

**GUARDIAN EXPLORATION INC.**

Management's Discussion & Analysis

For the Three and Nine Months

Ended September 30, 2009

**GUARDIAN EXPLORATION INC.**

Consolidated Interim Financial Statements

(Unaudited)

Three and Nine Months Periods Ended September 30, 2009

## **Notice to Reader**

The consolidated financial statements of Guardian Exploration Inc. and the accompanying consolidated interim balance sheets as of September 30, 2009 and the consolidated interim statements of operations and deficit and cash flows for the three and nine month periods ended September 30, 2009 are the responsibility of the Company's management.

The interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and are considered by management to present fairly the financial position, operating results and cash flows of the Company.

These interim consolidated financial statements have not been reviewed by an auditor. These interim consolidated financial statements are unaudited and include 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: November 27, 2009

Signed "*Graydon Kowal*"

Graydon Kowal  
President and Chief Executive Officer

**GUARDIAN EXPLORATION INC.  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)**

	<b>September 30 2009 \$</b>	<b>December 31 2008 \$</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	349,203	693,056
Accounts receivable	294,884	404,248
Due from related company (Note 4)	14,605	449,951
Prepaid expenses	24,815	50,640
	<u>683,507</u>	<u>1,597,895</u>
<b>Deposit</b> (Note 5)	389,308	438,380
<b>Future income taxes</b> (Note 8)	-	694,000
<b>Property and equipment</b> (Note 6)	2,815,613	4,430,541
	<u>3,888,428</u>	<u>7,160,816</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	1,641,016	2,933,038
	<u>1,641,016</u>	<u>2,933,038</u>
<b>Asset retirement obligations</b> (Note 7)	1,232,199	1,161,783
	<u>1,232,199</u>	<u>4,094,821</u>
Going Concern, Commitments and Contingencies (Notes 1, 10 & 12)		
<b>Shareholders' equity</b>		
Share capital (Note 9)	10,349,866	11,021,365
Warrants (Note 9)	1,618,440	1,618,440
Contributed surplus (Note 9)	1,679,108	1,603,505
Deficit	(12,632,201)	(11,177,315)
	<u>1,015,213</u>	<u>3,065,995</u>
	<u>3,888,428</u>	<u>7,160,816</u>

See accompanying notes to the consolidated financial statements

**Approved on behalf of the Board of Directors**

Graydon Kowal  
Director

Scott Reeves  
Director

**GUARDIAN EXPLORATION INC.**  
**CONSOLIDATED STATEMENTS OF INCOME (LOSS), COMPREHENSIVE INCOME (LOSS)**  
**AND DEFICIT**  
**(UNAUDITED)**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2009</b>	2008	<b>2009</b>	2008
	\$	\$	\$	\$
<b>Revenue</b>				
Petroleum and natural gas	<b>967,268</b>	2,220,965	<b>3,468,222</b>	4,979,033
Royalties	<b>(368,832)</b>	(51,233)	<b>(1,157,460)</b>	(223,972)
Other income	-	74,727	-	143,727
Interest income	<b>24</b>	761	<b>11,927</b>	18,363
	<b>598,460</b>	2,245,220	<b>2,322,689</b>	4,917,151
<b>Expenses</b>				
Operating	<b>312,446</b>	347,124	<b>1,204,573</b>	822,172
General and administrative	<b>334,266</b>	349,766	<b>1,286,541</b>	931,769
Bad debts recovery	-	-	-	(3,141)
Interest expense/(recovery) (Note 12a)	<b>31,196</b>	5,830	<b>(254,951)</b>	25,197
Stock-based compensation	<b>(55,908)</b>	132,342	<b>75,603</b>	324,093
Depletion, depreciation and accretion	<b>319,417</b>	468,306	<b>1,614,766</b>	1,404,624
Foreign exchange loss (gain)	<b>38</b>	(5,404)	<b>18,937</b>	(60,126)
	<b>941,455</b>	1,297,964	<b>3,945,469</b>	3,444,588
<b>Income (loss) from operations</b>	<b>(342,995)</b>	947,256	<b>(1,622,780)</b>	1,472,563
Income/(loss) attributable to settlements of accounts payable	<b>167,894</b>	-	<b>167,894</b>	-
<b>Income (loss) before income taxes</b>	<b>(175,101)</b>	947,256	<b>(1,454,886)</b>	1,472,563
<b>Future income tax recovery</b>	-	-	-	(833,000)
<b>Net income (loss) and comprehensive income (loss)</b>	<b>(175,101)</b>	947,256	<b>(1,454,886)</b>	2,305,563
<b>Deficit, beginning of period</b>	<b>(12,457,100)</b>	(7,916,335)	<b>(11,177,315)</b>	(9,274,643)
<b>Deficit, end of period</b>	<b>(12,632,201)</b>	(6,969,080)	<b>(12,632,201)</b>	(6,969,080)
<b>Net income (loss) per share (Note 9)</b>				
<b>Basic</b>	<b>(\$0.00)</b>	\$0.02	<b>(\$0.04)</b>	\$0.07
<b>Diluted</b>	<b>(\$0.00)</b>	\$0.02	<b>(\$0.04)</b>	\$0.07

See accompanying notes to these consolidated financial statements

**GUARDIAN EXPLORATION INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Cash and cash equivalents provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss)	(175,101)	947,256	(1,454,886)	2,305,563
Items not affecting cash:				
Depletion, depreciation and accretion	319,417	468,306	1,614,766	1,404,624
Future income tax recovery	-	-	-	(833,000)
Stock-based compensation	(55,908)	132,342	75,603	324,094
Income attributable to settlements of accounts payable	(167,894)	-	(167,894)	-
Foreign exchange loss (gain)	38	(5,404)	18,937	(60,126)
	(79,448)	1,542,499	86,527	3,141,155
Changes in non-cash working capital	(93,499)	(1,529,525)	(843,460)	(2,059,838)
	(172,947)	12,974	(756,933)	1,081,317
<b>Financing activities</b>				
Debentures issued	-	-	-	400,000
Debentures repaid	-	(30,000)	-	(400,000)
Advances from (repayment to) related party	(5,421)	(29,676)	435,346	(867,477)
Issuance of share capital, net of costs	-	16,170	22,501	5,365,938
	(5,421)	(43,506)	457,847	4,498,461
<b>Investing activities</b>				
Proceeds on disposition of property and equipment	75,874	-	92,013	-
Recoveries (expenditures) on property and equipment	(20,626)	226,704	(136,780)	(5,397,719)
	55,248	226,704	(44,767)	(5,397,719)
<b>Change in cash</b>	<b>(123,120)</b>	<b>196,172</b>	<b>(343,853)</b>	<b>182,059</b>
<b>Cash, beginning of period</b>	<b>472,323</b>	<b>57,913</b>	<b>693,056</b>	<b>72,026</b>
<b>Cash, end of period</b>	<b>349,203</b>	<b>254,085</b>	<b>349,203</b>	<b>254,085</b>
<b>Supplemental cash flow information</b>				
Interest paid	-	5,830	10,203	25,197
Taxes paid	-	-	-	-

See accompanying notes to these consolidated financial statements

**GUARDIAN EXPLORATION INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008  
(UNAUDITED)**

**1. BASIS OF PREPARATION**

The consolidated interim financial statements of Guardian Exploration Inc. (the “Company”) as at and for the three and nine months ending September 30, 2009 are comprised of the Company and its controlled entities. The consolidated interim financial statements are stated in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The consolidated interim financial statements have been prepared on the same basis as the annual consolidated financial statements for the year ended December 31, 2008, except as discussed in Note 3. These consolidated interim financial statements do not contain all the note disclosure required for annual financial statements and therefore should be read in conjunction with the December 31, 2008 annual audited consolidated financial statements. A copy of these are available on SEDAR ([www.sedar.com](http://www.sedar.com)).

**Going Concern**

These consolidated financial statements have been prepared by management in accordance with GAAP on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the ordinary course of business. As at September 30, 2009, the Company had a working capital deficiency of \$957,509, an accumulated deficit of \$12,632,201, and capital expenditure commitments of approximately \$1 million. Should the Company be unsuccessful in realizing the value of its current and future projects and successfully raising financing to develop its current and future projects, it may not be able to realize its assets and discharge its liabilities in the normal course of operations.

In 2008, the global credit market crisis, volatility in the price of oil and natural gas, the recession in North America and the slowdown of economic growth in the rest of the world created a substantially more volatile business environment. These conditions, which have continued into 2009, have limited certain of the Company’s previously planned business development activities and will continue to provide uncertainty for the Company in the future.

The Company’s efforts and resources are directed at developing a portfolio of projects and realizing on the value of such projects in the future. Due to numerous risks inherent in these projects, there can be no assurance the Company will be successful. While the Company seeks to mitigate risks by working with joint venture partners and developing a stable production base, the Company’s success largely depends on its ability to finance the development of existing projects and finance the acquisition and development of new projects. Financing sources may include proceeds realized from the divestiture of its petroleum and natural gas assets.

The Company’s recent operating losses, negative working capital, and uncertainty regarding its ability to obtain financing in a timely manner raises significant doubt as to the Company’s ability to continue as a going concern. If the going concern basis is not appropriate, adjustments may be necessary to the carrying amounts and classification of the Company’s assets and liabilities. The accompanying consolidated financial statements do not include any adjustments that might result if the Company is unable to continue as a going concern.

**2. NATURE OF OPERATIONS**

Guardian Exploration Inc. (“Guardian”) was incorporated in Alberta as Guardian Resources Inc. on March 27, 2001. On May 14, 2001, Guardian changed its name to Guardian Exploration Inc. and obtained Extra-provincial Registration in British Columbia on September 22, 2001. On April 21, 2006, Guardian amalgamated with Resilient Resources Ltd. (“Resilient”), a public company listed on the TSX Exchange. The amalgamated company continued under the name Guardian Exploration Inc. (the “Company”). The Company is engaged in the acquisition, exploration, and development of petroleum and natural gas properties in western Canada and the State of Montana.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

**3. CHANGES IN ACCOUNTING POLICIES**

On January 1, 2009, the Company adopted CICA Handbook Section 3064, “*Goodwill and Intangible Assets*”. The standard replaces CICA sections 3062 and 3450 and provides guidance relating to the recognition, measurement, presentation and disclosure of goodwill and intangible assets. There was no impact on the consolidated financial statements as a result of the adoption of this standard.

On January 20, 2009, the Company adopted Emerging Issues Committee abstract 173 “*Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*”. The abstract requires an entity’s own credit risk and the credit risk of counterparties to be taken into account in determining the fair value of financial assets and financial liabilities. There was no impact on the consolidated financial statements as a result of the adoption of this abstract.

Effective July 1, 2009, the Company prospectively adopted the CICA amendments to section 3855 “*Financial Instruments – Recognition and Measurement*.” Amendments to this section have prohibited the reclassification of a financial asset out of the held-for-trading category when the fair value of the embedded derivative in a combined contract cannot be reasonably measured. The adoption of the amendments to this standard did not have an impact on the consolidated financial statements.

**Future Changes in Accounting Standards**

- a) In January 2009, the CICA issued Section 1582, *Business Combinations*, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. Management is currently assessing the impact of the adoption of this section on the results of operations, financial position and disclosures.
- b) In January 2009, the CICA issued Sections 1601, *Consolidated Financial Statements*, and 1602, *Non-controlling Interests*, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. Management is currently assessing the impact of the adoption on the results of operations or financial position.
- c) In June 2009, the CICA amended Section 3862 to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The Company plans to adopt this standard prospectively effective December 31, 2009. The adoption of this standard will not have a material impact on the consolidated financial statements.

**4. DUE FROM RELATED PARTY**

Amounts owed to the Company by a director and a company controlled by that director of the Company are unsecured, bear no interest, and have no fixed terms of repayment.



**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

**5. DEPOSIT**

As part of the finalization of the Third Amended Agreement with the Blackfeet Nation, the Company has placed a deposit of \$389,308 (USD\$ 360,000) (2008 - \$438,380; USD \$360,000), in favor of the Bureau of Indian Affairs-Blackfeet Agency to cover the costs of future site restoration and abandonment liabilities. This deposit is considered to be refundable, subject to application for refund, which may or may not be granted. Accordingly, the deposit is shown as a long-term asset.

**6. PROPERTY AND EQUIPMENT**

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	<b>\$</b>	<b>\$</b>
Petroleum and natural gas properties and equipment	17,204,863	16,952,474
Accumulated depletion, depreciation and impairment	(14,389,250)	(12,521,933)
	<u>2,815,613</u>	<u>4,430,541</u>

**Canadian and US cost centers**

For the three and nine month periods ended September 30, 2009 and 2008, there were no capitalized general and administrative expenses in either the Canadian or US cost center.

Unproven property costs of \$40,000 (2008 - \$nil) have been excluded from capitalized costs subject to depletion in the Canadian cost center and \$nil (2008 - \$nil) in the US cost center.

No impairment was recorded at September 30, 2009 (September 30, 2008: \$nil). A \$2.7 million impairment in property and equipment was recorded at December 31, 2008.

**7. ASSET RETIREMENT OBLIGATIONS**

The Company's asset retirement obligations are based on the Company's net ownership in wells and facilities, management's estimates of costs to abandon and reclaim those wells and facilities, as well as an estimate of the future timing of the costs to be incurred.

The total undiscounted amount of cash flows required to settle the obligations as measured at September 30, 2009 are estimated to be \$1,739,272 (December 31, 2008 - \$1,830,000). These obligations are expected to be settled at various times until 2016. The credit-adjusted risk free rate at which the estimated cash flows were discounted was 8% during the period ended September 30, 2009 and the estimated inflation rate used to project future costs was 2.5%.

A reconciliation of the Company's asset retirement obligation is provided below:

	<b>Nine Months Ended September 30, 2009</b>	<b>Year ended December 31, 2008</b>
	<b>\$</b>	<b>\$</b>
Asset retirement obligation, beginning of period	1,161,783	876,947
Obligations incurred	-	37,020
Acquisitions	-	34,481
Revisions to obligations	-	136,122
Accretion expense	70,416	77,213
Asset retirement obligation, end of period	<u>1,232,199</u>	<u>1,161,783</u>

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

**8. INCOME TAXES**

In February 2009, the Company renounced \$2,777,110 of eligible expenditures pursuant to a flow-through share issuance in 2008. As a result, the future income tax asset was decreased by \$694,000 for the tax effect of this renouncement. A full valuation allowances continues to be taken on the Company's net future income tax asset in Canada and the United States.

**9. SHAREHOLDERS' EQUITY**

**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 and outstanding**

<b>Share Capital</b>	<b>Number of Shares</b>	<b>Amount \$</b>
<b>Balance, December 31, 2008</b>	39,737,877	11,021,365
Tax effect of flow-through shares	-	(694,000)
Share issue cost recovery	-	22,501
<b>Balance, September 30, 2009</b>	<b>39,737,877</b>	<b>10,349,866</b>

In February 2009, the Company renounced \$2,777,110 of eligible expenditures pursuant to a flow-through share issuance in 2008. As a result, share capital and the future income tax asset were decreased by \$694,000 for the tax effect of this renouncement.

<b>Warrants</b>	<b>Number of Warrants</b>	<b>Amount \$</b>
<b>Balance, December 31, 2008 and September 30, 2009</b>	8,871,300	1,618,440

On December 8, 2008, the Corporation announced that it was commencing a Normal Course Issuer Bid (the "Bid") whereby it may purchase for cancellation up to 3,009,322 common shares of the Corporation in the open market, until expiry of the Bid in December 2009. Since the Corporation's announcement of the Bid no common shares have been repurchased.

**c) Stock options**

The Company has a stock option plan under which directors, officers, employees and consultants are eligible to receive stock option grants. The stock options issued shall not exceed 10% of the issued shares of the Company at the time of granting of options. The exercise price and vesting terms of any options granted are fixed by the Board of Directors of the Company at the time of grant. The following table outlines the stock option plan activity:

	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
<b>Balance, December 31, 2008</b>	2,950,000	\$0.40
Forfeited	(1,050,000)	(\$0.27)
<b>Balance, September 30, 2009</b>	<b>1,900,000</b>	<b>\$0.44</b>
<b>Exercisable, September 30, 2009</b>	<b>1,900,000</b>	<b>\$0.44</b>

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

<b>Exercise Prices</b>	<b>Stock options outstanding</b>			<b>Stock options exercisable</b>	
	<b>Outstanding Options</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>	<b>Options Exercisable</b>	<b>Weighted Average Exercise Price</b>
\$0.150	800,000	\$0.150	3.0	800,000	\$0.150
\$0.220	200,000	\$0.220	3.3	200,000	\$0.220
\$0.285	400,000	\$0.285	0.6	400,000	\$0.285
\$1.100	500,000	\$1.100	0.5	500,000	\$1.100
	1,900,000	\$0.44	1.9	1,900,000	\$0.44

**d) Warrants**

	<b>Number of Warrants</b>	<b>Weighted Average Exercise Price</b>
<b>Balance, December 31, 2008 and September 30, 2009</b>	8,871,300	\$0.32

**e) Agent Warrants**

	<b>Number of Warrants</b>	<b>Weighted Average Exercise Price</b>
<b>Balance, December 31, 2008 and September 30, 2009</b>	1,816,600	\$0.28

**f) Debenture warrants**

	<b>Number of Warrants</b>	<b>Weighted Average Exercise Price</b>
<b>Balance, December 31, 2008 and September 30, 2009</b>	783,613	\$1.53

All debenture warrants expired unexercised subsequent to September 30, 2009.

**g) Contributed surplus**

	<b>2009</b>	<b>2008</b>
	<b>\$</b>	<b>\$</b>
Balance, beginning of period	1,603,505	878,990
Issue/exercise of agent warrants	-	206,621
Stock-based compensation	75,603	517,794
<b>Balance, end of period</b>	<b>1,679,108</b>	<b>1,603,505</b>

**h) Earnings per share**

Basic per share amounts are calculated using the weighted average number of shares outstanding of 39,737,877 for the three and nine months ended September 30, 2009 (2008: 39,438,175 and 33,004,480 for the three and nine months respectively).

The Company's dilutive instruments have not been included in the computation of income (loss) per share as the effect would be anti-dilutive (consistent with 2008).

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

**10. COMMITMENTS**

**a) Flow-through share issuance**

Pursuant to a flow-through share issuance completed in 2008, the Company is committed to incur \$2,777,110 of qualified expenditures by December 31, 2009. At September 30, 2009, approximately \$1.8 million of the obligation has been fulfilled. The expenditures were renounced to investors in February 2009.

**b) Employment contract**

Under the terms of an employment contract with the Chief Executive Officer, the Company is committed to pay severance under certain circumstances equal to 2 years salary plus 15%.

**c) Office sub-lease**

The Company is currently committed to sub-lease payments of approximately \$2,100 per month through February 2010.

**11. RELATED PARTY TRANSACTIONS**

- a)** The balance in the Due from Related Party account has decreased from \$449,951 at December 31, 2008 to \$14,605 at September 30, 2009 due primarily to repayments to the Company of approximately \$438,000 in the second quarter. This was offset by an advance of \$100,000 to the related party during the third quarter of which \$50,000 was repaid by September 30, 2009.

The Company also received helicopter services in conjunction with the servicing of natural gas wells in Northern B.C. from a company controlled by a major shareholder and director of the Company. The Company was charged \$38,744 for the nine months ended September 30, 2009 (2008: \$273,329), which was paid in 2009 via a reduction in the Due from Related Party account.

- b)** The Company obtained engineering consulting services in the amount of \$23,460 for the nine months ended September 30, 2009 (2008: \$190,575) from a company controlled by a Company director, who was appointed in 2008. A balance of \$123,888 is included in accounts payable and accrued liabilities at September 30, 2009 (December 31, 2008: \$180,729).
- c)** Legal fees in the amount of \$43,057 for the nine months ended September 30, 2009 (2008: \$62,804) have been incurred from a legal firm of which a Company director, who was appointed in 2006, is a partner. A balance of \$nil is included in accounts payable and accrued liabilities at September 30, 2009 (December 31, 2008: \$4,358).

These transactions are in the normal course of business and are recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

**12. CONTINGENCIES**

**a) Flow-through shares**

Pursuant to a flow-through share issuance completed in March 2006, the Company was committed to incur \$4,000,000 of qualified expenditures by December 31, 2007. The Company had originally disclosed in its 2007 and 2008 financial statements that it had failed to incur \$1,850,000 of qualified expenditures. The Company, in consultation with its advisors, has now determined, based on a subsequent technical review of its 2006 drilling program, that it has met its obligations to incur \$4,000,000 of qualified expenditures by December 31, 2007. As a result, the accrued liability for interest and penalties was reduced by approximately \$296,000 in the first quarter of 2009, resulting in a recovery of interest expense.

However, there can be no assurance that the tax authorities will agree with the Company's evaluation of the 2006 drilling results. If the tax authorities were to successfully challenge the Company's evaluation of the 2006 drilling results, the Company could be liable for additional Part XII.6 tax, interest and penalties of approximately \$350,000.

**b) Mineral Management Services**

The Mineral Management Service ("MMS"), a bureau of the US Department of the Interior that manages that nation's natural gas and oil resources, alleged during the year that a subsidiary of the Company had been deficient in various administrative filing requirements in the past and that, as a result, civil penalties of approximately \$578,000 (US\$500,000) were being levied against the subsidiary. The subsidiary is disputing these penalties and, along with its legal counsel, has been negotiating with MMS, its collection agencies and its counsel towards a satisfactory resolution of this matter.

A provision of \$86,900 (US\$80,000) has been made for these civil penalties. This provision has been based on a settlement with the collection agency representing MMS (US\$50,000), and a probationary settlement arrangement made directly with MMS (US\$30,000). The details of the settlements have yet to be finalized but have been agreed to in principle.

The current draft of the settlement with MMS includes a probationary portion of the agreement that requires the subsidiary to remain compliant with its reporting requirements over a 36 month time frame, otherwise the full amount of the penalties, reduced on a declining basis for the period of compliance, will be due immediately to MMS. The subsidiary has been compliant with its reporting requirements since June 2008, and it is anticipated that the compliant months since then will go toward the 36 month requirement.

**c) Other**

The Company is also involved in various other claims arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favour, the Company does not currently believe that the outcome of adverse decisions in any proceedings related to these matters or any amount which it may be required to pay would have a material adverse impact on its financial position, results of operations or liquidity.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

**13. SEGMENTED DISCLOSURES**

For the nine month period ended September 30, 2009:

	<b>Canada</b>	<b>United States</b>	<b>September 30, 2009</b>
Petroleum and natural gas revenue	\$2,945,414	\$522,807	\$3,468,222
Interest expense (recovery)	(\$261,841)	\$6,890	(\$254,951)
Depletion, depreciation and accretion	\$1,513,251	\$101,515	\$1,614,766
Loss for the period	\$1,344,834	\$110,052	\$1,454,886
Property and equipment	\$2,468,899	\$346,714	\$2,815,613

For the nine month period ended September 30, 2008:

	<b>Canada</b>	<b>United States</b>	<b>September 30, 2008</b>
Petroleum and natural gas revenue	\$4,073,286	\$905,747	\$4,979,033
Interest expense	\$17,097	\$8,100	\$25,197
Depletion, depreciation and accretion	\$1,288,154	\$116,470	\$1,404,624
Income for the period	\$2,017,084	\$288,479	\$2,305,563
Property and equipment	\$6,492,407	\$1,292,067	\$7,784,474

**14. FINANCIAL INSTRUMENTS AND CAPITAL MANAGEMENT**

**a) Fair value of financial assets and liabilities**

The Company's carrying value of cash, accounts receivable, accounts payable, and due from related company approximates their fair values due to the immediate or short-term maturity of these instruments. The carrying value of the deposit (Note 5) also does not differ significantly from its fair value.

**b) Interest rate risk**

At September 30, 2009, the Company is not exposed to interest rate risk.

**c) Commodity price risk**

The nature of the Company's operations results in an exposure to fluctuations in commodity prices. At September 30, 2009, the Company had no financial derivative or physical delivery contracts in place.

**d) Currency risk**

Currency risk is the risk to the Company's earnings that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company is exposed to currency risk on the translation of its U.S. dollar denominated subsidiary. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

**e) Capital Management**

The Company's objective when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders. The Company

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company's objective is met by retaining adequate equity to guard against the possibility that cash flows from assets will not be sufficient to meet future cash flow requirements. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year over year sustainable growth in net income and funds flow. There have been no changes to the Company's objectives in managing capital or in management's management of capital since December 31, 2008.

The capital structure of the Company is as follows:

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	<b>\$</b>	<b>\$</b>
Total shareholders' equity	1,015,213	3,065,995
Total shareholders' equity as a percentage of total capital	51%	70%
Working capital deficiency	957,509	1,335,143
Total indebtedness	957,509	1,335,143
Total indebtedness as a percentage of total capital	49%	30%
Total Capital	1,972,722	4,401,138

**f) Credit Risk**

Credit risk arises when a failure by counter parties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. A majority of the Company's credit risk arises when a failure by counter parties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. The Company is subject to credit risk on its cash and accounts receivable. The Company's cash is held at major financial institutions and as such is subject to credit risk. A majority of the Company's accounts receivable at the balance sheet date arise from crude oil, natural gas liquids and natural gas sales. Industry standard dictates that commodity sales are settled on the 25th day of the month following the month of production.

The Company assesses quarterly if there has been any impairment of the financial assets of the Company. The Company does not have any significant credit risk exposure to any single counterparty other than to the operator of its Girouxville area wells. As at September 30, 2009, the receivable from this company represented approximately 73% of the Company's total accounts receivable balance. This balance was collected subsequent to period-end.

The carrying value of cash and accounts receivable approximates their fair value due to the relatively short periods to maturity on this instrument. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Company considers past due.

**g) Liquidity Risk**

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value less than what they are worth; or
- The Company may be unable to settle or recover a financial asset at all.

The Company's operating cash requirements, including amounts projected to complete the Company's existing capital expenditure program, are continuously monitored and adjusted as input variables change.

**GUARDIAN EXPLORATION INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008**  
**(UNAUDITED)**

These variables include but are not limited to oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects and regulations relating to prices, taxes, royalties, land tenure, allowable production and availability of markets. As these variables change, liquidity risks may necessitate the Company to conduct equity issues, obtain project debt financing, enter into joint venture arrangements or conduct asset divestitures. There is no assurance that adequate funds will be available to the Company in a timely manner (refer Note 1 Going Concern). All financial liabilities mature within one year.

**17. SUBSEQUENT EVENTS**

**a) Proposed Amalgamation with Luxor Oil & Gas Inc**

In September 2009, the Company signed a Letter of Intent with Luxor Oil & Gas Inc. ("Luxor"), an Alberta based private oil and gas company, to amalgamate the two companies. The amalgamation as proposed involved an exchange of the existing share capital in both the Company and Luxor at specified ratios for shares in a new company.

The proposed amalgamation was terminated in November 2009. A termination fee of \$10,000 was paid by the Company to Luxor as part of the termination and mutual release process.

**b) Farm-Out and Participation Agreement**

In October 2009, the Company signed a Farm-Out and Participation Agreement with Castle Rock Petroleum Ltd ("Castle Rock"), a wholly owned subsidiary of Arrow Energy Ltd, whereby in return for a drilling commitment on a particular well ("test well"), the Company can earn a 6% interest in certain property interests held by Castle Rock in the Pembina region of Alberta. The commitment represents 10% of the estimated cost to drill and case the test well, and the Company's share is estimated at \$250,000. In November 2009, the Company paid a cash call in the amount of \$250,040 to Castle Rock. The expenditure reduces the Company's remaining capital expenditure commitments with regard to the 2008 flow-through share issue (refer Note 10a and Note 1 Going Concern) to approximately \$0.75 million. The cash call was funded by a related party loan.

As part of the agreement, the Company provided an option to Castle Rock to re-purchase the 6% earned interest for an amount equivalent to the costs incurred by the Company, plus \$15,000. The option expires 90 days after first production from the test well, and may be exercised no sooner than January 1, 2010.



## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management discussion and analysis ("MD&A") of financial conditions and results of operations is as of November 27, 2009 and should be read in conjunction with the unaudited consolidated financial statements of Guardian Exploration Inc. ("Guardian" or the "Company") for the three and nine months ended September 30, 2009 and the audited consolidated financial statements for the years ended December 31, 2008. Additional information relating to the Company can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com).

Discussion with regard to Guardian's current financial position and outlook for the remainder of 2009 is based on currently available information. The financial data presented below has been prepared in accordance with Canadian generally accepted accounting principles (GAAP). The reporting and operating currency is the Canadian dollar. The information in this MD&A was approved by the Company's Board of Directors on November 27, 2009.

This MD&A contains the terms "funds flow from operations", "funds flow per share" and "operating netback" which do not have standardized meanings prescribed by Canadian GAAP and therefore may not be comparable to performance measures presented by others. Funds flow from operations, as used by the Company, is comprised of cash flow from operating activities before changes in non-cash operating working capital. Operating netback represents revenue less royalties, operating expenses and transportations expenses. These non-GAAP measures may not be comparable to the calculation of similar measures for other entities. The Company believes that operating netback and funds flow from (used by) operations represent indicators of the Company's performance and a key measure of the Company's ability to generate the necessary cash to fund future capital expenditures. Funds from (used by) operations and operating netback as presented is not intended to represent operating cash flow or operating profits for the period nor should they be viewed as an alternative to cash flow from operating activities, net earnings (loss) or other measures of financial performance calculated in accordance with Canadian GAAP. See "Funds Flow from Operations" and "Netbacks".

The term barrels of oil equivalent ("boe") may be misleading, particularly if used in isolation. A boe conversion ratio of 6 thousand cubic feet (mcf) equals 1 barrel (bbl) is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. All boe conversions in this report are derived by converting gas to oil in the ratio of six thousand cubic feet of gas to one barrel of oil.

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain information regarding the Company set forth in this report includes forward looking statements. All statements other than statements of historical facts contained in this MD&A, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "should," "plan," "expect" and similar expressions, as they relate to us, are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions described elsewhere in this report.

Other sections of this report may include additional factors, which could adversely affect our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Readers are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur, which may cause the Company's actual performance and financial results in future periods to differ materially from any estimates or projections of future performance or results expressed or implied by such forward-looking statements.

We undertake no obligation to update publicly or revise any forward-looking statements. The forward-looking statements in this report are expressly qualified by this cautionary statement.

## **CORPORATE OVERVIEW**

Guardian Exploration Inc. (“Guardian”) was incorporated in Alberta as Guardian Resources Inc. on March 27, 2001. On May 14, 2001, Guardian changed its name to Guardian Exploration Inc. and obtained Extra-provincial Registration in British Columbia on September 22, 2001. On April 21, 2006, Guardian amalgamated with Resilient Resources Ltd. (“Resilient”), a public company listed on the TSX Exchange. The amalgamated company continued under the name Guardian Exploration Inc. (the “Company”). The Company is engaged in the acquisition, exploration, and development of petroleum and natural gas properties in western Canada and the State of Montana. The Company’s shares trade on the TSX Venture Exchange under the symbol “GX”.

## **CORPORATE UPDATE**

The third quarter of 2009 saw a continuation of the conditions prevailing during the first half of the year, including declining oil production from the Company’s three main producing wells at Girouxville, offset somewhat by improved oil prices. The Company recorded a loss for the third quarter of \$175,101 on revenue of just under \$1 million and average daily oil production of 146 barrels. For the nine months ended September 30, 2009 the Company recorded a loss of \$1,454,886 on revenue of \$3.5 million and average daily production of 220 boe.

As at September 30, 2009 the Company had a working capital deficiency of \$957,509 and capital expenditure commitments of approximately \$1 million in relation to flow-through funds raised in 2008.

As disclosed in the MD&A for the second quarter of 2009, in April 2009 the board of directors approved a decision by management to engage an agent to commence the sale of substantially all of the Company’s property and equipment. In September 2009, the Company signed a Letter of Intent with Luxor Oil & Gas Inc. (“Luxor”), an Alberta based private oil and gas company, to amalgamate the two companies. The amalgamation was to involve an exchange of the existing share capital in both the Company and Luxor at specified ratios for shares in a new company. The proposed amalgamation was terminated in November 2009. A termination fee of \$10,000 was paid by the Company to Luxor as part of the termination and mutual release process.

In October 2009, the Company signed a Farm-Out and Participation Agreement with Castle Rock Petroleum Ltd (“Castle Rock”), a wholly owned subsidiary of Arrow Energy Ltd, whereby in return for a drilling commitment on a particular well (“test well”), the Company can earn a 6% interest in certain property interests held by Castle Rock in the Pembina region of Alberta. The commitment represents 10% of the estimated cost to drill and case the test well, and the Company’s share is estimated at \$250,000. In November 2009, the Company paid a cash call in the amount of \$250,040 to Castle Rock. The expenditure reduces the Company’s remaining capital expenditure commitments with regard to the 2008 flow-through share issue (refer Note 10a and Note 1 Going Concern to the interim financial statements) to approximately \$0.75 million. The cash call was funded by a related party loan.

As part of the agreement, the Company provided an option to Castle Rock to re-purchase the 6% earned interest for an amount equivalent to the costs incurred by the Company, plus \$15,000. The option expires 90 days after first production from the test well, and may be exercised no sooner than January 1, 2010.

The Company is currently evaluating a number of other options to finance both its capital commitments and ongoing operations/working capital needs. These alternatives may include the sale of certain oil and gas assets, a shareholder loan, or combination thereof.

## SELECTED INFORMATION

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
	\$	\$	\$	\$
Petroleum and natural gas revenue, before royalties	967,268	2,220,965	3,468,222	4,979,033
Funds flow from (used in) operations	(79,448)	1,542,499	86,529	3,141,155
Funds flow from (used in) operations per share - basic	(\$0.00)	0.04	\$0.00	0.09
Funds flow from (used in) operations per share - diluted	(\$0.00)	0.04	\$0.00	0.09
Net income (loss)	(175,101)	947,256	(1,454,886)	2,305,563
Net income (loss) per share - basic	(0.00)	0.02	(0.04)	0.07
Net income (loss) per share - diluted	(0.00)	0.02	(0.04)	0.07
Capital expenditures (proceeds on disposition and settlement gains)	(55,248)	(226,704)	44,767	5,397,719
Production (boe/day)	146	232	220	180
		<b>September 30 2009</b>	<b>December 31 2008</b>	
Working capital deficiency		\$957,509	\$1,335,143	
Total assets		\$3,888,428	\$7,160,816	

## RESULTS OF OPERATIONS

### PRODUCTION

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
	<b>Production (boe/day)</b>			
Crude oil	146	179	209	139
Natural gas	0	53	11	41
Oil equivalent production	146	232	220	180

The increase in crude oil production for the nine months ended September 30, 2009 in comparison to the 2008 is attributed primarily to three wells in the Girouxville area that were completed and placed on production throughout various periods in 2008 under the farm-in agreement with Breaker. The three wells produced an average of 174 boe/day during the nine months ended September 30, 2009 as compared with 107 boe/day over the same period in 2008.

Oil production for the third quarter of 2009, however, was lower than the third quarter of 2008, reflecting production declines in the Girouxville wells, all of which were on production in the third quarter of 2008.

Production from the Company's subsidiary in Montana in 2009 remained consistent with 2008, at approximately 35 boe/day.

Guardian's gas production was shut-in in February 2009 due to uneconomic conditions from increasing amounts of water and decreasing amounts of gas being produced. The Company's independent reserve engineers determined at December 31, 2008 that the two producing wells in 2008 no longer had any economic proven reserves.

## PRICING

### Benchmark Prices

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
	Crude oil – WTI (US\$ per Bbl)	\$68.19	\$117.98	\$56.86
Crude oil – Edmonton Par Price (\$ per Bbl)	\$71.71	\$122.91	\$62.68	\$116.28
Natural gas – AECO Spot (\$/mcf)	\$3.11	\$9.21	\$4.13	\$8.54
Exchange rate (\$US/\$Cdn)	1.10	1.04	1.17	1.11

West Texas Intermediate at Cushing, Oklahoma (“WTI”) is the benchmark reference price for North American crude oil prices. Canadian crude oil prices are based upon the average of several postings, primarily at Edmonton Alberta, and represents the WTI price adjusted for quality and transportation differentials, the US/CDN dollar exchange rate and local demand and supply influences.

For the three and nine months ended September 30, 2009, WTI crude oil prices averaged US\$68.19 and \$56.86 per barrel and \$71.71 and \$62.68 respectively per barrel at Edmonton. The recovery in oil prices over the summer months is evident in these figures, although prices are still well below the very high prices experienced in 2008.

United States natural gas prices are commonly referenced to the New York Mercantile Exchange at Henry Hub in Louisiana (“NYMEX”) while Canadian natural gas prices are typically referenced to the AECO Hub in Alberta. Natural gas prices are influenced more by North American supply and demand than global fundamentals. Natural gas prices averaged \$3.11/Mcf and \$4.13/Mcf respectively for the three and nine months ended September 30, 2009, reflecting the recessionary conditions and excess supply in the gas market.

### Realized Prices

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
	<b>Average Prices</b>			
Crude oil (\$/bbl)	\$71.80	\$125.74	\$59.51	\$116.76
Natural gas (\$/mcf)	-	6.12	\$4.08	8.03
Oil equivalent (\$/boe)	\$71.80	\$105.29	\$57.83	\$100.99

Guardian’s averaged realized price for its crude oil was \$71.80 and \$59.51 per barrel for the three and nine month periods ended September 30, 2009, reflecting the Edmonton benchmark prices described above. Realized prices are well below 2008, again reflecting the lower price environment in 2009.

For the nine months ended September 30, 2008 the Company’s average realized price for its natural gas was \$4.08/mcf compared to \$8.03/mcf in the prior period. The nine months ended September 30, 2009 represented one month of production because the Kotcho field was shut-in due to uneconomic conditions as noted previously.

## REVENUE

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Production Revenue</b>				
Crude oil	\$967,268	\$2,042,862	\$3,397,920	\$4,433,156
Natural gas	-	178,103	\$70,302	545,877
Total production revenue	\$967,268	\$2,220,965	\$3,468,222	\$4,979,033

The year-to-date decrease in crude oil revenue is largely due to the lower commodity prices of 2009 compared to 2008, while the more pronounced decline in revenue for the third quarter as compared to 2008 reflects both lower prices and declining production at the three Girouxville wells.

The decrease in natural gas revenue is attributable to decreased production following the Company's Kotcho property being shut-in during the first quarter of 2009, as noted previously.

The Company currently has no financial derivatives or physical delivery contracts in place. All production volumes are currently sold into the spot market.

## ROYALTIES

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Royalties	\$368,832	51,223	\$1,157,460	223,972
As a percentage of revenue	38%	2%	33%	4%

The increase in royalty percentage for the three and nine months ended September 30, 2009 from the comparative periods in 2008 is due primarily to the fact that the Company's three wells at Girouxville no longer qualify for the one year, \$1 million Alberta royalty holiday, which ceased in late 2008 for two of the wells and January 2009 for the other. As a result of the higher royalty rates applicable under the New Royalty Framework the Company expects that the royalties as a percentage of sales will remain at or around present levels, barring any significant changes in well productivity levels and/or commodity prices.

The Company's royalties as a percentage of sales on its Cutbank, Montana production remained consistent with 2008 levels.

## OPERATING EXPENSES

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Operating expenses	\$312,446	\$347,124	\$1,204,573	\$822,172
Operating expenses per boe	\$23.19	\$16.46	\$20.09	\$16.68
As a percentage of revenue	32%	16%	35%	17%

The increase in overall operating costs on a per boe basis during the three and nine months ended September 30, 2009 compared to the same periods in 2008 is due mainly to a delay in recording operating costs relating to 2008 by the operator of Girouxville. In addition, particularly in the third quarter of 2009, the impact of fixed operating costs on lower volumes contributed to the higher per boe cost.

On a percent of revenue basis, the significant increase in operating expenses for 2009 is due primarily to the decreased commodity price environment.

#### GENERAL AND ADMINISTRATIVE EXPENSES

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
General and administrative expenses	\$334,206	\$349,766	\$1,286,541	\$931,768
As a percentage of revenue	35%	16%	37%	19%

The increase in overall G&A expenses during 2009 is due to the utilization of increased staffing, compensation and consulting levels arising from the increased operational activities of the Company during the period. In addition, significant consulting and professional fees have been incurred in relation to the legal and regulatory matters involved in the preparation for the sale of substantially all of the Company's petroleum and natural gas assets. As a percentage of revenue, G&A expenses were also impacted negatively due to the lower commodity prices experienced in 2009 compared to the same periods of 2008.

#### STOCK-BASED COMPENSATION

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Stock-based compensation expense (recovery)	(\$55,908)	\$132,342	\$75,603	\$324,094

Stock-based compensation expense is the amortization over the vesting period of the fair value of stock options granted to employees, directors, and key consultants of the Company. The fair value of the stock options granted is estimated at the grant date using the Black Scholes option pricing model.

Stock-based compensation for the three months ended September 30, 2009 was a recovery of \$55,908 due to the reversal of previously recorded expense in relation to a number of options that were forfeited during the year. The year-to-date expense of \$75,603 is down significantly from 2008, due in part to the \$55,908 expense reversal but more generally due to the decreased number of options issued and outstanding, which have not fully vested.

#### INTEREST EXPENSE

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Interest expense (recovery)	\$31,172	\$5,830	(\$243,024)	\$25,197

Interest expense (recovery) and financing fees for the three months ended September 30, 2009 increased as compared to the same period in 2008 due mainly to an accrual for Part XII.6 tax due to Canada Revenue Agency in relation to flow-through funds raised in 2008. The year-to-date recovery of interest expense is due mainly to a reduction of \$296,000 in the amount of Part XII.6 tax owing in relation to flow-through funds raised in 2006, as outlined in the 'Guarantees, Contingencies and Off-Balance Sheet Arrangements' section of the MD&A.

## DEPLETION, DEPRECIATION AND ACCRETION

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Depletion, depreciation and accretion (“DD&A”) expense	\$319,417	\$468,306	\$1,614,766	\$1,404,624
DD&A expense per boe	\$23.71	\$22.20	\$26.93	\$28.49

Depletion of the Company’s oil and gas assets is calculated on a unit of production basis, using estimated proven reserves. The movements in depletion, depreciation and accretion expense for the three and nine months ended September 30, 2009 as compared to the same period in 2008 primarily reflects production levels. On a per boe basis, year-to-date DD&A is lower than in 2008, reflecting the impact of write-downs of property, plant and equipment recorded at the end of 2008.

Accretion of the asset retirement obligation contributed approximately \$25,000 and \$71,000 to DD&A expense for the respective three and nine months ended September 30, 2009. This cost reflects the unwinding of the discounted cash flows which form the basis for the asset retirement obligation.

The provision for asset retirement obligations are determined by management in consultation with the Company’s independent engineers and are based on prevailing regulations, costs, technology and industry standards. The Company estimates that the present value of its asset retirement obligations at September 30, 2009 is \$1,232,199. Current expenditures for actual abandonment and site restoration in the three and nine months ended September 30, 2009 were \$nil.

## TAXES

During the three months ended September 30, 2009 and 2008, the Company recorded no current or future income tax expense. In 2008, a future tax recovery of \$833,000 was recorded, as a result of the use of unrecognized tax pools to offset the \$833,000 future tax liability recorded on the issuance of flow-through shares during the second quarter of 2008.

As of September 30, 2009, the Company has approximately \$8.6 million in resource tax pools available to offset future taxable income.

## NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Net income (loss)	(175,101)	947,256	(1,454,886)	2,305,563
Net income (loss) - per basic share	(\$0.00)	\$0.02	(\$0.04)	\$0.07
Net income (loss) - per diluted share	(\$0.00)	\$0.02	(\$0.04)	\$0.07
Weighted average shares outstanding:				
Basic	39,737,877	39,438,175	39,737,877	33,004,480
Diluted	39,737,877	39,748,985	39,737,877	33,505,243

For the three months ended September 30, 2009 and 2008, all outstanding stock options and warrants are anti-dilutive and have been excluded in calculating the diluted weighted average shares outstanding.

## FUNDS FLOW FROM OPERATIONS

It is management's view that funds flow from operations is a useful measure of performance and a good benchmark when comparing results from period to period. Funds flow from operations is a non-GAAP measure, reconciled with net income (loss) in the table below:

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Net income (loss)</b>	(\$175,101)	\$947,256	(\$1,454,886)	\$2,305,563
Add back (subtract) items not effecting cash:				
Depletion, depreciation and accretion	319,417	468,306	1,614,766	1,404,624
Future income tax recovery	-	-	-	(833,000)
Stock-based compensation	(55,908)	132,342	75,603	324,094
Gain attributable to settlement of accounts payable	(167,894)	-	(167,894)	-
Foreign exchange loss (gain)	38	(5,404)	18,937	(60,126)
<b>Funds flow from (used in) operations</b>	<b>(79,448)</b>	<b>\$1,542,499</b>	<b>86,527</b>	<b>\$3,141,155</b>
Funds flow per share - basic	(\$0.00)	\$0.04	\$0.00	\$0.09
Funds flow per share - diluted	(\$0.00)	\$0.04	\$0.00	\$0.09

Funds from operations were much higher in 2008, as a result of greater revenue from higher realized prices for oil and natural gas. As well, royalty charges and general and administrative costs have been comparatively higher in 2009.

## SHARE CAPITAL

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Outstanding common shares</b>				
Basic	39,737,877	39,461,343	39,737,877	39,461,343
Diluted	39,737,877	54,082,855	39,737,877	54,082,855

Due to the anti-dilutive effect of Guardian's net loss for the three and nine months ended September 30, 2009, the diluted number of shares is equivalent to basic number of shares.

Outstanding Securities	Outstanding at September 30	
	2009	2008
Common shares	39,737,877	39,461,343
Stock options	1,900,000	3,150,000
Warrants	8,871,300	8,871,300
Agent warrants	1,816,600	1,890,100
Debenture warrants	783,613	783,613

As of the date of this MD&A, there were 39,737,877 common shares issued and outstanding.

On December 8, 2008, the Corporation announced that it was commencing a Normal Course Issuer Bid (the "Bid") whereby it may purchase for cancellation up to 3,009,322 common shares of the Corporation in the open market, until expiry of the Bid in December 2009. As of the date of this MD&A, no common shares have been repurchased.



## LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2009, the Company had no bank credit facility, a working capital deficit of \$957,509, and capital expenditure commitments of approximately \$1 million. The future operations of the Company are dependent on the Company's ability to raise capital through debt, equity or through the sale of certain of its assets to support its activities and meet its obligations as outlined in Note 1 to the interim consolidated financial statements, and receiving the continuing financial support from its creditors.

As outlined in the Corporate Overview section of this MD&A, the Company is pursuing various options to raise funds to meet its capital commitments, working capital deficiency, and ongoing operating activities.

The capital intensive nature of the Company's activities may create a negative working capital position in high levels of capital investment. The industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of crude oil and natural gas. This occurs for all the Company's Canadian operations on the 25<sup>th</sup> day following the month of sale. As a result, the Company's production revenues are collected in an orderly fashion. To the extent that the Company has joint venture partners in its activities it will attempt to collect on a monthly basis the partner's share of capital and operating expenses. These are subject to collection risk. The Company has experienced a significant amount of uncollectible accounts receivable in the past.

The Company's cash flow and earnings are highly sensitive to changes in commodity prices, exchange rates and other factors that are beyond the control of the Company.

## SUMMARIZED QUARTERLY INFORMATION

SELECTED QUARTERLY HIGHLIGHTS (unaudited)	2009			2008				2007
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
	2009	2009	2009	2008	2008	2008	2008	2007
(\$000's)								
P&NG net revenue	598	883	830	1,542	2,170	2,033	621	467
Production expense	312	375	518	987	347	283	192	156
DDA/impairment	319	467	828	4,315	468	777	159	523
G&A	334	512	440	530	350	350	232	479
Financing fees/interest	31	1	(287)	(13)	6	19	-	387
Income tax expense (recovery)	-	-		133	-	(833)	-	(1,200)
Net Income (loss) for the period	(175)	(503)	(777)	(4,209)	947	1,066	292	(1,912)
Net Income (loss) per share	(0.00)	(0.01)	(0.02)	(0.12)	0.02	0.04	0.01	(0.09)
Working Capital/(Deficiency)	(958)	(1,012)	(1,299)	(1,335)	(825)	(2,610)	(5,327)	(3,934)

The impact of higher oil and natural gas prices is evident during the first three quarters of 2008, the only recent quarters where the Company has recorded an after-tax profit. The impairment charge of \$2.7 million recorded at December 31, 2008 also stands out.

The Company's working capital position has fluctuated over the past eight quarters, dependent primarily on the timing of equity raisings and extent of exploration and development activities.

## CRITICAL ACCOUNTING ESTIMATES

### Oil and Gas Reserve Estimates

Estimates of economically recoverable oil and natural gas reserves (including natural gas liquids) and the future net cash flows therefrom are based upon a number of variable factors and assumptions, such as commodity prices, projected production from the properties, the assumed effects of regulation by government agencies and future operating costs. All of these estimates may vary from actual results. Estimates of the recoverable oil and natural gas reserves attributable to any particular group of properties, classifications of such reserves based on risk recovery

and estimates of future net revenues expected therefrom may vary. The Company's actual production, revenues, taxes, development and operating expenditures with respect to its reserves may vary from such estimates, and such variances could be material.

### **Ceiling Test**

The ceiling test calculation is used to assess the valuation of the Company's petroleum and natural gas properties. The first part measures whether impairment has occurred based on undiscounted future cash flows using estimated future prices, costs and proved reserves. When the first part indicates impairment exists, the second part of the test measures the amount of impairment based on discounted estimated future cash flows from proved and probable reserves. The Company reviews the related estimates when it performs its ceiling test on a quarterly basis. The impact of changes in the estimates of future prices and costs applied and the quantity of proved and probable reserves on the financial statements could be material.

### **Unproven Properties**

Costs related to unproven properties are excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly, based on management's estimates of future prospects and any impairment is transferred to the costs being depleted.

### **Stock-Based Compensation**

The Company has a stock-based compensation plan which reserves shares of common stock for issuance to key employees, consultants and directors. The Company accounts for grants issued under this plan using the fair value recognition provisions whereby the cost of options granted to employees is charged to income with a corresponding increase in contributed surplus, based on an estimate of the fair value determined using the Black-Scholes option pricing model and amortized over the vesting period of the options issued.

### **Asset Retirement Obligations**

The Company records the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the asset, normally when the asset is purchased or developed. The associated asset retirement costs are capitalized as part of the carrying amount of the long lived asset and depleted and depreciated using a unit-of-production method over the life of the estimated proved reserves. Subsequent to the initial measurement of the asset retirement obligations, the obligations are adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation.

Inherent in the fair value calculation of ARO are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement, and changes in the legal, regulatory, environmental and political environments. To the extent future revisions to these assumptions impact the fair value of the existing ARO liability, a corresponding adjustment is made to the petroleum and natural gas properties balance.

## **BUSINESS RISKS**

Exploration, development and production of petroleum and natural gas involves many risks that even the combination of experience and diligent evaluation may not be sufficient to overcome. Utilizing highly skilled professionals, focusing in areas where the Company has existing knowledge and expertise or access to such expertise, using the most up to date technology, and controlling costs to maximize margins, mitigate these risks. The Company maintains a comprehensive insurance program that insures liability and property consistent with good industry practices. The program is designed to mitigate risks and protect against significant loss. However, the Company is not fully insured against all these risks, nor are all such risks insurable.

The reserve and recovery information contained in the Company's independent reserve evaluation is only an estimate. The actual production and ultimate recovery of reserves from the properties may be greater or less than the estimates prepared by the independent reserve engineers. The reserve report was prepared using forecasted commodity prices as determined by independent engineers. If lower prices for crude oil, natural gas liquids and

natural gas are realized by the Company, the present value of the estimated future cash flows for the reserves would be reduced and such reductions could be significant.

Financial risks include exposure to fluctuation in commodity prices, currency exchange rates and interest rates. To mitigate the risks, the Company may enter into physical contracts for the sale of crude oil, natural gas liquids and natural gas at fixed prices. The Company may also institute financial hedging techniques for interest rates, currency exchange rates and commodity prices. If utilized, such transactions would be subject to certain limits on term and amount as established by the Board of Directors. No such transactions have been entered into to date.

### **Oil and Gas Risk**

Inherent in development of oil and gas reserves are risks, among others, of drilling dry holes, encountering production or drilling difficulties or experiencing high decline rates in producing wells. In addition, a major market risk exposure is in the pricing applicable to our oil and gas production. Realized pricing is primarily driven by the prevailing worldwide price for crude oil and spot prices applicable to our oil and natural gas production. Prices received for oil and gas production have been and remain volatile and unpredictable. If oil and gas prices decline significantly, even if only for a short period of time, it is possible that non-cash write-downs of our oil and gas properties could occur under the full-cost accounting method. Under these rules, we review the carrying value of our proved oil and gas properties each quarter to ensure that capitalized costs of proved oil and gas properties, net of accumulated depreciation, depletion and amortization do not exceed the "ceiling." This ceiling is the present value of estimated future net cash flows from proved oil and gas reserves, discounted at 10 percent, plus the lower of cost or fair value of unproved properties included in the costs being amortized, net of related tax effects. If capitalized costs exceed this limit, the excess is charged to additional depletion, depreciation and accretion expense. The calculation of estimated future net cash flows is based on forecasted prices for crude oil and natural gas except for volumes sold under long-term contracts. Write-downs required by these rules do not impact cash flow from operating activities; however, as discussed above, sustained low prices would have a material adverse effect on future cash flows.

### **Financial and Liquidity Risks**

The Company anticipates that it will make capital expenditures for the acquisition, exploration, development and production of oil and natural gas in the future. On an ongoing basis, the Company will typically plan to utilize three sources of funding to finance its capital expenditure program; internally generated cash flow from operations, debt where deemed appropriate and new equity issues, if available at favourable terms. In addition, the Company may contemplate the sale of producing properties or the sale of other assets to fund its contractual obligations.

Funds flow is influenced by many factors, which the Company cannot control, such as commodity prices, the United States versus the Canadian dollar exchange rate, interest rates and changes to existing government regulations and tax policies. Should circumstances affect cash flow in a detrimental way, the Company may have limited ability to expand the capital necessary to undertake or complete future drilling programs. In such circumstances, the Company would be required to either reduce the level of its capital expenditures or supplement its capital expenditure program with additional debt and/or equity financing. There can be no assurance that debt or equity financing will be available or sufficient to meet these requirements or, if debt or equity is available, that it will be on terms acceptable to the Company. Moreover, future activities may require the Company to alter its capitalization significantly. The inability of the Company to access sufficient capital for its operations could have a material adverse effect on the Company's financial condition, results of operations and prospects.

### **Issuance of Debt**

From time to time, the Company may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed partially or wholly with debt, which may increase the Company's debt levels above industry standards. Neither the Company's articles nor its by-laws limit the amount of indebtedness that the Company may incur. The level of the Company's indebtedness from time to time could impair the Company's ability to obtain additional financing in the future on a timely basis to take advantage of business opportunities that may arise.

## Supply of Service and Production Equipment

The supply of service and production equipment at competitive prices is critical to the ability to add reserves at a competitive cost and produce these reserves in an economic and timely fashion. In periods of increased activity, these supplies and services can be difficult to obtain. Demand for such limited equipment or access restrictions may affect the availability of such equipment to the Company and may delay exploration and development activities. The Company attempts to mitigate this risk by developing strong long-term relationships with suppliers and contractors. There can be no assurances that these relationships will increase the availability of the supplies and services.

## Regulatory Changes

On October 25, 2007, the Government of Alberta announced a new royalty framework (“NRF”) which took effect on January 1, 2009. The new framework was announced in response to a report released by an independent Royalty Review Panel appointed by the Government of Alberta that recommended an increase in the overall resource charges to oil and gas producers in the Province of Alberta. Under the new royalty framework, royalty rates will be increased on conventional oil, natural gas and the oil sands. The Government of Alberta estimates that the overall royalties will be increased by approximately \$1.4 billion over its previously estimated royalty revenues for 2010.

The implementation of the new royalty regime in Alberta is subject to certain risks and uncertainties. The significant changes to the royalty regime requires new legislation, changes to existing legislation and regulation and development of proprietary software to support the calculation and collection of royalties. An increase in the royalties payable by Guardian in addition to the costs of modifying the Corporation’s existing infrastructure to deal with the changes to the royalty regime will result in higher costs to Guardian and therefore reduced profitability.

## Related Party Transactions

- a) The balance in the Due from Related Party account has decreased from \$449,951 at December 31, 2008 to \$14,605 at September 30, 2009 due primarily to repayments to the Company of approximately \$438,000 in the second quarter. This was offset by an advance of \$100,000 to the related party during the third quarter of which \$50,000 was repaid by September 30, 2009.

The Company also received helicopter services in conjunction with the servicing of natural gas wells in Northern B.C. from a company controlled by a major shareholder and director of the Company. The Company was charged \$38,744 for the nine months ended September 30, 2009 (2008: \$273,329), which was paid in 2009 via a reduction in the Due from Related Party account.

- b) The Company obtained engineering consulting services in the amount of \$23,460 for the nine months ended September 30, 2009 (2008: \$190,575) from a company controlled by a Company director, who was appointed in 2008. A balance of \$123,888 is included in accounts payable and accrued liabilities at September 30, 2009 (December 31, 2008: \$180,729).
- c) Legal fees in the amount of \$43,057 for the nine months ended September 30, 2009 (2008: \$62,804) have been incurred from a legal firm of which a Company director, who was appointed in 2006, is a partner. A balance of \$nil is included in accounts payable and accrued liabilities at September 30, 2009 (December 31, 2008: \$4,358).

These transactions are in the normal course of business and are recorded at the exchange amount which is the amount of consideration established and agreed to by the related parties.

## **Contractual Obligations and Commitments**

### **a) Flow-through share issuance**

Pursuant to a flow-through share issuance completed in 2008, the Company is committed to incur \$2,777,110 of qualified expenditures by December 31, 2009. At September 30, 2009, approximately \$1.8 million of the obligation has been fulfilled. The expenditures were renounced to investors in February 2009.

### **b) Employment contract**

Under the terms of an employment contract with the Chief Executive Officer, the Company is committed to pay severance under certain circumstances equal to 2 years salary plus 15%.

### **c) Office sub-lease**

The Company is currently committed to sub-lease payments of approximately \$2,100 per month through February 2010.

## **GUARANTEES, CONTINGENCIES AND OFF-BALANCE SHEET ARRANGEMENTS**

### **a) Flow-through shares**

Pursuant to a flow-through share issuance completed in March 2006, the Company was committed to incur \$4,000,000 of qualified expenditures by December 31, 2007. The Company had originally disclosed in its 2007 and 2008 financial statements that it had failed to incur \$1,850,000 of qualified expenditures. The Company, in consultation with its advisors, has now determined, based on a subsequent technical review of its 2006 drilling program, that it has met its obligations to incur \$4,000,000 of qualified expenditures by December 31, 2007. As a result, the accrued liability for interest and penalties was reduced by approximately \$296,000 in the first quarter of 2009, resulting in a recovery of interest expense.

However, there can be no assurance that the tax authorities will agree with the Company's evaluation of the 2006 drilling results. If the tax authorities were to successfully challenge the Company's evaluation of the 2006 drilling results, the Company could be liable for additional Part XII.6 tax, interest and penalties of approximately \$350,000.

### **b) Mineral Management Services**

The Mineral Management Service ("MMS"), a bureau of the US Department of the Interior that manages that nation's natural gas and oil resources, alleged during the year that a subsidiary of the Company had been deficient in various administrative filing requirements in the past and that, as a result, civil penalties of approximately \$578,000 (US\$500,000) were being levied against the subsidiary. The subsidiary is disputing these penalties and, along with its legal counsel, has been negotiating with MMS, its collection agencies and its counsel towards a satisfactory resolution of this matter.

A provision of \$86,900 (US\$80,000) has been made for these civil penalties. This provision has been based on a settlement with the collection agency representing MMS (US\$50,000), and a probationary settlement arrangement made directly with MMS (US\$30,000). The details of the settlements have yet to be finalized but have been agreed to in principle.

The current draft of the settlement with MMS includes a probationary portion of the agreement that requires the subsidiary to remain compliant with its reporting requirements over a 36 month time frame, otherwise the full amount of the penalties, reduced on a declining basis for the period of compliance, will be due immediately to MMS. The subsidiary has been compliant with its reporting requirements since June 2008, and it is anticipated that the compliant months since then will go toward the 36 month requirement.

### c) Other

The Company is also involved in various other claims arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favour, the Company does not currently believe that the outcome of adverse decisions in any proceedings related to these matters or any amount which it may be required to pay would have a material adverse impact on its financial position, results of operations or liquidity.

## FUTURE CHANGES IN ACCOUNTING STANDARDS

- a) In January 2009, the CICA issued Section 1582, *Business Combinations*, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. Management is currently assessing the impact of the adoption of this section on the results of operations, financial position and disclosures.
- b) In January 2009, the CICA issued Sections 1601, *Consolidated Financial Statements*, and 1602, *Non-controlling Interests*, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. Management is currently assessing the impact of the adoption on the results of operations or financial position.
- c) In June 2009, the CICA amended Section 3862 to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair values of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 valuations are based on inputs that are unobservable and significant to the overall fair value measurement. The Company plans to adopt this standard prospectively effective December 31, 2009. The adoption of this standard will not have a material impact on the consolidated financial statements.

## International Financial Reporting Standards

The Accounting Standards Board has confirmed the convergence of Canadian GAAP with IFRS will be effective January 1, 2011. Management is currently assessing the impact of the convergence of Canadian GAAP with IFRS on our results of operations, financial position and disclosure.

## ADDITIONAL INFORMATION

Additional information relating to the Company is filed on the SEDAR website at [www.sedar.com](http://www.sedar.com). Also, information can also be obtained by contacting the Company at Guardian Exploration Inc., 440, 435 – 4<sup>th</sup> Avenue S.W., Calgary, Alberta, T2P 3A8.