated total depth of 850 metres. The two gas wells represent multi-zone targets and drilling is expected to be completed on as early as December 7. Estimated cost per well is approximately \$155,000. Pursuant to a November, 2007 farm-in agreement with Northern Sun Exploration Company Inc.,

the Company is earning a 35% working interest subject to minor overrides in each well in return for paying 50% of the drilling costs. Northern Sun Exploration is the operator and already operates production in the area. In the event of a successful outcome, it is anticipated that gas

production will be tied-in to a nearby pipeline. Further to the farm-in agreement, Montello also has the right to participate in other contingent offset wells in the area.

On December 5, 2007, the Company filed on [www.sedar.com](http://www.sedar.com) a Notice of Change of Auditor dated November 28, 2007 to the Alberta and British Columbia Securities Commissions and to the TSX Venture Exchange replacing new Auditor Ernst & Young LLP with the Company's previous Auditor Charlton and Company of 2005 and 2006. Also filed this same day were the letter from the successor auditor and former auditor, the Annual Management Discussion Analysis Form 51-102F1, Consolidated Financial Statements and Auditors' Report July 31, 2007 and 2006 Canadian Funds, and Form 52-109F1- Certification of Annual Filings CEO and CFO.

On December 6, 2007, Montello's Operating Joint Venture Partner, Northern Sun Exploration Company Inc., announced that it had drilled the two multi-zone gas wells at Grouard and the logs for the wells were being reviewed for imminent testing. Montello farmed in on these two wells pursuant to a farm-in agreement whereby Montello earns a 35% working interest subject to minor overrides in each well in return for paying 50% of the drilling costs.

On December 11th, 2007, Montello announced approval of their agreement with Vanguard Exploration Corp by the TSX Venture Exchange to purchase an undivided 6% working interest from the base of the Mannville Formation to the basement in "Sale Lands" encompassing approximately 2,560 acres located 15 miles west of Calgary Alberta. Key to the acquisition is a 6% interest in the suspended 10,957 foot 12-13-23-4 W5M cased potential Rundle Gas Well ("12-13 Well"). Montello purchased these interests based on the 10% discount factor value attributed to the Probable Developed Non-Producing gas reserves in the 12-13 Well and the 15% discount factor value attributed to the Probable Undeveloped gas reserves of the 7-23 Well Location as assigned by Chapman pursuant to their Reserve and Economic Evaluation Report, dated as of January 1, 2007 and updated as of November 1, 2007. Filing documentation was accepted by the TSX Venture Exchange pursuant to an assignment and novation agreement dated Nov. 1, 2007, whereby Montello agreed to this acquisition for the consideration of 11,663,333 common shares of the Company valued at CDN \$3,499,000 at a deemed price of 30 cents per share from treasury, which are subject to a (4) four month hold. This acquisition is beneficial to Montello in that it provides the company a net 8.5% interest versus its previous 2.5% working interest in the upcoming recompletion of the 12-13 Well as well as in the follow-up 7-23 Well Location which Montello also has the right to participate in, on a straight up basis, as to an undivided 8.5% working interest.

On December 17th, 2007 Montello announced that logging and evaluation of the John Bowen #2 Well would be deferred until at least mid January, 2008. Various logistical issues such as scheduling after US Thanksgiving; length of time to complete drilling, casing and cementing; initial aborted efforts to run open hole logs when open hole logging tools got stuck twice (following recommendations by Halliburton and our own geo-scientists to run cased hole logs); release of the rig to accommodate logging and evaluation; the December 14th acquisition by Park Place Energy of Great Northern Oilsands Inc.'s 5% interest; and the requirement to issue the last Supplemental AFE all contributed to the delay. Montello's President and CEO, Bill Cawker was then quoted saying the well was geologically evaluated with sampling from surface to total depth and that he was optimistic looking forward to completing logging & evaluation as early as possible. Over US \$1 million was forwarded to the AFE Account and the Company mentioned it wished to finalize another lease agreement to continue to consolidate and build upon its land package. The Company also announced a private placement for accredited investors of CDN

\$3.51 million non-brokered Flow Through Unit Financing consisting of 1,800,000 Units priced at CDN \$1.95 per Unit. Each Unit is comprised of 10 Flow Through Common Shares and 5 Non-flow Through Common Shares all of which are priced at \$0.13. In addition, a CDN \$1.2 million non-brokered Private Placement of up to 10 million Units at the price of \$0.12 per Unit. Each Unit consists of one Common Share at \$0.12 and one Common Share Purchase Warrant ("Warrant") priced at \$0.25 for accredited investors was announced. Finder's fees of 7% in cash and 7% in Warrants will be payable on certain portions of the Private Placements. The Private Placements are subject to the approval of the TSX Venture Exchange. Proceeds from the Private Placements will be used by Montello to: develop its oil and natural gas prospects in Morgan County, Tennessee; advance exploratory activities on joint venture properties, including Pincher Creek, Sarcee, Grouard, Mulligan as well as to explore lands that Montello may acquire or farm-in to, as well as for general working capital purposes.

Various reports and news releases discussing the Company's properties can be viewed on the SEDAR website at [www.sedar.com](http://www.sedar.com) or at [www.montello.com](http://www.montello.com).

## **Disclosure Controls and Procedures**

Management is responsible for establishing and maintaining disclosure controls and procedures for the Company. Due to its small size of operations, there is lack of segregation of duties within the Company's internal control systems. It is unlikely that segregation of duties can be properly addressed until the Company grows to a significant size. In order to compensate for the weaknesses in its internal control systems, the management has retained a private accounting company experienced with junior oil and gas companies to assist with its financial reporting and disclosures process.

However, the Company's management, including the Chief Executive Officer, believe that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control systems are met.