

**Form 51-102F1**  
**Quarterly Management Discussion and Analysis**  
**For Guardian Exploration Inc.**

**For the nine months ended September 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 September 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** net acres) 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 nine months ended September 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 September 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 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 nine months ended September 30, 2006 and the corresponding period ended September 30, 2005. Quarterly breakdown for 2005 represents the results of Guardian Exploration Inc. before the above noted amalgamation and are therefore less meaningful than they would be if the amalgamation had occurred a year earlier. The information set forth below should be read in conjunction with the consolidated unaudited nine month financial statements, prepared in accordance with the Canadian generally accepted accounting principals and related notes.

	<b>Nine Months Ended September 30, 2006</b>	<b>Nine Months Ended September 30, 2005</b>
Net Revenues	\$722,724	\$583,701
Expenses	\$2,255,254	\$979,240
Net income (loss)	\$(1,532,531)	\$(395,539)
Total Assets	\$17,378,464	\$6,233,362
Total short and long term liabilities	\$8,925,067	\$2,971,493

## Results of Operations

### Oil & gas sales

	<b>Nine Months Ended September 30, 2006</b>
Gas sales (Mcf)	162,331
Total BOE (6:1)	27,055
Average BOE/day	100
Gas sales	\$950,313

Gas prices averaged \$5.86/mcf for the period.

#### **Royalties and operating expenses**

	<b>Nine Months Ended September 30, 2006</b>
Royalties	\$214,612
Royalties/BOE	\$7.94
Royalty rate	22.6%
Operating expenses	\$521,695
Operating expenses/BOE	\$19.28
Operating net back/BOE	\$7.91

#### **General & administrative (“G&A”) expenses**

	<b>Nine Months Ended September 30, 2006</b>
G&A expenses	\$743,344
G&A/BOE	\$27.48

General and administrative expenses include certain severance 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 September 30, 2006 of \$290,699. Working capital deficiency was \$3,348,647. 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 nine months ended September 30, 2006, 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 September 30, 2006, after amalgamation the company had 20,079,422 shares outstanding for total paid up capital of \$ 7,960,076.

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

<u>Exercise Price</u>	<u>Number of Shares</u>	<u>Expiry Date</u>
\$ 1.10	1,225,000	May 29, 2011

**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 September 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.

**Subsequent Events**

Mega Production Testing Inc. has filed a claim dated October 24, 2006 relating to invoices for production testing services on the Corporation's Clarke Lake property in the amount of \$382,921.27. Management of the Corporation has a number of issues respecting the method of delivery of the claimed invoices and has filed a Statement of Defense in the matter. Management of the Corporation believes this Statement of Claim to be without merit and consequently has not provided for any loss.

KC Wellsite Management Ltd. has filed a claim dated November 20, 2006 against Greyhawke Resources Ltd., Azimuth Opportunity, Ltd. and the Corporation in the amount of \$127,127.74 relating to unpaid services pursuant to service agreement dated August 9, 2006. Management of the Corporation believes this Statement of Claim to be without merit and consequently has not provided for any loss.

**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.**

**Interim Consolidated Financial Statements (unaudited)  
For the Nine Months Ended  
September 30, 2006**

## **NOTICE TO READER**

The consolidated financial statements of Guardian Exploration Inc. and the accompanying consolidated interim balance sheets as at September 30, 2006 and the consolidated interim statements of operations, deficit and cash flows for the three and nine months period then ended are the responsibility of the Company's management.

These consolidated financial statements have not been reviewed on behalf of the shareholders by the independent external auditors of the Company.

The consolidated interim financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these consolidated financial statements in accordance with Canadian generally accepted accounting principles.

Dated November 29, 2006  
On behalf of Guardian Exploration Inc.

*Signed: "Graydon Kowal"*

Director, President & Chief Executive Officer

# GUARDIAN EXPLORATION INC.

## Interim Consolidated Balance Sheet

(In Canadian Dollars)	September 30, 2006 (unaudited)	December 31, 2005 (unaudited)
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 290,699	\$ 1,783,875
Accounts receivable	2,612,054	123,233
Prepaid expenses and deposits	426,838	16,560
	<u>3,329,591</u>	<u>1,923,668</u>
<b>Property, plant and equipment (Note 3)</b>	14,048,873	4,309,694
	<u>\$ 17,378,464</u>	<u>\$ 6,233,362</u>
<b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 6,678,238	\$ 1,419,000
Bank facilities payable	-	1,090,000
	<u>6,678,238</u>	<u>2,509,000</u>
Debenture payable (Note 9)	1,000,000	-
Due to related company	394,383	254,437
Due to shareholder	138,000	138,000
Asset retirement obligation	714,446	70,056
	<u>8,925,067</u>	<u>2,971,493</u>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 5)	7,960,076	3,874,542
Contributed surplus	97,357	(532)
Retained earnings, (deficit)	395,964	(612,141)
	<u>8,453,397</u>	<u>3,261,869</u>
	<u>\$ 17,378,464</u>	<u>\$ 6,233,362</u>

*The accompanying notes are an integral part of these financial statements*

**GUARDIAN EXPLORATION INC.**  
**Consolidated Statements of Operations and Retained Earnings (Deficit)**  
**(unaudited)**

	For the three months ended September 30, 2006	For the nine months ended September 30, 2006	For the three months ended September 30, 2005	For the nine months ended September 30, 2005
<b>Revenues</b>				
Oil and gas sales, net of royalty	\$ 237,260	\$ 722,724	\$ 302,668	\$ 583,701
<b>Expenses:</b>				
Operating expenses	187,280	525,790	42,847	136,247
Depletion, depreciation and accretion	213,772	423,852	(96,727)	573,629
General and administrative	226,517	743,344	104,767	205,256
Stock based compensation	-	97,357	-	-
Interest expense	52,766	443,226	21,903	64,108
Foreign exchange (gains) losses	4,086	21,685	-	-
	<u>684,421</u>	<u>2,255,254</u>	<u>72,790</u>	<u>979,240</u>
<b>Net earnings (loss) from operations</b>	(447,161)	(1,532,531)	229,878	(395,539)
<b>Gain (loss) on sale of assets</b>	2,540,636	2,540,636	-	-
Future income tax expense (recovery)	-	-	(100,124)	(100,124)
	<u>-</u>	<u>-</u>	<u>(100,124)</u>	<u>(100,124)</u>
<b>Net (loss) after taxes</b>	2,093,475	1,008,105	330,002	(295,415)
<b>Retained earnings (deficit), beginning of period</b>	(1,697,511)	(612,141)	(200,700)	424,717
<b>Retained earnings, end of period</b>	<u>\$ 395,964</u>	<u>\$ 395,964</u>	<u>\$ 129,302</u>	<u>\$ 129,302</u>

**GUARDIAN EXPLORATION INC.**  
**Consolidated Statements of Cash Flow**  
**(unaudited)**

	For the three months ended September 30,	For the nine months ended September 30,	For the three months ended September 30,	For the nine months ended September 30,
	2006	2006	2005	2005
<b>Cash flows from operating activities</b>				
Operations				
Net loss for the period	\$ 2,093,475	1,008,105	\$ 427,424	(355,447)
Item not involving cash				
Depletion, amortization and accretion	213,772	423,852	(167,182)	573,629
Future income tax recoveries	-	-	(100,124)	(100,124)
Stock-based compensation	-	97,357	-	-
Foreign exchange gains (losses)	4,086	21,685	-	-
Cash flow from operations	2,311,333	1,550,999	160,118	118,058
Change in non-cash working capital	(837,532)	2,360,141	193,398	3,331,113
	1,473,801	3,911,140	353,516	3,449,171
<b>Cash flows from financing activities</b>				
Repayment of demand revolving loan	385,000	(1,090,000)	25,000	(95,000)
Debenture issue	(3,500,000)	1,000,000	-	-
Repayments (advance) on loan from related company	(7,400)	139,946	162,318	166,930
Issue of share capital	-	4,085,534	11,756	168,488
Share issuance costs	-	-	52,244	(104,488)
Advances from shareholder	-	-	(69,000)	138,000
	(3,122,400)	4,135,480	182,318	273,930
<b>Cash flows from investing activities</b>				
Expenditures on petroleum and natural gas properties	761,275	(10,184,186)	(467,511)	(3,621,730)
Asset retirement obligations	644,390	644,390	-	-
	1,405,665	(9,539,796)	(467,511)	(3,621,730)
<b>Increase (decrease) in cash and cash equivalents</b>	(242,934)	(1,493,176)	68,323	101,371
<b>Cash and cash equivalents, beginning of period</b>	533,633	1,783,875	44,852	11,804
<b>Cash and cash equivalent, end of period</b>	\$ 290,699	290,699	\$ 113,175	113,175

**GUARDIAN EXPLORATION INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited – prepared by Management)**  
**For the Nine Months ended September 30, 2006**  
**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.

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 amalgamated 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.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 2 - Significant Accounting Policies** *(Continued)*

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

*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.

*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.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note 2 - Significant Accounting Policies** *(Continued)*

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

*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.

**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 is conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**For the Nine Months ended September 30, 2006**

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

**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.

**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.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited – prepared by Management)**  
**For the Nine Months ended September 30, 2006**

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

**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) 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**

	<b>September 30, 2006</b>		<b>December 31, 2005</b>	
	<b>Cost</b>	<b>Accumulated depletion and depreciation</b>	<b>Net book value</b>	<b>Net book value</b>
Petroleum and natural gas properties	\$ 33,385,881	\$ 19,612,040	\$ 13,773,841	\$4,309,694
Office equipment	276,347	1,315	275,032	0
	<b>\$ 33,662,228</b>	<b>\$ 19,613,355</b>	<b>\$ 14,048,873</b>	<b>\$4,309,694</b>

**GUARDIAN EXPLORATION INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**For the Nine Months ended September 30, 2006**

**Note 3 - Property and Equipment (continued)**

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

<b>Year</b>	<b>Alberta Par Crude CDN \$/bbl</b>	<b>AECO Natural Gas CDN \$/Mcf</b>
2006	77.70	6.85
2007	73.80	8.35
2008	69.70	8.00
2009	65.40	7.65
2010	60.90	7.25
Thereafter (inflation %)	2.5%/yr.	2.5%/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 September 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 \$714,446, which has been discounted using a credit adjusted risk free rate of 5.5% (2005 - 5.0%). An inflation factor of 2.5% 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:

	<b>September 30, 2006</b>	<b>December 31, 2005</b>
Balance, beginning of period	\$ 45,562	\$ 9,218
Liabilities incurred	648,441	33,765
Accretion expense	20,443	2,579
Balance, end of period	<u>\$ 714,446</u>	<u>\$ 45,562</u>

**GUARDIAN EXPLORATION INC.**  
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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>
Issued under contractual right to acquire	79,422	
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	(16,330,104)	
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, September 30, 2006</b>	<b>20,079,422</b>	<b>\$ 7,960,076</b>

**c) Share capital transactions during the thirteen months ended September 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 loss 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

**GUARDIAN EXPLORATION INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**For the Nine Months ended September 30, 2006**

were surrendered by the issuance of units to the agent, which are included as a reduction to share capital as share issue costs.

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

- 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. Under a contractual right to acquire shares by agreement dated December 20, 2005 between the shareholders and the Corporation, 79,422 shares were issued on June 9, 2006.
- vii. 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.

**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. Vesting terms are determined by the Board as they are granted and currently include portions vesting immediately followed by further portions vesting annually on the anniversary date of granting over a three year period.

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

	<b>September 30, 2006</b>	
	<b>Stock Options</b>	<b>Weighted Average Exercise Price (\$)</b>
Outstanding, beginning of period	-	-
Granted	1,650,000	1.10
Exercised	-	-
Expired	425,000	1.10
Outstanding, end of period	<u>1,225,000</u>	<u>1.10</u>
Exercisable, end of period	<u>1,225,000</u>	<u>1.10</u>

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

**d) Stock option plan**

The Company has recorded stock-based compensation expense of \$ 96,825 for the nine months ended September 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:

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

**e) Warrants**

A summary of the status of the common share purchase warrants as of September 30, 2006 is presented below. All warrants are exercisable into common shares at the prices and ratios shown:

<u>Issue Date</u>	<u>Warrants</u>	<u>Price Per Share</u>	<u>Expiry Date</u>
Dec. 31, 2004	159,661	\$ 1.50	Dec. 31, 2006
Sept. 16, 2005	86,294	\$ 1.94	Sept. 16, 2007
Oct. 26, 2005	393,384	\$ 0.75	Oct. 26, 2006
Oct. 31, 2005	538,734	\$ 0.75	Oct. 31, 2006
Nov. 04, 2005	289,066	\$ 0.75	Nov. 04, 2006
Nov. 09, 2005	27,209	\$ 0.75	Nov. 09, 2006
Dec. 30, 2005	350,072	\$ 1.00	Dec. 30, 2006
Mar. 30, 2006	233,582	\$ 0.65	May 11, 2007
Aug. 21, 2006	<u>783,612</u>	\$ 0.75	Oct. 21, 2009
	2,861,614		

**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.

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**Note 6 - Related Party Transactions (continued)**

During the period services were rendered to the Company in the amount of \$659,291 and loans were granted to the Company for an additional \$139,946 resulting in total indebtedness to related parties at September 30, 2006 of \$1,040,299. No specific terms of repayment have been made as of statement date.

**Note 7 - Commitments**

The Company signed a lease for office premises commencing November 1, 2003, and expiring October 31, 2008. The future minimum lease payments, excluding occupancy costs are as follows:

2006	\$ 9,736
2007	\$ 38,943
2008	\$ 32,452

**Note 8 - 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 9 - Significant Events**

**a) Property Sale**

Guardian announced on July 21, 2006 that it had 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 remains at 42.5% interest and operates the property. The \$5.5mm proceeds were used to reduce the Azimuth Opportunity Ltd. debenture by \$0.5 mm and the balance was used for general corporate working capital purposes.

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

**Note 9 - Significant Events (continued)**

**b) New Financing**

Guardian announced on August 18, 2006 that it had 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 entered into a \$1,000,000 convertible debenture financing (the “Debenture”) with Azimuth Opportunity Ltd. (the “Lender”).

The Debenture bears interest at the rate of 7% per annum (increasing to 14% if the Corporation is in default), matures 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 was 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.

**Note 10 - Subsequent Events**

Mega Production Testing Inc. has filed a claim dated October 24, 2006 relating to invoices for production testing services on the Corporation’s Clarke Lake property in the amount of \$382,921.27. Management of the Corporation has a number of issues respecting the method of delivery of the claimed services and quantum of the claimed invoices and has filed a Statement of Defence in the matter. Management of the Corporation believes this Statement of Claim to be without merit and consequently has not provided for any loss.

KC Wellsite Management Ltd. has filed a claim dated November 20, 2006 against Greyhawke Resources Ltd., Azimuth Opportunity, Ltd. And the Corporation in the amount of \$ 127,127.74 relating to unpaid services pursuant to a service agreement dated August 9, 2006. Management of the Corporation believes this Statement of Claim to be without merit and consequently has not provided for any loss.