



## ProspEx Announces 2009 Third Quarter Results

(All amounts are in Canadian dollars, unless stated otherwise)

November 2, 2009

ProspEx Resources Ltd. ("ProspEx" or the "Company") announces its financial and operating results for the three and nine months ended September 30, 2009.

"The third quarter marked the transition of ProspEx to a resource play focus", said John Rossall, President and Chief Executive Officer. "The results from our 2-33-63-4W6M East Kakwa horizontal well validated the concept of development using horizontal wells with multi-stage fracturing. The Company also established a new operating area in West Central Alberta that we believe offers repeatable opportunity similar to East Kakwa."

### HIGHLIGHTS

- The third quarter was highlighted by the successful drilling and completion of ProspEx's first horizontal well at East Kakwa in the Deep Basin (2-33-63-4W6M or the "2-33 well"). This well was tested at flow rates up to 11 million cubic feet ("mmcf") per day, and is expected to be on stream by mid November. ProspEx is the operator and has a 60% working interest in this well.
- ProspEx has established a new operating area in West Central Alberta. In 2009 to date, the Company has assembled a 12,000 net acre land position through the acquisition of oil and gas rights at Alberta Crown land sales at a cost of approximately \$4.3 million.
- Production for the third quarter decreased to 1,978 barrels of oil equivalent ("boe") per day, compared to 3,089 boe per day in the second quarter of 2009. This decrease in production was due to the disposition of approximately 750 boe per day of non-core production effective June 1, 2009, and the temporary curtailment of production during the third quarter due to the low natural gas price environment, both as previously announced by ProspEx, and natural declines of the Company's production base. Substantially all of the curtailed production was brought back on line in late October.
- Cash flow before changes in non-cash working capital items for the quarter was \$2.0 million, a decrease of 81% compared to the third quarter of the prior year due to a 49% decrease in production and a 50% decrease in realized commodity prices.
- ProspEx remains in strong financial condition. Net debt at September 30, 2009 was \$27.8 million, equivalent to 70% of the limit on the Company's credit facility. The Company has entered into various hedging arrangements to protect cash flow through to the end of the first quarter of 2010.

### MESSAGE TO SHAREHOLDERS

Over the course of 2009, ProspEx has focused on building an inventory of repeatable opportunities on assets where horizontal drilling using multi-stage fracturing technology has the potential to generate superior results. The third quarter saw these efforts come to fruition. As previously announced, the Company drilled and completed the 2-33 well, a successful horizontal well at East Kakwa in the Deep Basin, during the third quarter. This well was drilled to test the technical and commercial viability of horizontal drilling at East Kakwa. Given the success of this well, ProspEx is planning two additional horizontal wells for the upcoming winter drilling season that are intended to extend the application of horizontal drilling over the length of the Company's East Kakwa land base. This winter's drilling

program is designed to set the stage for a full scale development using horizontal wells at East Kakwa, which ProspEx currently sees as including 20 (10 net) additional horizontal wells.

ProspEx has also established a new operating area in West Central Alberta, with the majority of the 12,000 net acre land position held in two contiguous blocks. These lands were acquired by ProspEx because they showed potential in the same geological formations as the Company is exploiting in East Kakwa, allowing the Company to extend its horizontal drilling program over a larger land base. Drilling activity in West Central Alberta over the coming winter will be focused on drilling an initial horizontal well on each of two contiguous land blocks acquired in the area.

The success of the 2-33 horizontal well and the addition of the new lands in West Central Alberta reinforces ProspEx's commitment to a resource play focus featuring a repeatable prospect inventory utilizing horizontal drilling. The 2-33 well demonstrates the viability of horizontal drilling in East Kakwa, and the acquisition of new lands provides the Company with a substantially larger prospect inventory upon which to apply this technology.

In addition to transforming the Company's asset base, ProspEx's other priority in 2009 is to maintain financial flexibility during the current downturn in natural gas prices. The Company disposed of certain non-core assets in the second quarter to strengthen its balance sheet, and has entered into various hedging arrangements to protect cash flow through to the end of the first quarter of 2010.

ProspEx's activities in 2009 were intended to position the Company to emerge from the current downturn with an improved asset base and the financial flexibility to realize value from these assets. ProspEx believes that it is successfully executing this strategy, and looks forward to the coming winter drilling program.

## **OPERATIONAL REVIEW**

### **Capital Program**

Capital expenditures for exploration and development (before acquisitions and dispositions) were \$6.4 million during the third quarter of 2009. The Company's capital program was focused on two projects: the drilling of the 2-33 well, ProspEx's first horizontal well at East Kakwa in the Deep Basin, and the accumulation of oil and gas rights in West Central Alberta that offer opportunities that ProspEx believes are similar to the East Kakwa assets.

At East Kakwa, the 2-33 well was successfully drilled and completed during the third quarter. Following the completion, the well flowed up 4 ½" casing on clean up test with a final rate of 10.9 mmcf per day at a flowing wellhead pressure of 2,380 pounds per square inch ("psi"). A 66 hour extended flow test was then performed, with the well flowing up 2 3/8" tubing at a restricted rate to minimize operational risks associated with the flow back of frac sand. During the extended test the well produced at a stable flowing pressure of approximately 2,300 psi, with the flow rate increasing from 6.0 mmcf per day to 6.6 mmcf per day at the end of the test.

The estimated gross cost to drill and complete the 2-33 well was \$3.9 million, prior to the deduction of the estimated \$0.7 million Alberta Drilling Royalty Credit. The 2-33 well is expected to be tied into ProspEx's pipeline system and on production by mid November, 2009. ProspEx is the operator and has a 60% working interest in this well.

The Company believes that this well result confirms the technical and commercial viability of developing its East Kakwa properties using horizontal wells with multi-stage fracturing techniques. Based on this well result, existing vertical well control and 3D seismic coverage, ProspEx has identified 20 (10 net) additional horizontal drilling locations on its existing East Kakwa acreage, assuming a drilling density of two horizontal wells per section. The Company has regulatory approval to drill to a density of four wells per section on the majority of its East Kakwa lands.

ProspEx invested \$3.7 million in the third quarter on purchases of oil and gas rights at Alberta Crown land sales. This investment was largely targeted at the establishment of a new operating area in West Central Alberta. Year to date,

the Company has assembled a 12,000 net acre land position in West Central Alberta at a cost of approximately \$4.3 million. All of this land position is held by the Company at 100% working interest.

Using data from existing wells and two dimensional seismic, ProspEx has mapped a number of trends across these lands that the Company considers to be similar to the East Kakwa assets. The trends identified on the new lands exist in the same geological formations that ProspEx has been exploiting in East Kakwa, and ProspEx believes that the potential opportunity should be similar to that at East Kakwa. Industry activity on trend with the newly acquired lands has demonstrated the potential for a successful development using horizontal wells.

## Production

Production (boe/d)	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
West Central Alberta	1,289	1,635	2,099	1,914	1,847
Deep Basin	675	944	985	924	1,150
Southern Alberta	7	503	713	743	847
Other	7	7	10	6	6
Total	1,978	3,089	3,807	3,587	3,850

The third quarter production averaged 1,978 boe per day, compared to second quarter of 2009 production of 3,089 boe per day. This decrease in production was due to the disposition of approximately 750 boe per day of non-core production effective June 1, 2009, and the temporary curtailment of production during the third quarter due to the low natural gas price environment, both as previously announced by ProspEx, and natural declines of the Company's production base. Approximately 500 boe per day of production was curtailed in early August, and an additional 600 boe per day in late August. With the exception of the Company's wells in the Salter area, all of the curtailed production was brought back on stream in late October, 2009. The Salter wells are expected to be on stream by mid November, 2009. ProspEx estimates that current production is approximately 2,300 boe per day, with an additional 175 boe per day net to the Company expected from the Salter wells.

## FINANCIAL

The Company remains in strong financial condition despite the relatively low natural gas pricing environment of the past quarter. Net debt at September 30, 2009 was \$27.8 million, equivalent to 70% of the limit on the Company's credit facility. The next scheduled review date for the Company's credit facility is May 31, 2010.

The Company has entered into the following financial derivative sales contracts in order to partially mitigate commodity price risk over the fall and winter of 2009.

<u>Type</u>	<u>Amount (GJ/day)</u>	<u>Term</u>	<u>Price (\$/GJ at AECO)</u>
Fixed	2,500	Oct. 1 – Oct. 31, 2009	\$ 4.21
Costless collar	1,500	Oct. 1 – Oct. 31, 2009	\$ 4.00 - \$ 5.23
Costless collar	2,000	Nov. 1 – Mar. 31, 2010	\$ 4.25 - \$ 5.67
Fixed	2,000	Nov. 1 – Dec. 31, 2009	\$ 4.66
Fixed	2,000	Nov. 1 – Dec. 31, 2009	\$ 4.735
Put	3,000	Jan. 1 – Mar. 31, 2010	\$ 5.00

These hedges protect the price to be received for approximately half of the Company's forecasted natural gas production for the period August 1 to December 31, 2009 (after giving effect to the production curtailments described above), and approximately 35% to 40% of forecasted natural gas production for the period January 1 to March 31, 2010.

## GUIDANCE

ProspEx has obtained the necessary licenses to drill the next horizontal well in the East Kakwa program, and expects to have this well drilled prior to the end of 2009. One additional East Kakwa horizontal well is planned for the first quarter of 2010. In West Central Alberta, two horizontal wells are planned for the first quarter of 2010, one on each of the two contiguous land blocks recently acquired by the Company. The Company anticipates that the capital spending program planned for this upcoming winter program will be financed by forecasted funds from operations and existing credit facilities.

ProspEx reaffirms its previously issued production guidance as the Company expects annual average production in 2010 to range between 3,100 and 3,300 boe per day after forecasting risked production and on stream timing of the projected capital program, and estimated decline rates on new and existing production.

### Reader's Advisory

ProspEx is a Calgary based junior oil and gas company focused on exploration for natural gas in the Western Canadian Sedimentary Basin.

Certain information contained in this press release constitutes forward-looking information or statements including, without limitation, information and statements respecting: anticipated cash flow, capital expenditures, production forecasts, production additions and deletions, reserves and resources additions and deletions, additions to and deletions from the Company's historical and future capital programs, acquisitions or dispositions, operating expenses, G&A, royalties, expected timing of the tie-in of wells, expected timing of the receipt of regulatory approvals and expected timing of the completion of facilities projects.

Statements relating to "reserves" and "resources" are forward-looking information as they involve the implied assessment, based on certain estimates and assumptions that, among others, the reserves and resources described exist in the quantities predicted or estimated.

Forward-looking information and statements are often, but not always, identified by the use of words such as "anticipate", "seek", "believe", "expect", "hope", "plan", "intend", "forecast", "target", "project", "guidance", "may", "might", "will", "should", "could", "estimate", "predict" or similar words or expressions suggesting future outcomes or language suggesting an outlook. By their very nature, forward-looking information and statements involve inherent risks and uncertainties, both general and specific, and risks that predictions, forecasts, projections and other forward-looking information and statements will not be achieved. We caution readers not to place undue reliance on these statements as a number of important factors could cause the actual results to vary materially from the forward-looking information or statements. These factors include, but are not limited to: the volatility of oil and gas prices; production and development costs and capital expenditures; the imprecision of reserve and resource estimates and estimates of recoverable quantities of oil, natural gas and liquids; the Company's ability to replace and expand oil and gas reserves; environmental claims and liabilities; incorrect assessments of value when making acquisitions or dispositions; increases in debt service charges; the loss of key personnel; the marketability of production; defaults by third party operators; unforeseen title defects; fluctuations in foreign currency and exchange rates; adequacy of insurance coverage; compliance with environmental laws and regulations; changes in tax and royalty laws; the Company's ability to access external sources of debt and equity capital; and the Company's ability to obtain equipment in a timely manner to carry out development activities. Further information regarding these factors may be found under the headings "*Risk Factors*" and "*Industry Conditions*" in the Company's most recent Annual Information Form, under the heading "*Business Risks*" in the Company's Management's Discussion and Analysis for the year ended December 31, 2008, and in the Company's most recent consolidated financial statements, management

information circular, quarterly reports, material change reports and news releases available under the Company's profile on SEDAR ([www.sedar.com](http://www.sedar.com)). Readers are cautioned that the foregoing list of factors that may affect future results is not exhaustive. When relying on our forward-looking statements to make decisions with respect to the Company, investors and others should also carefully consider information set forth in the section "Forward-Looking Information" of the Company's most recent Annual Information Form respecting the assumptions upon which the Company bases certain forward-looking information and the uncertainties inherent in such assumptions.

The Company does not assume responsibility for the accuracy and completeness of the forward-looking information or statements and such information and statements should not be taken as guarantees of future outcomes. Subject to applicable securities laws, the Company does not undertake any obligation to revise these forward-looking information or statements to reflect subsequent events or circumstances. Furthermore, the forward-looking information contained in this press release are made as of the date of this document and the Company does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law. The forward-looking information and statements contained in this press release are expressly qualified by this cautionary statement.

For the purposes of this press release, boes have been calculated on the basis of six thousand cubic feet of gas to one barrel of oil. The term boe may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet to one barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Netbacks are calculated by subtracting transportation costs, royalties payable and operating costs from the average price received during the period.

ProspEx Resources Ltd.  
Consolidated Highlights  
For the period ended

(unaudited)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
<b>FINANCIAL (\$000's)</b>				
Oil and gas revenue	5,023	19,714	25,158	61,659
Net (loss) earnings	<b>(3,082)</b>	6,923	<b>(9,206)</b>	7,074
Cash flow <sup>(1)</sup>	1,969	10,626	10,165	34,734
Total assets	<b>160,129</b>	198,395	<b>160,129</b>	198,395
Total net debt <sup>(2)</sup>	<b>27,841</b>	48,191	<b>27,841</b>	48,191
Net (loss) earnings per share (\$ per share)				
Basic	<b>(0.05)</b>	0.12	<b>(0.16)</b>	0.12
Diluted	<b>(0.05)</b>	0.12	<b>(0.16)</b>	0.12
Cash flow per share (\$ per share) <sup>(1)</sup>				
Basic	0.03	0.19	0.18	0.61
Diluted	0.03	0.18	0.18	0.60
Weighted average common shares (000's)				
Basic	<b>57,385</b>	57,200	<b>57,385</b>	56,943
Diluted	<b>57,385</b>	58,215	<b>57,385</b>	58,339
<b>PRODUCTION VOLUMES</b>				
Natural gas (mcf/d)	<b>8,906</b>	18,379	<b>13,585</b>	19,131
Natural gas liquids (bbls/d)	<b>456</b>	722	<b>637</b>	703
Oil (bbls/d)	<b>37</b>	<b>65</b>	<b>51</b>	<b>80</b>
Total (boe/d)	<b>1,978</b>	3,850	<b>2,951</b>	3,972
<b>SALES PRICES</b>				
Natural gas (\$/mcf)	<b>3.70</b>	8.14	<b>4.83</b>	8.55
Natural gas liquids (\$/bbl)	<b>41.60</b>	78.24	<b>36.75</b>	74.08
Oil (\$/bbl)	<b>72.24</b>	<b>125.88</b>	<b>61.39</b>	<b>117.58</b>
Total (\$/boe)	<b>27.61</b>	55.65	<b>31.23</b>	56.65
<b>OPERATING NETBACKS (\$/boe)</b>				
Price	<b>27.61</b>	55.65	<b>31.23</b>	56.65
Royalties	<b>(1.21)</b>	(12.98)	<b>(3.83)</b>	(11.22)
Operating costs	<b>(8.37)</b>	(7.76)	<b>(8.18)</b>	(8.75)
Transportation	<b>(1.12)</b>	<b>(0.91)</b>	<b>(1.02)</b>	<b>(0.96)</b>
Total	<b>16.91</b>	34.00	<b>18.20</b>	35.72
<b>CAPITAL (\$000's)</b>				
Drilling and completion	<b>1,952</b>	8,761	<b>5,642</b>	20,905
Facilities	<b>(152)</b>	564	<b>(179)</b>	7,184
Land and lease	<b>3,661</b>	2,600	<b>5,551</b>	5,513
Seismic	<b>196</b>	19	<b>343</b>	2,846
Capitalized general and administrative	<b>781</b>	<b>749</b>	<b>2,342</b>	2,243
Total exploration & development	<b>6,438</b>	12,693	<b>13,699</b>	38,691
Net property acquisition (disposition)	<b>194</b>	3,156	<b>(27,267)</b>	9,206
Other capital assets	<b>3</b>	<b>1</b>	<b>10</b>	<b>159</b>
Total	<b>6,635</b>	15,850	<b>(13,558)</b>	48,056

(1) Cash flow is defined as cash flow from operations before changes in operating non-cash working capital.

(2) Total net debt is defined as long term debt plus accounts payable & accrued liabilities less accounts receivable and prepaid expenses.

Cash flow and total net debt do not have standardized measures prescribed by Canadian generally accepted accounting principles and therefore may not be comparable with calculation measures for other issuers.

## MANAGEMENT DISCUSSION & ANALYSIS

Management's Discussion and Analysis ("MD&A") is management's assessment of the financial and operating results of ProspEx Resources Ltd. ("ProspEx" or the "Company") as well as a prospective view of the Company's activities. The MD&A is for the three and nine months ended September 30, 2009, and was prepared as at November 2, 2009. The MD&A should be read in conjunction with the audited consolidated financial statements and MD&A for the year ended December 31, 2008 including the notes related thereto and the consolidated financial statements for the three and nine months ended September 30, 2009 together with the notes related thereto. The reader should be aware that historical results are not necessarily indicative of future performance.

### THIRD QUARTER HIGHLIGHTS

The third quarter of 2009 saw the achievement of key milestones in the Company's transition to a strategy focusing on building an inventory of repeatable opportunities utilizing horizontal drilling. During the quarter ProspEx successfully drilled its first horizontal well in East Kakwa, validating the concept of horizontal drilling of these lands. In addition, the Company established a new core operating area within West Central Alberta with the purchase of 12,000 net acres of land that ProspEx considers similar to the East Kakwa assets.

Natural gas prices continued on a downward trend, as concerns of oversupply reduced the overall price received in the quarter to \$3.70 per thousand cubic feet ("mcf") compared to the third quarter of 2008's price of \$8.14 per mcf. This resulted in cash flow before changes in non-cash working capital items of \$2.0 million in the third quarter, a 20% decrease compared to the prior quarter and an 81% decrease from the prior year. Production for the third quarter averaged 1,978 barrels of oil equivalent ("boe") per day, a 36% decrease compared to the second quarter of 2009 reflecting the previously announced disposition of the Medallion assets, curtailment of production in the quarter due to low gas prices, and natural declines of the Company's production base.

The Company continues to monitor current net debt levels given the current weakness in natural gas prices. Net debt at September 30, 2009 was \$27.8 million, equivalent to 70% of the limit on the Company's credit facility.

### Revenue

(\$000's)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Natural gas	\$ 2,654	\$ 15,214	\$ 16,231	\$ 47,557
Realized gain (loss) on financial instruments	376	(1,451)	1,692	(2,758)
Total natural gas	3,030	13,763	17,923	44,799
Oil	247	750	849	2,583
Natural gas liquids	1,746	5,201	6,386	14,277
Oil and gas revenue	5,023	19,714	25,158	61,659
Unrealized (loss) gain on financial instruments	(401)	8,277	(919)	977
Total revenue	\$ 4,622	\$ 27,991	\$ 24,239	\$ 62,636

Third quarter oil and gas revenue decreased \$14.7 million or 75% to \$5.0 million in 2009 from \$19.7 million in the third quarter of 2008. This decrease in revenues for the quarter is due to the combination of lower production levels and lower prices incurred in the period, as described below.

## Production

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
<b>Area (boe/d)</b>				
Deep Basin	675	1,150	867	1,312
West Central Alberta	1,289	1,847	1,671	1,663
Southern Alberta	7	847	405	988
Other	7	6	8	9
	<b>1,978</b>	<b>3,850</b>	<b>2,951</b>	<b>3,972</b>
<b>Product</b>				
Natural gas (mcf/d)	8,906	18,379	13,585	19,131
Natural gas liquids (bbls/d)	456	722	637	703
Oil (bbls/d)	37	65	51	80
Total (boe/d)	<b>1,978</b>	<b>3,850</b>	<b>2,951</b>	<b>3,972</b>

Third quarter production averaged 1,978 boe per day, compared to second quarter production of 3,089 boe per day and prior year's production of 3,850 boe per day. This decrease in production reflects the disposition of approximately 750 boe per day of non-core production effective June 1, 2009, the temporary curtailment of production during the quarter due to low natural gas prices, and natural declines in the Company's production base.

## Commodity Pricing

ProspEx Average Prices	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
<b>Natural gas (\$/mcf)</b>				
Sales price	\$ 3.24	\$ 9.00	\$ 4.37	\$ 9.08
Realized gain (loss) on financial instruments	0.46	(0.86)	0.46	(0.53)
	<b>3.70</b>	<b>8.14</b>	<b>4.83</b>	<b>8.55</b>
Oil (\$/bbl)	72.24	125.88	61.39	117.58
NGL (\$/bbl)	41.60	78.24	36.75	74.08
Average realized price (\$/boe)	27.61	55.65	31.23	56.65
Unrealized gain (loss) on financial instruments (\$/boe)	(2.21)	23.36	(1.14)	0.90
Total average price (\$/boe)	<b>\$ 25.40</b>	<b>\$ 79.01</b>	<b>\$ 30.09</b>	<b>\$ 57.55</b>
<b>Benchmark pricing</b>				
AECO C Spot (\$/mcf)	\$ 2.94	\$ 7.75	\$ 3.77	\$ 8.62
Edmonton Par – light oil (\$/bbl)	\$ 71.53	\$ 121.74	\$ 62.38	\$ 115.11

Average natural gas sales prices decreased 64% to \$3.24 per mcf in the third quarter of 2009, compared to \$9.00 per mcf in the third quarter of 2008. During the third quarter of 2009, AECO C daily spot prices for natural gas decreased 62% compared to the third quarter of 2008, while the AECO monthly index for the same period decreased 67%. Realized natural gas prices (including realized gains on financial instruments) for the third quarter of 2009 averaged \$3.70 per mcf, a decrease of 55% from \$8.14 per mcf realized in the third quarter of 2008. This decrease reflects the ongoing concern of an oversupply in natural gas markets.

Oil prices received for the third quarter of 2009 were \$72.24 per barrel ("bbl"). This is a 43% decrease from the \$125.88 per bbl received in the third quarter of 2008, consistent with the decrease in benchmark pricing. The price realized for natural gas liquids ("NGLs") in the third quarter of 2009 was \$41.60 per bbl, a decrease of 47% from \$78.24 per bbl in the third quarter of 2008. Overall, oil and NGL prices have declined substantially, as the world wide economic slowdown has reduced demand for commodities.

### *Financial Instruments*

The impact of the changes in the fair values of open financial instruments during the quarter ended September 30, 2009 was an unrealized loss of \$0.4 million. This compares to an unrealized gain of \$8.3 million for the third quarter of 2008.

The financial instruments open as of September 30, 2009 are described below:

<u>Type</u>	<u>Amount (GJ/day)</u>	<u>Term</u>	<u>Price (\$/GJ at AEEO)</u>	<u>Type</u>
Fixed	2,500	Oct. 1 – Oct. 31, 2009	\$ 4.21	Physical
Costless collar	1,500	Oct. 1 – Oct. 31, 2009	\$ 4.00 - \$ 5.23	Financial
Costless collar	2,000	Nov. 1 – Mar. 31, 2010	\$ 4.25 - \$ 5.67	Financial
Fixed	2,000	Nov. 1 – Dec. 31, 2009	\$ 4.66	Physical

Subsequent to the quarter the Company entered into the following financial instruments:

<u>Type</u>	<u>Amount (GJ/day)</u>	<u>Term</u>	<u>Price (\$/GJ at AEEO)</u>	<u>Type</u>
Fixed	2,000	Nov. 1 – Dec. 31, 2009	\$ 4.735	Financial
Put	3,000	Jan. 1 – Mar. 31, 2010	\$ 5.00	Financial

The Company's strategy is to selectively enter into financial instruments such as forwards, futures, swaps and costless collars in an effort to mitigate the effects of volatile commodity prices and protect cash flow to enable funding of its exploration and development programs. These financial instruments allow the Company to better forecast operating cash flow, in turn providing greater confidence in funding for its operations.

### **Royalty Expenses**

(\$000's)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Crown	\$ 20	\$ 3,152	\$ 1,994	\$ 8,679
Freehold and gross overriding	200	1,445	1,093	3,536
Total Royalties	\$ 220	\$ 4,597	\$ 3,087	12,215
\$ per boe	\$ 1.21	\$ 12.98	\$ 3.83	\$ 11.22
As a percentage of oil and gas revenue	4%	23%	12%	20%

In the third quarter of 2009, royalties totaled \$0.2 million or 4% of revenue compared to the previous year's \$4.6 million or 23% of revenue. During the first nine months of 2009 royalties totaled \$3.1 million or 12% of oil and gas revenue compared to \$12.2 million or 20% of oil and gas revenue for the same period of 2008.

On January 1, 2009 a new royalty framework came into effect in the Province of Alberta. This new framework provides for a greater sensitivity of royalty rate to natural gas prices and production rates, and thus royalties in the first nine months of 2009 have declined relative to the same period in 2008. The royalty gas cost allowance

deduction that offsets crown royalties (which is not sensitive to price or production changes) remained at a fixed monthly dollar amount which also contributed to a lower net royalty rate in 2009.

### Operating Costs

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Operating costs (\$000's)	\$ 1,524	\$ 2,750	\$ 6,589	\$ 9,524
Operating costs (\$/boe)	\$ 8.37	\$ 7.76	\$ 8.18	\$ 8.75

Quarterly operating costs of \$8.37 per boe are higher than the prior year's quarter of \$7.76 per boe. This reflects the lower production levels in 2009, resulting in higher per unit costs as fixed operating costs are spread over a lower production base. In addition, the third quarter of 2008 reflected a reversal of previously accrued process fees.

On a year to date basis, operating costs of \$8.18 per boe are lower than the prior year of \$8.75 per boe as the prior year included higher operating costs in the first half of 2008 to address operating issues at Medallion and Salter, as well as integration costs incurred from the Ricinus acquisition in early 2008.

### Transportation Expenses

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Transportation expenses (\$000's)	\$ 203	\$ 322	\$ 823	\$ 1,042
Transportation expenses (\$/boe)	\$ 1.12	\$ 0.91	\$ 1.02	\$ 0.96

Transportation expense per boe for the three and nine months ended September 30, 2009 have increased slightly compared with the same periods in 2008 as a result of the disposition of the Medallion property that had lower than corporate average transportation costs.

### General and Administrative Expenses

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Gross general and administrative	\$ 1,878	\$ 1,870	\$ 5,596	\$ 5,490
Recoveries	(197)	(217)	(598)	(688)
Capitalized expenses	(781)	(749)	(2,341)	(2,242)
Net general and administrative expenses	\$ 900	\$ 904	\$ 2,657	\$ 2,560
Net general and administrative expenses (\$/boe)	\$ 4.95	\$ 2.55	\$ 3.30	\$ 2.35

Gross general and administrative costs in 2009 are approximately in line with costs in 2008, as increases in office rents have been offset by reductions in personnel and other costs. However, unit costs have increased due to decreases in production levels.

### Interest and Bank Charges

With the disposition of the Medallion assets and decreased capital activity, overall debt levels were less than the prior year. This resulted in interest and bank charges of \$0.3 million in the third quarter and \$1.0 million year to date in 2009 which are lower compared to the prior year amount of \$0.4 million in the third quarter and \$1.5 million for the first nine months of 2008.

## Depletion, Depreciation and Accretion

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Depletion, depreciation and accretion (\$000's)	\$ 5,457	\$ 9,006	\$ 22,446	\$ 25,066
Depletion, depreciation and accretion (\$/boe)	\$ 29.99	\$ 25.43	\$ 27.86	\$ 23.03

Depletion, depreciation and accretion expense per boe in the third quarter of 2009 was \$29.99. This is an 18% increase from the third quarter 2008 rate of \$25.43 per boe. The overall increase in the rate reflects the Medallion disposition being credited to the depletion cost pool at a lower rate per boe than the overall historical corporate average.

## Ceiling Test

The Company performed a ceiling test at September 30, 2009 and determined that the carrying amount of the Company's oil and gas assets were not recoverable as the carrying amount exceeded the sum of the undiscounted cash flows expected to result from the production of the Company's proved reserves. However, the fair value of oil and gas assets exceeded their carrying amount and an impairment loss was not recorded. Fair value was determined based on discounted cash flows from proved plus probable reserves using current forward prices as at September 30, 2009. An impairment loss may be recorded in a future period.

## Stock-Based Compensation

Stock-based compensation expenses were down slightly for the three and nine months ended September 30, 2009 from \$0.2 million and \$0.7 million respectively in 2008, to \$0.1 million and \$0.3 million respectively in 2009. Costs have decreased as the initial grant of stock options and special performance units in 2004 have been fully recognized.

## Income Taxes

In the third quarter of 2009, the Company had a future income tax reduction of \$1.0 million compared to an expense of \$2.8 million in the same period in 2008. For the nine months ending September 30, 2009 future income tax reduction totaled \$4.0 million, compared to a \$3.0 million expense in the prior year period.

Estimated tax pools as at September 30:

(\$000's)	2009	2008
Canadian development expense	\$ 38,856	\$ 34,120
Canadian exploration expense	33,067	29,961
Canadian oil & gas property expense	21,686	39,012
Undepreciated capital cost	32,852	43,859
Other	4,352	5,003
	\$ 130,813	\$ 151,955

## Net (Loss) Earnings

Overall the Company reported a net loss of \$3.1 million for the third quarter of 2009, versus net earnings of \$6.9 million in the same period of 2008. This net loss was driven by the combination of overall lower oil and gas prices received in the quarter and year-to-date as well as an overall decrease in production.

## Capital Expenditures

(\$000's)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Drilling and completions	\$ 1,952	\$ 8,761	\$ 5,642	\$ 20,905
Facilities	(152)	564	(179)	7,184
Land and lease	3,661	2,600	5,551	5,513
Seismic	196	19	343	2,846
Capitalized G&A	781	749	2,342	2,243
Total exploration & development	<b>6,438</b>	12,693	<b>13,699</b>	38,691
Net property acquisitions (dispositions)	194	3,156	(27,267)	9,206
Other capital assets	3	1	10	159
Total net capital expenditures	<b>\$ 6,635</b>	\$ 15,850	<b>\$ (13,558)</b>	\$ 48,056

During the third quarter of 2009, the Company invested \$6.4 million in exploration and development (after the deduction of the Alberta Royalty Drilling Credit). Of this total, \$2.0 million was spent on drilling and completions, which included costs from the Company's first horizontal well in East Kakwa. This well provided confirmation of the commercial and technical viability of the development of the East Kakwa asset using horizontal wells.

ProspEx also invested \$3.7 million in the third quarter on purchases of oil and gas rights at Alberta Crown land sales. This investment was largely targeted at the establishment of a new operating area in West Central Alberta. Year to date, the Company has assembled a 12,000 net acre land position in West Central Alberta at a cost of approximately \$4.3 million. All of this land position is held by the Company at 100% working interest.

## Liquidity & Capital Resources

At September 30, 2009, ProspEx had the following financial resources available to fund its capital expenditure program.

(\$000's)	
Working capital deficiency, excluding financial instrument gains/losses and related tax and other current liabilities	\$ (2,694)
Long-term debt	(25,147)
Bank facilities available	40,000
Total capital resources available	<b>\$ 12,159</b>

ProspEx expects that it will be able to fund its 2009 capital program from operating cash flow and the capital resources noted above.

As at September 30, 2009, the Company's ratio of net debt to trailing annualized quarterly operating cash flow was 3.5 to 1.0, which exceeds the Company's guidelines on capital management (which call for a maximum of 2.0 to 1.0) as a result of the effects of lower commodity prices on cash flow, and the temporary curtailment of production due to low natural gas prices. The Company will continue to closely monitor this ratio, and believes that projected increases in production and improved prices will lower this ratio.

### *Bank Debt*

At September 30, 2009, the Company had a \$40.0 million revolving operating credit facility agreement. The facility revolves for 364-day periods, renewable at the option of the lender. The facility is subject to an annual review on May 31, 2010. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the

lenders, based primarily on reserves and using commodity prices estimated by the lenders, as well as other factors. A decrease in the borrowing base could result in a reduction of the credit facility which may require a repayment to the lenders within sixty days of receiving notice of the new borrowing base. The credit facility provides that advances may be made by way of prime rate loans, guaranteed notes (bankers' acceptances) and letters of credit. The credit facility is tested quarterly, in arrears, and bears interest based on a sliding scale. The interest rate varies depending on the Company's debt to cash flow ratio determined quarterly on a grid system, with the grid ranging from debt to cash flow ranges of lower than 1.0:1.0 to greater than 3.0:1.0.

The facility is secured by a general security agreement conveying a first floating charge over all real and personal property and after-acquired assets. The Company is required to meet certain financial based covenants under the terms of this facility. As at September 30, 2009, the Company is in compliance with all covenants in accordance with the terms of the credit facility.

The effective interest rate on the outstanding debt for the third quarter of 2009 is approximately 2.90% annualized.

### *Share Capital*

As at September 30, 2009, ProspEx had 57,385,162 common shares (2008 – 57,383,377), 2,016,269 warrants (2008 – 2,018,054), and 5,531,410 options (2008 – 4,866,887) issued and outstanding. Each warrant and option, upon exercise, entitles the holder to one common share. The warrants outstanding on September 30, 2009 expired on October 1, 2009.

As at November 2, 2009, ProspEx had 57,385,162 common shares, nil warrants, and 4,098,166 options issued and outstanding.

### **Contractual Obligations**

The Company has committed to certain payments as follows:

Payments due (\$000's)	2009	2010	2011	2012	2013	Thereafter
Long-term debt	\$ -	25,147	-	-	-	\$ -
Building lease	232	934	1,050	1,356	1,433	358
Process fees	95	379	63	-	-	-
Transportation	37	40	-	-	-	-
Other	4	7	-	-	-	-
<b>Total</b>	<b>\$ 368</b>	<b>26,507</b>	<b>1,113</b>	<b>1,356</b>	<b>1,433</b>	<b>\$ 358</b>

### **Off-Balance Sheet Arrangements**

The Company has not entered into any off-Balance Sheet transactions.

## Summary of Quarterly Results

The following table summarizes the quarterly operating statistics of the Company.

	Q3	2009 Q2	Q1	Q4	2008 Q3	Q2	Q1	2007 Q4
<b>Financial (\$000's, except per share amounts)</b>								
Oil and gas revenue	5,023	7,370	12,765	15,046	19,714	24,567	17,378	15,906
Net (loss) earnings	(3,082)	(3,899)	(2,225)	487	6,923	2,261	(2,110)	(180)
Per share - basic	(0.05)	(0.07)	(0.04)	0.01	0.12	0.04	(0.04)	0.00
- diluted	(0.05)	(0.07)	(0.04)	0.01	0.12	0.04	(0.04)	0.00
<b>Average Daily Production</b>								
Oil (bbls/d)	37	47	69	57	65	108	68	125
NGL (bbls/d)	456	645	811	719	722	851	536	515
Natural Gas (mcf/d)	<u>8,906</u>	<u>14,382</u>	<u>17,561</u>	<u>16,868</u>	<u>18,379</u>	<u>19,957</u>	<u>19,064</u>	<u>19,690</u>
Total (boe/d)	<u>1,978</u>	<u>3,089</u>	<u>3,807</u>	<u>3,587</u>	<u>3,850</u>	<u>4,285</u>	<u>3,781</u>	<u>3,922</u>
<b>Operating Netbacks (\$/boe)</b>								
Price <sup>(1)</sup>	27.61	26.22	37.25	45.59	55.65	63.00	50.50	44.09
Royalties	(1.21)	(1.21)	(7.37)	(8.18)	(12.98)	(11.97)	(8.57)	(5.41)
Transportation	(1.12)	(0.93)	(1.04)	(1.00)	(0.91)	(1.00)	(0.96)	(0.86)
Operating Cost	<u>(8.37)</u>	<u>(9.30)</u>	<u>(7.16)</u>	<u>(4.58)</u>	<u>(7.76)</u>	<u>(8.39)</u>	<u>(10.17)</u>	<u>(8.06)</u>
Operating Netback	<u>16.91</u>	<u>14.78</u>	<u>21.68</u>	<u>31.83</u>	<u>34.00</u>	<u>41.64</u>	<u>30.80</u>	<u>29.76</u>

<sup>(1)</sup> Price excludes unrealized financial instrument gain or loss.

Quarter to quarter results are influenced by many factors. The three main drivers are capital spending, production and commodity prices.

Capital spending is typically more heavily weighted to the winter drilling months, and therefore the fourth and first quarters of the year usually represent approximately 60% of the exploration and development budgets. The second quarter of each year usually has minimal capital spending, reflecting surface access restrictions due to spring break up conditions. Production additions typically lag capital spending by one or two quarters, resulting in production peaks in the second quarter of each year.

As previously mentioned, production is a key driver of overall quarterly results. Production is not only influenced by additions as a result of capital programs and dispositions, but also by natural declines as production from existing wells diminishes over time. With respect to the Company's overall quarterly production profile, production tends to peak in the second quarter of each year, reflecting new additions from the winter drilling programs, and the subsequent quarters reflect declining production as natural decline rates come into play.

World-wide commodity price environments have a significant influence on the overall Company's quarterly results. The Company is an overall price-taker in the oil & gas industry and as a result, world prices drive overall Company revenues. Natural gas prices are currently low, driven by high natural gas storage inventories, strong domestic production levels in the United States, and reduced demand for natural gas as a result of the global economic downturn. In the face of this uncertainty, the Company has adopted a conservative approach by restricting exploration and development capital spending and as a consequence total net oil and gas revenues has not followed traditional quarterly cyclical trends in 2009.

## **NEW ACCOUNTING PRONOUNCEMENTS**

### **Accounting Standards Adopted and Recent Pronouncements**

**Convergence with International Reporting Standards** – On February 13, 2008, the Canadian Accounting Standards Board confirmed that the effective date for the convergence of Canadian Generally Accepted Accounting Standards for publicly accountable entities to International Financial Reporting Standards ("IFRS") will be January 1, 2011. Although IFRS is principle based and uses a conceptual framework similar to Canadian GAAP, there are significant differences and choices in accounting policies, as well as increased disclosure requirements under IFRS. The Company is currently engaged in preparing for this transition and continues to monitor the developments and assess the impact of these prospective changes to the financial statements.

## **DISCLOSURE CONTROLS AND POLICIES**

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's CEO and CFO have concluded, based on their evaluation as of September 30, 2009, that the Company's disclosure controls and procedures as of the end of such period are effective to provide reasonable assurance that material information related to the Company, including its consolidated subsidiary, is made known to them by others within those entities. It should be noted that while the Company's CEO and CFO believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The CEO and CFO of the Company are able to certify the design of the Company's internal controls over financial reporting as required under Multilateral Instrument 52-109 of the Canadian Securities Administration with no significant weaknesses in design of these internal controls that require commenting on in the MD&A.

For the third quarter of 2009 there were no changes to the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **ADVISORIES**

Within the MD&A references are made to terms commonly used in the oil and gas industry. "Cash flow" is not defined by GAAP in Canada and is referred to as a non-GAAP measure. For the purposes thereof, "cash flow" is defined as cash flow from operations before the change in operating non-cash working capital. The MD&A contains the term "cash flow" which should not be considered an alternative to, or more meaningful than "cash flow from operations" as determined in accordance with GAAP. The Company considers cash flow to be a key measure as it demonstrates the Company's ability to generate the cash necessary to fund capital projects and to repay debt. Cash flow presented does not have any standardized meaning prescribed by Canadian GAAP and therefore it may not be comparable with the calculation of similar measures for other entities. Cash flow per share is calculated using the same weighted average number of common shares for the period as used in calculating the net earnings per share calculation.

The following table provides a reconciliation between cash flow from operations and cash flow for the periods below:

(\$000's)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Cash flow from operating activities	2,457	12,419	6,185	36,224
Change in non-cash working capital	<u>(488)</u>	<u>(1,793)</u>	<u>3,980</u>	<u>(1,490)</u>
Cash flow	1,969	10,626	10,165	34,734

The following table provides a reconciliation of net debt for the periods below:

(\$000's)	As at September 30, 2009	As at December 31, 2008
Accounts receivable	(5,823)	(10,770)
Prepaid expenses	(319)	(693)
Accounts payable and accrued liabilities	8,836	22,078
Long term debt	25,147	40,807
Net debt	27,841	51,422

Boe amounts have been calculated using a conversion rate of six mcf of gas to one barrel of oil. The term boe may be misleading if used in isolation. A boe conversion ratio of one barrel of oil to six mcf of gas is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the well head.

"Netbacks" are calculated by subtracting transportation costs, royalties payable, and operating costs from the average price received during the period.

### Forward-looking Information

Certain information regarding ProspEx including, without limitation, management's assessment of future plans and operations, constitutes forward-looking information or statements under applicable securities law and necessarily involve assumptions regarding factors and risks that could cause actual results to vary materially, including, without limitation, assumptions and risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, royalty rates, imprecision of reserve estimates, environmental risks, competition, incorrect assessment of the value of acquisitions or dispositions, failure to realize the anticipated benefits of acquisitions and ability to access sufficient capital from internal and external sources.

The reader is cautioned that these factors and risks are difficult to predict and that the assumptions used in the preparation of such information, although considered reasonable by ProspEx at the time of preparation, may prove to be incorrect. Accordingly, readers are cautioned that the actual results achieved will vary from the information provided herein and the variations may be material. Readers are also cautioned that the foregoing list of assumptions, factors and risks is not exhaustive. Additional information on the foregoing assumptions, risks and other factors that could affect ProspEx's operations or financial results are included in ProspEx's public disclosure documents on file with Canadian securities regulatory authorities. In particular see the Risk Factors and Industry Conditions sections of ProspEx's most recent Annual Information Form. ProspEx's reports may be accessed through the SEDAR website ([www.sedar.com](http://www.sedar.com)), at ProspEx's website ([www.psx.ca](http://www.psx.ca)) or by contacting the Company directly. Consequently, there is no representation by ProspEx that actual results achieved will be the same in whole or in part as those set out in the forward-looking information.

Furthermore, the forward-looking information and statements contained in this MD&A are made as of the date of this MD&A, and ProspEx does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

The forward-looking information and statements contained herein are expressly qualified by this cautionary statement.

**ProspEx Resources Ltd.**  
**Consolidated Balance Sheets**  
**(unaudited)**

(Stated in thousands of dollars)

**September 30, 2009** **December 31, 2008**

**Assets**

Current assets

Accounts receivable	\$	5,823	10,770
Prepaid expenses		319	693
Future income tax asset (note 2)		26	-
Unrealized financial instrument gain (note 6)		-	828
		<u>6,168</u>	<u>12,291</u>

Property, plant and equipment, net

		<u>153,961</u>	<u>190,693</u>
	\$	<u>160,129</u>	<u>202,984</u>

**Liabilities**

Current liabilities

Accounts payable and accrued liabilities	\$	8,836	22,078
Current portion of future income tax liability (note 2)		-	240
Current portion of other liabilities (note 3)		221	-
Unrealized financial instrument loss (note 6)		91	-
		<u>9,148</u>	<u>22,318</u>

Long-term debt (note 1)

25,147 40,807

Other liabilities (note 3)

250 -

Asset retirement obligation (note 4)

4,397 6,462

Future income tax liability (note 2)

5,452 9,119

Total liabilities

44,394 78,706

**Shareholders' Equity**

Common shares (note 5)		90,800	90,802
Common share performance warrants (note 5)		1,233	1,233
Contributed surplus (note 5)		7,423	6,758
Retained earnings		16,279	25,485
Total shareholders' equity		<u>115,735</u>	<u>124,278</u>
	\$	<u>160,129</u>	<u>202,984</u>

See accompanying notes to consolidated financial statements

ProspEx Resources Ltd.  
Consolidated Statements of (Loss) Earnings , Comprehensive (Loss) Earnings and Retained Earnings  
For the period ended  
(unaudited)

(Stated in thousands of dollars, except per share amounts)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Revenue				
Oil and gas	\$ 5,023	19,714	25,158	61,659
Unrealized financial instrument (loss) gain (note 6)	(401)	8,277	(919)	977
Royalties	(220)	(4,597)	(3,087)	(12,215)
	<u>4,402</u>	<u>23,394</u>	<u>21,152</u>	<u>50,421</u>
Expenses				
Depletion, depreciation and accretion Operating	5,457	9,006	22,446	25,066
Transportation	1,524	2,750	6,589	9,524
General and administrative	203	322	823	1,042
Interest and bank charges	900	904	2,657	2,560
Stock-based compensation	276	449	1,030	1,473
Loss on subleasing (note 3)	124	236	332	667
	-	-	524	-
	<u>8,484</u>	<u>13,667</u>	<u>34,401</u>	<u>40,332</u>
(Loss) earnings before income taxes	(4,082)	9,727	(13,249)	10,089
Income taxes (note 2) Future (reduction)	(1,000)	2,804	(4,043)	3,015
Net (loss) earnings and comprehensive (loss) earnings for the period	(3,082)	6,923	(9,206)	7,074
Retained earnings, beginning of period	19,361	18,076	25,485	17,925
Retained earnings, end of period	\$ 16,279	24,999	16,279	24,999
Net (loss) earnings per share				
Basic	\$ (0.05)	0.12	(0.16)	0.12
Diluted	\$ (0.05)	0.12	(0.16)	0.12

See accompanying notes to consolidated financial statements

**ProspEx Resources Ltd.**  
**Consolidated Statements of Cash Flows**  
**For the periods ended,**  
**(unaudited)**

(Stated in thousands of dollars)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
<b>Operations</b>				
Net (loss) earnings for the period	\$ (3,082)	6,923	(9,206)	7,074
Items not involving cash				
Depletion, depreciation and accretion	5,457	9,006	22,446	25,066
Stock-based compensation	124	236	332	667
Future income taxes (reduction)	(1,000)	2,804	(4,043)	3,015
Sublease loss	-	-	524	-
Rent inducement	161	-	161	-
Unrealized financial instrument (gain) loss	401	(8,277)	919	(977)
Amortization of sublease loss	(62)	-	(62)	-
Amortization of rent inducement	(21)	-	(21)	-
Asset retirement expenditures	(9)	(66)	(885)	(111)
	<u>1,969</u>	<u>10,626</u>	<u>10,165</u>	<u>34,734</u>
Changes in non-cash working capital	488	1,793	(3,980)	1,490
	<u>2,457</u>	<u>12,419</u>	<u>6,185</u>	<u>36,224</u>
<b>Financing</b>				
(Decrease) increase in long-term debt	4,197	1,595	(15,660)	9,264
Issuance of common shares	(2)	257	(2)	1,675
	<u>4,195</u>	<u>1,852</u>	<u>(15,662)</u>	<u>10,939</u>
<b>Investments</b>				
Exploration and development expenditures	(6,438)	(12,693)	(13,699)	(38,691)
Proceeds on property disposal	-	-	28,964	-
Property acquisition	(194)	(3,156)	(1,697)	(9,206)
Deposit on property acquisition	-	-	-	1,175
Other capital expenditures	(3)	(1)	(10)	(159)
	<u>(6,635)</u>	<u>(15,850)</u>	<u>13,558</u>	<u>(46,881)</u>
Changes in non-cash working capital	(17)	1,579	(4,081)	(282)
	<u>(6,652)</u>	<u>(14,271)</u>	<u>9,477</u>	<u>(47,163)</u>
Change in cash	-	-	-	-
Cash, beginning of period	-	-	-	-
Cash, end of period	\$ -	-	-	-

See accompanying notes to consolidated financial statements

## Notes to Consolidated Financial Statements

For the three and nine months ended September 30, 2009 and 2008  
(unaudited)

The interim unaudited consolidated financial statements of ProspEx Resources Ltd. (the "Company" and/or "ProspEx") have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Company is engaged in the acquisition, exploration, development and production of oil and natural gas in Canada.

The interim unaudited consolidated financial statements have been prepared by management following the same accounting policies and methods of computation as the audited consolidated financial statements for the period ended December 31, 2008 except as described below. Preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates. In the opinion of management, these interim consolidated financial statements contain all adjustments of a normal and recurring nature to present fairly the Company's financial position as at September 30, 2009 and the results of its operations and cash flows for the three and nine months ended September 30, 2009. The disclosures included below are incremental to those included with the annual consolidated financial statements except as disclosed below. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto in the Company's annual report for the year ended December 31, 2008.

### 1. LONG TERM DEBT

At September 30, 2009, the Company had a \$40.0 million revolving operating credit facility agreement. The facility revolves for 364-day periods, at which time the Company can request approval from the lender for an extension for an additional 364 day period or convert the outstanding bank indebtedness to a one-year term loan. The facility is subject to an annual review on May 31, 2010. The amount of the facility is subject to a borrowing base test performed on a periodic basis by the lenders, based primarily on reserves and using commodity prices estimated by the lenders, as well as other factors. A decrease in the borrowing base could result in a reduction of the credit facility which may require a repayment to the lenders within sixty days of receiving notice of the new borrowing base. The credit facility provides that advances may be made by way of prime rate loans, guaranteed notes (bankers' acceptances) and letters of credit. The credit facility is tested quarterly, in arrears, and bears interest based on a sliding scale. The interest rate varies depending on the Company's debt to cash flow ratio determined quarterly on a grid system, with the grid ranging from debt to cash flow ranges of lower than 1.0:1.0 to greater than 3.0: 1.0.

The facility is secured by a general security agreement conveying a first floating charge over all real and personal property and after-acquired assets. The Company is required to meet certain financial based covenants under the terms of this facility. As at September 30, 2009, the Company is in compliance with all covenants in accordance with the terms of the credit facility.

The effective interest rate on the outstanding debt for the third quarter of 2009 is approximately 2.90% annualized.

### 2. FUTURE INCOME TAXES

The provision for future income taxes differs from the amount computed by applying the combined expected Canadian Federal and Provincial tax rates to earnings before income taxes. The reasons for these differences are as follows:

(\$000's)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
(Loss) Earnings before taxes	\$ (4,082)	\$ 9,727	\$ (13,249)	\$ 10,089
Rate (%)	29.00%	29.50%	29.00%	29.50%
Computed expected reduction for future income taxes	(1,184)	2,869	(3,842)	2,976
Increase (decrease) in taxes resulting from:				
Stock-based compensation expensed	36	70	96	197
Effect of change in tax rate	135	(135)	(355)	(304)
Other	13	-	58	146
<b>Income tax reduction</b>	<b>\$ (1,000)</b>	<b>\$ 2,804</b>	<b>\$ (4,043)</b>	<b>\$ 3,015</b>

The current future income tax asset at September 30, 2009 of \$0.03 million (December 31, 2008 - \$0.2 million liability) results from the future tax impact of the unrealized financial instrument gain.

The components of the long term future income tax liability are as follows:

(\$000's)	September 30, 2009	December 31, 2008
Property, plant and equipment	\$ (6,365)	\$ (10,697)
Asset retirement obligation	1,099	1,773
Other liabilities	137	-
Share issue costs	177	305
	(4,952)	(8,619)
Valuation allowance	(500)	(500)
<b>Future income tax liability</b>	<b>\$ (5,452)</b>	<b>\$ (9,119)</b>

At September 30, 2009, the Company had estimated tax pools available to reduce future taxable income of \$130.8 million (December 31, 2008 – \$154.6 million).

Capitalized stock based compensation resulted in an increase to future tax liabilities of \$0.1 million during the nine month period (2008 - \$0.2 million).

### 3. OTHER LIABILITIES

(\$000's)	September 30, 2009	December 31, 2008
Loss on sublease	\$ 524	\$ -
Accretion expense	9	-
Expenses paid	(62)	-
Total liability	471	-
Less current portion	(221)	-
<b>Other liabilities</b>	<b>\$ 250</b>	<b>\$ -</b>

The loss on sublease relates to the subleasing of a portion of the Company's head office space. This provision represents the present value at a 7.0% discount rate of the difference between the original head lease rate and the estimated amounts recoverable under the sublease terms.

#### 4. ASSET RETIREMENT OBLIGATION

The Company has estimated the net present value of its total asset retirement obligation at September 30, 2009 to be \$4.4 million (2008 - \$6.3 million) based on a total future liability of \$10.6 million (2008 - \$22.0 million). The total future liability was estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities and the estimated timing of when the costs will be incurred. These payments are expected to be made over the next 33 years with the majority of costs incurred between 2029 and 2038. A 7% interest rate and 2% inflation rate were used to calculate the present value of the asset retirement obligation.

(\$000's)

Balance, at January 1, 2009	\$	6,462
Liabilities incurred		157
Liabilities settled		(884)
Change in timing of estimated cash flows		917
Assets sold		(2,570)
Accretion expense		315
Balance, at September 30, 2009	\$	4,397

#### 5. SHAREHOLDERS' EQUITY

##### (a) Common Shares & Common Share Performance Warrants Issued

	September 30, 2009		September 30, 2008	
	Number of Shares/Warrants (000's)	Amount (\$000's)	Number of Shares/Warrants (000's)	Amount (\$000's)
<b>Common shares</b>				
Balance at the beginning of the year	57,385	\$ 90,802	56,453	\$ 90,543
Flow-through shares tax adjustment	-	-	-	(2,218)
Issued on exercise of stock options	-	-	232	746
Shares issued on exercise of warrants	-	-	698	1,404
Issue costs, net of future tax reduction	-	(2)	-	(34)
Adjustment to contributed surplus for options exercised	-	-	-	357
Balance at the end of the period	57,385	\$ 90,800	57,383	\$ 90,798
<b>Common share performance warrants</b>				
Balance at the beginning of the period	2,016	\$ 1,233	2,716	\$ 1,661
Exercised	-	-	(698)	(427)
Balance at the end of the period	2,016	\$ 1,233	2,018	\$ 1,234
Share Capital at the end of the period		\$ 92,033		\$ 92,032

All outstanding performance warrants entitle the holder to acquire a common share at a price of \$1.40 and subsequently expired on October 1, 2009.

(b) Contributed Surplus

(\$000's)	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Balance at the beginning of the period	\$ 7,175	\$ 6,119	\$ 6,758	\$ 5,614
Stock-based compensation	248	472	665	1,334
Exercise of stock options	-	-	-	(357)
Balance at the end of the period	\$ 7,423	\$ 6,591	\$ 7,423	\$ 6,591

(c) Stock Options

Changes in outstanding stock options are summarized below:

	September 30, 2009		September 30, 2008	
	Options (000's)	Weighted Average Exercise Price	Options (000's)	Weighted Average Exercise Price
Outstanding at beginning of year	5,160	\$ 3.44	4,656	\$ 3.62
Granted	1,112	0.66	612	3.32
Exercised	-	-	(232)	3.22
Forfeited	(741)	3.51	(169)	4.30
Outstanding at end of period	5,531	\$ 2.88	4,867	\$ 3.58

The following table summarizes stock options outstanding and exercisable at September 30, 2009:

Range of exercise price	Options outstanding			Options exercisable	
	Number outstanding at period end (000's)	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at period end (000's)	Weighted average exercise price
\$ 0.61 - \$ 1.90	1,370	4.6	\$ 0.77	-	-
\$ 1.91 - \$ 3.22	1,518	0.5	\$ 3.19	1,351	\$ 3.21
\$ 3.23 - \$ 4.46	2,643	2.2	\$ 3.79	1,894	\$ 3.81
	5,531	2.4	\$ 2.88	3,245	\$ 3.56

495,000 options were granted during the third quarter of 2009. The fair value of options granted during the third quarter of 2009 was \$0.2 million. The fair value is determined using the Black-Scholes option pricing model, with weighted average assumptions for grants as follows:

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Risk free interest rate	1.93%	n/a	1.88%	3%
Expected life	5 years	n/a	5 years	5 years
Expected volatility	102%	n/a	101%	47%
Expected dividend yield	Nil	n/a	Nil	Nil
Forfeiture rate	10%	n/a	10%	10%

The estimated fair values of the options are being amortized against earnings and capitalized to property, plant and equipment over the vesting period. During the three months ended September 30, 2009, a total of \$0.1 million (2008 - \$0.2 million) of stock-based compensation was recorded against income and \$0.1 million (2008 - \$0.2 million) was

capitalized. During the nine months ended September 30, 2009, a total of \$0.3 million (2008 - \$0.7 million) of stock-based compensation was recorded against income and \$0.3 million (2008 - \$0.7 million) was capitalized.

(d) Per Share Amounts

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Weighted average common shares basic	57,385,162	57,200,496	57,385,162	56,943,470
Dilutive securities:				
Stock options	-	-	-	133,884
Performance warrants	-	1,014,149	-	1,261,976
Diluted	57,385,162	58,214,645	57,385,162	58,339,330

For the three months ended September 30, 2009, all options and warrants outstanding (2008 - 4,867,000) were excluded from the diluted calculations as they were anti-dilutive. For the nine month year to date all options were excluded due to their anti-dilutive impact (2008 - 3,761,400).

## 6. FINANCIAL INSTRUMENTS, RISK MANAGEMENT AND CAPITAL MANAGEMENT STRATEGY

### *Overview*

The Company has exposure to a number of risks from its use of financial instruments including:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities.

### *Credit Risk*

Credit risk relates to the Company's receivables from joint venture partners and petroleum and natural gas marketers and the risk of financial loss if a customer, partner or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable are with customers in the energy industry and are subject to normal industry credit risk. The Company generally grants unsecured credit but routinely assesses the financial strength of its partners and marketers.

Receivables from petroleum and natural gas marketers are normally collected on the 25<sup>th</sup> day of the month following production. The Company sells the majority of its production to two petroleum and natural gas marketers and therefore is subject to concentration risk. To date the Company has not experienced any collection issues with its petroleum and natural gas marketers. Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company attempts to mitigate the risk from joint venture receivables by obtaining joint venturer approval of significant capital expenditures prior to expenditure. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint venturers; however in certain circumstances, it may elect to cash call a joint venturer in advance of the work.

As at September 30, 2009 the Company's receivables consisted of \$2.8 million (December 31, 2008 - \$4.3 million) from joint ventures, \$1.2 million (December 31, 2008 - \$4.2 million) of receivables from petroleum and natural gas marketers and \$1.8 million (December 31, 2008 - \$2.3 million) of other receivables. Of the \$5.8 million in total accounts receivable, \$0.3 million is aged over 90 days.

The carrying amount of accounts receivable and cash and cash equivalents represents the maximum credit exposure. The Company does not have an allowance for doubtful accounts as at September 30, 2009 and did not provide for any doubtful accounts nor was it required to write-off any receivables during the quarter ended September 30, 2009.

### ***Liquidity risk***

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. Further, the Company utilizes authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures. To facilitate the capital expenditure program, the Company has a revolving reserve based credit facility, as outlined in note 1. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25<sup>th</sup> day of each month.

The following are the contractual maturities of financial liabilities and associated interest payments due as at September 30, 2009:

Financial Liability (\$000's)	< 1 year	1 - 2 years	2 - 5 years	Thereafter
Accounts payable and accrued liabilities	\$ 8,836	-	-	-
Long-term debt	-	25,147	-	-
Total	\$ 8,836	25,147	-	-

### ***Market risk***

Market risk is the risk that changes in market prices, such as foreign exchange rates, commodity prices, and interest rates will affect the Company's net earnings or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns.

The Company utilizes both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with the risk management policy that has been approved by the Board of Directors.

### ***Foreign Currency Exchange Risk***

Foreign currency exchange rate risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in foreign exchange rates. Although substantially all of the Company's petroleum and natural gas sales are denominated in Canadian dollars, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollars. Given that changes in exchange rate have an indirect influence, the impact of changing exchange rates cannot be accurately quantified. The Company had no forward exchange rate contracts in place as at or during the three and nine months ended September 30, 2009.

### ***Commodity Price Risk***

Commodity price risk is the risk that the fair value of financial instruments or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand. The Company attempts to mitigate commodity price risk through the use of financial derivative sales contracts. The following contracts were in place as of September 30, 2009:

<u>Type</u>	<u>Amount (GJ/day)</u>	<u>Term</u>	<u>Price (\$/GJ at AECO)</u>	<u>Type</u>
Fixed	2,500	Oct. 1 – Oct. 31, 2009	\$ 4.21	Physical
Costless collar	1,500	Oct. 1 – Oct. 31, 2009	\$ 4.00 - \$ 5.23	Financial
Costless collar	2,000	Nov. 1 – Mar. 31, 2010	\$ 4.25 - \$ 5.67	Financial
Fixed	2,000	Nov. 1 – Dec. 31, 2009	\$ 4.66	Physical

Subsequent to the quarter the Company entered into the following financial instruments:

<u>Type</u>	<u>Amount (GJ/day)</u>	<u>Term</u>	<u>Price (\$/GJ at AECO)</u>	<u>Type</u>
Fixed	2,000	Nov. 1 – Dec. 31, 2009	\$ 4.735	Financial
Put	3,000	Jan. 1 – Mar. 31, 2010	\$ 5.00	Financial

The contracts in place during the three months ended September 30, 2009 resulted in an unrealized loss of \$0.4 million (September 30, 2008 - \$8.3 million gain) and a realized gain of \$0.4 million (September 30, 2008 - \$1.5 million loss). During the nine months ended September 30, 2009 the contracts in place resulted an unrealized loss of \$0.9 million (2008 - \$1.0 million gain) and a realized gain of \$1.7 million (2008 - \$2.8 million loss)

With respect to commodity prices, during the three and nine month period ended September 30, 2009, a one dollar increase in the price per GJ of natural gas relevant only to the Company's production dedicated to derivative financial instruments would have resulted in a net earnings decrease of \$0.1 million. A \$1.00 decrease in the price per GJ of natural gas on the same production would have increased net earnings for the three and nine months ended September 30, 2009 by \$0.1 million. This excludes any impact relating to unrealized financial instrument gains/losses.

### ***Interest Rate Risk***

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its credit facility which bears a floating rate of interest. The Company had no interest rate swaps or financial contracts in place as at or during the three and nine months ended September 30, 2009. For the three and nine months ended September 30, 2009, a difference in the interest rate of 1% would change net earnings after tax by an estimated \$0.1 million and \$0.2 million (2008 - \$0.1 million and \$0.2 million), assuming all other variables are constant.

### **Capital Management Strategy**

The Company's policy on capital management is to maintain a prudent capital structure to allow the Company to fund future development. The Company considers its capital structure to include shareholders' equity, bank debt, and working capital.

(\$000's)	September 30, 2009	December 31, 2008
Shareholders' equity	\$ 115,735	\$ 124,278
Long-term debt	25,147	40,807
Working capital deficiency excluding unrealized financial instrument gain or losses and associated future tax assets (liabilities) and other liabilities	2,694	10,615

The Company manages its capital programs in order to maintain a prudent capital structure as changes in economic conditions occur. The Company may and has from time to time issued shares and adjusted spending to manage current or projected operating cash flows and debt levels.

The Company monitors its capital base using the ratio of net debt to annualized operating cash flow. This ratio is calculated as net debt, as defined as long term debt less working capital (or plus working capital deficiency) excluding unrealized financial instrument gain (loss) and associated future tax assets (liabilities) and other liabilities; divided by annualized cash flow from operations before changes in non-cash working capital (based on the most recent operating quarter). The Company's guideline is to maintain a ratio of approximately 1.0 to 1.0, not exceeding 2.0 to 1.0. This ratio will fluctuate depending on fluctuations of the commodity and business cycles. The Company prepares annual capital expenditure budgets which are updated periodically to monitor this ratio. The annual budget is approved by the Board of Directors with updates reviewed by the Board throughout the year.

As at September 30, 2009 the Company's ratio of net debt to annualized operating cash flow was 3.5 to 1.0, and compares to the ratio of 1.2 to 1.0 for the year ended December 31, 2008.

The Company's share capital is not subject to any external restrictions. The bank debt facility has no restrictions other than the limitation of borrowing under the facility on an annual basis and an adjusted working capital covenant ratio of 1.0 to 1.0. As at September 30, 2009, the Company is in compliance with all flow-through share expenditure requirements as well as all bank facility requirements.

There have been no changes to the Company's capital management strategy during the quarter ended September 30, 2009.

## 7. ADDITIONAL DISCLOSURES

### Interest and Taxes Paid

Net cash interest paid during the quarter was \$0.2 million (2008 - \$nil). Cash taxes paid during the period was \$nil (2008 - \$nil). On a year to date basis, net cash interest paid to September 30, 2009 was \$0.7 million (2008 - \$1.1 million). Year to date cash taxes paid to September 30, 2009 was \$nil (2008 - \$nil).

## 8. COMMITMENTS

The Company has committed to certain future payments as follows:

Payments due (\$000's)	2009	2010	2011	2012	2013	Thereafter
Long-term debt	\$ -	25,147	-	-	-	\$ -
Building lease	232	934	1,050	1,356	1,433	358
Process fees	95	379	63	-	-	-
Transportation	37	40	-	-	-	-
Other	4	7	-	-	-	-
Total	\$ 368	26,507	1,113	1,356	1,433	\$ 358

### Contact Information

For further information: John Rossall, President & CEO, [jrossall@psx.ca](mailto:jrossall@psx.ca), (403) 268-3940 or George Yee, Vice President Finance & Chief Financial Officer, [gyee@psx.ca](mailto:gyee@psx.ca), (403) 268-3940.