

MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with Monterey's unaudited interim Financial Statements for the three month and six months ended June 30, 2009 and audited Financial Statements and notes thereto for the year ended December 31, 2008. The Financial Statements have been prepared in Canadian dollars and in accordance with Canadian generally accepted accounting principles ("GAAP").

This MD&A contains forward-looking statements, non-GAAP measures, and disclosures of barrels of oil equivalent volumes. Readers are referred to the advisories concerning forward-looking statements, non-GAAP measures, and barrels of oil equivalent conversions are contained under the heading "Forward Looking Statements & Advisories". Disclosures in respect of the non-GAAP measures and Forward Looking Statements & Advisories are contained at the end of this MD&A.

Additional information regarding Monterey Exploration Ltd. such as the audited Financial Statements, Annual Information Form and other disclosure documents can be found on SEDAR at www.sedar.com or on the Corporation's website www.montereyexploration.com.

This MD&A is dated August 12, 2009.

Monterey Exploration Ltd. ("Monterey" or the "Corporation") is continued under the Business Corporations Act (Alberta) and is engaged in the acquisition, exploration, development and production of natural gas, natural gas liquids and crude oil in the Western Canadian Sedimentary Basin.

FREQUENTLY USED TERMS

In this document certain terms are used frequently. For instance, Monterey Exploration Ltd. is commonly referred to as either "Monterey" or the "Corporation" and barrels of oil equivalent are regularly noted with the term "boe".

Term or abbreviation

"boe"	Barrel(s) of oil equivalent
"mcf"	Thousand cubic feet
"bbl"	Barrel
"GJ"	Gigajoule
"LIBOR"	London Interbank Offered Rate
"m" preceding a volumetric measure	1,000 units of the volumetric measure
"mm" preceding a volumetric measure	1,000,000 units of the volumetric measure
"NGL"	Natural gas liquids
"NEBC"	Northeast British Columbia
"Upper Lake"	Upper Lake Oil and Gas Ltd.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of the financial statements in accordance with GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. In determining estimates required to prepare the Corporation's financial statements, management uses available information it considers to be reasonable under the circumstances. Readers are cautioned that actual results could differ from these estimates. Except for the items disclosed under "Accounting Pronouncements and Account Policy Changes", the accounting policies and estimates used to prepare the financial statements for the three and six months ended June 30, 2009 are consistent with those disclosed in Monterey's financial statements and MD&A for the year ended December 31, 2008. For a detailed discussion of the accounting policies and critical accounting estimates used please refer to the Corporation's December 31, 2008 year ended financial statements and MD&A.

ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING POLICY CHANGES

During the first quarter of 2009, Monterey adopted CICA handbook section 3064, Goodwill and Intangible Assets. The handbook section applies to goodwill subsequent to initial recognition and establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. Adoption of the new disclosure requirement did not have an impact on the Corporation's financial statements or disclosure in the notes to the financial statements.

During the second quarter of 2008, the accounting standards board ("AcSB") has confirmed the date of changeover to international financial reporting standards ("IFRS") will be for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Management has taken steps to educate its staff and reviewed its accounting systems to determine the differences between Canadian GAAP and IFRS. An implementation plan for the changeover from Canadian GAAP to IFRS will be prepared later in 2009. Changes in accounting policies are likely going to have a material impact on Monterey's financial statements; however Management is not able to quantify the impacts at this time.

INTERNAL CONTROLS REPORTING

Disclosure Controls and Procedures

The Chief Executive Officer and the Chief Financial Officer, together with other members of Management, have designed Monterey's disclosure controls and procedures to provide reasonable assurance that material information relating to the Corporation is disclosed in a timely manner and free from material misstatement. As at December 31, 2008, an evaluation of the effectiveness of Monterey's disclosure controls and procedures was conducted in accordance with Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual Financial and Interim Filings, based on that evaluation, the Chief executive Officer and the Chief Financial Officer concluded that the design and operation of Monterey's disclosure controls and procedures were effective as at December 31, 2008.

Internal Controls over Financial Reporting

Also in accordance with Multilateral Instrument 52-109, the Chief Executive Officer and Chief Financial Officer of Monterey are responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. The Chief Executive Officer and Chief Financial Officer

directed the assessment of the design and operating effectiveness of Monterey's internal controls over financial reporting as at December 31, 2008 and based on that assessment determined that the Corporation's internal control over financial reporting was, in all material respects, appropriately designed and operated effectively.

During the six months ended June 30, 2009, there have been no material changes in the design or operation of the Corporation's internal controls over financial reporting.

Summary

Due to inherent limitations of a control system, including the Corporation's disclosure controls and procedures and internal controls over financial reporting, no matter how well conceived or operated may not prevent or detect misstatements, errors or fraud and can only provide reasonable assurance that the objectives of the control system are met.

RISKS & UNCERTAINTIES

Some of the risks that Monterey is exposed to which impact Management's ability to execute the Corporation's business plan include but are not limited to:

- Exploration, development and production activities

Monterey's success depends upon its ability to find, secure rights, acquire, develop and commercially produce oil and natural gas reserves. Risks associated with the exploration, finding and development and production of oil and gas reserves is impacted by: attracting, hiring and retaining knowledgeable and experienced staff; competition for prospective land for exploration and development activities; geological and operational risks; application of changing or new technologies, imprecision of reserve estimates and valuation; timely receipt of required regulatory approvals; ability to secure or obtain equipment, services and supplies when needed; weather; field operating risks; and existence and ability to access production infrastructure to deliver production to market.

Management attempts to manage and overcome these risks by careful addition of staff, early identification and evaluation of opportunities; careful planning of operations and development of contingency plans; developing continuing relationships with reliable suppliers of services, equipment and supplies; and carrying appropriate levels of insurance.

- Global financial crisis

During 2008 market conditions and events led to significant disruptions of international credit markets and the overall deterioration of worldwide economic conditions leading to increased volatility in markets (including financial and product markets), reduced liquidity, widening of corporate spreads, increased credit losses and tightening of credit conditions. Governments throughout the world have been required to intervene in preventing the collapse of banks, insurers and financial institutions. These conditions have impacted Monterey due to continued volatility of commodity prices, currency exchange, interest rates, access to and the amount of debt and equity financing available, and the Corporation's valuations (stock market trading price and net asset value) have been negatively impacted.

Management has attempted to mitigate the impacts of the global recession and uncertain credit markets by disposing of non-core properties to reduce debt, reducing the size of the capital expenditure program to approximate funds flow from operations, fixing the cost of debt through the issue of guaranteed notes and entering into a new credit facility that allows Monterey to continue to access up to \$45 million in

borrowings from the lender. The Corporation has access to borrowings under the credit facility until the lender's next review which is scheduled to be completed prior to June 1, 2010.

➤ Capital requirements

The Corporation's core business requires sufficient funds for the future acquisition, exploration, development and production of oil and natural gas reserves. Economic conditions, such as the current worldwide recession can cause significant volatility of commodity prices meaning that internal generation of funds or reasonable return of investment is uncertain. In addition the global credit crisis can result in a reduction in the access to, timing, amount and cost of debt thus making Monterey's ability to conduct or complete exploration and development activities more difficult.

Management ensures that projects are adequately evaluated to estimate viability under challenging economic conditions. In addition development of capital spending plans are carefully prepared and are subject to ongoing review to ensure that sufficient financial resources are available and that projects will earn a positive return on investment. Management manages the components of its balance sheet, remains apprised of developments in the equity markets and changes in the current and forecasted commodity prices to maintain financial flexibility so that the business plans can be carried out.

➤ Third party credit risk

Monterey may be exposed to third party credit risk through its contractual arrangements with joint venture partners, purchasers of production and other parties. During challenging economic periods the Corporation's access to funds needed to finance the ongoing business or settle obligations due may be impacted by an increase in the amount of time required to collect or the lack of collectability of accounts receivables.

Management mitigates this risk by entering into joint ventures or sell production to a diverse portfolio of entities that have sufficient capital resources and an established record of paying obligations when due. The Corporation routinely monitors the amount and aging of accounts receivable to improve collectability and when necessary issues cash calls to collect payment in advance from a partner for its share of a project.

➤ Climate change

The determination of the impact of climate change is currently unknown and cannot be reasonably estimated. Physical access to opportunities and timing to conduct operations could change or become more costly. Potential new laws or regulatory requirements to control greenhouse gases or other emissions may increase the cost and the method of conducting exploration, development, production and processing oil and gas. Lastly new taxes, tariffs, penalties or costs to acquire offsetting credits as a result of finding, developing, producing, transporting and selling oil and gas may also impair the commercial viability of Monterey's activities or the oil and gas industry overall.

Management continues to monitor developments in this evolving area. Methods to be used to mitigate the risks associated with climate change include: education to understand the impact of physical changes in the environment on Monterey's operations and new and changes to laws or regulatory requirements, and careful planning to determine cost effective means to perform Monterey's exploration, development and production activities and ensure compliance with laws and regulations.

➤ Changes in laws and regulations

In February 2009 the Government of British Columbia announced changes to the Deep Royalty Program under which royalty credits can be earned as a result of the vertical depth or the length of the horizontal leg of new drills. Royalties earned by the drilling of a well are applied against the crown royalties on production from the well. The changes favorably adjusted the factor applied to calculating the royalty credits earned. On August 6, 2009 British Columbia announced an oil and gas stimulus package consisting of four royalty and two regulatory initiatives designed to attract investment in oil and gas activities in the province. The royalty changes include: (i) introduction of a reduction in the royalty rate for all wells drilled from September 2009 to June 2010 to two percent applied to the first year's production from successful drilling; (ii) an increase of 15% in the Deep Well royalty credits that are earned by drilling natural gas wells; (iii) reduction in the depth of horizontal wells to 1,900 meters to qualify a well as eligible for the Deep Royalty Credit Program; and (iv) allocation of an additional \$50 million that can be earned in infrastructure royalty credits as a result of investment in oil and gas roads and pipelines. The regulatory initiatives include permission for commingling production and amendments to the drilling license regulation.

The royalty rate reduction and the changes in the Deep Well Royalty Credit Program announced by the province of British Columbia will favorably impact the planned and future operations of Monterey by improving the economical viability future drilling, particularly horizontal wells to be drilled in the Groundbirch, Brassey and Squirrel areas of NEBC. The enhancement to the infrastructure royalty credit program may offset a portion of the Corporation's investment in the construction of a gas plant in the Groundbirch area.

On October 25, 2007 the Government of Alberta released the New Royalty Framework ("NRF") outlining revisions to its crown royalty program that became effective on January 1, 2009. To mitigate the impact of unintended consequences resulting for the NRF the Government of Alberta has introduced a number of programs, including: (i) In April 2008, the Government of Alberta announced a new program to support exploration and development of deep oil and gas reserves that would be uneconomic under the NRF. The incentives associated with the new program applies to oil exploration wells and natural gas wells having depths greater than 2,000 meters and 2,500 meters, respectively; (ii) on November 19, 2008 the Government of Alberta introduced a five-year transitional royalty program to promote new drilling. Companies that drill new conventional oil or natural gas wells between the depths of 1,000 and 3,500 meters, will be granted a one-time option per well to adopt the new transitional rates or those outlined in the NRF. The transitional royalty rates for conventional oil will range from 10 percent to 39 percent, and transitional royalty rates for conventional gas will range from five percent to 30 percent. These transitional rates have lower maximum royalty rates in comparison to royalty rates under the NRF which range from zero to 50 percent on oil production and five percent to 50 percent for natural gas production; (iii) on March 3, 2009, the Government of Alberta announced a three-point incentive program to stimulate new and continued economic activity in Alberta which included a drilling royalty credit for new conventional oil and natural gas wells and a new royalty incentive program. Under the drilling royalty credit program a \$200 per meter royalty credit will be available on new conventional oil and gas wells drilled between April 1, 2009 and March 31, 2010. The new well incentive program will apply to wells beginning production of conventional oil and natural gas between April 1, 2009 and March 31, 2010 and provides for a maximum 5% royalty rate for the first 12 months of production, up to a maximum of 50,000 barrels of oil or 500 mmcf of natural gas; and (iv) on June 25, 2009 the Alberta government announced that it would be extending the terms of the drilling royalty credit and new royalty incentive programs which were originally announced in March 2009, by one year, thereby extending the expiry of both programs by one year from March 2010 to March 2011.

Approximately 19 percent of the Corporation's production is from wells located in the province of Alberta; furthermore Monterey's Alberta production is largely from low productivity and shallow depth wells; and the majority of Monterey's drilling operations have historically been conducted in the province of British Columbia. As a result the regulatory changes in the province of Alberta outlined above will only have a nominal impact on Monterey's current operations. Nonetheless the Corporation's ability to attract investment capital for future investment in Alberta may be impacted by the negative effect the NRF will have on the economics of capital projects located in the province of Alberta.

SIGNIFICANT EVENTS

During the second quarter of 2009, the following items had a significant impact on either the current or future operations of the Corporation:

- Achieved average daily production for the quarter of 2,329 barrels of oil equivalent per day ("boe/d"), an 82 percent increase compared with 1,280 boe/d during the comparative quarter in 2008.
- Generated quarterly funds flow from operations of \$0.8 million versus \$4.4 million of funds flow from operations generated in the second quarter of 2008. The reduction in funds flow from operations is due to Monterey receiving an average natural gas price of \$3.60 per mcf, about 60 percent less than the \$9.03 per mcf in the second quarter of 2008. Second quarter funds flow from operations per basic and diluted share in 2009 was \$0.03.
- Engaged GLJ Petroleum Consultants Ltd. to prepare an independent evaluation of the Discovered Petroleum Initially-In-Place ("DPIP") on 5 net sections of Monterey's Montney landholdings in the Groundbirch area of northeast British Columbia ("NEBC"). The evaluation identified a current best estimate of net 659 billion cubic feet of DPIP in the upper Montney as disclosed in the Corporation's previous press release dated May 14, 2009.
- In July 2009, completed the disposition of 3 sections of undeveloped non-core lands in the Town area of NEBC for total net proceeds of \$2.7 million. There were no reserves or production associated to these lands and proceeds from the disposition will be applied to the second half drilling operations scheduled at Groundbirch.

SUMMARY OF FINANCIAL AND OPERATING RESULTS

<i>In \$000's unless referring to volumetric measures or otherwise noted (unaudited)</i>	Three months ended June 30, 2009	Three months ended Mar 31, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Average sales volumes:					
Natural gas (mcf/d)	11,151	11,939	6,598	11,543	6,883
Oil and NGLs (bbl/d)	470	461	181	466	211
Oil equivalent (boe/d)	2,329	2,451	1,280	2,390	1,358
Average sales prices:					
Natural gas (\$/mcf) ⁽¹⁾	\$ 3.60	\$ 5.59	\$ 9.03	\$ 4.62	\$ 8.02
Oil and NGLs (\$/bbl)	\$ 44.81	\$ 37.84	\$ 105.92	\$ 41.38	\$ 92.87
Oil equivalent (\$/boe) ⁽¹⁾	\$ 26.42	\$ 34.52	\$ 62.03	\$ 30.55	\$ 55.32
Financial:					
Production revenue ⁽¹⁾	\$ 5,597	\$ 7,614	\$ 7,227	\$ 13,211	\$ 13,671
Operating income ⁽²⁾	\$ 1,842	\$ 3,438	\$ 4,163	\$ 5,280	\$ 7,464
Funds flow from operations ⁽²⁾	\$ 844	\$ 2,620	\$ 4,417	\$ 3,464	\$ 7,964
Net earnings (loss)	\$ (5,485)	\$ (4,174)	\$ 601	\$ (9,659)	\$ 1,712
Total capital expenditures (net of disposition proceeds) ⁽²⁾	\$ 1,104	\$ (1,818)	\$ 2,167	\$ (714)	\$ 14,753
Per Share:					
Funds flow from operations per share ⁽²⁾ :					
Basic	\$ 0.03	\$ 0.08	\$ 0.18	\$ 0.11	\$ 0.32
Diluted	\$ 0.03	\$ 0.08	\$ 0.17	\$ 0.10	\$ 0.31
Net earnings (loss) per share:					
Basic and diluted	\$ (0.17)	\$ (0.13)	\$ 0.02	\$ (0.29)	\$ 0.07
Financial Position:					
Net debt ⁽²⁾	\$ 34,152	\$ 33,872	\$ 21,999	\$ 34,152	\$ 21,999
Total assets	\$ 131,162	\$ 137,060	\$ 100,460	\$ 131,162	\$ 100,460
Total long-term liabilities	\$ 4,439	\$ 4,274	\$ 2,417	\$ 4,439	\$ 2,417
Shareholders' equity	\$ 89,657	\$ 95,014	\$ 70,309	\$ 89,657	\$ 70,309
Share data:					
Outstanding:					
Common shares	32,902,500	32,902,500	25,106,796	32,902,500	25,106,796
Stock options	3,135,666	3,135,666	2,150,666	3,135,666	2,150,666
Total diluted shares	36,038,166	36,038,166	27,257,462	36,038,166	27,257,462
Weighted average:					
Basic	32,902,500	32,902,500	25,106,796	32,902,500	25,082,508
Diluted	33,136,082	32,932,759	25,329,319	33,136,082	25,305,031

(1) Includes processing and marketing revenue and gains / losses on financial instruments.

(2) See non-GAAP measure section for additional disclosure.

SECOND QUARTER 2009 VERSUS FIRST QUARTER 2009

	Three months ended June 30, 2009	Three months ended Mar. 31, 2009	Percentage Change
Average sales volumes:			
Natural gas (mcf/d)	11,151	11,939	(7)
Oil and NGLs (bbl/d)	470	461	2
Oil equivalent (boe/d)	2,329	2,451	(5)
Average sales prices:			
Natural gas (\$/mcf)	3.60	5.59	(36)
Oil and NGLs (\$/bbl)	44.81	37.84	18
Oil equivalent (\$/boe)	26.42	34.52	(23)

Sales Volumes

For the three months ended June 30, 2009, Monterey's average daily production was 2,329 boe/d, which is five percent lower than the 2,451 boe/d average daily production for the first quarter of 2009. The decrease reflects natural declines at the Corporation's areas and no production was added from exploration and development activities due to the 2009 reduction in capital expenditures.

Realized Prices

Monterey's average realized natural gas price during the second quarter of 2009 was \$3.60 per mcf, a decrease of 36 percent relative to the Corporation's average realized natural gas price per mcf of \$5.59 during the first quarter of 2009. Monterey's average realized liquids price for the second quarter of 2009 increased by 18 percent when compared to the first quarter.

The decrease in Monterey's average sales prices for natural gas during the second quarter is a reflection of lower commodity prices due to changes in the demand-supply balance as a result of the current global recession. The increase in the Corporation's average price received for its liquids sales represents higher anticipated North American demand due to the commencement of the summer driving season.

Royalties

During the second quarter of 2009, the Corporation had an average royalty cost per boe of \$4.29; and \$5.53 per boe in the first quarter. The decrease in royalty costs per boe over the first quarter of 2009 was due to lower average realized natural gas prices during the second quarter. As a percentage of Monterey's second quarter production revenue, the Corporation's average royalty rate remained at 16 percent, which was the same as the first quarter.

Operating Costs

Relative to the first quarter of 2009, operating costs per boe increased to \$11.93 from \$11.54 per boe. The primary reason for the increase during the second quarter of 2009 is due to lower average sales volumes in relation to Monterey's fixed operating costs.

Transportation Costs

Transportation costs during the second quarter of 2009 decreased in relation to the first quarter of 2009 due to lower production volumes. On a per boe basis, the unit transportation cost for the second quarter of \$1.50 per boe is nominally lower than Monterey's transportation cost per boe of \$1.85 during the first quarter of 2009.

Operating Income

During the second quarter of 2009, Monterey's average realized operating income per boe decreased to \$8.70, from \$15.60 realized in the first quarter of 2009, a decrease of approximately 44 percent. The decrease in natural gas prices accounts for the majority of the reduction in operating income relative to the first quarter of 2009.

(\$000's)	Three months ended June 30, 2009	Change due to:		Three months ended Mar. 31, 2009
		Price/Cost	Volume	
Operating Income:				
Production revenue				
Natural gas sales	\$ 3,681	(2,026)	(336)	\$ 6,043
Oil and NGLs sales	1,916	298	47	1,571
	5,597	(1,728)	(289)	7,614
Royalties	909	(263)	(48)	1,220
Operating costs	2,527	81	(101)	2,547
Transportation costs	319	(74)	(16)	409
Operating income	\$ 1,842	(1,472)	(124)	\$ 3,438
\$/boe	\$ 8.70			\$ 15.60

Depletion, Depreciation and Accretion ("DD&A")

(in \$000's except per boe amounts)	Three months ended June 30, 2009	Three months ended Mar. 31, 2009
Oil and gas properties	\$ 6,046	\$ 6,509
Office equipment	16	18
Asset retirement accretion	185	185
	\$ 6,247	\$ 6,712
\$/boe	\$ 29.48	\$ 30.43

DD&A expense for the second quarter of 2009 decreased by approximately \$0.5 million over the previous quarter. The decrease in total DD&A expense was a primarily the result of lower production volumes due to natural declines.

General & Administrative ("G&A")

Per unit total G&A costs, including stock-based compensation expense, of \$5.23 per boe for the second quarter of 2009 represents an increase of \$0.78 per boe over the first quarter of 2009. Costs associated with the Corporation's annual reporting documents such as the publishing of an annual report contributed to the increase over the previous quarter.

The combination of expensed and capitalized G&A expenses, excluding stock-based compensation expenses, in the second quarter of 2009 increased to \$1.1 million or about 13 percent more than the first quarter of 2009. The increased costs in 2009 are primarily due to the incremental costs of being a public entity.

(in \$000's except per boe amounts)	Three Months ended June 30, 2009	Three Months ended Mar. 31, 2009
Expensed G&A:		
General and administrative expenses	\$ 734	\$ 609
Stock-based compensation	82	82
Total expensed G&A	\$ 816	\$ 691
\$/boe	\$ 3.85	\$ 3.13
Capitalized G&A:		
General and administrative expenses	\$ 248	\$ 247
Stock-based compensation and income tax adjustment	45	44
Total capitalized G&A	\$ 293	\$ 291
\$/boe	\$ 1.38	\$ 1.32
Total G&A costs	\$ 1,109	\$ 982
\$/boe	\$ 5.23	\$ 4.45

The capitalized general and administrative costs include both general and administrative cash expenditures and non-cash stock-based compensation associated with exploration and development activities. The table below provides additional disclosure of the components of capitalized general and administrative costs.

(in \$000's)	Three Months ended June 30, 2009	Three Months ended Mar. 31, 2009
Salaries and employment costs	\$ 198	\$ 197
Office rent	48	48
Other general and administrative costs	2	2
Capitalized cash general and administrative costs	\$ 248	\$ 247
Capitalized stock-based compensation	45	44
Capitalized non-cash costs	\$ 45	\$ 44
Total capitalized general and administrative costs	\$ 293	\$ 291

Interest

(in \$000's except per boe amounts)	Three Months ended June 30, 2009	Three Months ended Mar. 31, 2009
Interest expense	\$ 309	\$ 217
Interest income	(45)	(8)
Net interest expense	\$ 264	\$ 209
\$/boe	\$ 1.25	\$ 0.95

The increase in the second quarter's net interest expense and net interest expense per boe, relative to the first quarter of 2009 is the result of higher average bank debt during the period and the increased cost of borrowing under the new bank credit facility.

FUNDS FLOW FROM OPERATIONS

(in \$000's except per boe amounts)	Three months ended June 30, 2009	Three months ended Mar. 31, 2009
Operating income	\$ 1,842	\$ 3,438
General and administrative expenses ⁽¹⁾	(734)	(609)
Net interest expense	(264)	(209)
Funds flow from operations	\$ 844	\$ 2,620
Operating income per boe	\$ 8.70	\$ 15.60
General and administrative expenses ⁽¹⁾	(3.46)	(2.76)
Net interest expense	(1.25)	(0.95)
Funds flow from operations per boe ⁽²⁾	\$ 3.99	\$ 11.89

(1) Excluding stock-based compensation.

(2) Funds flow from operations per boe is funds flow from operations divided by total boe production in the period.

Monterey's funds flow from operations for the second quarter decreased by approximately \$1.8 million relative to the first quarter of 2009 largely as a result lower natural gas prices.

Second quarter unit funds flow from operations of \$3.99 per boe was 66 percent less than the \$11.89 per boe recorded in the first quarter. Falling natural gas prices combined with the five percent decrease in production during the second quarter are the primary reasons for the decrease.

SECOND QUARTER 2009 VERSUS SECOND QUARTER 2008

	Three months ended June 30, 2009	June 30, 2008	Percentage Change
Average sales volumes:			
Natural gas (mcf/d)	11,151	6,598	69
Oil and NGLs (bbl/d)	470	181	160
Oil equivalent (boe/d)	2,329	1,280	82
Average sales prices:			
Natural gas (\$/mcf)	3.60	11.44	(69)
Natural gas including financial instruments (\$/mcf)	3.60	9.03	(60)
Oil and NGLs (\$/bbl)	44.81	105.92	(58)
Oil equivalent (\$/boe)	26.42	74.41	(64)
Oil equivalent including financial instruments (\$/boe)	26.42	62.03	(57)

Sales Volumes

For the three months ended June 30, 2009, Monterey's average daily production was 2,329 boe per day, a 1,049 boe per day which is an 82 percent increase compared to the average daily production for the second quarter of 2008. The increase in production relative to the second quarter of 2008 represents production additions resulting from new production as a result of successful drilling operations conducted in 2008 in the Brassey, Squirrel, Laprise, Ferrybank and Smoky areas, production enhancements resulting from Monterey assuming operatorship of the Harmattan area oil unit and production acquired as a result of the August 31, 2008 acquisition of Upper Lake Oil & Gas Ltd.

Realized Prices

Monterey's average natural gas price including financial instruments during the second quarter of 2009 was \$3.60 per mcf, a decrease of 69 percent in relation to the \$9.03 per mcf average natural gas price during the comparative quarter in 2008.

The Corporation's average realized liquids price of \$44.81 per barrel is a decrease of 58 percent in comparison to the \$105.92 realized in the second quarter of 2008.

Both North American natural gas and worldwide crude oil prices were at or near all time highs in the second quarter of 2008; while energy prices in the second quarter of 2009 have been depressed by the reduction in demand for commodities during the global recession.

Royalties

Monterey's average royalty rate in the second quarter of 2009 of 16 percent of production revenue was about the same as the Corporation's average royalty rate of 15 percent recorded in 2008. On a per boe basis, the Corporation's royalty cost of \$4.29 compares favorably to the comparative quarter of 2008 when Monterey's royalty cost per boe was \$11.09, primarily due to higher commodity prices.

The royalty expense for the second quarter of 2009 was \$909,000 which is about 30 percent less than in 2008. The change is then net impact of lower prices received on the sale of oil and gas production, see realized prices discussion above, offset against the 2009 increase in sales volumes, also discussed above.

Operating Costs

Relative to the second quarter of 2008, operating costs per boe decreased by \$1.66 or 12 percent during the current quarter to \$11.93. The 2009 decrease is explained by optimization activities completed at Monterey's Harmattan area and the impact of new production, added in late 2008 and early 2009, having a lower unit of production operating expense than Monterey's existing base production.

In 2009 operating costs have totaled \$2.5 million which is nearly 60 percent higher than the \$1.6 million for second quarter of 2008. The 2009 increase reflects the increase in sales volumes as discussed above.

Transportation Costs

Transportation costs of \$1.50 per boe for the second quarter of 2009 decreased by seven percent from transportation costs per boe incurred during the second quarter of 2008 of \$1.62. The decrease is the result of the October 31, 2008 expiry of firm service transportation agreements with a higher average transportation cost per unit.

Transportation costs for the second quarter of 2009 totaled \$319,000, about 68 percent higher than costs recorded in 2008. Lower costs per unit as discussed immediately above were offset by higher natural gas production in 2009.

Operating Income

In the second quarter of 2009 operating income amounted to \$1.8 million, about 56 percent less than the \$4.2 million recorded in 2008. On a per boe basis Monterey's average operating income of \$8.70 per boe for the second quarter of 2009 decreased by 76 percent when compared to the same period of 2008. The change in each of the absolute dollar amount and the per unit figure are the net result of higher sales volumes offset by significantly reduced oil and gas commodity prices.

(\$000's)	Three months ended	Change due to:		Three months ended
	June 30, 2009	Price/Cost	Volume	June 30, 2008
Operating Income:				
Production revenue				
Natural gas sales	\$ 3,681	(8,027)	4,780	\$ 6,928
Oil and NGLs sales	1,916	(2,613)	2,787	1,742
Loss from financial instruments	-	1,443	-	(1,443)
	5,597	(9,197)	7,567	7,227
Royalties	909	(1,441)	1,058	1,292
Operating costs	2,527	(352)	1,296	1,583
Transportation costs	319	(25)	155	189
Operating income	\$ 1,842	(7,379)	5,058	\$ 4,163
\$/boe	\$ 8.70			\$ 35.73

Depletion, Depreciation and Accretion Expense

(in \$000's except per boe amounts)	Three months ended	Three months ended
	June 30, 2009	June 30, 2008
Oil and gas properties	\$ 6,046	\$ 2,647
Office equipment	16	8
Asset retirement accretion	185	82
	\$ 6,247	\$ 2,737
\$/boe	\$ 29.48	\$ 23.49

In comparison to the three months ended June 30, 2008, the DD&A provision in 2009 increased by \$3.5 million as a result of 26 percent increase in per unit DD&A costs and 82 percent growth in production volumes. DD&A expense per boe increased by \$5.99 to \$29.48 per boe as proved reserves added from 2008 exploration and development activities and acquired in the Upper Lake transaction had a higher average cost relative to Monterey existing total proved reserves.

General & Administrative

Total General and Administrative expense of \$1.1 million for the second quarter of 2009 was \$0.2 million higher than total G&A expense for the same quarter during 2008.

The combination of expensed and capitalized G&A expenses, excluding stock-based compensation expenses, in the second quarter of 2009 increased to nearly \$0.9 million or about 39 percent more than the second quarter of 2008. The sources of the increased costs in 2009 are mainly higher office rental expenses and incremental costs of being a public entity.

On a per boe basis, 2009 expensed G&A costs fell to 26 percent to \$3.85 per boe, capitalized G&A costs decreased 38 percent to \$1.38 per boe and total G&A costs dropped 30 percent to \$5.23 per boe, the decrease in unit expensed, capitalized and total G&A costs represents economies of scale achieved from higher average sales volumes following the acquisition of Upper Lake Oil & Gas Ltd. and successful drilling activities in the second half of 2008 being place on-stream.

The following table summarizes the G&A costs recorded for each of the second quarters of 2009 and 2008.

(in \$000's except per boe amounts)	Three months ended June 30, 2009	Three months ended June 30, 2008
Expensed G&A:		
General and administrative expenses	\$ 734	\$ 503
Stock-based compensation	82	103
Total expensed G&A	\$ 816	\$ 606
\$/boe	\$ 3.85	\$ 5.20
Capitalized G&A:		
General and administrative expenses	\$ 248	\$ 205
Stock-based compensation	45	53
Total capitalized G&A	\$ 293	\$ 258
\$/boe	\$ 1.38	\$ 2.22
Total G&A costs	\$ 1,109	\$ 864
\$/boe	\$ 5.23	\$ 7.42

The capitalized general and administrative costs include both general and administrative cash expenditures and non-cash stock-based compensation associated with exploration and development activities. The table below provides additional disclosure of the components of capitalized general and administrative costs.

(in \$000's)	Three months ended June 30, 2009	Three months ended June 30, 2008
Salaries and employment costs	\$ 198	\$ 180
Office rent	48	25
Other general and administrative costs	2	-
Capitalized cash general and administrative costs	\$ 248	\$ 205
Capitalized stock-based compensation	\$ 45	\$ 53
Total capitalized general and administrative costs	\$ 293	\$ 258

Interest

(in \$000's except per boe amounts)	Three months ended June 30, 2009	Three months ended June 30, 2008
Interest expense	\$ 309	\$ 251
Interest income	(45)	(15)
Net interest expense	\$ 264	\$ 236
\$/boe	\$ 1.25	\$ 2.03

The Corporation's average outstanding bank debt was higher during the second quarter of 2009 combined with the increased borrowing costs under the new bank credit facility in effect during the second quarter of 2009 resulted in higher net interest expense compared to the second quarter of 2008.

FUNDS FLOW FROM OPERATIONS

(in \$000's except per boe amounts)	Three months ended June 30, 2009	Three months ended June 30, 2008
Operating income	\$ 1,842	\$ 4,163
Unrealized loss on financial instruments	-	993
General and administrative expenses ⁽¹⁾	(734)	(503)
Net interest expense	(264)	(236)
Funds flow from operations	\$ 844	\$ 4,417
Operating income per boe	\$ 8.70	\$ 35.73
Unrealized loss on financial instruments	-	8.52
General and administrative expenses ⁽¹⁾	(3.46)	(4.32)
Net interest expense	(1.25)	(2.03)
Funds flow from operations per boe ⁽²⁾	\$ 3.99	\$ 37.90

(1) Excluding stock-based compensation.

(2) Funds flow from operations per boe is equal to funds flow from operations divided by total boe production in the period.

The Corporation's funds flow from operations for the current quarter of \$0.8 million was 81 percent lower than the \$4.4 million reported during second quarter of 2008. The decrease was mainly due to the 64 percent decrease in commodity prices received for Monterey's sales volumes nominally offset by the Corporation's 82 percent increase in average sales volumes.

On a per unit basis, funds flow from operations of \$3.99 per boe decreased by 89 percent relative to the second quarter of 2008. Similar to the absolute dollar figures, the reduction in 2009 is explained by lower commodity prices tempered by the 82 percent growth in production volumes.

YEAR-TO-DATE JUNE 30, 2009 VERSUS YEAR-TO-DATE JUNE 30, 2008

	Six months ended June 30, 2009	Six months ended June 30, 2008	Percentage Change
Average sales volumes:			
Natural gas (mcf/d)	11,543	6,883	68
Oil and NGLs (bbl/d)	466	211	121
Oil equivalent (boe/d)	2,390	1,358	76
Average sales prices:			
Natural gas (\$/mcf)	4.62	9.96	(54)
Natural gas including financial instruments (\$/mcf)	4.62	8.02	(42)
Oil and NGLs (\$/bbl)	41.38	92.87	(55)
Oil equivalent (\$/boe)	30.55	65.17	(53)
Oil equivalent including financial instruments (\$/boe)	30.55	55.32	(45)

Sales Volumes

For the first half of 2009, Monterey's average daily production was 2,390 boe per day, a 1,032 boe per day or 76 percent increase compared to the average daily production for the first half of 2008. The increase in production relative to the first half of 2008 represents production additions resulting from new production as a result of successful drilling operations conducted in the second half of 2008 in the Brassey, Squirrel, Laprise, Ferrybank and Smoky areas, production enhancements resulting from Monterey assuming operatorship of the Harmattan area oil unit and production acquired as a result of the August 31, 2008 acquisition of Upper Lake Oil & Gas Ltd. ("Upper Lake").

Realized Prices

Monterey's average natural gas price during the first six months of 2009 was \$4.62 per mcf, a decrease of 54 percent in relation to the average natural gas price during the comparative period during 2008, while Monterey's average realized liquids price decreased by 55 percent in comparison to the first half of 2008.

The decrease in the Corporation's average realized sales prices in 2009 is a reflection of depressed commodity prices due to changes in the demand-supply balance as a result of the lingering global recession.

Royalties

Monterey's average royalty rate during the first half of 2009 of 16 percent of production revenue was the same as the Corporation's average royalty rate of 16 percent recorded in 2008. Royalty expense totaled \$2.1 million of the first half of 2009, about 18 percent less than the \$2.6 million for the same period of 2008.

The difference in the royalty expense in 2009 and 2008 is explained by the increase in sales volumes, and the reduction in realized prices, both discussed above.

Operating Costs

Relative to the first half of 2008, operating costs per boe decreased by \$1.25 or 10 percent during the current period to \$11.73. The 2009 decrease is explained by optimization activities completed at Monterey's Harmattan area during the first half of 2009 and the impact of new production, added in late 2008 and early 2009, having a lower unit of production operating expense than Monterey's existing base production.

In 2009 operating costs have totaled \$5.1 million which is 58 percent higher than the \$3.2 million for the first six months of 2008. The 2009 total reflects the 76 percent increase in sales volumes as discussed above.

Transportation Costs

Transportation costs of \$1.68 per boe for the first half of 2009 increased nominally by two percent from costs incurred during the first half of 2008. The increase is the result of new production volumes added from Monterey's Brassey area, which has higher transportation costs in relation to the Corporation's remaining base production.

Transportation costs for the first six months of 2009 totaled \$0.7 million, about 79 percent higher than costs recorded in 2008. Higher natural gas production, see sales volume discussion above, nominally offset by lower per unit costs, as discussed immediately above, explain the 2009 increase.

Operating Income

In the first half of 2009 operating income amounted to \$5.3 million, about 29 percent less than the \$7.5 million recorded in 2008. On a per boe basis Monterey's average operating income for the first half of 2009 of \$12.22 per boe is 60 percent less than the \$30.20 per boe recorded in 2008. The change in each of the absolute dollar amount and the per unit figure are the net result of higher sales volumes offset by significantly reduced oil and gas commodity prices.

(\$000's)	Six months ended	Change due to:		Six months ended
	June 30, 2009	Price/Cost	Volume	June 30, 2008
Operating Income:				
Production revenue				
Natural gas sales	\$ 9,725	(11,195)	8,377	\$ 12,543
Oil and NGLs sales	3,486	(4,341)	4,265	3,562
Gain / (loss) from financial instruments	-	2,434	-	(2,434)
	13,211	(13,102)	12,642	13,671
Royalties	2,129	(2,406)	1,944	2,591
Operating costs	5,074	(541)	2,406	3,209
Transportation costs	728	15	306	407
Operating income	\$ 5,280	(10,170)	7,986	\$ 7,464
\$/boe	\$ 12.22			\$ 30.20

Depletion, Depreciation and Accretion Expense

(in \$000's except per boe amounts)	Six months ended	Six months ended
	June 30, 2009	June 30, 2008
Oil and gas properties	\$ 12,555	\$ 5,640
Office equipment	34	17
Asset retirement accretion	370	160
	\$ 12,959	\$ 5,817
\$/boe	\$ 29.96	\$ 23.54

In comparison to the first half of 2008, the DD&A provision in 2009 more than doubled to nearly \$13.0 million. The DD&A provision increase is due to the combination of a 27 percent increase in the unit DD&A expense per boe and a 76 percent growth in production volumes.

DD&A expense per boe increased by 27 percent to \$29.96 per boe. Proved reserves added by 2008 exploration and development activities and acquired in the Upper Lake transaction had a higher average cost relative to Monterey existing total proved reserves.

General & Administrative

Total General and Administrative costs, including stock-based compensation expense for the first half of 2009 was nearly \$2.1 million or 19 percent higher than total G&A expense for the same period during 2008. The increase is largely due to additional costs associated with Monterey being a public corporation in 2009.

The combination of expensed and capitalized G&A expenses, excluding the stock-based compensation provision, for the first six months of 2009 increased to \$1.8 million or nearly 27 percent more than the

same period of 2008. The sources of the increase in G&A expenses in 2009 are higher office rental expenses and the incremental costs of being a public entity.

On a per unit basis, 2009 expensed G&A expenses decreased 27 percent to \$3.48 per boe, capitalized G&A costs fell 42 percent to \$1.35 per boe and total G&A charges dropped 32 percent to \$4.83 per boe, the decrease in each of per unit expensed, capitalized and total G&A expenses represents economies of scale achieved by higher average sales volumes following the acquisition of Upper Lake Oil and Gas Ltd. in August 2008 and successful drilling activities in the second half of 2008 being placed on-stream.

The following table summarizes the G&A costs recorded for each of the first half of 2009 and 2008.

(in \$000's except per boe amounts)	Six months ended June 30, 2009	Six months ended June 30, 2008
Expensed G&A:		
General and administrative expenses	\$ 1,343	\$ 985
Stock-based compensation	164	199
Total expensed G&A	\$ 1,507	\$ 1,184
\$/boe	\$ 3.48	\$ 4.79
Capitalized G&A:		
General and administrative expenses	\$ 495	\$ 464
Stock-based compensation	89	115
Total capitalized G&A	\$ 584	\$ 579
\$/boe	\$ 1.35	\$ 2.34
Total G&A costs	\$ 2,091	\$ 1,763
\$/boe	\$ 4.83	\$ 7.13

The capitalized general and administrative costs include both general and administrative cash expenditures and non-cash stock-based compensation associated with exploration and development activities. The table below provides additional disclosure of the components of capitalized general and administrative costs.

(in \$000's)	Six months ended June 30, 2009	Six months ended June 30, 2008
Salaries and employment costs	\$ 395	\$ 390
Office rent	96	50
Other general and administrative costs	4	24
Capitalized cash general and administrative costs	\$ 495	\$ 464
Capitalized stock-based compensation	\$ 89	\$ 115
Total capitalized general and administrative costs	\$ 584	\$ 579

Interest

(in \$000's except per boe amounts)	Six months ended June 30, 2009	Six months ended June 30, 2008
Interest expense	\$ 526	\$ 517
Interest income	(53)	(18)
Net interest expense	\$ 473	\$ 499
\$/boe	\$ 1.10	\$ 2.02

Despite increased bank debt in the first half of 2009 net interest expenses and the increase in borrowing costs under the bank credit facility in place in the second quarter of 2009 net interest expense is marginally lower than net interest expense recorded in the comparative period of 2008. The reduction in interest costs reflects the lower prime lending rate and the absence of incremental interest charges arising from remaining flow through expenditure requirements.

The economies of scale arising from Monterey's growth in production volumes reduced the Corporation's 2009 unit of production interest expense to \$1.10 per boe approximately 46 percent less than amounts recorded in the first half of 2008.

FUNDS FLOW FROM OPERATIONS

(in \$000's except per boe amounts)	Six months ended June 30, 2009	Six months ended June 30, 2008
Operating income	\$ 5,280	\$ 7,464
Unrealized loss on financial instruments	-	1,984
General and administrative expenses ⁽¹⁾	(1,343)	(985)
Net interest expense	(473)	(499)
Funds flow from operations	\$ 3,464	\$ 7,964
Operating income per boe	\$ 12.22	\$ 30.20
Unrealized loss on financial instruments	-	8.02
General and administrative expenses ⁽¹⁾	(3.10)	(3.98)
Net interest expense	(1.10)	(2.02)
Funds flow from operations per boe ⁽²⁾	\$ 8.02	\$ 32.22

(1) Excluding stock-based compensation.

(2) Funds flow from operations per boe is equal to funds flow from operations divided by total boe production in the period.

The Corporation's funds flow from operations for the first six months of 2009 of \$3.5 million was 56 percent lower than the \$8.0 million reported during first six months of 2008. The decrease was largely due to lower realized oil and gas prices received for Monterey's sales volumes partially offset by the Corporation's 76 percent increase in average sales volumes.

On a per unit basis, funds flow from operations of \$8.02 per boe is about a 75 percent reduction relative to the first half of 2008. Similar to the absolute dollar figures, the reduction in 2009 is explained by the lower commodity prices slightly tempered by the growth in production volumes.

INCOME TAXES

During the three and six months ended June 30, 2009 Monterey did not pay any cash taxes and currently does not anticipate the payment of any cash income taxes in the foreseeable future. At June 30, 2009 Monterey has tax pools totaling approximately \$194.8 million available to be utilized against future taxable income. The tax pools include approximately \$54.8 million in non-capital losses to reduce future taxable income, \$58.7 million in Canadian exploration and development expenses, \$48.0 million in oil and gas property expenses, \$32.1 million in tangible expenses and \$1.2 million of share issue costs.

In accordance with GAAP the financial statements do not reflect the full value of benefit of the tax pools. In order to recognize the value of the pools in the financial statements, the Corporation has to demonstrate consistent positive earnings before income taxes over an extended number of fiscal periods.

Based upon the application of the June 30, 2009 tax pools against future net funds flow from operations that will be generated from estimated proved developed producing reserves, approximately \$3.3 million and \$17.5 million of the non-capital losses may expire unutilized at the end of 2009 and 2012 respectively. Nonetheless, Management anticipates that increased funds flow from operations resulting from future successful exploration and development activities will reduce this risk of non-capital losses expiring unutilized.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2009, Monterey's financial statements reflected total capitalization of nearly \$123.8 million consisting of \$34.2 million in net debt and \$89.7 million in equity. Management reviews its net debt to equity ratio and net debt to forward cash flow and compares the ratios to accepted prudent financial ratios, against the ratios of similar sized publicly listed entities operating in the upstream oil and gas exploration and development industry and the anticipated business environment, opportunities and operations of the Corporation. If any of Monterey's ratios did not meet Management's expectations then actions such as an equity financing, disposition of oil and gas properties, reduction of capital expenditure programs would be undertaken to ensure the Corporation is able to settle its obligations when due and to carry on conducting business.

Capitalization <i>(\$000's)</i>	June 30, 2009	Dec. 31, 2008
Net current deficiency	\$ 931	\$ 2,414
Bank indebtedness	33,085	35,286
Obligation under capital lease	136	224
Share capital	92,944	92,944
Contributed surplus	3,931	3,678
Retained earnings (deficit)	(7,218)	2,441
Total Capitalization	\$ 123,809	\$ 136,987

Net current deficiency

As at June 30, 2009 Monterey had a net current deficiency of \$0.9 million which is nearly \$1.5 million less than the Corporation's net current deficiency on December 31, 2008.

During the first half of 2009, Monterey's outstanding accounts receivable balance has been reduced by \$1.0 million as a result of an increased emphasis on the collection of billings outstanding in excess of 60 days and the impact of lower natural gas prices on sales of June 2009 sale of production. Prepaid expenses and deposits increased by \$1.2 million in 2009 largely due to the recording of stamping fees

paid on guaranteed note borrowings. The accounts payable balance is \$2.6 million lower at June 30, 2009 than at December 31, 2009, this is primarily due the very limited exploration and development spending incurred during the second quarter of 2009. The net effect of these items resulted in a 61 percent decrease in Monterey's net current deficiency from the end of 2008.

Bank indebtedness

At June 30, 2009, the Corporation had total bank indebtedness of \$33.1 million, resulting from Canadian drawings against the credit facility in the form of guaranteed rate notes with terms to maturity of less than one year. The drawings are comprised of \$32.7 million in guaranteed notes, having various maturity dates over the July 2009 to February 2010 period, and revolving overdraft borrowings of \$0.4 million. In addition, Monterey has issued approximately \$149,000 in letters of credit/guarantee under the facility.

During the first quarter, at Management's request, the Corporation's lender (the "Lender") conducted the annual review of the credit facility. As a result of the review, Monterey and the Lender agreed to a new \$45 million demand revolving credit facility (the "Facility"). In association with the Facility, Monterey paid approximately \$0.1 million to the Lender in respect of commitment fees and will also pay, upon maturity of the outstanding guaranteed notes, \$0.3 million in respect of stamping fee adjustments. The next annual review of the Facility is scheduled to be completed prior to June 1, 2010.

Under the Facility, Monterey has the ability to borrow from the Lender up to \$45 million in the form of: (i) revolving prime based and US prime based borrowing in multiples of \$25,000; (ii) issue of guaranteed notes and LIBOR borrowing subject to minimum borrowings of \$1 million and additional amounts in multiples of \$0.1 million having terms to maturity from 15 to 365 days from the date of issue; and (iii) letters of credit/guarantee, to a cumulative maximum of \$12.5 million, for a period of up to one year. The Facility maintains Monterey's access to the previously established derivatives facility, whereby the Corporation may enter into U.S. foreign exchange forwards contracts or interest and commodity derivatives contracts with the Lender. Covenants on Monterey's derivatives facility continue to limit the commodity derivatives contracts entered into by the Corporation to a maximum of 60% of Monterey's annualized before royalties production as report in the most recently completed calendar quarter and that the term of any commodity contract will not exceed a period of two years.

Under the terms of the Facility, interest rates on: (i) Canadian and US dollar prime based borrowing will be at the applicable Lender's prime lending rate plus 1.25%; (ii) on the issue of guaranteed notes or LIBOR borrowing Monterey will pay the base rate plus a stamping fee of 2.5% per annum; and a fee equal to 1.25% per annum, payable at issue, on letters of credit/guarantee. Monterey borrowings in excess of \$40.5 million will incur interest at an additional 1% per annum. Monterey also pays a monthly stand-by fee on the average unused portion of the Facility at a rate of 0.35% per annum.

The covenants and requirements under the Facility remain unchanged from those in the previous credit facility.

The Lender has the right to demand repayment of all borrowings at any time without notice or terminate the availability of the unused portion of the Facility five business days after serving notice to the Corporation. Monterey has the right to draw against the Facility, repay amounts borrowed or convert the type of borrowings subject to providing same day notice for borrowings less than \$5.0 million and one business day notice for borrowings of \$5.0 million or more.

The Facility is guaranteed by a Monterey general security agreement providing a floating charge on all the Corporation's lands and a security interest over all present and subsequently acquired personal property. Under the terms of the Facility, Monterey is obligated to meet certain covenants including

providing certain financial and engineering information in a timely manner; however, Monterey is not required to meet any specific numerical financial covenants, such as a debt to equity ratio or minimum working capital or liquidity amounts.

Currently the undrawn amount available under the Facility and the anticipated funds flow from operations and proceeds from the oil and the gas property disposition completed after June 30, 2009 will be sufficient for Monterey to complete its planned capital expenditure program and settle its obligations for 2009 and at least the first five months of 2010. In the event that business conditions deteriorated to the point where the Lender felt that it was unable to advance all of the funds under the Facility, if necessary, management would consider additional dispositions of non-core properties, delay the timing of the planned exploration and development program or consider other balance sheet measures available to Monterey to ensure that the Corporation remains a going concern.

Share Capital

At August 12, 2009, Monterey had 32,902,500 voting common shares, and 3,135,666 stock options (1,566,669 exercisable at June 30, 2009) outstanding.

Contributed Surplus

The Corporation's contributed surplus is equal to the fair value of stock options accrued over the vesting period of the stock options. The fair value of the stock options is estimated at the date the options are granted using the Black-Scholes option pricing model. When shares are issued as a result of the exercise of stock options the fair value of the stock option reflected in contributed surplus is credited to share capital and the contributed surplus balance reduced.

CAPITAL EXPENDITURES

(\$000's)	Three Months ended		Six Months ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Land and lease retention	\$ 27	\$ 615	\$ 111	\$ 4,965
Geological and geophysical	15	170	128	625
Drilling and completions	494	1,838	3,414	7,935
Production equipment and facilities	320	570	1,158	1,744
Capitalized G&A	248	206	495	464
Exploration and development expenditures	\$ 1,104	\$ 3,399	\$ 5,306	\$ 15,733
Property acquisitions	-	31	-	277
Office furniture, equipment and software	-	4	(4)	10
Capital expenditures before dispositions	\$ 1,104	\$ 3,434	\$ 5,302	\$ 16,020
Property dispositions	-	(1,267)	(6,016)	(1,267)
Capital expenditures	\$ 1,104	\$ 2,167	\$ (714)	\$ 14,753

Monterey's second quarter capital spending program of \$1.1 million was almost entirely directed towards operations at Groundbirch. It was comprised of the drilling costs associated with the successful vertical Monterey exploration test well spud late in the first quarter, the facility design, consultation and application costs related to the processing facility application and survey and licensing costs associated with the next phase of exploration and development drilling locations. The Corporation's total capital expenditures for the first half of the year, prior to dispositions, amounted to \$5.3 million.

COMMITMENTS

As at June 30, 2009 Monterey has the following contractual obligations:

(\$000's)	Recognized in financial statements	Less than 1 Year	1 – 3 years	4 – 5 years	After 5 years	Total
Credit Facility	Yes	\$ 33,085	\$ -	\$ -	\$ -	\$ 33,085
Stamping fees	No	302	-	-	-	302
Asset retirement ⁽¹⁾	Yes	-	753	727	6,503	7,983
Leases	No	175	1,050	642	-	1,867
Total		\$ 33,562	\$ 1,803	\$ 1,369	\$ 6,503	\$ 43,237

(1) Asset retirement costs shown are undiscounted.

Leases

Monterey is committed to future payments under an operating lease for head office space and parking facilities totaling approximately \$1.9 million until October 30, 2014. Of this total, Monterey is committed to payments of \$350,000 for each of the years from 2010 to 2013, and \$292,000 in 2014. For the remainder of 2009, the Corporation is committed to making equal monthly payments totaling \$175,000.

RELATED PARTY TRANSACTIONS

Legal Services

A director of Monterey is a partner at a law firm that provides legal services to the Corporation. During the six months ended June 30, 2009, the Corporation incurred approximately \$49,000 in legal services and disbursements associated with this related party. At June 30, 2009 the Corporation's accounts payable include an accrual of \$5,000 for amounts owed to the law firm for legal fees and disbursements which have not yet been billed.

Transactions with Shareholder

During the six months ended June 30, 2009, the Corporation had transactions totaling approximately \$107,000 with an entity that holds approximately 24% of the outstanding common shares of Monterey. The transactions primarily consisted of Monterey's participation in the joint exploration, development and production of petroleum and natural gas properties. All transactions were completed on an arm's length basis consistent with normal industry terms. The value of the transactions between Monterey and the related party were recorded at the carrying amount, which approximated their fair value. At June 30, 2009, Monterey's records include \$14,000 in accounts receivable and \$11,000 in accounts payable with this shareholder.

Common Management and Directors

Certain directors of Monterey are also the directors or management of other entities that participate in joint operations with the Corporation. Transactions with these related parties are on terms that are consistent with parties dealing at arm's length. During the first half of 2009, the aggregate value of transactions entered into between Monterey and these entities was approximately \$1,232,000. At June 30, 2009 Monterey's records include outstanding payables owed to the related parties of \$72,000 and accounts receivables due to Monterey of approximately \$135,000.

SUBSEQUENT EVENT

In July 2009, Monterey completed the disposition of 3 sections of undeveloped non-core lands in the Town area of NEBC for total net proceeds of \$2.7 million. There were no reserves or production associated to these lands and proceeds from the disposition will be applied to the second half drilling operations scheduled at Groundbirch.

OUTLOOK

Monterey is increasing the full year capital expenditure guidance from \$10 million to \$13 million based on the recent disposition of undeveloped lands and the scheduled operations at Groundbirch. All remaining exploration and development capital spending during the second half of the year will be directed to the Monterey development in the Groundbirch area. With no further capital in the second half of the year being applied to near term production addition projects, production guidance for the full year 2009 is estimated to be approximately 2,200 boe/d.

SENSITIVITY ANALYSIS

Monterey's financial performance is impacted by changes in production and the business environment. The table below indicates the key factors impacting Monterey's financial performance for the second half of 2009. The table below indicates Monterey's assumptions and the impact to funds flow from operations over the July 1, 2009 to December 31, 2009 period as a result of a change in each key item.

Variable	Monterey Assumption	Variance	Impact on Funds flow from operations (\$000's)
Natural gas production	9.0 – 10.0 mmcf/d	1.0 mmcf/d	370
Natural gas prices	\$4.20 mcf	\$1.00/mcf	1,545
WTI oil price	\$66.00US	\$1.00US	50
Foreign exchange rate	\$1.15Cdn : \$1.00US	\$0.01Cdn	115
Bank prime lending rate	2.25%	1.00%	45

QUARTERLY SUMMARY INFORMATION

<i>(in thousands, except for commodity prices, per share amounts, or unless otherwise noted)</i>	Three Months Ended							
	June 30 , 2009	Mar. 31 , 2009	Dec. 31 , 2008	Sept. 30, 2008	June 30, 2008	Mar. 31, 2008	Dec. 31, 2007	Sept. 30, 2007
Average sales volumes:								
Natural gas (mcf/d)	11,151	11,939	10,058	8,400	6,598	7,168	7,969	7,484
Light oil and NGL (bbl/d)	470	461	453	292	181	241	212	288
Oil equivalent (boe/d)	2,329	2,451	2,130	1,691	1,280	1,435	1,540	1,535
Average sales prices:								
Natural gas (\$/mcf) ⁽¹⁾	\$ 3.60	\$ 5.59	\$ 7.35	\$ 10.24	\$ 9.03	\$ 7.09	\$ 6.54	\$ 6.00
Light oil and NGL (\$/bbl)	\$ 44.81	\$ 37.84	\$ 51.78	\$ 101.08	\$ 105.92	\$ 83.07	\$ 80.32	\$ 67.84
Oil equivalent (\$/boe) ⁽¹⁾	\$ 26.42	\$ 34.52	\$ 45.75	\$ 68.45	\$ 62.03	\$ 49.34	\$ 44.95	\$ 42.17
Financial:								
Production revenue ⁽¹⁾	\$ 5,597	\$ 7,614	\$ 8,965	\$ 10,652	\$ 7,227	\$ 6,444	\$ 6,366	\$ 5,957
Operating income ⁽¹⁾	\$ 1,842	\$ 3,438	\$ 4,191	\$ 6,445	\$ 4,163	\$ 3,301	\$ 3,126	\$ 3,716
Funds flow from operations	\$ 844	\$ 2,620	\$ 3,694	\$ 3,345	\$ 4,417	\$ 3,547	\$ 2,588	\$ 3,327
Net earnings / (loss)	\$ (5,485)	\$ (4,174)	\$ (2,110)	\$ 1,301	\$ 601	\$ 1,111	\$ (1,101)	\$ (113)
Total capital expenditures	\$ 1,104	\$ (1,818)	\$ 10,900	\$ 40,930	\$ 2,167	\$ 12,586	\$ 3,615	\$ 12,956
Net current surplus / (deficiency)	\$ (931)	\$ (2,640)	\$ (2,414)	\$ (7,486)	\$ (3,961)	\$ (5,874)	\$ (1,517)	\$ (4,492)
Bank debt ⁽²⁾	\$ 33,221	\$ 31,052	\$ 35,510	\$ 22,606	\$ 18,038	\$ 18,227	\$ 13,625	\$ 14,875
Per share:								
Funds flow from operations:								
Basic	\$ 0.03	\$ 0.08	\$ 0.11	\$ 0.12	\$ 0.18	\$ 0.14	\$ 0.11	\$ 0.14
Diluted	\$ 0.03	\$ 0.08	\$ 0.11	\$ 0.12	\$ 0.17	\$ 0.14	\$ 0.11	\$ 0.14
Earnings / (loss):								
Basic	\$ (0.17)	\$ (0.13)	\$ (0.06)	\$ 0.05	\$ 0.02	\$ 0.04	\$ (0.04)	\$ (0.00)
Diluted	\$ (0.17)	\$ (0.13)	\$ (0.06)	\$ 0.05	\$ 0.02	\$ 0.04	\$ (0.04)	\$ (0.00)
Share data:								
Outstanding:								
Common shares	32,903	32,903	32,903	32,903	25,107	20,046	19,993	18,378
Non-voting common shares	-	-	-	-	-	5,061	5,061	5,061
Total outstanding	32,903	32,903	32,903	32,903	25,107	25,107	25,054	23,439
Stock options	3,136	3,136	3,136	2,771	2,151	2,151	2,296	1,676
Total diluted shares outstanding	36,039	36,039	36,039	35,674	27,258	27,258	27,350	25,115
Weighted average:								
Basic	32,903	32,903	32,903	27,818	25,107	25,058	24,528	23,439
Diluted	33,136	32,933	32,904	27,818	25,329	25,255	24,684	23,474

(1) Includes gains and losses from financial instruments

(2) Bank debt includes obligation under capital lease

NON-GAAP MEASURES

Within this MD&A, references are made to terms commonly used in the oil and gas industry. Management uses funds flow from operations, operating income, capital expenditures and net debt to analyze operating performance. These measures do not have standardized meanings prescribed by GAAP, and may not be comparable to similar measures presented by other companies. For this MD&A the measures used are: (i) Funds flow from operations; (ii) Operating income; (iii) Capital expenditures; (iv) Total capital expenditures (v) Funds flow from operations per basic and funds flow from operations per diluted share is calculated by dividing funds flow from operations as described earlier, by the total number of respective weighted average basic and diluted common shares outstanding during the period; (vi) Net debt; (vii) Net current surplus (deficiency); and (viii) Estimated forward cash flow being funds flow from operations for a particular month adjusted for one time or extraordinary items which is then annualized. This non-GAAP measure provides a quick and reasonably accurate estimate, under current business conditions, of the funds flow from operations for the next twelve months.

The following tables reconcile the non-GAAP measures used in this Management Discussion and Analysis to the most directly comparable measure calculated in accordance with GAAP:

Funds flow from operations

(\$000's)	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Cash provided by operating activities	\$ 1,517	\$ 4,650	\$ 3,549	\$ 7,926
Changes in non-cash working capital	(693)	(381)	(491)	(153)
Asset retirement expenditures	20	148	406	191
Funds flow from operations	\$ 844	\$ 4,417	\$ 3,464	\$ 7,964

Funds flow from operations is an important measure to Management and investors because it provides a better indication of Monterey's internal funds generated from ongoing operations, versus cash flow provided by (used in) operating activities. Cash flow from (used in) operating activities takes into account the net change in non-cash working capital items and asset retirement expenditures which may vary significantly from one period to the next, are likely to be infrequently incurred or are not considered part of normal operations.

Operating income

(\$000's)	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Net earnings (loss)	\$ (5,485)	\$ 601	\$ (9,659)	\$ 1,712
Add: Future income tax expense (recovery)	-	(17)	-	(1,748)
Add: Depreciation, depletion and accretion	6,247	2,737	12,959	5,817
Add: Net interest expense	264	236	473	499
Add: General and administrative	816	606	1,507	1,184
Operating income	\$ 1,842	\$ 4,163	\$ 5,280	\$ 7,464

Management views operating income as an important measure of the Corporation's viability and contribution from the operation of its core business and is reflective of Monterey's gross margin.

Capital expenditures and Total capital expenditures

<i>(\$000's)</i>	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
Cash used in investing activities	\$ 3,506	\$ 4,461	\$ 1,260	\$ 12,469
Change in non-cash working capital	(2,402)	(2,294)	(1,974)	2,284
Capital expenditures and total capital expenditures	\$ 1,104	\$ 2,167	\$ (714)	\$ 14,753

Capital expenditures measure the net cash resources directed to exploring for and developing of oil and gas reserves along with the investment in office furniture and equipment to support Monterey's business activities. While total capital expenditures is comprised of capital expenditures plus the recorded cost of oil and gas properties of corporate acquisitions, including the costs of the acquisition and the allocation to long lived asset retirement. These measures are each considered by Management to be better measures than capital additions recorded under GAAP to determine the Corporation's success and efficiency in growing its reserves and reserve value.

Capital expenditures indicate the investment customarily incurred in the exploration and development activities and is readily comparable to other periods. The capital additions under GAAP include non-cash adjustments, such as long lived asset retirement costs, that impair Management's and the reader's ability to accurately assess Monterey's performance in respect of adding reserves organically and complemented with property acquisitions. Reserve growth from organic and property acquisitions activities represent the typical methods employed by the Corporation.

Total capital expenditures also includes the incremental costs incurred to increase Monterey's reserve base via business combinations. The total capital expenditures measure is provided in addition to capital expenditures as growth via corporate acquisition has historically been atypical of Monterey's activities. Total capital expenditures measure assists the reader to assess the Corporation's overall performance to increase its reserves.

Net debt

<i>(\$000's)</i>	As at June 30, 2009	As at Dec. 31, 2008
Bank indebtedness	\$ 33,085	\$ 35,286
Less: Current assets	(2,914)	(5,661)
Add: Accounts payable and accrued liabilities	3,845	8,075
Add: Obligation under capital lease	136	224
Net debt	\$ 34,152	\$ 37,924

Net debt is an important measure as it provides a measure of the net obligations that can be reasonably expected to be settled with the Corporation's assets in the near term. Total liabilities under GAAP, also include asset retirement obligations as well as liabilities arising from financial instruments for which the timing of settlement with the Corporation's existing and future assets involve greater use of estimation and as a result the timing and amount expended to satisfy the obligation may be subject to significant variation.

Net current deficiency

<i>(\$000's)</i>	As at June 30, 2009	As at Dec. 31, 2008
Current liabilities	\$ 37,066	\$ 43,540
Less: Current assets	(2,914)	(5,661)
Working capital deficit	34,152	37,879
Less: Current portion of bank indebtedness	(33,085)	(35,286)
Less: Current portion of obligation under capital lease	(136)	(179)
Net current deficiency	\$ 931	\$ 2,414

Net current deficiency is a key measure for the Corporation as it gives a measure of net working capital excluding unrealized financial instrument assets and liabilities. Unrealized financial instrument assets and liabilities for Monterey primarily consist of the estimated future settlement value of forward financial contracts which are not necessarily indicative of the actual net cash inflows or outflows at the settlement date of the financial instruments. As at June 30, 2009 and December 31, 2008, Monterey did not participate in forward financial contracts for which unrealized gains or losses would arise.

FORWARD LOOKING STATEMENTS & ADVISORIES

Certain information regarding Monterey set forth in this MD&A, including but not limited to Management's expectations regarding the timing of its IFRS change over plans, expectations regarding its financial capabilities, continued availability of debt financing, expectations regarding tax pool expiries, expectations concerning future funds flow from operations, future exploration and development activities, planned capital expenditures, treatment under royalty regimes, plans regarding the development of the Corporation's project inventory and expectations relating to production levels and forecast production may constitute forward-looking statements under applicable securities laws and regulations involve substantial known and unknown risks and uncertainties. The use of any of the words "anticipate", "continue", "depends", "estimate", "expect", "may", "will", "project", "should", "believe", "would", "potential" and similar expressions are intended to identify forward-looking statements. Such statements represent Monterey's internal projections, estimates or beliefs concerning, among other things, an outlook on the estimated amounts and timing of capital expenditures, anticipated future debt, revenues or other expectations, beliefs, plans, objectives, assumptions, intentions or statements about future events or performance. These statements are only predictions and actual events or results may differ materially. In addition, statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. Although Monterey believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity, performance or achievement since such expectations are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause Monterey's actual results to differ materially from those expressed or implied in any forward-looking statements made by, or on behalf of, Monterey.

The forward-looking statements included in this MD&A also include, but are not limited to, statements with respect to the size of, and future net revenues from, crude oil and natural gas reserves; the focus of capital expenditures; expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development; projections of market prices and costs; the performance characteristics of Monterey's crude oil and natural gas properties; crude oil and natural gas production levels; Monterey's future operating and financial results; expectations regarding Monterey's capital expenditure programs; supply and demand for crude oil and natural gas; average royalty rates;

development drilling; amount of general and administrative expenses; treatment under governmental regulatory regimes and tax laws; the risk of non-capital losses expiring unutilized; and expectations regarding operating costs.

These forward-looking statements are subject to numerous risks and uncertainties, certain of which are beyond the Corporation's control, including the impact of general economic conditions; volatility in market prices for crude oil and natural gas; industry conditions; volatility of commodity prices; currency fluctuation; imprecision of reserve estimates; liabilities inherent in crude oil and natural gas operations; environmental risks; incorrect assessments of the value of acquisitions and exploration and development programs; competition from other producers; the lack of availability of qualified personnel or management; changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry; hazards such as fire, explosion, blowouts, cratering, and spills, each of which could result in substantial damage to wells, production facilities, other property and the environment or in personal injury; stock market volatility; and ability to access sufficient capital from internal and external sources.

With respect to forward-looking statements contained in this MD&A, Monterey has made assumptions regarding: the success of exploration and development activities, the impact of increasing competition; the general stability of the economic and political environment in which Monterey operates; the ability of the Corporation to retain or obtain qualified staff, equipment and services in a timely and cost efficient manner; drilling results; the ability of the operator of the projects which the Corporation has an interest in to operate the field in a safe, efficient and effective manner; Monterey's ability to obtain financing on acceptable terms; field production rates and decline rates; the ability to replace and expand oil and natural gas reserves through acquisition, development or exploration; the timing and costs of pipeline, storage and facility construction and expansion; the ability of the Corporation to secure adequate product transportation; future oil and natural gas prices; currency, exchange and interest rates; the regulatory framework regarding royalties, taxes and environmental matters in the jurisdictions in which the Corporation operates; and Monterey's ability to successfully market its oil and natural gas products.

Management has included the above summary of assumptions and risks related to forward-looking information provided in this MD&A in order to provide readers with a more complete perspective on Monterey's future operations and such information may not be appropriate for other purposes. Monterey's actual results, performance or achievement could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that Monterey will derive there from. Readers are cautioned that the foregoing lists of factors are not exhaustive. These forward-looking statements are made as of the date of this MD&A and Monterey disclaims any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or results or otherwise, other than as required by applicable securities laws.

However, in the event that subsequent events are reasonably likely to cause actual results to differ materially from material forward-looking statements or information previously disclosed by Monterey for a period that is not yet complete, Monterey will provide disclosure on such events and the anticipated impact of such events.

Discovered Petroleum Initially in Place

This MD&A contains references to estimates of gas classified as Discovered Petroleum initially in Place ("DPIP") in the Corporation's Groundbirch area in British Columbia which are not, and should not be confused with oil and gas reserves. "Discovered Petroleum Initially in Place" is defined in the COGE Handbook as the quantity of hydrocarbons that are estimated, as of a given date, to be contained in known accumulations. DPIP is divided into recoverable and unrecoverable portions, with the estimated future recoverable portion classified as reserves and contingent resources. There is no certainty that it will be commercially viable to produce any portion of this DPIP. Resources do not constitute, and should not be confused with, reserves.

BOE Disclosure

For the purpose of calculating unit measures, natural gas is converted to a boe at a conversion rate of six thousand cubic feet of natural gas being equal to one boe. Disclosure provided herein in respect of boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf: 1 boe is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.