

## **GUARDIAN EXPLORATION INC.**

### **Form 51-102F1 Quarterly Management Discussion and Analysis**

#### **For the Ten Months ended June 30, 2006**

The following discussion should be read in conjunction with the Unaudited Financial Statements of Guardian Exploration Inc. ("Guardian" or the "Company") for the period ended June 30, 2006.

#### **Forward-Looking Information**

Certain statements contained in this management discussion and analysis ("MD & A") may contain words such as "could", "should", "expect", "believe", "will" and similar expressions and statements relating to matters that are not historical facts are forward-looking statements. Such forward-looking statements are subject to both known and unknown risks and uncertainties which may cause the actual results, performances or achievements of Guardian to be materially different from any future results, performances or achievements expressed or implied by such forward-looking statements. Such factors include, among other things, the receipt of required regulatory approvals, the availability of sufficient capital, the estimated cost and availability of funding for the continued exploration and development of Guardian's prospects, political and economic conditions, commodity prices and other factors.

#### **Overview of Financial Performance**

Guardian is an oil & gas exploration company exploring and producing oil & gas in Western Canada and Montana. On March 20, 2006, following a vote by the shareholders of Guardian and Resilient Resources Ltd., the two companies amalgamated securing a listing for the previously private Guardian Exploration Inc. Its common shares are now listed and posted for trading on the TSX Venture Exchange Inc. under the trading symbol GX.

The private company "Guardian" was incorporated in Alberta as Guardian Resources Inc. on May 27, 2001. On May 14, 2001 the Company changed its name to Guardian Exploration Inc. and obtained Extraprovincial Registration in British Columbia on June 22, 2001. The Company is engaged in the acquisition, exploration, and development of petroleum and natural gas properties in Western Canada.

#### **Review of Operations**

Guardian presently has approximately **124,000** gross acres (approximately **115,000** acres net) of developed and undeveloped lands, consisting of both purchased and farm-in acreage, with additional potential farm in lands being evaluated by management. During the ten months period ended June 30, 2006, the Company drilled and completed 1 gross well (65% net) at a cost of \$3.5 million dollars.

Guardian management estimates production at the end of June 2006, at approximately 100 boe/day, with an estimated 100 additional boe/day waiting for tie-in.

#### **2006 Capital Program**

For the balance of 2006, Guardian's exploration and development program contemplates drilling or recompleting approximately 3 gross wells at a cost of approximately \$1.5 million including drilling and well completions and tie-ins. Completion of the program is dependent upon, among other things, the availability of capital. The Corporation intends to fund the exploration program through a combination of cash on hand, cash flow, a credit facility and equity offerings.

## Selected Annual and Quarterly Information

Unless otherwise noted, all currency amounts are stated in Canadian dollars.

The following table summarized selected financial data for the Company for the ten months ended June 30, 2006 and the year ending August 31, 2005. Quarterly breakdown for 2005 would not be meaningful. The information set forth below should be read in conjunction with the consolidated audited annual and unaudited ten month financial statements, prepared in accordance with the Canadian generally accepted accounting principals and related notes.

	<b>Ten Months Ended June 30, 2006</b>	<b>Year Ended August 31, 2005</b>
Total Revenues	\$1,417,118	\$427,030
Expenses	\$3,057,514	\$909,062
Net income (loss)	\$(1,640,196)	\$(482,032)
Total Assets	\$16,187,012	\$5,293,954
Total short and long term liabilities	\$9,827,989	\$4,581,558

## Results of Operations

### Oil & Gas Sales

	<b>Ten Months Ended June 30, 2006</b>
Oil sales (BOE)	1,626
Gas sales (Mcf)	207,236
Total BOE (6:1)	36,166
Average BOE/day	137
Oil sales	\$106,817
Gas sales	\$1,824,688

Oil prices averaged \$65.70/bbl for the period while gas sold for \$ 8.81/mcf.

### Royalties and Operating Expenses

	<b>Ten Months Ended June 30, 2006</b>
Royalties	\$453,478
Royalties/BOE	\$12.54
Royalty rate	23.5%
Operating expenses	\$577,918
Operating expenses/BOE	\$15.98
Operating net back/BOE	\$24.89

**General & Administrative (“G&A”) expenses**

	<b>Ten Months Ended June 30, 2006</b>
G&A expenses	\$846,572
G&A/BOE	\$23.41

General and administrative expenses include certain settlements for Mr. Bud MacDonald and Mr. Michael Erickson totaling \$210,000.00 as a result of the amalgamation. Ongoing administrative expenses are expected to decline significantly on the amalgamated company.

**Liquidity & Capital Resources**

The company had cash as of June 30, 2006 of \$533,633. Working capital deficiency was \$3,373,651. The company plans to deal with what it believes is a short-term working capital deficiency by liquidating non-core assets and reviewing further equity offerings.

During the period the company issued 6,762,908 shares on a flow through basis for gross proceeds of \$4,929,224 and a further share issue of 6,336,976 shares for gross proceeds of \$3,256,098. At June 30, 2006, after amalgamation the company had 20,000,000 shares outstanding for total paid up capital of \$ 7,960,076.

As at June 30, 2006, the following options are outstanding:

<u>Exercise Price</u>	<u>Number of Shares</u>	<u>Expiry Date</u>
\$ 1.62	4,364	December 31, 2006 to April 21, 2010
\$ 1.10	<u>1,350,000</u>	May 29, 2011
	<u>1,354,364</u>	

**Commitments**

Under the terms of the flow-through share agreement entered into in 2005, the Company is committed to spend 100% (\$929,223.75) of the gross proceeds on qualifying exploration and development expenditures prior to December 31, 2006. Further, the 2006 flow through agreement requires the same for the \$4,000,000 raised by December 31, 2007. As at June 30, 2006, the Company has incurred \$1,000,000.00 of qualifying expenditures which exceed the commitments required under these flow-through agreements.

**Financial Instruments and Other Instruments**

Guardian's financial instruments consist of cash, accounts receivable and accounts payable. Unless otherwise noted, it is management's opinion that Guardian is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying value due to their short-term maturity and capacity for prompt liquidation.

**Approval**

The board of directors of Guardian has approved the disclosure contained in this MD & A Report. A copy of this MD & A will be provided to anyone who requests it.

**Additional Information**

Additional information relating to Guardian is on SEDAR at [www.sedar.com](http://www.sedar.com).

# **GUARDIAN EXPLORATION INC.**

## **Consolidated Financial Statements**

**Period Ended June 30, 2006  
(unaudited)**

### **Notice to Reader**

These interim financial statements have not been reviewed by an auditor. These interim consolidated financial statements are unaudited and included all adjustments, consisting of normal and recurring items, that management considers necessary for a fair presentation of the consolidated financial position, results of operations and cash flows.

Dated August 28, 2006

signed "Graydon Kowal"  
President & CFO

**Guardian Exploration Inc.**  
**Interim Consolidated Balance Sheets**  
**(Unaudited)**

	June 30, 2006	August 31, 2005
	\$	\$
<b>Assets</b>		
Current assets:		
Cash	533,633	7,397
Accounts receivable	756,491	144,890
Prepaid expenses and deposits	409,643	-
	<u>1,699,767</u>	<u>152,287</u>
Property, plant and equipment (note 3)	14,487,245	5,141,667
	<u>16,187,012</u>	<u>5,293,954</u>
<b>Liabilities</b>		
Current liabilities		
Accounts payable and accrued liabilities	4,413,462	2,422,659
Demand revolving loan	-	1,475,000
	<u>4,413,462</u>	<u>3,897,659</u>
Long Term Debt		
Debenture	4,500,000	-
Due to related company	401,783	254,437
Due to shareholder	138,000	138,000
Asset retirement obligation	373,845	45,562
Future income taxes	-	245,900
	<u>9,827,090</u>	<u>4,581,558</u>
<b>Shareholders' Equity</b>		
Capital stock (note 5)	7,960,076	769,711
Contributed surplus	97,357	-
Deficit	(1,697,511)	(57,315)
	<u>6,359,922</u>	<u>712,396</u>
	<u>16,187,012</u>	<u>5,293,954</u>

See accompanying notes.

**Guardian Exploration Inc.  
Interim Consolidated Statement of Loss and Deficit  
(Unaudited)**

	<b>For the period ended</b>	
	<b>June 30, 2006</b>	<b>August 31, 2005</b>
	<b>\$</b>	<b>\$</b>
<b>Revenues</b>		
Oil and gas sales, net of royalty	1,417,118	138,015
Other	-	289,015
	<u>1,417,118</u>	<u>427,030</u>
<b>Expenses</b>		
Operating expenses	544,168	150,560
Deletion, depreciation & accretion	1,335,950	573,629
General and administrative	846,572	196,965
Stock based compensation	97,357	-
Interest expense	417,921	88,032
Foreign exchange losses (gains)	17,598	-
Future tax recovery	(202,253)	(100,124)
	<u>2,513,145</u>	<u>758,502</u>
<b>Loss for the period</b>	(1,640,196)	(482,032)
<b>Retained earnings (deficit) - beginning of period</b>	<u>(57,315)</u>	<u>424,717</u>
<b>Deficit - end of period</b>	<u>(1,697,511)</u>	<u>(57,315)</u>

*See accompanying notes.*

**Guardian Exploration Inc.**  
**Interim Consolidated Statement of Cash Flow**  
**(Unaudited)**

	<b>For the period ended</b>	
	<b>June 30, 2006</b>	<b>August 31, 2005</b>
	<b>\$</b>	<b>\$</b>
<b>Cash provided by (used for)</b>		
<b>Operating activities:</b>		
Loss for the period	(1,640,196)	(482,032)
Items not affecting cash		
Depletion, depreciation and accretion	1,335,950	573,629
Stock-based compensation	97,357	-
Foreign exchange gains (losses)	17,598	-
Cash flow from operations	(189,291)	91,597
Future income tax recoveries	(202,253)	(100,124)
Changes in non-cash working capital balances	952,007	1,974,893
	560,463	1,966,366
<b>Financing activities:</b>		
Repayment of demand revolving loan	(1,475,000)	35,000
Debenture issue	4,500,000	-
Increase in loan from related company	147,346	690,494
Issuance of share capital	8,185,322	966,500
Share issuance costs	(1,038,190)	(104,488)
Advances from shareholder	-	138,000
	10,319,478	1,725,506
<b>Investing activities:</b>		
Expenditures on property, plant and equipment	(10,681,528)	(3,688,882)
Asset retirement obligations	327,823	-
	(10,353,705)	(3,688,882)
<b>Increase (decrease) in cash</b>	526,236	2,990
Cash, beginning of period	7,397	4,407
<b>Cash, end of period</b>	533,633	7,397

*See accompanying notes.*

### Note 1 - Nature of Operations

Guardian Exploration Inc. was incorporated under the Business Corporations Act (Alberta) on March 27, 2001 as Guardian Resources Inc. On May 14, 2001 the Company changed its name to Guardian Exploration Inc. The Company obtained Extra-provincial Registration in British Columbia on June 22, 2001.

The Company's principal business activities include the evaluation, acquisition, exploration and development of oil and gas properties in Western Canada and Montana.

### Note 2 - Significant Accounting Policies

The financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles and accordingly, have been prepared using the same principles as those for a going concern. Should the Company be unsuccessful in realizing the value of its current and future projects, it may not be able to realize its assets and discharge its liabilities in the normal course of business.

#### a) Property and Equipment

##### *i. Petroleum and natural gas properties and production equipment*

The Company follows the Canadian accounting standards guideline on full cost accounting for its petroleum and gas operations, whereby all costs associated with the acquisition of, exploration for and the development of petroleum and natural gas reserves, including asset retirement costs, are capitalized and accumulated in a single Canadian cost centre. Such costs include lease acquisition, drilling, geological and geophysical expenditures, lease rentals on non-producing properties, equipment costs and overhead expenses directly related to exploration and development activities.

Proceeds from the disposition of petroleum and natural gas properties are accounted for as a reduction of capitalized costs, with no gain or loss recognized, unless such disposition would alter the rate of depletion and depreciation by 20% or more.

##### *ii. Depletion and depreciation*

Depletion and depreciation of petroleum and natural gas properties is calculated using the unit of production method based upon production volumes, before royalties, in relation to total proved petroleum and natural gas reserves, as estimated by independent engineers. In determining costs subject to depletion, the Company includes estimated future costs to be incurred in developing proved reserves and excludes estimated salvage values. The cost of undeveloped properties are excluded from costs subject to depletion until it is determined that proved reserves are attributable to the property or impairment has occurred. For depletion and depreciation purposes, natural gas volumes are converted to equivalent oil volumes based upon a relative energy content of six thousand cubic feet of natural gas to one barrel of oil.

**Note 2 - Significant Accounting Policies (Continued)**

**a) Property and equipment (Continued)**

*iii. Mineral property interests*

Direct costs relating to the acquisition, exploration and development of mineral properties, including interest on borrowings directly related to a property, are capitalized on an area of interest basis. When the Company is the operator of a project and incurs costs on behalf of joint venture partners, these costs are periodically charged back to the partners and are recorded as operator recoveries. Operator recoveries are credited to exploration costs. Cumulative expenditures will be charged against income, through unit-of-production depletion, when properties are developed to the stage of commercial production. Where the Company's exploration commitments for an area of interest are performed under option agreements with a third party, the proceeds of any option payments under such agreements are applied to the area of interest to the extent of costs incurred. The excess, if any, is credited to operations. If an area of interest is abandoned or management determines there is a permanent and significant decline in value, the related costs are charged to operations.

*iv. Office equipment*

Office equipment is carried at cost and depreciated over the estimated useful life of the assets at a rate of 20% to 30% per annum on a declining balance basis. Depreciation is charged at half rates in year of acquisition.

*v. Ceiling test*

Under the full cost method of accounting, a "ceiling test" is performed to recognize and measure impairment, if any, of the carrying amount of petroleum and natural gas properties. Impairment is recognized if the carrying amount of petroleum and natural gas properties, less the cost of undeveloped properties not subject to depletion, exceeds the estimated undiscounted future cash flows from the Company's proved reserves. The future cash flows are based on a forecast of prices and costs, as provided by an independent third party. If recognized, the magnitude of the impairment is then measured by comparing the adjusted carrying amount to the estimated discounted future cash flows from the Company's proved and probable reserves. The future cash flows are discounted at the Company's credit adjusted risk-free interest rate, using forecasted prices and costs, and are exclusive of indirect costs such as interest charges, general and administrative expenses and future income taxes.

**Note 2 - Significant Accounting Policies (Continued)**

**b) Asset retirement obligations**

The fair value of estimated asset retirement obligations (“ARO”) is recognized in the financial statements in the period in which they are identified and a reasonable estimate of fair value can be made. The ARO includes the costs of abandonment of petroleum and natural gas wells, dismantling and removing tangible equipment, returning land to its original condition. The asset retirement cost, equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. Asset retirement costs for petroleum and natural gas assets are amortized using the unit of production method and are included in the depletion, depreciation and amortization on the statement of operations.

Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion expense on the statement of operations. Any revisions to the original estimate of cost or the timing of the cash outflows may result in a charge to the ARO. Actual expenditures incurred to abandon petroleum and natural gas properties reduce the ARO liability.

**c) Joint operations**

A portion of the Company's exploration, development and production activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

**d) Cash and cash equivalents**

Cash and cash equivalents include cash on hand, balances with banks and short-term deposits with original maturities of less than three months.

**e) Flow-through equity instruments**

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to shareholders. To recognize the foregone tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to subscribers. The tax effect is recorded on the date that the renouncement forms are mailed to the shareholders.

**Note 2 - Significant Accounting Policies (Continued)**

**f) Stock-based compensation**

The Company follows the fair value method of accounting for stock options granted to directors, officers, employees and consultants. Fair value is determined at the grant date using the Black-Scholes option pricing model. The value attributed to options is recognized over the vesting period as stock based compensation expense with a corresponding credit to contributed surplus. The contributed surplus balance is reduced as the options are exercised with the amount initially recorded being credited to share capital.

**g) Revenue recognition**

Revenue from petroleum and natural gas is recognized based on volumes delivered to customers at contractual delivery points and rates. The costs associated with the delivery, including operating transportation, and production based royalties are recognized in the same period in which the related revenue is earned.

**h) Refundable deposits**

The Company capitalizes refundable deposits, which are held in trust by the Alberta Energy & Utilities Board ("EUB") for the EUB Licensee Liability Rating program.

**i) Income taxes**

The Company follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period in which the change becomes substantively enacted. A valuation allowance is recorded against any future income tax asset if the Company is not "more likely than not" to be able to utilize the tax deductions associated with the future income tax asset.

**j) Per share amounts**

Basic earnings per common share are computed by dividing earnings (loss) by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method of calculating diluted per share amounts is used whereby any proceeds received from the exercise of in-the-money stock options or warrants are assumed to be used to purchase common shares of the Company at the average market price during the year.

# Guardian Exploration Inc.

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## Notes to Financial Statements

For the ten months  
Ended June 30, 2006

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### Note 2 - Significant Accounting Policies (Continued)

#### k) Measurement uncertainty

The timely preparation of financial statements in conformity with Canadian generally accepted accounting principles requires that management make estimates that affect the amounts of assets, liabilities, revenues and expenses as they primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, actual results could differ from those estimated.

Specifically, the amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties, the provision for asset retirement obligation costs and the ceiling test calculation are based on estimates of proved reserves, production rates, commodity prices, future costs and other relevant assumptions. The amounts recorded relating to fair values of stock options are based on estimates of future volatility of the Company's share price, expected lives of the options, expected dividends to be paid by the Company, and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

### Note 3 - Property and Equipment

	June 30, 2006		August 31, 2005	
	Cost	Accumulated depletion and depreciation	Net book value	Net book value
Petroleum and natural gas properties	\$33,421,715	\$19,210,372	\$14,211,343	\$5,141,667
Office equipment	276,347	445	275,902	0
	<u>\$33,021,116</u>	<u>\$19,210,817</u>	<u>\$14,487,245</u>	<u>\$ 5,141,667</u>

The Company performed a ceiling test calculation at June 30, 2006 to assess recoverable value of property and equipment. The oil and gas prices used in the calculation are based on the August 1, 2006 benchmark commodity price forecast of our independent reserve evaluators as follows:

## Guardian Exploration Inc.

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### Notes to Financial Statements

For the ten months  
Ended June 30, 2006

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Year	Alberta Par Crude CDN\$/bbl	AECO Natural Gas CDN\$/Mcf
2006	77.60	8.05
2007	75.36	8.86
2008	69.68	8.35
2009	65.14	7.85
2010	64.00	7.60
Thereafter (inflation %)	2% / yr	2% / yr

Based on these assumptions, the undiscounted value of future net revenues from the Company's proved reserves exceeded the carrying value of property and equipment as at June 30, 2006.

#### Note 4 - Asset Retirement Obligations

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites. The Company estimates the total undiscounted amount of the cash flows required to settle its asset retirement obligations is approximately \$, which has been discounted using a credit adjusted risk free rate of 5.5% (2005 - 5.0%). An inflation factor of 1.5% has been applied to estimated asset retirement costs. These obligations are to be settled based on the economic lives of the underlying assets, which currently extend up to 18 years into the future and will be funded from general corporate resources at the time of abandonment.

A reconciliation of the asset retirement obligations is provided below:

	June 30, 2006	August 31, 2005
Balance, beginning of period	\$ 45,562	\$ 9,218
Liabilities incurred	331,520	33,765
Accretion expense	3,237	2,579
Balance, end of period	\$ 373,845	\$ 45,562

# Guardian Exploration Inc.

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## Notes to Financial Statements

For the ten months  
Ended June 30, 2006

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### Note 5 - Share Capital

**a) Authorized:**

Unlimited number of Class A common voting shares  
Unlimited number of Class B Non-voting common shares  
Unlimited number of Class A Voting preferred shares, 7% non-cumulative, redeemable by the Company.

**b) Issued Class A common shares:**

	<u>Number</u>	<u>Amount</u>
<b>Balance, August 31, 2004</b>	<b>116</b>	<b>\$ 255,951</b>
70,000 to 1 stock split, December, 2004	8,119,884	-
Issued for cash	722,000	902,500
Share issue costs	-	(104,488)
Share issue costs, net of tax effect	-	(284,252)
<b>Balance, August 31, 2005</b>	<b>8,842,000</b>	<b>\$ 769,711</b>
2.6 to 1 stock split, September 2005	14,147,200	-
Issued for cash	6,336,976	3,147,639
Issued as agent's commissions	241,020	108,459
Redistribution of shares on amalgamation	(16,089,084)	
Issued for cash pursuant to flow through share private placement	6,762,908	4,929,224
Share issue costs, net of tax effect		(994,957)
<b>Balance, June 30, 2006</b>	<b>20,000,000</b>	<b>7,960,076</b>

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**Note 5 - Share Capital (continued)**

**c) Share capital transactions during the ten months ended June 30, 2006:**

- i. In the year ended August 31, 2005, the Company renounced for income tax purposes, to the holders of the flow through shares, expenditures of \$902,500 that was to be incurred in the year then ended. The income tax benefit lost of approximately \$321,470 was applied to share capital.
- ii. In September 2005, the Company split its stock on a 2.6 to 1 basis.
- iii. During October and November 2005, the Company completed a private placement raising gross proceeds of \$2,294,098. The private placement consisted of the issuance of 5,097,996 units at \$0.45 per unit. Each unit consisted of 1 common share and one-half of one common share purchase warrant ("Purchase Warrant"). Each whole Purchase Warrant entitles the holder to acquire, subject to adjustment, one Class A common share of the Company at a price of \$0.75 per share one year from issue date. Upon completion of this private placement, the agent received a 6% commission on the proceeds raised by the agent. These costs were surrendered by the issuance of units to the agent, which are included as a reduction to share capital as share issue costs.
- iv. In December 2005, the Company completed a private placement of 1,429,575 common shares on a flow through basis at a price of \$0.65 per flow through share for proceeds of \$929,224.
- v. Under the Amalgamation shares were redistributed based on a formula of net contributed values and resulted in a reduction of 16,089,084 issued and outstanding common shares.
- vi. In April 2006, the Company completed a private placement of 5,333,333 common shares on a flow-through basis at a price of \$0.75 per flow-through share for proceeds of \$4,000,000. An additional placement of 1,480,000 common shares was completed at a price of \$0.65 per common share for proceeds of \$962,000.

# Guardian Exploration Inc.

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## Notes to Financial Statements

For the ten months  
Ended June 30, 2006

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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. Stock options are granted at various times throughout the year and vest immediately.

A summary of the status of the stock option plan as of June 30, 2006 is presented below:

	<b>June 30, 2006</b>	
	<b>Stock Options</b>	<b>Weighted Average Exercise Price (\$)</b>
Outstanding, beginning of period	4,364	1.62
Granted	1,350,000	1.10
Exercised	0	0
Cancelled	-	-
Outstanding, end of period	<u>1,354,364</u>	<u>1.10</u>
Exercisable, end of period	<u>1,354,364</u>	<u>1.10</u>

The Company has recorded stock-based compensation expense of \$ 96,825 for the ten months ended June 30, 2006. The compensation expense has been 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:

	<b>June 30, 2006</b>
Risk free rate	5.62%
Expected volatility	39.0%
Annual dividend yield	0.0%
Expected life of options	5 years

# Guardian Exploration Inc.

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## Notes to Financial Statements

For the ten months  
Ended June 30, 2006

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### e) Warrants

A summary of the status of the common share purchase warrants as of June 30, 2006 and August 31, 2005 and changes during the years then ended is presented below:

	<b>June 30, 2006</b>	
	<b>Warrants</b>	<b>Weighted Average Exercise Price (\$)</b>
Outstanding, beginning of period	-	
Issued	109,086	1.85
Exercised	-	
Outstanding, end of year	<u>109,086</u>	<u>1.85</u>

### Note 6 - Related Party Transactions

The Company is related to several other corporations through common control and stock ownership.

All related party transactions occurred in the normal course of operations, have been measured at the agreed to exchange amounts, which is the amount of consideration established and agreed to by the related parties and which are similar to those negotiable with non-arms length parties.

### Note 7 - Financial Instruments

#### a) Fair values

The Company's financial instruments recognized in the balance sheet consist of cash and cash equivalents and accounts receivable, accounts payable and accrued liabilities. The carrying value of these accounts approximates their fair value due to the relatively short periods to maturity of these instruments.

#### b) Commodity price risk

The Company's operations are at risk to commodity price fluctuations for the delivery of natural gas and crude oil. The Company has not entered into any hedging arrangements.

**c) Credit risk**

Substantially all the Company's accounts receivable are with customers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks.

**Note 8 – Subsequent Events**

**a) Property Sale**

Guardian announced on July 21, 2006 that it has closed the sale of a portion of its Clarke Lake Pine Point “E” Pool interest to Ramshorn Canada Ltd., a subsidiary of Nabors Drilling Ltd.; and to a second Calgary based oil and gas company. Guardian will remain at 42.5% interest and operate the property. The \$5.5mm proceeds will be used to reduce the Azimuth Opportunity Ltd. debenture by \$0.5 mm and the balance will be used for general corporate working capital purposes.

Operations are proceeding to restore gas production from the two existing wells on the property.

**b) New Financing**

Guardian announced on August 18, 2006 that it has fully satisfied its obligations under its \$4,500,000 convertible debenture described in the press release of Resilient Resources Ltd. (the pre-amalgamation entity) dated April 13, 2006.

In order to provide working capital for the ongoing development of Guardian, it has, subject to due diligence and approval of the TSX Venture Exchange, entered into a proposal for a \$1,000,000 convertible debenture financing (the “Debenture”) with Azimuth Opportunity Ltd. (the “Lender”).

The proposed Debenture will bear interest at the rate of 7% per annum (increasing to 14% if the Corporation is in default), mature on April 21, 2007 and is convertible into common shares of Guardian at the rate of \$0.75 per share. The Debenture may be prepaid in its entirety prior to the maturity of the Debenture upon 5 days notice to the Lender, if the Corporation is not in default under the terms of the Debenture. If the Corporation raises new equity or debt capital (excluding proceeds from warrant and option exercises) subsequent to the closing of the Debenture financing, the Lender has the right to require that these funds be used to repay all or part of the outstanding principal amount of the Debenture, excluding the first \$1,000,000 of funds received from the issuance of flow-through shares by the Corporation.

In connection with the Debenture financing, the Lender shall be issued common purchase warrants to acquire 783,612 common shares of Guardian at an exercise price of \$0.75 per share until October 21, 2009.